



NatWest Group plc
Quarter 1 Results Sell-Side Update
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Katie Murray (KM)

Good morning, everybody. Thank you for joining us in the room. It's particularly nice to see to see different faces in this room as well. So, thank you very much for those that were able to come this morning. I know it doesn't work for everybody. Just in terms of what else is going on. So also welcome to those of you who are on the telephone.

So, joining me today, I've got DQ, Group Treasurer who is well known to you all. And I also have SN who's on the screen and, he's joining from Scotland this morning. Stuart is the Finance Director for the retail bank. He used to be my right arm in terms of FP&A (Financial Planning and Analysis) prepping for all of these sessions.

So, he's well versed in many of your questions and has provided over the years many of the fodder for my answers. So, let's make sure we test him out this morning. But before we open up for questions, I'm just going to remind you of a couple of points of guidance and try to respond a little bit to some of the conversations you've been having individually but regularly with IR over the last the last week.

First of all, revenues.

We are making strong progress and we now expect to deliver income, excluding notable items, comfortably above the £11bn for 2022. As you know this assumes the UK base rate reaches 1.25% in the fourth quarter which obviously from the 1% it went to yesterday. I'm sure we'll have some conversation on that as well. But this assumption is unchanged from what we have told you in February, we purposely didn't update it for Q1.

Our improved outlook for 2022 reflects that rate increases came through higher than we had expected, in our plan and also that, that deposit pass through had been quite some lot lower. Regarding the deposit beta, we told you that we've increased customer saving rates in early April by around 10bps or 40% of the March base rate increase of 25bps.

It's very much in line with the changes that you've seen in that pass through across the sector in terms of activity. Some of you have asked what proportion of our £466bn deposit base in the go forward is at a managed rate and subject to that pass through assumption and you can work it out in the accounts, but you have to work pretty hard.

So, it's, it's around half or £230bn and around 40% is non-interest-bearing and the remaining 10% is linked to reference rates. Secondly, just costs, we expect other operating expenses to be around 3% in 2022 reduction and also 2023. The Q1 year on year reduction of 4.6% is not the run rate for the rest of the year and it will be lumpy as we go through that.

So please don't take 4.6% and put it in for the year because I'll get a miss and you'll be wrong and we'll both be unhappy... in terms of that. So, there will be lumpiness throughout the year and thirdly, capital we are in a strong position 15.2% CET1 after absorbing the 1.2bn direct buyback, and we've obviously done the first accrual for the minimum billion of dividends, of the 250 million.

We are committed to getting to around 14% by the end of 2022 and are achieving our starting 13-14% target by the full year 2023. Very happy to move into questions and I'll bring in Donal and Stuart as we see. Hi Robin, lovely to see you.

QUESTION - Robin Down, HSBC

Well, nice to see you. Just a quick question after the BoE yesterday and some of the forward estimates around economic contraction which, we all have our views on whether that's going to happen or not. But obviously investors clutched on to that quite a bit recently. And it seems to me that the post GFC era for a bank such as yourselves has been one of ever higher loan standards, and not a lot of growth in the system.

Not a lot of tail risk being taken out of that one outside of banks such as yourselves. But just on the on the rates point - how do you how are you stressing for, you know, higher interest rates and underwriting decisions. Like we used to be something like SVR plus three points or something like that? I mean, are you ultimately now stressing for something like a 7% SVR rate?

KM

Yeah. So, if you look at it, the way that we do it, we do it at 3% above the SVR rate. And SVR is 4.4%. So, you can kind of go 3% and that's an important point. Sorry, let me say it again, it's the 4.4 is the average for the book, it's like 3.82% that kind of range. You put 3% on top of that.

But that's only one of the tests that we do. What we also do is to then say actually if we take your kind of expenses and we shock them for inflation, we also, we have adjusted that we adjust annually we updated it probably more in this in this last month. It's a March adjustment that we do and then we have done for some time in terms of building in much more inflation.

We haven't disclosed exactly what that number is, but it's it would certainly deal with the various challenges. We do it quite statically over the next three years. So ,you get quite a compounding effect in terms of that piece. So that's kind of how we look at it. So that's in terms of the affordability. What we also do on impairments, those of what's on what's on our book already is we do a lot of single stresses.

So, what's happening with inflation, what's happening with interest rates going in, in different ways as well to try to make sure that we've got the right kind of view in terms of what's on the book. Of course, the challenge is what's on the book is that is of such good quality at the moment that it's very hard to see where your problems lie,

QUESTION - Robin Down, HSBC

It just seems to me, that if there's a slowdown it's almost relative to other cycles. But let's take out the balance sheet recession of '09. That it would be a relatively provisionless cycle based on, I don't mean zero provisions, but in the historical context of things like cumulative loss could be prospectively incredibly low based on these stresses.

KM So, I mean, I would think I mean there are two things as you look into this. We're not unworried. I sometimes feel that I also like I don't want to sound like not worried at all but if I look at it as two things that are really important in terms of our balance sheet - one is actually the quality of that debt book, the PMA we've got on for economic uncertainty.

I mean, we try to work it out as quantitatively as we can, so that it's not just a kind of a thumb suck in terms of what the number would be, but that's £650m. There are reasons why we hold it. But ultimately is a judgemental overlay that you put on your book.

I think the most important thing is also the level of deposits as well. And if you look at what deposits we actually have in the sector, compared with two years ago and certainly compared

with 2008 and '9 we are in a very different kind of place. You know we've seen the savings rate go up. We've seen people who've never save you start to save.

And I think it's also important to remember who we lend to. We have a prime book we don't have a subprime book and I think so, therefore, there will be issues, we will not be immune to them, but we feel that we're entering this situation in a good place in terms of all of what we've prepared for. Others will have more challenges than we will have.

QUESTION – Rohith Chandra-Rajan, Bank Of America

Just stay on the same thing, given it's pretty topical at the moment. Just on the provisioning coverage. So, its 99bps now, was 113 at the end of 2019. You just mentioned there's more uncertainty in there, lower coverage over underlying coverage if you like. So, I wondered if you could just talk about how the composition of the books changed or your confidence in the credit quality to, to meet that, those coverage levels between 2019 and now.

KM

Yes, I think if, and Stuart I will come to you on retail, just to pre-warn you. I'll talk a little bit about Commercial. So I think what we've done within the commercial piece we obviously during sort of '20 and '21 we had the kind of focus areas, which is not a phrase I like because all of our areas are areas of focus. Obviously, you're not casual about any of them.

But the kind of retail, leisure, airlines and I've forgotten the last one...

Property thank you very much sorry - so we had a look at them and if we look at those what we we've, you'll have seen us do over the last couple of years which is a continuation of what we were doing before that is to really look to manage that. So, if you look at the kind of risk weight intensity, we have off the book it's sitting at sort of, its sitting at 54% at the end of full year 2019 and at the end of Q1 22 it was sitting at 48%.

If you look at that on a like for like basis before you had those capital uplifts that was sort of 58% down to 43%. So, we've done a lot to manage the Commercial side in terms of the transactions we've done. But there's also a relative game of actually, we know we've grown mortgages more than we've grown commercial. So, you've got the benefit of that lower weighting in terms of that piece.

So, we think the book is of better quality in terms of... and I think that's the kind of feed through that you're getting. Stuart, what would you add on from a retail perspective, comparing the last couple of years?

Stuart Nimmo (SN)

Yeah, I would echo much of much of what you said, Katie. So, our overall coverage is about 83bps at the moment, down just a shade on where we were at the end of the year. Good book coverage is 36bps. If I compare that to pre-pandemic. So, if I go to end of 2019 our coverage was 37bps in the good book. Now you need to adjust that for the change in mix.

So, if you take into account the change in mix over that period, so that the vast majority of our growth has been mortgages - the like for like comparison would be something more like 27bps plays 37bps. And if you go further and take into account a Brexit overlay, we had around that time, it would have been a bit more like 24 plays 37.

So, versus where we were pre the COVID crisis, we are, we are far better provisioned overall. I would say as well and similar to the focus areas with Commercial, clearly as we went into COVID, particularly Q2 2020, we did tighten all of our credit quality criteria. So across unsecured and secured, the business that we wrote during that period was safer business than, than would have been prior to that.

KM

Thanks Stuart. I'll come to you then I'll come over to you next. OK.

QUESTION – Guy Stebbings, BNP Paribas

One on mortgage rates but kind of some off the moves we saw yesterday, post the Bank of England. You know sort of rates will be up and down all over the place. But if they do settle a little bit lower than where they were two to three weeks ago, I appreciate...

KM

They settled a little bit lower than where they were two to three weeks ago.

Guy Stebbings

Yeah, I appreciate that for commercial reasons you can't say too much about your own book, but do you think it's fair that we probably wouldn't see banks suddenly cut the rate hikes they've just put through in the past few weeks. So at an industry level or to put it another way, in an environment where swaps are just a little bit lower than there were previously you'd have more conviction that we do see a bit of spread widening on the mortgage book rate levels.

KM

Obviously, it depends what happens in the market. But I think that that would be fair in terms of that piece. I think that, this stock moves of yesterday were probably helpful. But it's important, and I know you know this, we don't price mortgages on a daily, daily spot piece. We do all sorts of hedging things like that. But you can't outrun the swap curve it will catch you know, whether it's today or next month, depending where you are in your hedging programme it will it will get you there.

I'm not sure, given the volume that's coming in, that we would be in a rush to particularly cut those cut those rates. I mean, Stuart, I don't know if I mean your view in terms of what's happening as we see the trading curve still moving up into Q1, I'm not sure that we'd be reversing rates.

To reduce that spread back down to where we were bearing in mind that what I said last week was we're not happy with where we are.

SN

Yeah, indeed. Absolutely not. We have got no, no intention to cut mortgage rates. In fact, we've just put a price increase through this morning, plus 30bps in the mix on new business. And we expect to go again pretty soon and we expect to go again pretty soon and we expect our peers will as well. Whilst the swaps came off a little bit yesterday, that's a daily move..

The general direction of travel over the last month has been upwards. And that's going to continue to come through pricing. So, you can see that we moved in the market this morning

and we intend to continue to do so, in line with Katie's comments last week around not being happy and moving our application margins upwards.

KM

I think what's, you know is who doesn't reprice in one in one moment it's 2.9 years is the average lifetime of our book. What's been interesting is the move, the continuing move from five to two years five year. If we talked we talked a lot about that a couple of years ago, how it used to always be sub 50%. I think if I'm looking at our kind of numbers now the sort of the total for the book is 60 odd percent now for five years so it's lengthening out in terms of that piece.

So one of the things that surprised me about the newspapers today is you know, consumers will be hit with X and Y but if you've just got a five year mortgage and you got that price in the last two years you can probably ride this out, you know, sort of thing, and I think you know, as we look at that total book, there's much more five-year, because you have heard us talk about the lengthening of that book. So don't reprice it but it is it's you know, it's a model where the whole thing does reprice quickly in terms of that as well.

QUESTION – Guy Stebbings, BNP Paribas

Can I ask a quick question just on FTEs, I don't know if it's a small sort of data quirk, but it looks like it was first quarter that FTEs went up in a very, very long time. Is that a quirk or is that actually a significant milestone?

KM

So, it's interesting. Okay you've asked me about FTE levels. I'm sitting in bank ExCo going look at this FTE number? So its not a quirk but there is some positive actions that we've taken to do that. So, within a bank and within your organisations that you make sure of full time, you know, contractors, managed service workers.

What we did in this last year was to say actually we're paying too much for managed service workers. So can we take more of them on the payroll, the number that gets disclosed is the fully employed people on our payroll. So, actually when you take apart different, different departments, you can see that retail went down, Commercial went down, services went up, that was about bringing managed service workers on.

So higher numbers of FTE, but lower price, price points per FTE. So, it's not a quirk it's absolute action, but it's also the first the first quarter that it's happened, but it's as a result of that that managed service workers process.

Alexander Holcroft (AH)

Thank you ,Katie, can we have one more and then we'll go to the line. We have a few questions on the line.

KM

Thank you, Alexander. I would. Let's go here.

QUESTION – Perlie Mong, KBW

Hi Katie, so staying on mortgages, I'm just looking at Best Buy tables and I've noticed that I think your top or top two in a two-year fixed and five year fixed rates, which you know signals you

want to be competitive in that market, which is great. But and obviously house prices have stayed very, very strong up till now.

But, you know, it feels like there's going to be a point when the interest rate environment could have an impact with the housing market. So, at what point would you consider being a bit more cautious in there and maybe a little bit less competitive in terms of like gain market share. So that's one. And then obviously...

KM

I'll come back to you for the second one.

Don't worry, I'll come straight back. So, if I look at the tables, the really interesting and Stuart can say a bit more about them but we don't aim to be number one and two you know, and as I say, the price as we've got through today will become number one and two again. And then we'll slip off again in the next the next three or four weeks. We quite like to be middle of the pack in term in terms of that, so it's one of the big things we can talk about a lot. We talk a lot about internally is how do we manage that volume versus margin kind of debate.

And the challenge from say, so I mean, the guys we track the tables a lot, as you can imagine. It's I would say on average we're more, more middle than we are one or two. We may be one or two today. I mean, Stuart I don't know if you've got any particular comments on that.

SN

Yeah, that's absolutely right. And look it depends on how you look at this. And the way that brokers would talk to customers is on a true cost basis, so take into account not just the headline rate but the impact of fees etc, in that in that rate to get the true comparison and obviously, it's important to look at, you know, high flow price points and make comparisons there.

But as you've said, Katie, if I look across Q1, there's absolutely been moments where we've been top, because it's been a very dynamic market. As you know, we've made you know, another 12 price adjustments in the first quarter, taken overall since mid, start of November about 25. Some competitors have been similarly active. So, at any one moment in time, it's possible to find yourself for a number of days in those points.

But that's not our intention. On average, we've been middle of the pack I've got the comparisons in front of me on both our headline rate and true cost basis for this morning. We're at or around Santander and Halifax and way behind HSBC, Nationwide, Barclays on virtually and pretty much every price point.

KM

So, it does move. What was your second question? And then we'll go to Alvaro.

QUESTION - Perlie Mong, KBW

Yes, second one just staying on credit quality. I mean, think I heard you loud and clear that you are not seeing the stresses in the book as of yet, and that's for the whole sector as well. But if I look at a sort of country wide deposit and credit card spend data, deposit has been - is still growing, but it's coming down and credit card spend is going up.

Now you can take it positively and think, oh, you know, economy's reopening and people are spending more, that's good. Is that what you're seeing or are you seeing sort of more stress, household maybe dipping into their saving and then borrowing credit card because, you know, it's not 90 days yet. So, you might not see it in credit quality yet.

KM

What, so what we what we look for, we obviously have when things coming into item monitoring when people come into debt management, they've already got the problems.

One of the things we the retail team spend a lot of time looking at is say, right, so KM normally uses her debit card to pay for everything. Has she started using her credit card to pay for things? Does Katie now start to take cash out on her credit card which she would never do before. Is she now moving from repaying the full amount and she's only paying the minimum? So, actually we're looking for those behavioural changes in how people are using their card.

We're not seeing it and that is what is amazing. We're just not seeing it.

So, you know, and we're looking really hard for it and it's one of the things when you're looking so hard, it's important not to, you know, blow out one sector and sort of say well actually that's happening there, so it must be the reality. But we're not seeing - so they are using their cards more. More people are paying them in full than they were historically in terms of that level.

But that that's the kind of before people get into trouble. We spend a lot of time looking to see how are they behaving in their underlying use of their cards and are we, are we seeing a movement in that space? And that's kind of our first sign and we don't have anything yet to share.

Alvaro, can I come to you on the line.

QUESTION - Alvaro Serrano (Morgan Stanley)

Morning and sorry for not being there in person, but can you hear me OK?

KM

Yeah, perfect. Thanks Alvaro.

Alvaro Serrano

Thanks. Two questions. One is a follow up on a comment from Stuart on pricing. Did I understand correctly that you've increased pricing this morning by 30bps and that you expect to follow up with more and can I compare that to the 40bps sort of mortgage margin sort of exit rate that I think you quoted in that you quoted in in the main call last week. Just it just seemed like a very big move in a in a single price action.

Obviously, it's the same amount as you did throughout Q1. Just wanted to make sure if I understood it correctly and if there's anything you want to add to that to put it into perspective. And second, on cost, it's kind of a follow up question as well from the Bank of England yesterday, given the inflation sort of numbers look pretty scary. Can you in that -3% that your cost guidance that you updated with the full year, I don't know if you can give us sort of any underlying sort of assumptions around either wealth, sorry, salary inflation or underlying inflation versus structural action, sort of embedded in that -3%.

Thank you.

KM

Sure. Stuart, do you want to take the first one.

SN

Yeah, absolutely. So, yes, the price the price rise on average is somewhere just shy of that for new business as opposed to switcher, which is slightly below that level. If you look at our various price points, you'll see some that have gone up more than 30bps and some that have gone up slightly below that.

But in the round, it's of that type of level. So yeah you interpreted it correctly as a reasonably significant, significant move. Can you take it and put it on top of the 39bps retail market margin on 44bps application margin for the group last week. I would caution against doing that the, that is an average for the quarter swaps were rising throughout the quarter particularly from February onwards.

So, you should instead of doing that I would guide you to think about the guidance that Katie gave last week around working towards an application margin in the sixties for the second quarter. And this is part of our actions in order to get it.

Alvaro

Thank you.

KM

Thanks Stuart. I think we've got a Chris Cant on the line as well. And then I'm happy to come back into the room. And then we can go back to the phones. Hi Chris.

QUESTION - Chris Cant, Autonomous

Hi. Good morning. If I could just also say I would have been there in person today, but something came up I'm afraid. Two questions, please. One on Ulster. So obviously you've now entered into exclusive talks over the tracker mortgage book. And if I think about the kind of the deals that are either in train or about to be concluded, potentially, I mean AIB yesterday talked about potentially having this book on their balance sheet by 3Q or 4Q. Most of the Ulster assets will be gone by the end of this year, potentially.

Maybe some of the mortgages in terms of the phased transfer to PTSB spilling into next year. But it all seems to be lining up fairly well. And obviously you haven't taken any. Well, I can't really see a big charge in relation to Ulster in the first quarter. Should we be expecting better guidance on this at some stage?

It feels like this could conclude quite quickly and I think previously you were talking about costs running out to 2025 for the Ulster business, but if all of the assets are gone by some point in 2023 that feels, that feels like quite a long period of time. So should we be getting, I mean is it wrong to think we could be thinking about the Ulster process ending sooner than your previous commentary on the cost side. And then unsecured – obviously NatWest has a historic underweight in unsecured relative to some of your large UK peers appreciating what you just said in response to the previous question from earlier.

Has there been any change in your appetite to seek to grow unsecured as a consequence of the downshift in macro expectations? You obviously don't have as much of an exposure there to begin with, and that was beneficial during COVID, but do you still think it's a good time to be seeking to grow share in unsecured, given the uncertainties? Thank you.

KM

Sure. Chris, thanks so much. And Alvaro I realise I didn't answer your second question, so I'll come back and do that as well just at the end of this. But if I look at unsecured, if anybody remember about how we were growing our unsecured.

We're growing it within our own customer base. So, we can see what their accounts are doing. What's really interesting was a feature on the app about know your credit score. What we can see is the number of people that go to look at know your credit score and then take action about taking out a credit card or taking out a personal loan.

What we've also built into that is the ability to predict, if I do this what will it do to my credit score? So, people are managing it quite wisely, and we can see the customers we're doing. We've always said we'd like to go to have the ability to go whole of market. That's something that we're continuing to build and I think as we enter that piece, we will enter it slowly and gently in terms of that bit.

So, we do think it's still an appropriate time to kind of keep going. I think in terms of Ulster... I think we've given you quite good guidance already. I'll ignore your comment on why should we get better guidance. So, the guidance you've got is pretty good. What I would say it's actually happening almost in line with how we expected Chris in terms of that.

So, if you look at it what we'd say and I completely agree with what AIB said yesterday, end of the end of the year Q3 / Q4 that will move off. We'll start to see some of the transfers to PTSB. They'll take a little bit longer, but the majority of the book will be there. This most recent tracker piece, you're absolutely right.

All that's going to be left on the asset side is a little bit of offset mortgages and a little bit of NPLs. We will deal with them as we go through. We've obviously started on the liability side, and we said that they would lag, so that we will see them. We can see them move already. I think in Q1, 800 million, it moved off.

But there's still there's still a big balance there to move. But we'll see that kind of move off as we as we go through. We do think that the majority of the charges that we'll take and if you think of them, they were in different levels. The disposal loss, the loss of disposals will happen as those books transfer.

So, you'll start to see that come in Q3 / Q4 and then the restructuring charges. We said we'd expect to see most of them in '22 and '23 however the impact being on '24. I would hope Chris, that by the time we get to '25, while there might still be a presence in, in Ireland. It would be de minimis.

So, most of the activity in the way that we think about it is in that '22 the book's moving; '23 the remainder of the book's moving and liabilities accelerating in their move and '24 the kind of wind up of all the bits you've got there. So, we would hope that by '24 it's kind of done. What you will see in Q2 because of the announcement of the tracker group piece is the whole thing will move substantially into discontinuing, so that you'll have a kind of set as well.

You don't have this kind of half and half straddle which we had hoped that we'd get to in Q1, but we didn't, quite make it there.

And then Alvaro sorry, if I just come back in terms of your inflation question. So, the 3% reduction. Within that, if you are salary, salaries are obviously they are a mixture of a union negotiated deal, which we did at the beginning of the year, and that was just over 3% in terms of what was negotiated within there.

And then we obviously have our high level of staff who are non-unionised and sometimes more specialist in their nature. So, what we are seeing is a bit of pressure, particularly in some of those the kind of quants, the stress testing, all of those kind of areas in that piece. So that's what we're kind of having to manage within that around 3% in terms of the cost reduction.

So, I would say if I was to speak to my own teams who are recruiting and you know, Donald in Treasury would be a great example of this is actually we're probably seeing a little bit of paying up for people. So then you have to make sure that internally you're not leaving people behind just because they didn't they didn't move roles.

What's interesting actually is it's often not the paying up that's the challenge is we can work out how to deal with that. Because clearly, if you've got, they don't come in until a few months later than you have. It's actually finding people, I think is more of the pressure. Now finding people taking a bit longer helps the cost structure in '22, but you all know it doesn't help the cost reduction in '23.

So, it's how you kind of balance that aspect of it.

QUESTION: Chris Cant, Autonomous

Katie, if I could just possibly clarify on the Ulster disposal loss piece and the reclassification of assets to help the sales. So, in terms of the accounting assuming the track book is going to be reclassified in the second quarter, and that you agreed a deal, your entire loan book, pretty much other than that stock will have been reclassified, held to sale and should be held on balance sheet at fair value less costs to sell.

So, where do the disposal losses come from in 3Q and 4Q how does that accounting, I guess a misunderstanding, something but I thought I would have thought that if you reclassify that remaining book in 2Q, you book the disposal loss there and put the mark in 2Q.

KM

We book the disposal loss at the time it actually all leaves the balance sheet. So, you're right we will have fair valued those loans in terms of dealt with their impairment. So whichever but there will just be some other costs that kind of attached to it that we'll recognise at, the point is when they leave the balance sheet, which is that £300m that we guided you, guided you to.

Chris Cant

OK, thanks.

KM

Thanks Chris. OK, Martin let's go.

QUESTION – Martin Leitgeb, Goldman Sachs

Could I follow up on Ulster just in terms of capital progression at Ulster Bank. Could you just give a snap of where we are for Q1 and is there any intention or has there been any dividend upstream?

KM

There has not been any dividends upstream yet. What our intention is as the first transaction moved over so when the first, the AIB transaction moves at that point we'll make an application for a dividend in relation to the capital there that moved over and then when the next piece moves, we'll do that next piece now capital moves in the company they come a little bit slower.

So, in my own plans I'm not anticipating any capital upstreaming this year, but I'm told we'd get some early next year as that kind of moves through. But what we'd like to do is think into a kind of a regular pattern, as books transfer that we've transferred that capital over as well.

Martin

And then a more broader question in terms of competitive landscape in the UK, as obviously the expectations are for a slowdown in economic activity and a pickup in unemployment letters going forward. Do you expect a bit more pricing discipline to come back to banks, try to brace themselves for some of the impact by being more disciplined on mortgage pricing, some other things? How would you see that?

KM

Yeah, so I mean, it's interesting and I think it depends what your thesis is on, on, on unemployment. So, I mean clearly the Bank of England yesterday was pretty negative, particularly in those outer years. So, if they come true I think you'll see it getting harder to borrow on the individual basis because you'll just continue to see that that continue to kind of tighten because it is our economy that drives most of our kind of impairment piece.

I think you've got to decide where you are on that. They're quite a way from the kind of consensus view at this point. But we'll kind of see, we'll see what happens. Obviously the most recent numbers on unemployment were better again. So that gives you a bit of a time lag that. What I think we need to see for things to be, to know that they're coming as an issue is that we start to see some corporate defaults, which then of course, convert into unemployment numbers.

We just not seeing that at the moment. So yeah, it's interesting where the view is on our bank's been disciplined or undisciplined in their pricing. I think it's been hard to kind of keep up with in terms of that piece. I think we were very disciplined in our deposit pass through. You know, others not sitting round this table, would have different views about whether that was the right thing to do or not for the not for the economy. And it's very, just on Friday, it was quite addressed in the conversations with the media in the morning and the investors and analysts in the afternoon. And their views on obviously deposit pass through were quite different in terms of that piece.

So, you're trying to balance a little bit of a challenge there as well. Let me come here and then Alexander and then we're on the phones.

QUESTION – Omar Keenan, Credit Suisse

I've sadly got another asset quality question.

KM

That's OK. I I've spent an hour on asset quality this morning already, so I'm very well prepped.

Omar Keenan

It was in relation to your point about saying if we see an unemployment problem, it will be corporate defaults that come first. I guess just by its nature, capital commercial exposures are a lot more, you know, lumpy and a lot more idiosyncratic, you know, we heard a lot written about some of these big companies and so forth, so I mean, how do you think about stress testing these companies?

You know, we understand with the mortgages, what happens with the affordability checks. But could you tell us a little bit around the process of how you stress test, you know, various companies for cost inflation that might pressure their profitability, that may not be in a good place to start with it.

KM

I'm actually going to bring Peter in at this point. Peter obviously used to be the FD of Commercial and he's now over with me in the centrepiece. Do you want to talk a little bit about that, I know you've been intimately involved in a huge amount of those conversations?

Peter Norton (PN)

Yeah, so look, I mean, I think what we've been doing is spending a lot of time looking at those and we did it obviously through Covid looking at those sectors that were most impacted. And that's really kind of continued, right? So, we had a sort of Covid supply chain disruption, which has then kind of morphed into a Russia / Ukraine, broader supply chain, energy shock.

And so, it really is that kind of sector by sector, that are going through, kind of what are the input costs? What are the pressures? And what is, what is the sort of management response to that ability to pass through pricing, etc?

I think the kind of (more) broadly across the bank and particularly in Commercial, the level of stress that we actually see in the book is very, very modest at this point.

What we are seeing on very, very low numbers is that those that are coming into item monitoring. So, where we are actually seeing some stress crystallising, but at super low levels, those are now starting to be driven by supply chain disruption, inflation pressures etc. But the level of stress, in the book is incredibly...

KM

You know it's not just energy that's a challenge... that have come through.

PN

But I mean you gotta and on energy like the retail piece, I mean, there are big Fixers that insulates a huge number of corporates so long based Fixers, so that that stress is yet to come through. But what we've been doing is kind of working through when it does what is the impact.

QUESTION – Omar Keenan, Credit Suisse

Are you able to see, kind of if we you know, the cost inflation comes through the manner that you expect it in the next couple of years and interest rate costs do this and you have an understanding of how different industry sectors can pass on pricing to their customers that can look at their profitability and how that impacts their metrics. Do you have that sort of two three year forecast?

PN

I think the places where you see the potential stress coming through are where you see you know, kind of where we've got relative you know kind of significant price inflation, an assumption more broadly, I think a consensus assumption around modest, modest wage inflation means that you know kind of we're likely to have by material kind of compression in real incomes and then that then passes through into the commercial sector, the sectors that are most exposed to that. So, your leisure, your retail etc. It's not a dissimilar kind of picture to what we saw through Covid in that picture.

KM

The areas that were under stress will be under stress no matter what. Shall we go to Jonathan on the line.

QUESTION - Jonathan Pierce (Numis)

I've just got one question. It strikes me that at a time when banks have got a fairly good story to tell on income, the markets ended up being fairly myopically focussed on things like deposit betas around a single rate hike or mortgage margins in isolation and just hoping on this call to get a bit more colour from you on the hedge, particularly because it's going to provide a massive offset to the refinancing headwinds on the mortgage book in the coming years.

So just very simply, we can all see that you've got a £200bn plus hedge that's generating 0.72% yield and the five and the ten-year swap rate this morning is you know, 1.9 to 2%. So the notional mark to market on that of about two and a half to £3 bn per annum of revenue. Clearly over the course of five to ten years that that will come through if swap rates remain where they are.

Can you help us though over the next two years because this is when the mortgage refinancing headwind is particularly large. What are the total maturities of the hedge? 2020 to 2023. What's the average yield of the stuff that's rolling off. Because that would then give us a really good idea if swap rates stay where they are and mortgage margins don't recover appreciably, as to what the total quantum of the offset from the hedge is gonna be.

Donal Quaid (DQ)

I'll have a go at that one.

KM

You have a go at that one, yes.

DQ

I think the maturities, because we've always talked about taking a very mechanistic approach, it's very easy to calculate what the what the roll-offs are on an annual basis. So, we roughly have about 190 and 195 billion product hedge, which I think you're probably talking about most.

So, you can probably take 35 to 40 billion of, of maturities on an annual basis, and you can even break that down quite consistently month by month or quarter by quarter given the mechanistic approach we take.

If we look back to, I suppose stuff that's rolling off the product hedge that was put on 2017, I think roughly if you look at the average five-year rate during that period, 60/70 bps. So again, there's assumptions on where swap rates are between it's clear where that where that was put on in Q1.

Obviously, we need to, you need to take a view on where swap rates, stay for the remainder of the year. You know, so that's very clear. The bit of nuance I suppose to add on there is the additional incremental growth we've put on over the last few years. So, you will have some of that rolling off at a lot lower rates, but it's very easy, you can work through and calculate probably the income upside that you could get to on, on that roll off. And similar to 23, I think if I look at the average rate of, of product hedge that rolls off through 23, it's probably higher, it's probably in the reach about a hundred bps.

So again, you know, I think 100-110bps so again just your view on, on where swap rates and where that will roll through 23. Obviously, you know we're a bit reluctant to give any further guidance on that because it is very driven by what, what swap rates do from here. And already we're seeing a big disconnect between what the Bank of England's view on where base rate's going versus probably you know, market implied curves at present.

So, you know, there is the risk that we do kind of get more volatility in swap rates. But, you know, that should give you kind of a good guide definitely on product and you can do the same on, on the on the capital hedge, which is obviously a smaller percentage, a much smaller annual churn but that will continue to be a drag you know, offsetting some of that product, product growth income upside.

QUESTION -Jonathan Pierce, NUMIS

Well, yeah, I mean, certainly the capital hedge and the and the newer hedges that were feathered are the more difficult piece of this whole, whole equation. But it sounds like in the round, if we assume that's the I don't know, a hundred odd billion of hedge – 90bnof hedge, that's maturing in the next two years is coming off an average not that dissimilar to what the total hedge is currently generating 72 bps. Is that the sort of maths we should be thinking about.

DQ

It's yeah if swap levels stay around these levels. That's, that's I think that's a fair assumption.

Jonathan

Cool. Thanks very much.

KM

Thanks Jonathan good to see you. I hear we've got James up on the phone line as well. Hi James.

QUESTION - James Irvine (Société Generale)

Hey thanks for taking the question. I just wanted to ask about deposit betas, please. So, we're all trying to work out what the deposit betas are going to be over the coming months. And I guess

there are plenty of reasons to raise your, your deposit rates, you know, competitive and so on. I was just wondering, did you actually find them to be useful for customer acquisition?

So, do you find that when your deposit rates go up, you have a good inflow of deposits? Is it helpful for recruiting customers new to the group? So, is there you know, is that, you know, aside from the competitive aspects, a reason why you may actually have a higher deposit beta than perhaps we might expect?

KM

So, I mean, a couple of things I say, I don't think we have a very high deposit beta. We've passed through ten bps of 75. You know, in terms of that, if you look back. So, I mean, I guess Retail was at an average of 5. But over the last 6 to 5 updates, we've passed through 10. So, I don't think it's, it's, it's particularly high.

It was 40% of the last one. We didn't do it the same day. So, I think it's not it's not necessarily dictating the next one will be at that kind of level. I think we've got to work out what's happening on our levels of liquidity. What's happening in the competitive market. What our view is, is the expectation of rate rises.

So, I think one of the conversations that we're having today very much is obviously - they rose rates today, what happens if they rise rates, again on June 16th. Would you do one change in two weeks' time? What would you do? So how are you going to deal with it? So, there's a lot of different factors you do. The reality, it does it doesn't bring in new customers in terms of that, particularly at these at these levels.

You know, if you want a good deposit return in our bank at the moment, you'd be a digital saver and you're getting 3.25% in terms of, on that digital savings account. Now its 3.25% up to a thousand pounds, so if you're a pensioner with significant cash deposits, it's not going to particularly meet you in terms of where that is. But as you move the rates at this level, banks all move by 10bps, more or less within sort of a month or so of each other.

In terms of that piece, it doesn't have a particular impact and what we do see when other accounts have come in, some of the US banks have come in and they've raised their rates a bit faster, we're not seeing flows out to them either, particularly.

What's been interesting, the thing that has moved rates and the savings activity more than anything in the last little while is a very small thing we've done in our account, which is called a roundup, which you're all kind of familiar with for some of the newer banks that we put on a couple of months ago, you could only do round ups if you had a savings account.

So that caused large number of savings accounts to be open within our organisation by people who were then doing those small roundups in terms of that piece. But they are the kind of 50p, £2.50 a day sort of thing. But if you've never seen it before actually you've now gone from, I've never had a savings account, to have a savings account and I'm doing some round up numbers in, clearly at this stage doesn't impact our balance sheets in terms of what that is but that's almost been the biggest move on any savers activity, which of course is completely unrelated to the rates.

I think what will be interesting is, if you believed the market consensus view of where rates might go, and the saving pass through got to a much higher kind of level and then you would I think, what is the point that savers really move that money around and clearly, we wouldn't

want to be left behind at that point, so we'd be actively working towards it. But at this moment it's still it's not movement.

DQ

Can I add on that Katie as well, because I think, you know, we're obviously in very, very strong position from a liquidity perspective versus, you know, a number of our peers, a number of the UK banks, which gives us a lot of flexibility, but also, it's the value of our deposit franchise, which is driving a lot the rate sensitivity upside as well. So that that needs to be considered what we when we talk about pass through.

But I think a lot of people who say, got caught up with the 40% of the most recent rate rise, if we even take into account 25bps of yesterday, our accumulative pass through is 10%. So, I think you need to look in the rounds over a number of moves and how rates are kind of transitioning as well.

James Irvine

Lovely. Thanks. Yeah, sorry I kind of was meaning future deposit pieces rather than historic ones but that's been really interesting.

KM

We'll definitely, we'll see them increase and you know our sensitivities kind of done it on an equal kind of basis by the time we get into that sensitivity that we've given you. So, we definitely will see them increase. But they've been slow to start, which has been helpful to us, but will and we should in fairness, be the purpose led bank that we want to be.

We should see them increase as well. So, Jason, I think I'll come to you.

James Irvine

Okay thanks.

QUESTION – Jason Napier (UBS)

Thank you. Perhaps another question for Donal on the hedge, and it's one I get from clients quite often, and I appreciate it's a difficult one, and that, there is a huge disparity in opinion as to whether the Bank of England rate goes to 2.7% where the curve says. Well, if you listen to the governor yesterday, as he's implying. Are there any distortions in the market for swaps or those sorts of underlying assets that suggest that, that makes sense?

And then secondly, from a hedging strategy, I think most investors would forgive you, if you wanted it to be over hedged to the curve as it is now, extend your duration, just grow the hedge as quickly and as aggressively as you can. I appreciate that's a change to past practise. But what would be wrong with taking the other side of the view that the Bank of England is not going to go beyond 2.5% at 12 months.

DQ

So, I'll maybe start with the second question as it's an easier question at answer. It's probably fair to say we had the same conversation with some analyst investors in H2 of last year, when swap rates were probably 100bps lower so in effect, you know, what you're doing is, what I said then was we don't, take rate views because we cannot predict where rates will go.

So, if we had taken a few in terms of extended duration or, you know, over receiving at that point in time, we wouldn't be great at this point in time.

Some peers have taken a different approach on that, so we're just very comfortable with the mechanistic approach because we cannot predict where rates are going from here.

By doing that, I suppose the argument is, one, around stability of your balances over time, because you could, if you wanted to take a view on rates and go and lock in higher yields now, you want to be sure that your deposit balances are stable. You don't see some outflows over time, because then your kind of possibly offsetting the overheads at a loss and so in fact, we what we're doing is we just continue with our mechanistic approach.

In terms of the distortions in the swap rate. I think basically we were talking about this earlier on. I think there is just a very different view from, I suppose a number of participants in the market versus what Bank of England view is.

I think that's probably based on track record and credibility, has been quite poor over the last 12-18 months and I think there's a feeling probably amongst a number of market petitioners that inflation is more entrenched and will be more entrenched in, probably in society for a while being and Bank of England will need to move further than they're expecting or I suppose consensus economists are expecting as well.

So, I think you do have that kind of divergence which I'm sure will converge at some stage over the 6-12 months when we get more clarity maybe on inflation, on macroeconomic environment.

Jason Napier

It's interesting that because the latter part of the curve, you know, that same people who think inflation may be more out of control than maybe the Bank of England thinks, clearly that's your recession, not studying the base rates that will eventually lead to higher rate cuts.

DQ

And even yesterday's move, we saw a bit of, also last week we saw the curve, it was quite inverted beyond three year and it's kind of flattened a little bit as well. So interesting to see how that evolves, will it be slower hikes, but actually higher terminal rate? But yeah.

KM

I'm getting a nudge from Alexander. I need to speed up a little bit. Look, I'm so happy to have you all here. It's so nice to keep chatting.

I said I'd come to you, then I'll go back onto the phone and then I'll come back if I get a chance ok.

QUESTION –Benjamin Toms, RBC

It's just one on the cost of living, potential squeeze and everything you said this morning makes us feel quite comfortable about asset quality. There's the other side of this in terms of volume growth. If you look at mortgages for people, it's in line with historic averages. Your cost of your mortgage is proportionate to your income. That might change quite quickly with costs for the first-time buyer.

Getting on the ladder is kind of more difficult than it's ever been. In terms of the cost of living crisis if we put asset quality to one side. Is that where you think you might see kind of, the real squeeze in the next 12, 18 months, the volumes for first-time buyers becoming something like 20/30% of total volumes. Is that kind of a risk area in terms of the cost-of-living crisis?

KM

I mean, not specifically, I think that we're still quite confident about the next 12 months in terms of volumes, I would say that specifically in the first half, I don't think we're as strong there as we should be, so therefore it not growing as much, doesn't impact us in the same way which is probably one of the conversations that the retail team of how to strengthen that, so we do see volume still.

I mean I think volumes this year, we expect quite a drop off from last year which was so high and that's not what we seen in the in this first quarter. Obviously, know our Q2 pipeline. We're currently writing our Q3 pipeline. But we're not seeing particular drop offs and that's when we're pretty comfortable on that piece.

But ultimately, you're right. Borrowings and growth is where people are really being squeezed of the cost of living. What we spend more time looking at, what's happening in Commercial and so there we've seen some nice activity at the larger end. You saw that in our numbers, but we've also in the invoice asset finance space.

We've seen that continue to grow and that's one of the first indicators of the kind of wider spread smaller and mid-market kind of growth piece. So, at the moment, you have this economic narrative which isn't matched to the experience we're having today. So, then it's a question of what's the real reality of the 12-18 months from here. So that's not terribly helpful, but at the moment we're not overly concerned.

And I would say our increases in income are much more rate dependent than volume growth dependent in terms of the statements that we'd be making. So, it's important to remember that piece as well.

Andrew, can I come to you on the line and then Robert, I'll come to you as well just after Andrew.

QUESTION - Andrew Coombs, Citi

Thanks Katie, so, we've talked a bit about the divergence between where consensus is and what the Bank of England's saying and taking a look at that commentary, both in terms of GDP growth or lack thereof for next year and they're still reiterating the view of moving to 5% unemployment rate by 2024 as well. So, from what I can see, you haven't updated your IFRS9 economic assumptions. I was looking in slide 39 this quarter. If you look at Bank of England, what they're saying, at face value. I mean, is it somewhere more between your downside and extreme downside scenario in terms of GDP and unemployment progression.

So, just trying to get a feel if you can provide, and I know you did this during the pandemic and I gave a sensitivity around those UK consumptions, say a 1% moving GDP versus your base case or 1% increase in unemployment versus your base case that could be helpful.

Thank you.

KM

Yeah. So, I mean, you can see the sensitivities in the annual accounts. I think it's something like page 266 approximately, in terms of where you'd find them in the accounts. What you can see there, so we didn't publish it this year end, the single point sensitivities I don't think, but what you can see there is if we had moved 100% to our downside case, it would be in £692m that it would have gone down by in terms of that piece.

So, that would have been quite a dramatic move to have go 100% from where we are today. So, then you think, well actually, if you look at what they're looking at today, then maybe they'll move 10% up to that or 15%. You wouldn't see, when you look at the ratings, I mean I'm sure you put all the rating charts beside each other.

Although people kind of move around, you don't see huge 40% movements between those different ratings and it's not as simplistic, our at risk guys would tell me you don't just say, move 10% down so I'll take 10% of that number. But in terms of all that,.... that kind of shows you the quantum and that's not a huge number if you also think, one of the reasons we've got the mezze is to kind of cover that.

So, you think, well they've maybe got a bit of coverage for that kind of change in that piece. So, we're pretty relaxed about it. I don't think Alexander we did publish the single point one of this last year?

Alexander Holcroft

It's on page 212.

KM

It's page 212 not 206. But we didn't do the single point one though did we, is what I'm saying in terms of what happens if we move the interest rate piece? No, no, so we only gave you the whole scenarios together this time, but you can see them quite nicely in the accounts but that 690 move is an important number but it's not so significant because you would not move 100% to it.

But what you can see is that in our scenarios, there's very little upside move. So, if I made 100% to the upside, it would only be about 90 odd that I would be getting as a benefit. So, there's not a lot of upside benefits come through in terms of where we are.

Andrew

And it's completely mutually exclusive from the PMA? So, it's not a case of you up your usership, your IRFS9 assumptions, economic assumptions, and then take some offset through on the PMA because there's great clarity on the economic outlook?

KM

So, in reality that's what we do at that time, but what this is telling you is, if in the situation where we've got this stage, if we did that, then that's what we'd move there. But what you would see is, if we saw greater ratios coming through in the underlying book, you would see some of the PMA being scraped into that.

So, you'd end up in a net nil almost at that point in terms of where we are.

PN

Maybe just one point that if I may, just on the on the interpretation of the Bank of England forecast, I do think it's worth just noting in terms of the Bank of England sort of structures is when they forecast, they don't forecast any broader fiscal policy response, so I think just as you think about kind of benchmarking, I think it's quite important to think about that interaction.

KM

I mean we would probably expect despite our Prime Minister's comments on the Lorraine Kelly that there might be something, but we'll see anyway.

Robert, can we come to you? Thank you.

QUESTION - Robert Noble, Deutsche Bank

Hi, just a quick question for me. What's the average balance that a current account holder has as a customer and what do you pay them effective interest rate over time adjusting for all of your kind of promotional rates and things like that?

KM

So, the average balance is about £5,000 that a current account has at any one time, and sorry, what was your second question Robert, I'm sorry?

Robert Noble

What's the effective interest rate that they get on £5,000?

KM

In a current account it'll be zero.

Robert Noble

Zero. Cool.

KM

OK, let's go here and then we'll draw it to a close, is that, are you happy, yeah perfect, lovely thanks Aman.

QUESTION - Aman Rakkar, Barclays

Yeah, two questions on Capital returns and second on Wealth.

On capital return, your 15.2% CET1 ratio which has got dividend accrual in it

KM

The first £250m, yeah.

Aman

Yeah, so, probably more like 15.4% as a start point, if you repeated your capital generation in Q1 through the remainder of the year, you would probably be in excess of 16.5% pre-distributions this year.

I think that's about £4.5bn in terms of CET1 capital, well you've spent £1.2bn on the directed buyback, you've got £1bn pencilled in for the ordinary dividend, there quite a gap there in terms of surplus distribution that doesn't look to be in consensus.

Could I just check whether there's anything wrong with my thinking there?

Sorry, and that's in terms of you running your CET1 ratio down to 14%. So, I guess that's an important point, can we expect you to announce something in February next year that gets your CET1 ratio down to 14%?

KM

So, the way that I look at our capital return there, there's 4 levers we've got to use, ordinary and specials, we've told you a minimum of £1bn in terms of that number and we'll continue to look at that. You've then got the direct buy, we've done it, you're absolutely right. There's then the IBB. The IBB's going quite well, we've executed about half of it in about at least a few months, so I think one of the things we'll continue to look at is to see, well actually what more could be do with that?

So, I mean, that we more than likely consume some of that excess, and there's obviously acquisition, but it's not something, we've not said anything yet, so, you get to the point as you go through the year that nothing would impact and that's not as important. But we always look at that for value in terms of that historically was a relatively small thing in that space. I would say in your numbers, I wouldn't necessarily take the Q1 capital generation and multiply that by four.

So, your number feels a bit slightly toppy, but your maths, your approach is appropriate and then I think, what are the levers that they might use throughout the year to continue to bring that down.

And bear in mind that one of the things that we do that some of the banks don't do, is if we announce an in-market buyback in February next year, we'll put that off the year end number as well, because we will immediately start doing that trade the next week, so think a little bit about as you look at it, look at H1 '23 for your views of what we might continue to do on in markets at that stage.

QUESTION: Aman Rakkar, Barclays

Yeah, just a final one of then, around wealth and your aspirations in the UK wealth, and the extent to which you think you can reach meaningful scale as an earnings driver at the group level, in house or whether you want a bit to supplement it something?

KM

Yeah. So, we were pleased with what we've done so far, and I think we've only scratched the surface of in house. So, I think there's much more that we can continue to do with in house. What we've always said, is that we've looked to add volume or capability in those areas that we're more underweight. So, you've seen us do it in mortgages. We've added a little bit of kind of a capability in terms of the Rooster Money account, which is important, not for money making today, but actually for connectivity for those that will come after all of us, as those customers get that kind of level of connection. We have said that we would look at wealth, in terms of that piece, we've also said we would look at unsecured, there are areas that are more underweight.

But we're very focussed on making sure that if we were to do any transaction, that it's the right value creation for our shareholders today, in terms of that piece. But that's an area that is an obvious growth point as we move forward. But we're pleased with what we've done.

We think there's a lot more that we could do internally as well and you know, the Natwest Invest, I think it's got some more distance to go. We see really strong growth from where we were a year ago in that space as well and we're quite excited by it, and it's a simple thing for us to deliver in house without having to rely on kind of external partners, which I think also helps with growth as well.

Lovely. Look, wanted to you say thank you very much for both joining on the telephone today and also for coming to join us here at 250.

It's good to see you. Thank you for the support, and we continue to appreciate the questions and challenges as we work our way into H1, which thankfully is a little bit further away than Q1, Q1 always comes round a little bit fast, it must be said. So, enjoy what promises to be a lovely weekend here in London.

Anyway, thank you very much indeed.