



**NatWest**  
Group

**NatWest Group plc**  
**H1 2023 Results Call Transcript**  
**28<sup>th</sup> July 2023**

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**Howard Davies**

Good morning and thank you for joining us today.

I'll start with a short introduction before Katie takes you through our financial performance.

On Wednesday we announced that Alison Rose had agreed with the Board to step down as CEO with immediate effect by mutual consent.

It was a sad moment. She had dedicated all her working life to date to NatWest and leaves many colleagues who respect and admire her greatly.

Subject to regulatory approval, the Board has appointed Paul Thwaite, the current CEO of our Commercial and Institutional business, as interim Group CEO.

Before Paul became CEO of our Commercial & Institutional business, he led the Group's Commercial Banking division.

He is a very experienced banker with a track record of success in senior roles within Wholesale, Corporate, International, Retail Banking and Risk, and has worked across the UK, in Europe and in the US.

He has been a member of our Executive Committee since 2019 and has played an important role in delivering our current strategy which remains unchanged.

Paul will present results from Q3 onwards and looks forward to meeting investors on a one-to-one basis in the near future.

The Board began the process of appointing my successor in April as I will have been in post for 9 years by July 2024, the maximum recommended tenure under the UK Corporate Governance Code.

My successor will be responsible for leading the process to select a permanent CEO and we fully expect Paul to take part in that process.

With that I'll hand over to Katie to run through the results.

**Katie Murray (KM)**

Thank you, Howard.

The business continues to perform well, and we have delivered a strong first half with growth in lending of 6 billion pounds and new customer acquisition in key areas.

We delivered first half operating profit of 3.6 bn and attributable profit of 2.3 bn.

Income grew to 7.4 bn and costs were 3.8 bn.

Our strong capital generation gives us the flexibility to invest in the business, consider other value creating strategic options and return capital to shareholders.

We are proposing an interim dividend this year of 5.5 pence, up from 3.5 pence last year; we have completed the 800 million on-market buy back announced in February; and today we are announcing another on-market buyback of up to £500 million which we expect to start next week.

Together with the directed buyback of 1.3 billion in May, this brings our CET1 ratio to 13.5%, within our target range of 13 -14 % for the first time.

Our return on tangible equity was 18.2%.

Macro-economic outlook remains uncertain.

We have updated our economic forecasting since we last spoke.

Although the UK economy has been stronger than expected, inflation remains relatively high, and rates have continued to rise, resulting in ongoing economic uncertainty.

We now expect peak rates of 5.5% this year, up from 4.25% in our previous forecast.

We are also seeing liquidity in the banking system reduce.

In the face of ongoing inflation and rising interest rates, customers are behaving rationally.

Corporates are deleveraging, overall demand for borrowing is muted, we are seeing customers adjust their spend habits, and some are using deposits to pay down more expensive debt.

Given the macro-economic environment and higher rates we have taken the decision to strengthen impairment reserves by about 210m.

Against this backdrop, our strong balance sheet is more important than ever – with robust liquidity, a high-quality deposit base and well-diversified loan book enabling us to continue supporting our customers and fuelling the UK economy.

I'll now take you through the second quarter performance using the first quarter as a comparator on slide 6.

Total income was stable at £3.9bn.

Income excluding all notable items was £3.6 billion, down 6.7%.

Within this, Net interest income was 2.7% lower at £2.8 billion and non-interest income was down 19.5% at £739 million.

Operating expenses fell 3.1% to £1.9bn

The impairment charge increased to £153 million or 16 basis points of loans, driven by higher Post Model Adjustments.

Taking all of this together, we delivered operating profit before tax of £1.8 billion.

We incurred some notable charges bringing profit attributable to ordinary shareholders to £1 billion.

And return on tangible equity was 16.4%.

We are pleased to have delivered further net lending growth in the quarter.

Gross loans to customers across our three businesses increased by £0.3 billion to £356 billion.

Taking Retail Banking together with Private Banking,

Mortgage balances grew by £1.9 billion or 1% in the quarter.

Gross new mortgage lending was £8 billion, representing flow share of around 15%.

And our stock share has increased from 12.3% at the start of the year to 12.6%, demonstrating how we are delivering on our growth strategy.

Given volatility in swap rates during the quarter, our average application margin was below our intended range of around 80 basis points, but we were back to this level at the beginning of July as we repriced customer rates.

Unsecured balances increased by a further 600 million to £15 billion, driven by additional card issuance and ongoing share gains.

In Commercial & Institutional, gross customer loans decreased by £2.3 billion.

At the mid to large end, we saw some demand for Asset Finance and Revolving Credit Facilities.

At the smaller end, demand remains muted, and customers with surplus liquidity continued to deleverage, including repayment of government scheme lending.

So, let me turn now to deposits on slide 8.

Customer deposits across our three businesses were stable in the quarter at £421 billion.

As expected, outflows in Retail Banking and Private Banking slowed following tax payments made in the first quarter.

In Commercial & Institutional, deposits increased by £1.0 billion.

Our loan to deposit ratio of 83% allows us to manage our deposit base for value and importantly allows us to support customers and grow our share in target areas.

The UK base rate has increased by 75 basis points to 5% since we presented Q1 results and customers are increasingly moving balances from non-interest bearing to term accounts.

Non-interest-bearing balances have reduced from around 40% of the total to 37% and term deposits are now 11% of the total, up from 6% at the beginning of the year.

Customer behaviour is difficult to predict however we assume ongoing migration.

Turning now to what this means for income on slide 9...

Income excluding all notable items was 3.6 billion, down 6.7% on Q1.

Net interest income was 2.7% lower at 2.8 billion, driven by lower bank NIM in the quarter of 3.13% driven by lower margins on mortgages and deposits and lower Group average interest earnings assets, which reduced by 1.5% to £514 billion, driven by a reduction in liquid assets which more than offset loan growth.

You will find our usual disclosure on net interest income in the appendix.

Non-interest income, excluding notable items, was down 179 million to £739 million.

Around half of this was due to lower market volatility.

We continue to expect full year income excluding notable items of around £14.8 billion, however we now expect Bank Net Interest Margin of around 3.15%, down from around 3.20%.

This assumes the UK base rate increases by a further 50 basis points in Q3 to 5.5%, and remains there for the rest of the year and the average reinvestment rate of our product structural hedge for the full year is 4.4%, up from 3.6%

The benefit from higher rates on Bank NIM is more than offset by our expectation of further deposit mix changes and passthrough and a reduction in the product hedge notional from £202 billion to around £190 billion by the year end, reflecting a catch up with eligible spot deposit balances.

Moving on to Costs on slide 10...

Other operating expenses were £1.9 billion for the second quarter.

That's down £57 million or 3% on the first quarter driven by lower severance and consultancy costs.

In Ulster Bank we have incurred £163m of direct costs in the first half, and we continue to guide to around £300m for the full year.

We continue to expect other operating costs of around £7.6 billion for the full year, in line with our guidance.

This cost performance is delivering a cost income ratio of 49.3% for the first half, benefiting from the notable income gains. Excluding these the cost income ratio is 51.6%.

I'd like to turn now to impairments on slide 11 ...

We booked a net impairment charge of £153 million in the second quarter, equivalent to 16 basis points of loans on an annualised basis.

This was driven by an increase in our post model adjustment for economic uncertainty of £129 million to £462 million, together with further reserve building, that more than offset the £98 million Expected Credit Loss release from the update to our economic assumptions.

The PMA increase is largely against our wholesale book to cover any potential cash flow issues as a result of higher interest rates and inflation.

Excluding this, we would have had further net impairment releases in our Commercial & Institutional business.

In Retail overall, stage 3 charges and defaults remain stable. The impairment charge driven by new day 1 provisions relates to unsecured lending growth.

As you know, our 2023 impairment guidance is 20-30 basis points. We see this as prudent, and we would need to see a material deterioration in performance to be inside the range.

I'll talk a bit more about the composition and quality of our loan book on slide 12...

We have a well-diversified prime loan book which is performing well, and which demonstrated its resilience in the recent Bank of England stress tests. Over 50% of our Group lending consists of mortgages, where the average Loan to Value is 55% or 69% on new business.

We continue to have low levels of arrears and forbearance in our mortgage book. 91% of our book is fixed, 5% are trackers and 4% is on a Standard Variable Rate. Over two thirds of mortgage balances are fixed for 5 years and less than a quarter are fixed for 2.

The composition of our mortgage book means a lower proportion of our customers will face a change to their mortgage repayments in the second half relative to the sector average.

The majority of our customers are rolling off 5Y fixed rates where the uplift is lower than for those rolling off 2-year rates. Since mortgage rates began to rise in Q4 last year, more than 70% of our customers in the [6-month] pre roll off window have taken the opportunity to refinance early and take advantage of lower rates.

Our personal unsecured exposure is less than 4% of group lending and is performing in line with expectations.

Our corporate book is well diversified, and we have brought down concentration risk over the past decade, including reducing Commercial Real Estate which is less than 5% of group loans, with an average Loan to value of 48%.

As one of the largest lenders to business in the UK we are pleased to see the Bank of England's recent Financial Stability Report recognise corporate indebtedness is at its lowest point in the past 20 years.

Turning now to look at returns and capital generation on slide 13 ...

We are pleased to have delivered 16.4% Return on tangible equity this quarter, driving capital generation of 50 basis points, excluding non-recurring impacts such as our acquisition of Cushon. This brings capital generation to 100 basis points for the first half.

We ended the quarter with a Common Equity Tier 1 ratio of 13.5%, down 90 basis points on the first quarter. This was driven by distributions which account for 114 basis points in the quarter. Our £1.3bn directed buy back consumed 71 basis points of capital.

We accrued 40% of second quarter attributable profit, equivalent to 15 basis points, in line with our 40% pay-out ratio; this excludes the Foreign Exchange recycling gain which is neutral for capital.

Finally, our £500m on-market buyback programme announced today is accrued in our 13.5% CET1 ratio.

Turning now to our balance sheet strength on slide 14.

Our CET1 ratio of 13.5% is now within our target range of 13-14%, which includes a buffer above our minimum requirements. Our UK leverage ratio of 5.0% has reduced from 5.4% in line with the decrease in Tier 1 capital and remains well above the Bank of England minimum requirement.

Our Liquidity Coverage Ratio was 141% at the end of the first half on a spot basis, and 145% on a 12-month average basis. This remains well above our minimum requirement.

Turning to 2023 guidance

We expect:

Income, excluding notable items, to be around 14.8 billion, at a UK base rate of 5.5%

Net Interest Margin about 3.15%, and group operating costs, excluding litigation and conduct, to be around £7.6 billion, delivering a cost income ratio below 52%. We anticipate a loan impairment rate in the range of 20-30 basis points, and together we expect this to lead to a Return on Tangible Equity at the upper end of our 14 to 16% range.

I'd like to turn now to talk more broadly about the first half and our strategy, which is delivering and remains unchanged.

So we maintain our focus on: responsible targeted growth, continued cost and investment discipline, together with effective capital allocation to enhance shareholder returns.

I'll talk more about each of these areas in turn.

I'll start with our progress driving targeted growth on slide 17.

The strength of our balance sheet and risk management means we retain capacity to grow, even in challenging market conditions, and we are doing this in three ways.

First, we are focused on driving customer lifetime value.

We are the leading high street bank for entrepreneurs and start-ups, with a share of 17.7%, up from 13.0% this time last year. And we added 55,000 new start-up accounts during the first half as we continue to strengthen our offering.



In Retail Banking we continue to grow our customer base with a focus on personalisation and particular segments such as youth and affluent. For example, we have significantly strengthened our youth offering with the acquisition of Rooster Money which we have extended by connecting it with our app. Rooster card subscriptions increased by 93,000 during the first half and we now serve around 20% of the youth market.

In Wealth Management, despite more volatile markets we grew assets under management and administration during the first half, including net new money of a billion pounds.

Secondly, we are helping customers transition to a net zero economy which remains a strong commercial opportunity. Across the Group we have delivered over 48 billion of Climate and Sustainable Funding and Financing towards our ambition of lending £100 billion between 2021 and 2025.

This includes 16 billion in the first half this year.

Thirdly, we continue our digital transformation which is delivering value for customers, employees and the bank.

Our services for small businesses such as Mettle and Tyl are good examples.

Mettle is our digital only business bank account and with a customer base of around 100,000 which includes 17,000 acquired during the first half.

Our award-winning payments platform, Tyl, has carried out £2.2 billion of transactions in the first half, up 64% on the same period last year.

In Retail Banking we have recently extended our credit card offering to the entire market, not just our own customers, taking our flow share to 9.6%, up from 5.7% this time last year.

So you can see from a range of measures – whether it's customer acquisition, net new money or share – how our targeted approach is delivering organic growth to achieve a sustainable medium term return target of 14 to 16%.

We continue our disciplined approach to cost and investment.

We expect to invest around 3.5 billion between 2023 and 2025 to future proof the business as our ongoing digital transformation helps to drive efficiencies, improve customer experience and deliver future growth.

We have been re-engineering customer journeys since 2019 and expect this to deliver run-rate savings of around 250 million by the end of 2023.

As a result of this simplification 99% of our loans are delivered with straight through processing, and our Net Promoter Score for this journey has improved from 42 at the end of 2020 to 57.

We believe the responsible use of Artificial Intelligence will be a game changer as we embed it in our journeys and processes, so we are accelerating its deployment.

We are now using natural language processing to analyse around 560,000 conversations a week, covering telephone and chat channels, so that we serve our customers better.

And we use AI to analyse around 36 million events a day to help predict patterns of behaviour and identify financial crime or fraud.

Finally, we are investing for long term growth by deepening and diversifying future income streams.

I've already spoken about how we are growing in starts ups, wealth and the youth market. We are also expanding into new areas.

We recently announced the acquisition of a majority stake in a fintech called Cushon which allows us to enter the fast-growing workplace savings and pension market.

We have also entered a strategic partnership with Vodeno Group in order to create a leading UK Banking-as-a-Service business branded as NatWest Boxed.

So, whilst we continue to keep tight cost control, we are also investing for the future.

Now let's turn to capital on slide 19...

Over the past 3 years we have significantly improved the allocation of capital to higher returning business.

Our phased withdrawal from Ulster Bank has contributed to this.

We have now closed all our branches and around 95% of deposit accounts in the Republic of Ireland. In July, we completed the transfer of the asset finance business to Permanent TSB, and we migrated the majority of performing tracker and linked mortgages to Allied Irish Bank. We expect the remainder of this migration to complete by the year end.

We have also received a dividend of €800m in the second quarter, the first since 2019.

We have made or accrued distributions of 13.5 billion to shareholders since 2019 and expect to make significant returns to shareholders this year as we continue to generate capital through organic growth.

We are building on the strength of our existing franchise to create value for shareholders.

We serve over 19 million customers across the Group.

We are the number one commercial bank supporting businesses and the UK economy.

We play a leading role in sustainable financing. We are the second largest UK mortgage lender and we have a strong and growing wealth business.

As we continue to grow our franchises organically, we are delivering a significant improvement in return on tangible equity which in turn is driving strong capital generation allowing us to deliver distributions to shareholders.

Through our buybacks we have reduced our share count by 26% since the end of 2019, which in combination with profitable growth means our interim dividend per share has more than doubled.

The business continues to deliver a strong performance. This is underpinned by the strength of our balance sheet which positions us well in the current economic environment and enables us to support our customers as well as the UK economy.

We continue to drive operating leverage with disciplined investment in digital and technology transformation and cost management.

And we are benefiting from our focus on effective capital allocation with an €800 million dividend from Ulster Bank.

We have significantly improved our Return on Tangible Equity over the past 3 years and maintain our guided range of 14 to 16% over the medium term.

This gives us scope to return significant capital to shareholders and we have made or accrued distributions of 2.5 billion during the first half whilst remaining well capitalised.

Thank you very much – we're happy to open it up for questions now.

**Operator**

Our first question comes from Aman Rakkar of Barclays, if you could please unmute and go ahead.

**Aman Rakkar,  
Barclays**

Good morning, Katie, just have a couple of questions please. Firstly, on the hedge. I just wanted to double check your comments around the structural hedge. I think you said that the product hedge would be coming down from £202 to £190 bn by year end? I just wanted to check the comment around the deposit experience, I think you talked about it being a catch up. So, is that based on the backward-looking experience on deposits, tells you that the hedge needs to come down by £12Bn in H2? And to what extent does it capture any kind of forward look around your expectations on deposited behaviour into H2?

And as a kind of related question on that, what then have you naturally assumed for things like mix shift as part of this, how many current accounts are you assuming to have at year end and how did that drive into your full year 23 NIM guide?

Then the second question was just on, non-interest income. I note that your kind of sticking with the £14.8bn revenues this year, that looks like it's going to be less Net Interest Income than consensus has but probably a bit more non-interest income. Indeed, I think the H2 run rates that you're affectively pointing to suggest a better outlook for non-interest income through the second half of this year....

I guess can you confirm or deny that thinking and does that give you confidence, if NII looks like it's a bit softer here than what we were looking for before, do you feel more confident around non-interest income and if so, where is that coming from?

**Katie Murray**

Thanks, Aman, so, look, in terms of the hedge. As we look at it, we're going from £202 to £190bn, it's very mechanistic as you know, so we basically look backwards over the last 12 months, obviously we had three quarters where we fell, this last quarter we stabilised on deposits, and that's the impact of that coming back through.

What's interesting is, we've raised our rates that we are expecting on the swap rate, is around an average of 4.4, what you see on income side is, although you've got this fall off in the hedge, the 4.4 versus the 3.6 we talked about the last time we spoke, it balances itself out, so it doesn't have a particular income affect. I haven't taken any forward look, in terms of that, we do on a 12 month roll backwards.

In terms of the mic shift, we have seen some mic shift, you can see that very clearly obviously from the 40% to the 37% of non-interest bearing, and then if you look in the financial supplement, you can see that across private, which is actually a little bit further....And in the Retail bank as well, in terms of that piece.

I'm probably not going to go into specifics in terms of the exact percentages that we've picked on that, but I have taken thought of some further migration as we go into there.

And then in terms of income specifically on the non-NII what I would say is H1 trends were positive, and we do expect to grow non-NII into H2, but the numbers are impacted by volatility, but what we can see in the C&I business is more normalising into H2, following some lower volatility in the trading business, in the second quarter particularly, due to things like the US debt ceiling...

Because we just didn't see that volatility in FX, that number is a little bit lower, and obviously we know, and you know that people held back a little bit from the capital markets. That will normalise in that early performance in July, it's confirming that view. Hope that helps, thanks Aman.

**Operator**

Thanks very much, our next question comes from Alvaro Serrano of Morgan Stanley, Alvar, if you could please unmute and go ahead.

**Alvaro Serrano,  
Morgan Stanley**

Hopefully, you can hear me ok now. Just really a follow up on deposit balances and the outlook. When I benchmarked, loosely benchmarked your offerings, in terms of deposits in particular I'm talking about now, versus your peers. It does seem like you've stepped up your offerings during June with 5% term. First of all, do you recognise that it's coming through balances so maybe that's fair and post that increase in remuneration, after the last rate hike, are you seeing the migration accelerate or what trends are you seeing? Maybe in July you can speak to that to give us a bit more colour.

And related to that, maybe the second question is, how do you think the visibility is, how confident are you on the visibility, obviously you've lowered the NIM guidance today, and I'm not sure if you can reassure us, giving us some granularity around how low the mix on non-interest-bearing balances can go? Thank you.

**Katie**

Lovely thanks very much Alvaro.

So, if I look at it, when I look to see what's happening in terms of those customer deposits, what we do see is this catch up, in customer deposit rates and that was very much because of the impact on some of the pricing changes that we did during this second quarter. You know, effectively, as you look at those last couple of rate rises, we passed through 75%, so that was a bit higher. That's taken our accumulative pass through to date to 50% of all of the rate rises.

We do think we're now competitive on rates, when you look at our sensitivity in terms of what we think of the impact of that competitiveness would be, we've changed the structural hedge

sensitivity, which I'm sure we'll talk about more later, to a 60% pass through rather than the 50% model that we had done previously. I think that reflects a little bit more. As I look at what's happening in July, the mix and move is kind of in line with our expectations, I think it would be a brave person to say today, where we think the NIBBs and IBBs might land, it has been interesting for us, in the last number of quarters, there was so little movement but then what we saw as customers really then moved into the fixed term that we did see a movement from that 40% down to the 37%, and that was people really moving straight from non-interest bearing all the way into term deposits so that's why we saw that step up happening in that space. Where I'm probably not going to look to call, in terms of where I think that might go, I think it will take some time to get there.

**Alvaro**

And, just a follow up, because in the past I think you and other banks have said that the big shifts typically happen around rate hikes and that's where all the noise happens and when the mix happens. Do you still think that will be the case. i.e., if we're very close to the peak, it'll be a much more stable progression later on this year, next year.

**Katie**

I think that's definitely a theme, and I think we would certainly expect the shift to slow as we approach that peak, I think there's other things that are happening as well that you've got to be mindful of. If I look within our own product offering, we've opened up our New to Bank, so therefore it's a whole of market offering, which we didn't have before. That will attract some funds as well.

I think there's also the rollover, that when we saw people starting to tie their money up in Q4 last year, what offers are available now, and how that moves around. I think we'll see a little bit of that and then Alvarro you're obviously very familiar with the TFSME funding piece, and I think as that starts to get close to full repayment, you might start to see people behaving in a slightly different way. At the moment, it's very connected to rate rises and given that we are certainly predicting further rate rises in Q3, I'd probably expect it to attach itself to that as well. Thanks, Alvaro.

**Operator**

Thank you. Our next question comes from Rob Noble of Deutsche Bank, Rob if you could please unmute and go ahead.

**Rob Noble,  
Deutsche Bank**

Morning, thanks for taking my questions. I ask on the credit card book. The growth in cards, what's the EIR that you assume against that now that you've gone whole of market and kind of the quality of the customers that you're adding as you grow?

And secondly, thanks for all the information on the risk profile of the mortgage book, do you give, what proportion of your book is on high

**Katie**

loan to income multiples that are also refinancing soon as well, because obviously those are the customers that are more at risk? Thank you. Yep sure, absolutely. So, if we look at the credit card book. What we have seen as we've gone to more of the whole of market, what we're actually seeing is its actually slightly better quality that's coming in, so it's lifting the quality of that book which we're pleased about. If I look at the EIR, it depends on the card and how you're looking at it, but it would be low single digits in terms of EIR, it's quite conservative in our approach on that piece. So, certainly a better quality.

You can certainly see as you look at mortgages in terms of that risk profile of the re-financing of the high ones, I've not given you the split of the book in that way, but you can see that our average loan to value is 54%. We have I think less than about 3% is sitting at that higher LTV level, so it's a relatively small piece of the book and given the structure of our book, it must more of a 5 year book these days, that actually, you've heard me say already, only about 20% of the book is actually re-financing this year, so I think given that high LTV is small, and the lower level of re-financing, that's not something we consider a particular risk for our book as we move forward from here. Thanks Rob.

**Operator**

Thank you, our next question comes from Jonathan Pierce of Numis, Jonathan if you could please unmute and go ahead.

**Jonathan Pierce,  
Numis**

Hello, couple of questions. The first on the margin. The margin looks now to be stabilising a bit based on your guidance in the second half so, down a few basis points, but nothing that significant versus what we have been seeing. I was just wondering if you could talk to the moving parts in H2, the ups and the downs, but particularly into 2024, because one would assume that mortgage re-financing pressure is easing, maybe deposit churn isn't quite as significant as you're expecting for the second half of this year... whereas you've still got obviously the tail wind from the asset re-pricing from the structural hedge....

So, I'm wondering about margin dynamics, particularly into next year, could we start seeing it move back up a little bit again, and just supplementary to that, the other banks have told us now, what the yield on the maturing hedge is next year, it would be helpful if you could give us that.

Second question is on non-interest income weakness. Hear your comments on FX and volatility but the Natwest Markets subsidiary disclosure showed, actually not bad performance again the second quarter.

There was though, I think deep in the group announcement, tucked away in about page 83 or something, a notably big drop in FX trading

revenue at the group level. I'm just trying to square the circle here, I'm wondering whether this is anything to do with this FX management of US surplus deposits that you talked about just after Q1 and if it is, you told us at Q1 that there was a natural offset in net interest income, so, if we get a recovery of non-interest income in the second half, if this is the reason for it in part, is that captured within the net interest income guidance as well? Thanks very much.

**Katie**

Yep sure, thanks very much. Let me deal with the end of that question first. So, you're absolutely right, page 84, talks about the foreign exchange, it's gone from 258 down to 125. I think what you've got to remember as well, that we have, Natwest Markets is a subsidiary level of the Group, so it is important that you actually look, when you're trying to look at the Group result, is to look at the Group piece because obviously they've got revenue share and things that go on in different lines. So, it's not anything to do with the FX management of the US surplus, it is the volatility of our numbers. There is a little bit, in the notable items side, we mentioned something about £23m but that's not material, in that space, so, as I look at that, I do see the strengthening of that performance, given FX we expect to be more volatile this quarter, given the change in that.

As I go then onto margins, I think, certainly we're at 313 for this quarter, 320 for the half, we're saying 315 for the full year in terms of that average now, rather than the 320 we had originally said, so, I definitely do see some stabilisation in terms of that piece. What will happen in terms of that piece, it is subject to a number of different factors as you would be aware of, the timing of the UK base rate, we are assuming a 50 basis points increase at the August MPC meeting, if that comes through in August and September that will have a little bit of an impact on it.

Obviously, the pass through to customer deposit rate, both the timing and the quantum as well as the customer behaviour, and I've talked about that already in terms of that move from the NIBBs to the IBBs and then from instant access into the fixed term as well has an impact on it.

I'm not going to give you the exact what I think on Q3 and Q4, but I think you're in the right space, it will move around a little bit, as we move forward from here.

And then, in terms of 2024, I do see the mortgage pressure easing as we see the roll through of the COVID piece come to an end. We'll start to see that at the end of 2023, and into 2024, as we move forward in that piece, so that is a benefit certainly to NIM and I think my last point I just need to hit on your question and Jonathan if I've missed anything



let me know at the end. In terms of the roll off yields, 2023 we're rolling off at 1.1, because our hedge is so mechanistic, it's easy for you to work this out, look at what the swap rate curves were 5 years ago and you can get a feel in terms of what's happening, so 2023 roll off is 1.1, and then 2024 the roll off rate is lower at around 80 basis points and 2025 its even lower again at around 50 basis points, and so that means that even as the 5 year swap rate reduces, we do expect through to 2025 that the uplift from the hedge activity remains sizeable, particularly with our narrative our stabilisation of deposits.

**Jonathan**

That's really helpful, thank you and sorry just one follow up to that, if the hedge, accepting the hedge itself may get smaller but of course then you'll just be rolling into floating rate assets anyway, given the strength of the hedge tail wind, and the easing of the headwinds into next year, is it in your minds reasonably plausible the margin could start going back up a bit and maybe accelerate into 2025, is that a reasonable scenario?

**Katie**

I think the other thing to think about in terms of the margin of course is, the hedge will work certainly but we're also in our own economics assuming that the rates start to fall a little bit as well, in terms of that piece. I'm probably, not going to try to give, you know I don't like giving you quarterly views on NIMs, I'm not going to try to give you one into next year, sort of 6 or 9 quarters away from here, but I do think often, we talk about, are we at peak NIM, I actually think for me as I look at my income as I go forward from here, I think there are reasons that, you know you can feel quietly positive about that in terms of that strong income tail wind we've already had from the hedge, the unwind of the mortgage piece, I've spoken about already, and that is a positive force as we move forward.

I think the level of lending, we are in our economics, predicting growth, it's not huge growth, but we are certainly forecasting that growth within there, and you now, and I do think the deposit stabilising is there, so in the medium term, feel comfortable that we've got real growth in that income. I think the short-term dynamic of customer behaviour, we're watching very closely and the exact timing of when that moves from 23 into 24 is something I'm sure we'll talk about in Q3 and Q4 but certainly in the medium term, those other things are quite positive for income. Thanks Jonathan

**Operator**

Thank you very much, our next question comes from Guy Stebbings of BNP Paribas Exane, Guy if you could please unmute and go ahead.

**Guy Stebbings,  
BNPP Exane**

Hi, morning, thanks for taking the question. One on mortgages and then one back onto deposits if that's alright.

So, I guess you're growing quite strong in mortgages relative to many of your peers in, what is quite a tough volume and spread backdrop, so can you just talk about your approach there and how you weigh up, spreads versus volumes, whether you're driven by return hurdles or volume metrics or market share or a combination of all three...

And also, what you're seeing in terms of cost-free payments of balances right now and mix of lending between internal re-financing versus new to bank.

And then on deposits, thanks for all the comments and thanks for slide 8, not everyone gives that granularity, and it is appreciated. Just wondering if I could push you on that NIBB movement from 40% to 37%, do you have any updated views as to where that might eventually settle? Thank you.

**Katie**

Yeah, no, sure thanks. Let me start with mortgages. So, look, if I look at our mortgages clearly, we manage this group on income and RoTE, so therefore we will make decisions and given if you think that mortgages, we try to manage it on 80 basis points, so as we write more mortgages, that's going to pull your NIM down a little bit, so we're comfortable on that, because we're very much looking at the income and the RoTE aspect of that and the team would be very much looking to manage that piece.

What we do see is that during the second quarter, the swap curves did move really quickly, and so therefore there would have been a period we were writing below where we would necessarily have wanted to write, overall still hurdling our metrics but not at that 80 basis point level that we talked to.

By the end of the quarter, we were back up to where we wanted to be, and in fact we're probably a little bit ahead of there, so fine with that.

If I look at customer repayment. We have seen our increase in terms of the customer repayments, what we work with our customers, is, since mortgages have started to rise at Q4 last year, more than 70% of eligible customers have taken the opportunity to refinance early in the 6-month window that we give them, so that they can take advantage of those lower rates by securing them early in the process.

We can see that about 35% of customers are making an overpayment at the point of re-financing. In absolute terms we saw lump sum repayments in Q2 of about £500m. But just to give you a feel for that, that would be about double what we would have seen in Q2 of last year. So, people are definitely looking to pay up a little bit more on that.

But I think it's also important to note that mortgage balances grew by £1.9bn in the quarter, net of this elevated lump sum repayment

number. A bigger factor for the overall mortgage balances from here is the macroeconomic outlook, and then we do see that people are using some of their deposits to make that payment, incredibly logical thing for people to do, as we move on from there.

And then in terms of NIBBS and IBBS, we do expect the NIBS to reduce a little bit further, it's very hard to be definitive of where they settle.

I think there's not really a historic narrative that we can look at to help us guide that, so we are watching different customer cohorts very closely. A couple of supporting factors on them, we do see wage inflation, we do see people re-engaging with savings of course which all makes that move, and as well as the de-leveraging of growth, at the moment, we've made some assumptions as to where it will go from here, but we're comfortable in terms of that £14.8m that we've guided for this year and being at the upper end of that 14-16% RoTE as well, but I think there's a lot of different moving parts but hopefully that slide 8 is helpful to you, so I'm glad you like it, thanks very much Guy.

**Operator**

Thanks, our next question comes from Andrew Coombs of Citi, Andrew if you could please, unmute and go ahead.

**Andrew Coombs,  
Citi**

I have one question for Howard and one for Katie please. Just for Howard just on permanent succession planning, how do you envisage the process playing out from here and any thoughts on timing? And then for Katie, I just wanted to ask about liquid asset buffer, given that the AIEA is excluded from the bank NIM, but obviously the NI is not, it's gone from 162 to 152, so any thoughts on the trajectory there going forward as well please? Thanks.

**Howard**

Yeah, thanks Andrew, let me take you through it as clearly as I can. I've been here for just over 8 years. So, if you look at the corporate governance code which says that 9 years is pretty much effectively the maximum now, we decided to begin the search we announced in April that the Senior Independent Director would begin the search, so they appointed head-hunters then, and that's a matter for them, I'm not directly involved in that, so, that's underway. This of course has come in the middle of that period, therefore, since I think the replacement for me in due course, will need to be behind a choice of long-term CEO, we decided that we would implement what was already our contingency plan and ask Paul to take over as Chief Executive.

A good few months ago, we reviewed our contingency arrangements and the Board agreed that Paul was the short-term successor, in the number 11 bust scenario. There hasn't been a number 11 bust exactly but something a little bit similar, and that was all agreed with the regulator, so we implemented that. Paul and I agreed that the sensible way of doing it was to say he would be CEO for 12 months, so an initial

period of 12 months, which could be extended, which would allow time to find my successor, get my successor in, and that successor then to decide how he or she wants to proceed, whether they want to have an open contest looking at external candidates or what they want to do.

So, I think the position is, quite stable for 12 months, and thereafter, my successor will have to take a view. Very grateful to Paul for agreeing to do it on that basis, he's very experienced in the bank, and the mood in the Executive Committee and elsewhere is positive about this, so I can't say it's exactly what one would normally have done, but I think it's pretty good interim solution.

**Katie**

Thanks Howard and then Andrew, in terms of that liquid asset buffer (LAB) question. The LABs our average interesting assets reflect changes in the customer funding surplus, so of course deposits, we think that deposits are broadly stable, so you should see stabilisation in the lab AIEA's as well as the results. Thanks Andrew.

**Operator**

Let's move onto to Fahed Kunwar of Redburn, Fahed, if you can please unmute and go ahead.

**Fahed Kunwar,  
Redburn**

Hi Katie, thanks for taking the questions. Just had a couple. I just want to follow up on Guy's question on the loan growth. I think one of your peers talked about the re-mortgage spread being a lot lower than the new business spread, could you give us the completion margins on that, are you seeing similar trends right now? And I guess looking forward now on mortgage growth, it probably does shrink from here, people are paying off and if you're talking about the macro being in effect, is that the right way of thinking about it?

And the second question I had, well actually just on the NIBBS question, if I look at your NIBBS, it's always been the mix of like 40% now, 37's all well ahead of your peers, you say about 25%. I've always assumed it's because of your SME business, so the drop off from 40 to 37 in the mix, was it retail customers, or was it SME customers, what difference as in behaviour are you seeing? And I'm going to sneak in a third question, if you don't mind... In 2024, your costs are sitting at I think 1% year on year growth in consensus. How realistic is that given wage growth? Running at 7% in the UK. Thank you.

**Katie**

Yeah sure, thanks so much Fahed. So, I'll deal with the cost one first, you know what we've said on cost, is that this year we are looking to hit a cost income ratio of lower than 52%, we're currently sitting at 49.6, that's a little bit lower than reality because of that FX recycling game we've got in income, so it's better to think of it as a 51-51.5 kind of number. What we've then said to you is we'd expect to get to a cost income ration of below 50 by 2025, I'd expect that 2024 would be something on the journey towards that. I think we do manage our costs

incredibly carefully, we've got a long history of that in the bank, and we'll continue to make sure that we do that, so costs always a challenge but comfortable in terms of the direction that we're kind of heading on that.

If I look to the loan growth piece, the re-mortgage spread is a bit lower than new business. As you know we manage around 80 basis points over time on a combined basis across the book, but I think that re-mortgage piece is obviously part of it, but then it's lower LTV so it's also very good return, in terms of that piece, just in terms of the amount of capital that it's doing. As I said earlier in my speech, we were a bit lower on spreads at the beginning part of the quarter, just because of the move of the swap rates, but we're back to where we wanted to be by the end.

I do think you're right that the volume is a bit lower most likely in Q3 and Q4, but I think it's really important to remember on mortgages. These are multiyear products for us, we have retention that's in that 75-80% so actually the first year is important but what's really important is the second, the third and the fourth kind of renewal as well which is there.

And then if I just move on to NIBBs. Look, we are seeing some migration across the piece and in our financial supplement I show you the split of current accounts versus savings accounts across retail and private. I don't show you that way annoyingly on the main section, on the commercial section but you can kind of get a feel for that.

Then what we know in the commercial piece is, you're absolutely right, we've got very strong transactional accounts within there, so therefore they are themselves quite stable as we look through on that piece, but you can see the fall off that we got in retail and private, and then the commercial piece a bit more stable just because they are so embedded in that kind of transactional saving piece. I think I got all of them Fahed, let me know if I missed anything. Thank you.

**Operator**

We're going to go across to Chris Cant of Autonomous, Chris if you can please unmute and go ahead.

**Chris Cant,  
Autonomous**

Good morning, thanks for taking my questions. Sorry, I was struggling with my other device, can you hear me ok now?

**KM**

Yes, perfect Chris, that's great. I'm glad you got through.

**Chris**

So two follow up questions really, firstly, there was an earlier question around trends on deposits during July, I'm just conscious you did also hike your fixed term deposit rates in response to the swap moves in June and just keen to understand whether what we're seeing into the third quarter is a continuation of trends you'd already been seeing

during the second quarter or whether you were actually seeing accelerating, terming out, obviously you've given us the deposit split at the end of 2Q but conscious that, that could be accelerating potentially into 3Q so any further commentary there would be helpful?

And then I also just wanted to return to a comment you made Katie around peak NIM, I mean the idea of peak NIM has sort of been plaguing the UK banks broadly for a little while now and I guess it comes down in part to the timing of the different pressures, puts and takes on the NII line. In the short term, you're obviously seeing this beta catch up you referred to during the second quarter, but as we look into 24, I think you were sort of indicating actually that the net of forces may then become a net positive relative to where we're exiting this year, just in terms of fewer mortgage pressures, deposit trends stabilising and then this very material, structural hedge benefit still to come through. I think I asked you a similar question on the 1Q call but if I could invite you to talk about that again, based on stable-ish base rates or something close to your trajectory, into 24, is that the right way to think about it, that actually the structural hedge benefits should be outweighing the mortgage pressures and the deposit forces, at least the short-term deposit forces around betas catching up to a more sensible level sort of abate? thank you.

**Katie**

Yeah, so if I look at deposits, the easy sort of answer is to say look Q3 is behaving as we expected it to, there's nothing unusual within that, we're seeing good performance in the fixed term account, which is, we're pleased with. We just also launched our Instant Access which is using our Ulster Bank Northern Ireland brand, we're expecting that to play a positive part in the mix as we go through, it's literally been launched in the last couple of days, I'd invite you to have a look at that and we'll talk more about that performance when we get to Q3, but so far, it's been very much in line with the messaging I've been talking about.

Chris, I'm probably going to give you a very similar answer that I gave to you in Q1, I don't really want to get drawn on a quarterly Q4 NIM forecast, but I think the things that we need to consider is, you know this as well as I, what's happening on base rates, the timing of them, is our assumption around the 5.5 right, will it go higher? Pass through to customer deposit rates, if we are at that peak kind of level and then also just the mix and balances that we'll see going through. You know, I think the hedge and the marrying more closely of the mortgage market margin is helpful to us, but I think let's talk more about 24 when we get into 24 if you don't mind, so going to avoid giving you any views on that. Lovely, thanks very much, Chris.

**Operator**

My next question comes from Robin Down of HSBC, Robin if you could

please unmute and go ahead.

**Robin Down, HSBC** Just one really quick question, I would have asked this on Monday but I got to be wall-crossed on HSBC, so I can't ask then. The mortgage back book spread, you've given us that number in the past and it's quite useful to compare with new business spreads. I can't see it in...

**Katie** Let me give it to you, its, the back book margin is 102% down from 115 at Q1.

**Robin** Great, and the new business, I think you were saying you were kind of, lower than 80 in the quarter, but ending at 80.

**Katie** I'm not going to give you that exact number in terms of that, we can try to manage it over time and given this is a multiyear product I can get too obsessed by quarterly moves so, managing to 80 I said, we were a bit lower in the beginning of the quarter, we're a bit better at the end. I think you can also, the one or two I've given you, you can also calculate it on the FinSupp [Financial Supplement] if you like but that's what the back book is at the moment.

**Robin** Brilliant, great, thanks Katie.

**Katie** Good luck to you on Monday.

**Operator** Our next question comes from Ed Firth of KPW, Ed please do go ahead.

**Ed Firth, KBW** Yeah, I have two questions if that's ok. I mean the first one was just to explore, I think you made a comment about a 50% deposit beta, which is where you were running at today, I mean, if I look at your savings, by far in a way, the biggest pool of savings is instant access, and I guess the biggest pool of that again by quite a large margin as I understand it is less than £25,000 which you're currently paying 1.4% on, which is, so you're making somewhere around a 3.6% spread on that, which, I've gone back 20 years and I don't think I've ever seen a spread that big on customer savings, so, I'm just trying to think, in terms of, I'm not asking you to tell me exactly how it's going to move, but if we forget about rate changes and just assume rates were to stay flat here, or that you'd have 100% beta going forward, is your general thinking that, that 1.4% is a fair rate and is sustainable in a market where, I mean the biggest bank in the world is offering 3.8 today, so I'm just trying to get the sense of, culturally do you think that is a good rate for your customers or do you think, even without rates changing that may have to start moving up, given the current environment? I guess that's the first question. And then the second question was, I'm going to tackle the Farage question, because people have generally avoided it. If I look in the press, people talking about 10,000 subject access requests and Twitters going bonkers with people closing accounts and stuff like that. Is it possible that we could see some sort of a charge in the second half in terms of the cost of managing all that, because I do remember with things like PPI, even if you don't ever have to pay anything out, just the sheer administrative burden of dealing with some of this stuff can be

quite onerous. So, any, I know it's early days but any thoughts you might have around that would be very helpful thanks.

**Katie**

Yeah sure, thanks I'll take that, so what I would say is, you shouldn't always believe everything you read in the papers. My bit of counsel to you. We've had an increased number of SARS, they are still in the 100s in terms of that piece. Clearly, given it's a higher number than we normally have, we'll have to put a little bit more money away to manage them, I'm not worried about that, we've kind of calculated that number, at this stage it's not something that's a concern within there, so, on that piece at the moment, given they're in the several 100s it's in the manageable kind of space. I'm sure we'll see some more continue to come through.

If I look then at your thoughts on the deposit pieces, I would actually probably push you a little bit and say that the majority of our balances aren't in that less than £25,000, it's important and there are significant balances but as I kind of look up, I would see more of them across my instant saver and flexible saver products being in that £25-100,000 and still significant balances in the £250,000 plus so they're 210 all the way up to kind of 310 in terms of those amounts, so there are different rates that are available.

I think you need to consider that a proportion of these balances are hedged, so the upside in terms of that change between what we're paying and what we're receiving it comes through over time, so the margins are a little bit lower, you can't just take base rate minus that because of the hedging that we've done over time on that.

There are a wide range of deposits available that people can go to look at and I think what we're all doing more and certainly the regulators are encouraging us to do is to make sure our customers really know the different varieties of rates that are available to them.

**Ed**

Great, I mean just coming back on that a little bit, I sort of get the logic of that, so, it seems to me quite plausible that as the hedge matures, effectively the savers will get the benefit of that, because if one of the reasons you're paying 1.4 is because I can see the asset side of that is hedged, that is completely plausible, is that, I know they're not directly related but is that a way we should think about it going forward?

**Katie**

I think it's really interesting because I think what you're paying to depositors it kind of depends a little bit on market as well in terms of what's happening elsewhere, I mean I would say that about 80% of our balances are actually above £25,000 so actually I think the rates that are being passed through are much higher than you probably realise and I think importantly, the system liquidity and what happens as we



approach things like TFSME will all kind of play their parts to how this evolves.

**Ed** Thanks so much.

**Katie** Lovely, thanks Ed.

**Operator** Thank you, our next question comes from Adam Terelak of MedioBanca, Adam could you please unmute and go ahead.

**Adam Terelak,  
Mediobanca**

Morning, I just had a follow-up on deposits, you mentioned in your forward planning assumptions a Bank of England rate cut, just an update on how you're thinking about deposit pricing in the face of cuts given you're still, a lot of your products are priced well below Bank of England rates, so could that, in terms of numerator going down, and the denominator going up, mean an increase in Beta even when we've kind of got to the end of the rates cycle?

**Katie** I think the end of the rate cycle is going to be an interesting time and I think there's a lot of different things going on, so at the moment, our rates are looking through mid-2024 that we start to see them come down, we've taken a probably reasonably conservative view on this. In the documentation on the structural hedge, we show you the kind of sensitivity on that, we've given you a 60% pass through, rather than a historical 50% pass through, and we've given you a 25% up and down, but what I would say that if the pass through was 10% higher or 10% lower, on a static balance sheet that would have about a £50m impact on income, obviously that's an annual number, in terms of that piece, so you can kind of prorate that through, but I really think at the moment it's quite early to be talking exactly what that might do to our numbers.

What I would guide you back to for us as a bank is that the sustainable 14-16% return, we have clearly built in some views on that, and we remain very comfortable with that as our medium-term view on returns.

Thanks, Adam.

**Operator** Thank you very much, I would now like to hand back to Katie for any closing comments.

**Katie** Lovely, thanks very much and thanks everyone for your questions and participation this morning, it is very much appreciated. We have had a strong performance in H1, which demonstrates that the strategy is working. We have a robust balance sheet, growing lending to support our customers. We are on track to meet our 2023 cost guidance. We have distributed £2.5bn to shareholders in H1. We continue to target a sustainable medium-term RoTE of 14-16%. With that I thank you all for your ongoing support and I look forward to talking to many of you as we meet you over the next couple of weeks, thank you.