H1 Results 2019
Host: Howard Davies
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FORWARD-LOOKING STATEMENTS

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OPERATOR: This is Conference #: 4519918.

Howard Davies: Good morning. Thank you all for joining, a rather cozy room, standing room only. I don't know if that's a good sign or bad. In the first half of this year, the banks faced another period of economic and political uncertainty, and you all know the reasons for that. The subdued outlook for interest rates is affecting all banks, indeed all financials I would say.

Global economic growth prospects are less favorable than they were at the beginning of the year. There are trade tensions. Relationships between the China and the U.S. continue to be strained and we saw further evidence of that last night. All of these things were affecting market confidence.

Against that backdrop, we have continued to deliver bottom line profitability and plan to return more capital to our shareholders including, of course, to the U.K. government and taxpayer.

Of course here, uncertainty around Brexit continues. As far as the bank is concerned, our preparations are in place with our Amsterdam and Frankfurt offices operational and we're pleased that we've made those decisions at the right time.

We believe we can ensure continuity of service in all circumstances. In the meantime, our focus continues to be on supporting our customers with advice and lending when they need it, because in the long term, that, of course, is more important to us than the mechanics of the bank's licenses and permissions.

It's very difficult for our large corporate customers in these circumstances to make significant investment decisions without clarity on the future trade terms to which they will be subject, and we see evidence of that uncertainty and that hesitation in our business. The sooner large corporates have that clarity, the more proactive our support can be to help them with the transition to wherever we're going.

As you know, the requirements of the ring-fencing legislation came into effect on the 1st of January this year, so these are the first results prepared on that basis with NatWest Holdings inside the ring fence and NatWest Markets and RBS International outside it.

Our ring-fenced bank incorporates all our domestic commercial and personal businesses, including Coutts and Ulster Bank in Ireland, so only NatWest Markets and RBSI are outside, so the impact on our presentation is relatively modest.

Inside and outside the ring-fence, our management is focused on growth initiatives as well as we'll discuss and we must also continue to bear down on costs and today's results show we're making good progress there. One strength we now have is our extremely resilient balance sheet with ample capital and liquidity.

Before I hand over to Ross, I know you'll be interested in the search for a successor to continue his excellent work. We are making good progress with a rigorous internal and external search and we will update you as soon as we can, but it will not be today. Ross will remain in role until an orderly handover to the new CEO is completed.

I'll now hand over to Ross and then to Katie for more detail, and then I will host the Q&A. Thanks.

Ross McEwan: Thanks very much, Howard. For the first half of 2019, we delivered an operating profit before tax of GBP 2.7 billion and a GBP 2 billion bottom line attributable profit. These represent a return on tangible equity of 12.1 percent for the first half and 15.8 percent for the second quarter. You will have noted that our results for Q2 are positively impacted by Alawwal and the transaction we announced in June. After many, many years of negotiations it was good to make progress on exceeding our position and bringing to an end the large-scale restructuring of this bank.

We do expect further income benefits in H2 as a consequence of this transaction. With the external environment uncertain, we are focused on the areas that we can control. Costs are down, lending is up and our capital position remains very strong.

On costs, I'm pleased to report that we reduced these further by GBP 173 million or 5 percent in the first 6 months of 2019. The overall reduction is against our 2019 costs target of GBP 300 million. We have now taken out over GBP 4.3 billion of costs over the last 5 years, and there is more to come.

On lending, we've grown the balance sheet in a disciplined way. We grew net lending by GBP 3.6 billion or 2.5 percent on an annualized basis in the first half across the retail and the commercial businesses. On capital, we are advancing today an interim ordinary and a special dividend. And after these, our Common Equity Tier 1 capital ratio will sit at 16 percent.

The positive aspects of what we have achieved in restructuring the bank is there are strong capital liquidity and funding positions that position us very well in this environment. We've taken no additional provision to payment protection insurance this quarter. We will monitor volumes over August to check for any behavioral changes. Today, however, we feel we are adequately provided. This is a solid performance in the current operating environment.

These results are set against an external operating environment which is impacting us in areas we have no control over. The yield curve has continued to fall. Markets are now including – indicating that a cut in interest rates is more likely than an interest rate increase in the next 6 to 9 months. This is challenging our net interest margin today.

Business confidence surveys are pointing to deterioration in investment appetite. This is affecting the volume of lending growth that we can achieve. As we've mentioned previously, we continue to see small and medium-sized businesses borrow to develop their businesses. However, many of the large corporate customers are pausing until they get clarity on the terms of the U.K. exit from the EU.

And finally, the mortgage market, the competition here remains intense. Average rates across a range of loan-to-values sit at historic lows. We continue to see good growth in this market, but margins are under pressure. Our NIM in the personal bank is down 11 basis points this quarter.

These factors are headwinds for our business, and they are proving challenging. Excluding NWM, central items and notable items, income decreased by 1.7 percent compared to the first half of 2018.

Given this operating environment, achieving a 12-plus percent return on tangible equity by the end of 2020 is very unlikely, but remains the target in the medium term. I am confident that this bank is now in a position of strength and able to support customers and the economy going forward.

The progress we've made since 2014 through resolving legacy issues, restructuring the business and delivering profitability stands us in very good stead. And the Alawwal transaction strengthens our capital position even further. I'm pleased to announce further dividends to our shareholders who have supported the bank through its recovery, an interim dividend of 2p per share and a special dividend of 12p per share.

Added to the GBP 1.6 billion we returned in 2018, this will represent close to GBP 3.3 billion in dividend payments, of which GBP 2 billion will have been returned to the U.K. taxpayer.

Today's announcement – I'm sorry, today's announced dividend payments will take us to a post-dividend CET1 capital ratio of 16 percent, which remains well above our medium-term target of circa 14 percent.

We will target further capital returns for the full year 2019, and we will continue to look for efficient ways to deploy any excess capital that we do generate.

We have continued to support our customers where demand exists and it's within risk appetite. In the first half of 2019, UK PB provided GBP 14.3 billion in gross new mortgage lending, which is a market flow share of approximately 12 percent compared to our stock share of circa 10 percent.

In addition, we grew our personal advances by GBP 0.6 billion or 8 percent in the first half of 2019. Our private bank delivered lending growth of GBP 0.4 billion or 3 percent in the first half on top of AUM growth GBP 2.1 billion or 11 percent. This is a really strong business with an H1 2019 return on equity of 16.6 percent.

For our business customers, we have total loans and advances of GBP 30.6 billion to our SME and mid-corporate customers. This is up GBP 0.6 billion or 2 percent on H1 2019.

We're also taking the lead on supporting our customer's transition from LIBOR. Together, NatWest Commercial and NatWest Markets delivered the first loan reference to the SONIA rate with one of our large customers and we're working with others before launching the product for wider use.

RBSI also continued to deliver good results for the group with an operating profit of GBP 194 million and a return on equity of 29.7 percent for the first half. And now has a credit rating from S&P, Moody's and from Fitch.

NatWest Markets continues to experience challenging market conditions but has performed in line with peers, generating core income of GBP 325 million in Q2 2019. That's up 3 percent compared with the same quarter last year, and an operating profit of GBP 362 million including a GBP 444 million benefit from the Alawwal transaction.

Compared to Q2 2018, other expenses in Q2 2019 continued to fall down 15 million or 4.9 percent due to the lower back-office cost in NatWest Markets. Our customers continue to adopt digital channels at an increasing rate.

In June this year, for the first time in the personal bank, a majority of new product sales were via digital channels. And we're also growing our current account customer base with 350,000 new customer accounts in the last 6 months alone, that's up from 313,000 new customer accounts from the same period last year.

And for the first time since the current account switching process was put in place in 2018, we have had positive switcher numbers across the personal bank for a 6-month period. This is good progress and is also being recognized externally with NatWest being voted the best online current account provider by consumers in the 2019 YourMoney.com awards.

Last month, we were the first U.K. bank to launch a new facial recognition capability for NatWest Personal customers. Customers can verify ID using a selfie, taking the account opening process to under 10 minutes.

We're also piloting biometric debit cards. Customers will use their fingerprint to verify transactions over GBP 30, increasing security and making it easier for customers to pay for goods and services as no PIN will be required.

Recently, we announced to the market our pilot launch of NatWest Rapid Cash. This supports working capital requirements by offering a credit limit of up to GBP 300,000 based on the customer's unpaid invoices. This will not only help customers but could potentially have positive benefits for the supply chain as a whole.

After many years of being out of the zero balance transfer market, we've launched a new credit card proposition that is focused on helping customers manage their debt effectively. This is driving stronger customer numbers with net 35,000 joining in the last 6 months, that's almost double the same period last year.

These are all improvements that we've deployed in the last 6 months and there are much more to come from this bank. I know many of you were at our technology seminar in June and I've been encouraged by the feedback that we received and we will continue to update you on the progress that the team are making.

In H2, we will be launching both Bó, our personal digital bank, and Mettle, our digital SME platform. Both have been on trial and are close to delivering these out to our customers.

The summary, before I hand back to Katie. We've delivered a pretax operating profit of GBP 2.7 billion in the first half, taking our attributable profits for the first 6 months to GBP 2 billion. This represents a return on tangible of 12.1 percent for the half and 15.8 percent for the second quarter.

I'm pleased to announce the 2p ordinary interim dividend and the 12p special dividend per share. As I said since we've resumed dividend payments, we have returned GBP 3.3 billion to shareholders, including GBP 2 billion to the U.K. tax payer.

We continue to support our customers' net lending, up GBP 3.6 billion or 2.5 percent on an annualized basis across our retail and our commercial bank. And we've delivered further improvements for customers this quarter and there is much more to come.

Given the uncertain economic outlook and the highly competitive market, I reiterate we believe achieving a 12-plus percent return on tangible equity target by the end of 2020 is very unlikely, but this still remains the target in the medium term.

I'll now hand over to Katie.

Katie Murray: Thanks, Ross. Good morning, everybody. Let me start by taking you through the P&L. Our total income was 6 percent higher than H1 2018. However, as Ross has already discussed with you, this is a result of the disposal of our Alawwal holding, which added some GBP 990 million to income.

So if you take this out, our income was lower than 2018. There were 3 main reasons for this: Ongoing margin pressure in the personal banking business; GBP 192 million of fair value and disposal gains in commercial in the prior year; and in line with what we see in the market, lower client activity in NatWest Markets. Which saw their income in the core down GBP 26 million or 4 percent in the half, though it was up Q2-on-Q2 by GBP 9 million or 3 percent.

Much of the Alawwal transaction comes through this entity, and so the total income for NatWest Markets franchise reflecting the disposal of Alawwal was

GBP 942 million with a 1 percent ROE; however, a minus 4 percent ROE excluding Alawwal.

Moving onto margin. I would really actively encourage you to model the banking NIM and that's what I will talk to today. Our bank NIM was down 5 basis points in the quarter, mainly due to mortgage income pressures as well as tighter deposit margins as the yield curve flattened and the structural hedge income reduced. This particularly impacted U.K. personal banking.

In recent quarters, the competitive pressure on asset margins, notably mortgages, was partially offset by deposit margin pressures following the rate rise in August 2018. However, in Q2, we saw the yield curve fall very sharply, putting pressure on our deposit funding benefit as well as on our structural hedge.

The margin in the commercial business held up comparatively well in the period, only moving down by 2 basis points. While margins in RBSI and Ulster were down 2 and 3 basis points, respectively, which combined to build to the 5 percent down overall.

Continuing down through the P&L. We have reduced our other operating costs by GBP 173 million or 5 percent in H1 2019. This is after having absorbed around GBP 20 million of additional authorized push payment fraud costs we are now required to refund as a result of a new industry code of practice issued earlier this year.

There were GBP 629 million of strategic costs and GBP 60 million costs of conduct and litigation. This combined to create our all-in cost:income ratio of 57 percent for the half year.

Our impairments were 21 basis points in H1, which includes a number of charges for single names within the commercial business in the quarter. We still do not see any material changes in the underlying performance of our loans and advances book, but we do recognize some signs of strain.

Putting these together, we produced an operating profit before tax of GBP 2.7 billion in H1, up 48 percent on 2018. On taxes, I would like to highlight one item. The effective tax rate of 7 percent benefits from a deferred tax asset credit of GBP 215 million following the finalization of the transfer of tax losses from NatWest Markets Plc to NatWest Holdings.

H1 attributable profit was GBP 2 billion, with a return on tangible equity of 12 percent for H1 or 16 percent for Q2. Excluding items associated with the Alawwal merger, the H1 return on tangible equity was 7.5 percent.

Our fully diluted H1 TNAV was 289p, up 3p on the year-end, following the payments of our full year dividends and inclusion of our profits from the period, and of course, the Alawwal transaction.

I know you are interested in NIM, so let me spend a few more minutes taking you through this in some detail. Q2 2019 Bank net interest margin was 202 basis points, both on a headline and an ex one-off basis. Excluding these one-offs, NIM was down 6 basis points compared with Q1 2019 or 9 basis points if you compare it to Q2 2018. The reason is, of course, the ongoing competitive pressures we see in the mortgage market which showed no signs of abating.

Our margin on the mortgage book for new business has improved to around 95 basis points throughout Q2, and we have seen this further improving slightly as we've gone into Q3 as the yield curve has flattened, providing a benefit on the funding cost side.

Commercial NIM was resilient, down 2 basis points in Q2, mainly due to lower deposit funding benefits. Given an almost flat yield curve, our structural hedge is being reinvested at the lower yield.

At H1, the 5-year product hedge was yielding 1.01 percent and the 10-year equity hedge 2.31 percent, while the corresponding swap rates at the 30th of June were 0.83 percent and 0.97 percent, respectively, and since then fallen further to 65 basis points and 82 basis points.

This creates a further income headwind. We will continue to manage our liquidity position in response to the market conditions as we have done in the past. During May, we repaid GBP 4 billion of TFS, taking our outstanding balances to GBP 10 billion as at the end of June.

Despite this, in Q2, central liquidity buildup was a headwind of 1 basis point on NIM. Going forward, there are a number of factors which impact the NIM and so we continue not to provide guidance on a forward-looking basis.

As you know, we started this year with 4 clear priorities: 2 percent to 3 percent loan growth; GBP 300 million of cost takeout; capital generation; and lastly, capital return.

So let me start with loan growth. In the first half of 2019, we've grown at an annualized rate of 2.5 percent across personal, Ulster, commercial and private banking. This is considerably better growth than we achieved in Q1, where our annualized growth rate was 0.8 percent. Our target for 2019 is 2 percent to 3 percent growth and we are very firmly on track.

Our gross new mortgage lending in H1 was GBP 14.3 billion, with market flow share of approximately 12 percent, supporting the stock share of circa 10 percent.

We continue to see momentum in personal advances. These were up 8 percent in H1 and this was largely driven by our investment in technology, making it easier for our customers to do business with us.

It's worth noting that this growth in lending is matched by the growth in main current account acquisition, where we saw gross new customers to the bank of 350,000 in the first half of the year. Ulster also has had a strong quarter in new business and is taking a 16.5 percent share of new mortgage lending, for example.

In Commercial, we continue to grow in our chosen parts of the book and this headline of flat growth hides a strong position in business banking, SME and mid corps and specialized banking business lending, where we achieved combined net growth of GBP 1.5 billion in the half. That's a 5.8 percent growth rate on an annualized basis, which is a pleasing result and demonstrates our ongoing commitment to supporting U.K. businesses.

As Ross discussed, large corporates and institutional businesses have reduced by GBP 1 billion. So while commercial remained flat overall compared to the year-end, we are satisfied with the key areas of growth within our business.

I also wanted to highlight the strong lending growth in both Private and RBSI which have grown at 5.6 percent and 4.5 percent, respectively, in the first half. In Private, this was driven by mortgage lending, while in RBSI, this was due to higher volumes in the institutional business. We have, of course, maintained our prudent risk approach and pricing in a very competitive market across all of our businesses.

So overall, a strong story of growth across the business, 2.5 percent across NatWest Holdings and 2.6 percent if you consider RBSI as well. And while the NIM is undoubtedly challenged, we are very comfortable that this growth is returning above our cost of equity and we are adding long-term shareholder value to the group as we continue to grow our balance sheet.

Our second priority is cost reduction. We continue to bring down our costs. We've taken GBP 173 million or 5 percent out in the first half. That's against our GBP 300 million target for 2019.

To give you some examples of how we're taking costs out: This year, we're spending around GBP 400 million in strategic costs on building exits, which will result in an annual cost saving of around GBP 75 million a year in direct property costs alone.

We continue to see a shift from physical to digital activity. Digital sales are up 19 percent year-on-year and U.K. personnel mobile users are 5 percent up year-on-year at 6.3 billion – million, sorry. This helps us to reduce our headcount. FTEs are down 3,000 in the last 12 months across the bank and down 9 percent year-on-year in personal as the transition to digital yields real financial benefits.

We keep simplifying our technology architecture. We closed over 100 applications in the first 6 months of the year with the intention to close a further 300 during H2.

On strategic costs, we have utilized GBP 629 million of the GBP 1.2 billion guidance for this year, including GBP 200 million in relation to our exit from 280 Bishopsgate.

As we've now got the larger legacy issues behind us, conduct and litigation costs have also significantly reduced. I would, however, caution you from assuming that litigation will fall away as quickly as the GBP 60 million charge this half might suggest. You'll see in our financial statements, we still have a number of smaller legacy issues that we're dealing with and the costs of these will certainly flow through in time.

Turning to our third and fourth priorities: Capital generation and capital returns. Our third priority is to generate capital. This is one of our strongest areas. We've ended the quarter with a CET1 ratio of 17.1 percent before any dividend accrual. Our underlying capital generation, if we exclude Alawwal, was 15 basis points versus 30 basis points in Q1, down as a result of the increased impairments and strategic costs.

In line with our 40 percent dividend payout ratio, we have reflected 20 basis points against our CET1. And from this, we have announced an interim ordinary dividend of 2p per share. In addition, we have also announced the special dividend of 12p or 80 basis points.

In doing this level of special dividend, we are passing directly back to you the gains that we made of 60 basis points from the Alawwal transaction, which we recently completed. This is also in line with our aim not to continue to grow our capital levels from the 16 percent CET1 ratio that we ended last year on.

This combined interim and special dividend represents a payout of 90 basis points of CET1, an 83 percent dividend payout ratio or a GBP 1.7 billion prime payment to our shareholders, which coupled with GBP 1.3 billion we made during Q2, equates to GBP 3 billion paid out to our shareholders in this calendar year-to-date.

We do, of course, continue to maintain the capacity to participate in a directed buyback from the government at any stage they feel appropriate. It is quite clear that we have built a very strong capital position through organic capital build and optimizing our capital usage. I believe today that we have demonstrated again our desire to distribute our excess capital back to the shareholders.

We end the year with a solid set of balance sheet metrics. Our CET1 ratio was 16 percent at the half year, comfortably above our medium-term target of 14 percent, supported by our organic capital build.

Our LDR remains at 86 percent, with our customer lending supported by a solid core deposit base. Our LCR was, for H1, was 154 percent with a total liquidity pool of GBP 203 billion. We will continue to manage our liquidity positions in response to market conditions and Brexit uncertainty.

Looking at RWAs, they were down GBP 2 billion in Q2 at GBP 188.5 billion, with the Alawwal merger benefits partially offset by increases in the Core NatWest Markets business and also UK personal lending.

We retain our full year 2019 RWA guidance of around GBP 185 billion to GBP 190 billion for the end of the year. It's a strong balance sheet by any measure. So to summarise. We've continued to deliver strong loan growth of 2.5 percent annualized or GBP 3.6 billion in the first half. We have done that in challenging times. Costs are absolutely within our control, and we remain committed to taking out GBP 300 million this year, having taken out GBP 173 million to date.

On capital, we're in a very good position to generate and distribute sustainable returns. We continue to believe that 12 percent remains the right target for the group and is achievable in the medium term. And I am confident that we are delivering on the levers today to take this business forward.

As we look at Ross' possibly last announcement with me on stage, we can rest assure that he's delivered a bank that is growing well with a strong and stable financial position supporting it and returning significant capital to shareholders, so quite different from what he inherited.

And with that, I will now hand back to Howard to host some Q&A.

Howard Davies: Thank you very much, Katie. So we'll now go straight to Q&A. I may have questions from the ether but I'm going start with the room, if you can give name and institution. Let's start. Yes, first here.

Jennifer Cook: Jenny Cook, Exane. First one, just on the net interest margin. Appreciate if you could break down that 4 basis points of competitive pressure between the structural hedge and the front book rolling?

And I appreciate you don't give forward-looking guidance, but we can all roll the structural hedge to see the pressure that's coming in H2. Is there anything that could offset this?

Second question was just on the incentivized switching scheme. Looking at the latest data, that's people are switching across at a far slower rate than I think anybody was expecting. I just want to check, was there any impact on income in Q2 from incentivized switching?

Howard Davies: I think, Katie, do you want to take that?

Katie Murray: Yes, sure, absolutely. So if we look at NIM and I'll probably just give a slightly broader answer in the hope of cutting others off of the – at the pass as we go if that's all right. But look, I mean, as you know, we don't give NIM guidance. And as a reminder, we have introduced a bank NIM, so I would really encourage as you work your models, that you do try to move to that bank NIM and I know that Alexander will happily take you through the mechanics of that. But it's pretty simple. It literally is just removing the NatWest Markets impact.

There's a number of moving parts within the NIM, and I think at the moment the headwinds of reality are certainly weighing the kind of tailwinds as we look at it. And for me, I think you kind of have 3 main dynamics at play. The first is obviously the new mortgage margins. So we're trading in a range, I think, over the half year of 80 to 100 basis points.

At the moment we're at the top of that range. If we were to move down to the bottom, which we'd still be comfortable at an ROE basis but obviously it would have a bit more of an impact on NIM. And this is against the back book that's about an average of 160 basis points.

It's important that you remember that when the 80 to 100 is talking about new to bank margins, so there is also obviously a mix of different loan-to-values, where our SVR book is and also the kind of buy-to-let book as well as the switcher balance. So the overall book is a little bit stronger than that.

But the reduction in the 5-year stock curve has provided some benefit to our Q2 application margin, which we talked about, and that bodes quite well as we move into Q3 in terms of the falloff in NIM. But the reality is we have to see how competitors also react as we are reacting to each other, I think, much more actively than we maybe have in the past.

The second main part of NIM is also the yield curve, which has contracted significantly in Q2 and this has impacted the benefit that we get from our structural hedge with the latest 5-year and 10-year swap curves trading below the current average yield.

I think somebody informed me that was coming in the 10-year swap curve is about 0.54 basis points which is quite kind of horrifying number. Now this price is over the long term. If you look at the 5-year a 60th ofit comes on each month. And the real purpose of the structural hedge is to make sure that we smooth our income stream and so we haven't altered our hedging approach. In the back of the slides, we gave you quite a lot of detail of both the up and the down. And the 25 basis point movement downwards has a 1-year impact on us of about GBP 144 million of income.

And then lastly, we've issued MREL with GBP 3.7 billion issued in H1, which does increase obviously our capital and funding costs. Against that, we repaid a bit of TFS, which we did halfway through the end quarter, which will have a little bit of impact coming through, but I think it would be quite nominal in that. So I think at the moment, NIM is quite a challenging place to be just now.

With your second question, switching, in terms of the income impact from the switching, it's really not material. I mean you will have seen the switching numbers that came out the other day and that doesn't have a particular impact on our income as we go through.

Howard Davies: OK. Yes, straight behind. Grey pullover.

Jonathan Pierce: It's Jonathan Pierce from Numis. I got 2 questions. The first is on consensus numbers and returns into next year and the second on capital generation. You’re understandably, I guess, a bit reluctant to talk about anything into next year.

But given it was only a couple of months ago, you still felt reasonably comfortable we're getting to 12 percent returns. I wonder whether you could talk a little bit about next year, maybe frame it in the context of consensus returns which were at 9.5 percent for next year, how you're feeling about that here today.

Second question, which I guess is kind of related, is on capital generation, 45 basis points ex Alawwal in the first half of the year. Give a sense as to where the capital generation again may be moving into next year is going to settle once restructuring charges fall away, et cetera?

Howard Davies: I think, Katie, you're up again.

Katie Murray: Yes, absolutely. No problem. So if I look at consensus, look, it's hard to obviously call out what's going to happen, I think, in the next year completely on income as we watch also as well of dynamics kind of happening in the market. And we're obviously disappointed to move out to the medium term and conscious we would love a definition of the medium term.

But as I look at consensus, I'm seeing about 9.5 percent ROTE for next year. I have to say that I'll probably be a bit disappointed if we were in a bit ahead of there so I would say while you have concerns on income, I wouldn't necessarily flush all the way through down to the ROTE, and there's a number of different things within there. Obviously, what we spend on strategic costs is important.

What we actually do to our cost base is important. The amount of capital that we will be seeking to return as well is quite a key impact on that number as well. So I would say with consensus, we're happy in the round with it and I think none of us can call exactly what will happen on income. But in the round out, I feel I'm happy there.

I think, Jonathan, you're absolutely right. I was on the call at the end of Q1 saying I was broadly comfortable. I think then as I talked about, we just saw this massive move down in the yield curve during Q2.

And I think when you look at the – almost use the structural hedge as a barometer of actually what that cost us in terms of income and I shared the numbers earlier, but there's a 101 down to 58 when I – 60 when I wrote my script the other day and already it's gone down from there a little bit further. That kind of shows the income impact that we have.

In terms of the second question, in terms of capital generation, so 45 bps in the quarter split – sorry, in the half, split 30 bps first quarter and 15 bps in the second. The second was we took a lot more restructuring costs and we also had our impairments. I would say our impairments were high for the quarter.

And if you look at 22 basis points over a year that probably, over the half, that feels a little bit ahead of where we were last year. And while we've had a couple of single names, we're not actually seeing any real sign within there. So I think it's a bit of a view of where you might go on impairments and things like that and as well as how conduct might land.

So only 45 for the half. We were 130 basis points of capital generation on profit for the previous year. That contained a couple of the one-offs. So I'd say kind of somewhere between that last year and where we are for the half probably gets you to a reasonably good kind of approximation of what we might be thinking of at the moment for the year.

Howard Davies: Thank you. Yes?

Martin Leitgeb: Martin Leitgeb from Goldman Sachs. Could I ask in terms of the broader picture in terms of liability, repricing, deposit repricing, fees and, obviously, the environment? The low interest rate environment is weighing on bank profitably, not only RBS, but the broader system. Do you see any scope for some of the repricing of some of the products, some of the deposits, some of the other things? So is this essentially for the banks to be in terms of profitability?

The second question is on – just on NatWest Markets. I was just wondering if the revenue outlook and the revenue guidance you have given us previously is impacted in any way or form by the lower rate environment we have today.

And the third question, if I may, just more broader, back in August 2016, after the Brexit vote, the Term Funding Scheme was introduced. Obviously, there's uncertainty ahead heading into the next couple of months. Overall, would you think if the Term Funding Scheme was similar, a facility were to be introduced, would that be supportive of bank profitability? Or would that be essentially more ineffective from your perspective?

Howard Davies: Thank you. Katie, do you want to take 1 and 3, and then I may get Chris Marks to come in on 2.

Katie Murray: Yes, sure. Absolutely. Thanks, Howard. So in terms of where we are on the product repricing, I don't think we expect something particularly significant. If you look particularly at mortgages, the average price is 160. We're moving down to somewhere like 100, there'll be movements roundabout there. But I don't think we'll see it in the short term move up. We have plenty of liquidity, others in the market have plenty of liquidity in order to fund those mortgages.

And the reality, they're all still yielding at that level good ROEs. I think until you start to see the economy crunch much more and your level of impairment starts to go up, that's where we'll drive a cost increase and that's not something we see particularly in the short term.

If I look at TFS, I think TFS was brought in for very good reasons, to kind of help some of the smaller challenger banks, but we all kind of benefited. It was certainly cheap funding. We're happy to repay ours as we look to the capital stack and things like that. It's not something I think that we are particularly looking for.

We still have our MREL requirements that we need to hit and wouldn't replace. But it's not that we're always interested. If there's a possibility for effective funding available, I'm sure we'd avail ourselves over again as it made sense, but I'm not sure it really helps in terms of the profitability of the banking sector particularly.

Howard Davies: Thanks. Chris, can you comment on the interest rate prospect NatWest ?

Chris Marks: We're seeing customer activity hold up pretty well in the first. The – our numbers are impacted by being an entity, so we've got high funding charges. But at GBP 702 million core income for the first half, we're still confident we'll be in the range of GBP 1.4 billion to GBP 1.6 billion by the year-end, probably at the lower end of that range, but we're still confident.

I think there's a lot of events likely in the second half this year that's irrespective of the general dovish feel in the market and the interest rate outlook will mean that clients need to act, need to risk manage, need to hedge particularly around Brexit and we expect the levels of activity could be actually significantly elevated in October.

Howard Davies: Thanks. I'm going to take one from the screen. It's Raul from JPMorgan.

(technical difficulty)

Katie could you tell us what is the 2020 headwinds to net interest income if the swap rates remain at current levels and the negative move in interest income from NatWest Markets, at what point would you reconsider your mortgage growth strategy and look to preserve NIM if these competitive pressures persist?

Katie Murray: Thanks very much, Raul, and hopefully, you're all on the screen in front of me, so it's a long question to take you through. So let me take you through step by step. In terms of 2020, the best place for you really to look is in the appendix of our slides, which is Slide 29, where we've laid out what change in NII happens for the – as the 25 basis point movement in the yield curve. So you can see within 1 year a downturn from, I guess, where we are at the end of June is an impact of GBP 144 million.

In terms of the negative moves in NII within NatWest Markets, I think it's important when you look at NatWest Markets really to always look at the total income number. Obviously, there's some noise in there which we're actually very grateful for on Alawwal.

It was a great transaction to kind of – to get completed. But because you have a situation where your interest expense comes through your NII and then your income is coming through your other income line, so to look at one independently of the other is – it doesn't always make complete sense.

But specifically, in NII, you'll recall we talked earlier in the year that we moved a number of legacy instruments which remained within NatWest Markets Plc as a result of ring fencing may now bear the cost of those and that is a number of GBP 170 million in terms of cost for the year.

As we move into 2020, that will be about GBP 50 million as a significant portion, about GBP 1.9 billion, matures in Q3 and another significant portion again matures in Q1 next year. So you'll see those instruments being replaced with instruments which have about half of the coupon that they're paying today. So that was a real benefit. But that's why you see this negative move really happening within NII.

And at what point would you reconsider your growth strategy and look to preserve NIM? Look, at the moment, we're in an 80 to 100 basis points kind of corridor. If it went a little bit below 80, we probably start to look at it a bit more closely, but we're really quite comfortable.

NIM is a really important measure, but ROE is a really important measure as well, and at the moment, they're still continuing under the current basis to earn over 20 percent. And even when we move to the new mortgage floors, it's over 15 percent ROE. And in reality, we're kind of happy to write that business all day long in terms of bringing that in.

Ross McEwan: OK. So just talking that one, this is to nip to burden of pricing pressure on the mortgage book in total because you've got people rolling on a 2- to 5- year now. And as they come up, they're looking for a deal. And if we're not there in the price and the market to actually get it, we won't get the business.

What recently happened is the margin on front book went up to over 100 basis points that has been completed at the marketplace and we're a price taker. So if that was completed at the marketplace because there's lots of liquidity out there looking for a home and I don't think that goes away for another 12 to 15 months.

And in that period of time, the book, the NIM will be under pressure in the mortgage book not just of us but of every bank in the U.K. That's a reality of just the numbers.

Howard Davies: Thanks. Let's take someone from the cheaper seats. The – yes, there, the middle there. Can you pass it along? Sorry. Fourth row. That's it.

Christopher Manners: It's Chris Manners from Barclays. Just a couple of questions, if I may. The first one was on capital distribution. I saw the interim dividend came in at 2p, that was flat year on year.

You do look to be pretty awash with capital and Katie, if you can make consensus EPS for next year. If you do a 1/3, 2/3 split, that's having your dividend in '19 up a little bit, looks like quite a low payout ratio. Just wondering how you think about framing that ordinary dividend.

And the second one was just on maybe to move away from the sort of mortgage margin point. It does seem to me that the UK PB does make a very good return and can hurdle, but actually if we look at Slide 22 in your deck, you got 30 percent of risk-weighted assets in NatWest Markets and in Ulster that are doing sort of 1 percent to 2 percent ROE.

Could you maybe explore with us what you're doing to improve the returns there? Because that actually looks like a meaningful part of leverage to get that group return back up again.

Howard Davies: Do you want to take the first and then maybe Ross get the – talk...

Katie Murray: Yes, perfect. Absolutely. So in terms of the ordinary dividend at 2p per share, I guess we do have a 40 percent payout ratio. But I guess what I would observe is that if you take Alawwal out of our attributable profits, we were down from the prior year. So it's actually a kind of expectation of growth in that ordinary, doesn't feel necessarily completely appropriate.

And I think coupled with the 12 percent payout ratio, this clearly had been a very strong payout in the period. As we look forward, I mean we're certainly not deviating from that 40 percent payout and you will have seen that we did, given our levels of profitability, accrue more than that as part of our CET1 carry in the half year. So I think you should be comfortable they are – we're remaining on track on that piece.

Ross McEwan: Well, there are 2 parts of our business that are not hurdling as of yet, one of them NatWest Markets. Chris gave you the assessment of what he thinks the income will be at start here. My view, I should never walk away from the 1.3 to 1.4. We had a couple of good years and the income gets pushed out and your expectations go up.

But we do have to get the cost out of that business and that's the work that Chris and his team have done a very good job of final year as this year is pushed into next year. They've got higher funding cost because of the entity that they've taken out and most of that rolls off by the first half of next year, which makes a difference to it.

And I've got a big program of cost reduction as they put more technology into this business. But it is a trying part of the market at the moment. And as

Chris said, he will do about 1.4 this year, would expect similar from next year, but the costs need to come down to around that GBP 1 billion next year to start getting the returns.

And it does link across to our commercial corporate business and the activities that go across there as well. We picked up some cost in there because of Brexit, which was not anticipated. And run again another vehicle over in Amsterdam, you see in the numbers there's about a GBP 50 million-plus cost base of running that business that we didn't anticipate. But it's doing as we asked it to do in that business, and it's stayed very focused on the 3 core parts of that business which are important across the commercial business.

On the Irish business, we've got it doing 2 things this year. One, getting the nonperforming loan book down to around that 5 percent, which is very important given ECB the targets. And it's also getting down the number of remediations, customer remediations particularly the big 2 by the end of this year, which then shows us the business that we have.

What's interesting in Ireland is it's starting to grow its market share again, we believe, safely this time around rather than what happened to it last time and Jane and the team are doing a very good job. We look to get some capital out of that business this year and more out next year. As long as we keep delivering on behalf of the – what the requirements of the regulator are, we do believe that is possible to get the capital out of that business and to create a good business.

It's why I haven’t given up on Ireland, but it is going to take some time. As I said to you, be another 3 to 4 years before we get cost of capital out of that business but I think the alternatives are that good. And this is a much better alternative, which is to quietly persevere and get it into better shape, which is showing through.

Howard Davies: Thanks, Ross. I've got one other from the screen, Edward from KBW. You've guided to NatWest Markets income of GBP 1.4 billion in 2020. Can we finally drop that as well?

Katie Murray: Well, if anything, I almost quote Ross where he said a moment ago he wished he'd never changed from 1.3 to 1.3 to 1.5. The reality is this business, it's hard to kind of call the cut. It's all dependent on the customer activity. What we do know is over the last number of years, we have a lovely kind of 1.3, 1.4, 1.5, 1.6, 1.7. I think you need to kind of find your own way within that. What we are pleased about is actually our income in this quarter has held up comparatively well in terms of the market pressure that's out there.

Howard Davies: OK. Next, the second row here.

Christopher Cant: It's Chris Cant from Autonomous. If I can just come back to your comments around consensus and being happy in the round with how things look for next year. The messaging around income is obviously fairly downbeat. So what are you trying to steer us on costs, if you expect to beat consensus 9.5 percent ROTE?

You haven't really talked about costs beyond 2019 all that much but, Ross, you alluded in your comments to more to do on cost and your ROTE target is a statutory target, of course. So are you trying to tell us that the restructuring charges are going to be lower next year?

Are you pushing those out further into 2021? Or are there further OpEx savings that you can point us to? It would just be good to understand whether confidence on beating consensus comes from given that you just missed quite badly on income.

Ross McEwan: Maybe if I can start, Katie, and then you can come in because I won't be here next year.

Howard Davies: We're going to take questions on that a little bit later.

Ross McEwan: Yes. First off on costs, costs continue – need to continue. We see we'll take out GBP 300 million this year and we need to take out a decent-sized chunk out next year as well. Cost reductions in banking does not stop. Technology is taking – making its play and fixed costs have to come out. The GBP 2.5

billion that we put forward on the restructuring charge, there's GBP 300 million left of that for next year, don't forget that.

We've said that it needs to be GBP 300 million next year to finish the job. And I suspect, in any bank, not just this bank, in any bank, there will be a level of restructuring going forward. As you continue to move from a very fixed toward digital play and our assessments, we sought that around the GBP 300 million going forward. But we've got GBP 300 million of the GBP 2.5 billion left for the shift. So I think this year we'll be doing about GBP 1.2 billion, which makes the total to GBP 2.2 billion out of the GBP 2.5 billion.

I think that's the reality. We do need to keep the cost base coming down, particularly as income becomes more problematic in the industry with a very low interest rate environment.

The other thing this bank needs to do is look at its capital position and continue to do so. I still think we're running quite high levels of capital in this bank, particularly RWAs. And there's a lot of work to do as we stabilize the business to really see how much is really required to run this bank. As we get better and run through normal stress test, we're learning more and more about this bank.

So I think, yes, income is going to be difficult in the environment we're all heading into. Growth, I think this bank is very capable of continuing to grow, but it will be more problematic on the net interest margin, as I've said, particularly around mortgages. That doesn't go away until liquidity soaked up a bit more. Katie?

Katie Murray: In terms of the ROTE, look, what I'd say is I'm kind of happy in the round. I'd hoped we'd be a little bit better than that. I wouldn't read too much into that. I'm not suggesting it will be 11.2 in terms of a little bit better than that. Kind of happy, the 9.5 is in there. Costs, as Ross said, it's a continuing journey. It's continuing for us and for, I think, actually every quite historic institution as we transform and digitize. So we will continue to work on that.

And strategic costs, we will spend GBP 1.2 billion this year and GBP 300 million next year. So then you kind of come down to actually what are your views on income, what's your view on impairments, where are you maybe on conduct and what might come through in the earnings on the kind of capital return. So I think there's no particular magic or any number that I'm starting to see. All I'm saying is I thought we'd do a bit better and be kind of in the round we're in the right – I feel that we're in the right sort of place.

Howard Davies: Yes, Tom?

Thomas Rayner: It's Tom Rayner from Numis. The U.K., which you've mentioned a couple of times, would sort of suggest the U.K. is heading maybe for a more severe slowdown than sort of current consensus economic forecast suggests. And there's very little focus, I think, in this presentation today on your impairments.

I just wonder if you could talk a little bit more about how sort of comfortable you are, the assumptions within the overall ROTE comments you've been making around impairments, if we are heading for a little bit more of a rocky economic outlook than maybe we thought even just a month or 2 ago.

Howard Davies: I think just as a general comment before Katie specifically answers that, I mean, we take a consensus view here. We're not trying to guess the course of the economy or the interest rates. But as you'll have heard yesterday, from the Governor, the prospect is uncertain.

I mean the bank's central view is that the economy will continue to grow, but a little bit less rapidly than they had previously forecast. And I think we must continue to plan on that assumption. I can't disagree with you that there is an alternative course which is worse than that. But we've modeled a kind of what I might describe as a cautious consensus in our forward look.

Katie Murray: I think one of the pleasures of IFRS 9 is we now tell you all of our assumptions that we use. So you probably haven't a chance to get through to it yet but on Page 7 of our appendix in the document, we go through all of those assumptions. And so what you can see in terms of the base case, which interestingly kind of use the sort of – some of the ACS assumptions. But in there, there's been very little movement in terms of the GDP growth.

What's interesting, as you look at them, we have moved our probabilities very slightly more to the downside. In terms of our Downside One has gone from sort of 25.6 percent probability to 29.7 percent. Obviously, model sort of suggests that kind of level of spurious accuracy in there, but certainly there's a bit more weighting on the downside.

We're not seeing in terms of the impairments big messages are coming through but – things like that and there are some little signs of strain that we see through that. We've talked about that we'd always be caught by some tall trees. We haven't for about 6 quarters in reality and so we knew that some would come through and this was this quarter.

Now we continue to manage and I think we've actually a really great story, particularly in our commercial business, on managing those tall trees. So we hope to kind of continue to be a bit lucky and a bit clever as we kind of move through the next few months as we look to manage those come through.

Howard Davies: Yes. Second, right here.

James Invine: It's James Invine here from SocGen. Katie, did I hear you correctly when you said that you're now seeing some strains in the loan book? And if you did say that, can you just...

Katie Murray: Oh, it's one of those words I say, will I say or will I not sort of thing. We're seeing some small signs of strain. I think the movement in the probability kind of confirms that. It's really – it's very small, about 22 basis points. And for the half year, that 22 basis points includes a number of kind of single names. I guess this time last year, we were sort of seeing in the high teens.

So there are definitely some small signs of strain within there but it's not – we don't believe we're moving quickly to our 30 to 40 bps through-the-cycle guidance, but things are certainly a little bit more uncomfortable than they were a year ago and I would read no more into what the small and little words I meant to indicate on that.

James Invine: Is there any commonality between them by industry or by region?

Katie Murray: No. I mean you can see in the bowels of our segment [disclosures] they all fall into large corporates. Interestingly, there are no – even no U.K. domestic losses. So there's no particular commonality within them as there generally isn't in these things.

Howard Davies: Alison, do you want to add to that? I think you'd probably confirm that point.

Alison Rose-Slade: The impairments that you've seen are what I would describe as spike. There's no commonality. And then if you look at the underlying work, as Katie says, there's no, what I would describe, systemic movements of increasing impairments or strain. So obviously, we keep a very cautious and plays on it, but it's actually as Katie said.

Katie Murray: Yes.

Howard Davies: Thanks. Any more, yes, one behind. Have you finished?

James Invine: Just had one small one. I think you made a residual stake in Saudi British Bank. What's the plan for that stake? Is that going or staying?

Katie Murray: So we have – I think it's a 6-month restriction before we could do any action on it. I think we'll wait and see how it evolves. In total, it was about GBP 1.1 billion of RWAs and it's a 4 percent stake, but it's performing well just now. We'll deal with it as we go. But it's certainly not part of our long-term kind of strategic future. So in time, we'll manage it as and when it's the appropriate time to do so.

Howard Davies: When I send you out to look at it, you can drive there now.

Katie Murray: Well, there we go. I could get myself to the office.

Howard Davies: Straight behind. I think – yes.

Jason Napier: It's Jason Napier from UBS. Just coming back on IFRS 9 and credit. I think we're all trying to figure out what IFRS 9 is good for. And with less than 3 months to go to the current deadline for a departure from the EU, I wondered if you could point to a dependable way to use your disclosures to figure out what a hard-deal exit might mean for provisioning in the first quarter. It's obviously very dependent on what the economy will actually do. But what does it actually mean for the overlays and the P&L in that quarter?

Katie Murray: Yes. So I mean, it's – I mean it's an interesting standard. I think if you're hoping as we leave the EU we might toss IFRS 9 to the wind, I wouldn't get myself there, unfortunately. The reality is we're all still a little bit bedding in with it. I mean I think that that's inevitable, and it's almost – it's a good thing but it's harder to bed in when actually the economics aren't moving that dramatically because I mean, beyond the yield curve, there hasn't been a particularly large amount of movement in that space.

I would say the best place to start is with our sensitivities that we published at the year-end. They won't have moved particularly based on the assumptions that we have today.

And the important thing to remember, those are the sensitivities at that moment and then obviously things will happen in the book and then you'll see more come on as you work your way through the life of many of these deals.

For us, the important thing is that we continue to write within the right risk appetite, working with our customers, making sure we're not moving up the risk curve and taking on things that we don't want to do. And actually, that's for me the best indicator of what will happen with the IFRS 9, the right appropriatly controlled growth of the loan book as we move forward.

Howard Davies: I've got one more from the online, a couple of questions from John from Goodbody. One, to the extent that mortgage spreads were to stabilize around 80 bps level and were a smooth Brexit to ensue, would you ultimately look to pursue a flow share target materially above 12 percent given the comments you've made around mortgages ROTE contribution?

Secondly, on PPI, you mentioned that at the Q1 result stage your provisioning bakes in the expectation of late surging complaints. Is what you've seen in recent months consistent with those previously communicated expectations? Can you give us some numbers on information requests and complaints run rates? I think the first one – do you want to deal with the second one or do you want...

Ross McEwan: I'll take them both, if you like. Just on mortgages, we were writing down as low as 80 basis points. Now for new business, it's around 95- 97 basis points, has been as high as 102, I think. As I said, to be quite clear, we are a price taker in this market. But at those sort of prices, we're beginning at that 12 percent flow, we're comfortable with that.

I think if we start participating and growing than that, we're the ones setting the price and we don't plan to do so. So around that, but we like mortgages. We like them as long as we're making good money out of them. We continue to grow that book.

We're still only 10 percent share of stock and would like to be higher over the next 5 years. I don't think that strategy is going to change. So yes, we'll keep writing them as long as we're making a good ROTE. But to push it even harder, I think you do start influencing the price, which is not our own.

On PPI, look, we're just waiting to see what the final push looks like on the claims. We believe we have got enough provisioned away. And we had in our provisioning a spike at the end as well. Well, let's just see what that looks like and having them actually pull through into the true claims back at. So at this stage, I think we're pretty well provisioned. But if we get a massive spike in August, we'll have to review final quarter, but we've got a good provisioning.

Howard Davies: Thanks. These beeps are rather irritating, I don’t quite know what it is. Anymore? Yes?

Guy Stebbings: It's Guy Stebbings, Exane BNP Paribas. Just one follow-up on structural hedge in commentary on NII outlook. Would it be fair to assume that the mix, the notional will probably pivot slightly more towards the products hedge rather than equity given given planned distributions but obviously an impact on duration and yield? And I presume just to check the sensitivity assumes a static mix going forward.

Katie Murray: It does. And in terms of the pivot, the other, I think, if you look at the kind of level of liquidity and funding that we have. I'm not sure it would move materially. And I think the thing about it is because it comes through so slowly in terms of the amount as we put on now, (om 5 years a 60^{th}) as it comes through to you.

So I wouldn't see that having a particular impact. These are good sensitivities for you to work with. And I've completely forgotten your other question. I'm sorry I didn't write it down.

Guy Stebbings: Well, it was very much linked between the 2.

Howard Davies: OK. I think we've not got anything more online. I think we may have exhausted you in the room. Thank you once again for coming along. And I imagine many of you will be going off on holiday, so have a good break and we'll see you in Q3. Thank you.

Ross McEwan: Thank you.

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