



NatWest Group plc
H1 2023 Sell-Side Update Transcript
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Alexander: Thank you and welcome to our H1 CFO round table. Thank you for those in the room and those on Zoom. Just quickly to add and we'll start off the questions in the room and then we'll move on to the phone lines and to Zoom.

And could I ask for those who are listening on Zoom and in the room just to say your name and your institution just so that all the audience can hear. We're also joined today by Donal, our treasurer, by Matt Waymark, CFO with C&I and also by Stuart Nimmo, CFO of the Retail Bank. And with that, Katie I will hand over to you.

Katie: Lovely. Thanks very much. Apologies for starting a few minutes late. See, we need to invest further into our reception apparently. In terms of that I'm sorry for that. I know it's frustrating when you can't get up the stairs. I wasn't really going to say very much really. We spoke at length on Friday morning, and I so I'm very happy to just jump into Q&A. Shall we start in the room.

James: So, first of all, deposits. One area that's gone up this year is the corporate & institutional line. What have you done to drive that up. How sticky is it? Anything more on that would be great. And then the second thing is just the government's mortgage charter. So, as I understand it, they're giving people the ability to choose a mortgage deal six months ahead and then if mortgage rates come down, they can switch to one of those lower rates. How are you going to hedge that risk, please?

Katie: Yeh sure. On the C&I piece, what we have done, obviously, as all banks have, is more of a big focus on deposits. There are a portion of those deposits that are being raised outside the non-ringfenced bank. They would still be time deposits. So, they're sticky enough. Obviously, they roll as they go through and they've got kind of liquidity, obviously, for shorter tenors because given where they are raising. So that's probably where you saw the increases on that side. Matt, anything else you would say on those deposits.

Matt: Yeah, that's exactly right, Katie. I would say, year to date we've lost a little bit in the commercial mid-market. And that, I think, is a function of the market going down on NIBS where we're pretty strong on our NIBS proportion. And at the lower end of business, banking is pretty much a customer macro play. We're broadly flat Q-on-Q but slightly down, which is really January tax rate outlays, which the major driver of that year to date move.

Katie: In terms of the Government mortgage charter, so we already give you the option to renew your rate six months ahead. We've been doing that for quite some time. We also give the option that you can move if a lower rate comes on as long as you actually haven't started. So it's not a new phenomenon for us. However, it doesn't change your question around the hedging of. Stuart, do you want to talk a little bit about how you hedge that and maybe just give a little bit of colour of what kind of level of take up we've seen so far, which to me is pretty muted, I know in terms of that piece.

Stuart: Thank you, Katie. Maybe the last piece firstly, you know, across the book, we've only seen about 2,000 applications through the charter and right though that's heavily skewed to people taking interest only deals and it is in the customer population that you would expect. That's the customer population that's under a little bit more pressure. So it's not more broadly based than that so far.

On the hedging point, you're absolutely spot on. This isn't new for us. We introduced six months out, probably this time last year, if not a little bit earlier. And, in managing the risk, obviously my team and Donal's team work closely together to assess what the conversion looks like in a rising rate or a benign rates environment.

That's not an issue right now where the yield, the yield curve looks a little bit more inverted. That's something we have to manage. And look, we take a view on that so that we catch that hopper risk as we refer to it appropriately. But it's not been a major factor for us so far, but something that we do assess, and we average out how we put on the hedges through that six-month period appropriately.

Katie: Other questions.

Ed: Yeah, Can I can I come back to the same sort of question I asked last week, and I probably just asked it badly, so I apologise. In your instant access savings, is it possible to tell us what you pay today. If I look at the Bank of England, it's I think the sector pays 1.3, something like that.

And I'm thinking both what do you pay today and what do you think you have to pay to be at a sort of normalised level? Because we saw the consumer charter, I think was out 20 minutes ago from that 14-point plan, I think from the FCA, I

don't know if you see that you could have got an early start to that.

Katie: I have not seen this morning, but we would have been talking about that.

Ed: Yeah. So I just said they highlight sight deposits, as I said, a key focus. So I think that is really the area where everybody is looking. So, I'm just trying to get a sense as to what does that have to get to.

Katie: So, if I just look at the retail bank. So instant saver, it starts at 1.4 up to £25,000 and it goes up to 3.10 if you're £250,000 up and between the 25 to 100 is 2.1 and 100 to 250 is 2.6 in terms of that piece.

And then that rate would be matched on our flexible saver accounts as well. In terms of that piece. And then obviously with things like the Digital Regular Saver and the Savers Builder, but those are the main instant access accounts, in terms that piece.

Ed: What does that equate too though? So, if I take the whole 200 billion, what on average are you paying across that?

Katie: In terms of what are we paying in terms of.

Ed: Yeah, when I add up, you know, because I don't know the mix, so it's impossible for me to work it out. But I can see that the sector as a whole pays 1.3. You're 15, 16%. I guess you must be somewhere, somewhere around.

Katie: I guess I can show in this. Yeah.

Claire: We give you the average customer rate on all interest bearing you can see that there's a very small amount that's term. So you could make an assumption that the term rate is higher. back them out, it will give you a good proxy so, that's on slide 29 and 28. So 197 is the overall average rates on all interest bearing. So, you could assume it's a bit lower on the instant access and a bit higher on the term.

Katie: Okay. And if you go to the very bowels of our accounts, which is on page [83], you can see what we're actually paying as part of our net interest income in terms of what we pay on customer deposits, the 1.7 billion. And then we've given you the shape for that.

Ed: And then I guess the more important question is what do you think is a - if we look through the cycle and it's obviously basically moving a lot recently - once it all smooths out, what do you think is a competitive reasonable rate to pay savers?

Katie: So, as we look at the way that we've done so we don't have a firm house view in terms of that piece because I think it varies according to the kind of saver that you are in reality. So, if you're long term, you're willing to tie your money up for two years, and I'm trying to match that to a mortgage kind of transaction, then I want to have them more or less in parity in terms of piece, which is why we've got this five and a half, 5.8 kind of accounts there.

So that's obviously more valuable to me. I want to make sure that for those that are only saving a little, that I've got a fund that also pays well and that's the £150 per month up to the £6,000 mark. And for most of our customers, in terms of customer numbers, that's a very good rate. And if they were saving £150 per month, they would be delighted, sort of thing.

And actually that's a kind of a good rate. I think then within there you've got all sorts of different kind of ranges. We'd always given you a sensitivity on a 50% pass through in terms of that piece. And then I probably get more into the kind of instant access kind of piece. I mean what you can see, the kind of 2.6, 2.1 is quite set, some kind of 50% pass through level at those rates.

So it is about trying to pay a bit for the time value of money. But I can't just say I think a fair pass-through is 'X' because actually you've seen we'll passed-through far more if the deposits are far more valuable to us as well. And then I think what's really happening in terms of competition, I think the rates have been moving up and down.

But I think what we'll see as we get into next year is the impact of TFSME, I think we keep rates higher as rates actually start to come down and I'm really interested as to how we all react to that when it comes time to react to that. Yeah, so it's unfortunately not just a simple answer.

Ed: But I guess you've had quite extensive discussions with the FCA, which we're not obviously party to, so and they're obviously not happy. So, it's somewhere between the two. But I don't know what I think. It's very difficult for us to scope.

Katie: They have they have backed away from saying what we think you should pay you because I think they've also had to go through this journey of people look at instant access and low fund value and then actually go, well, that should be that should be higher.

But then you kind of go back to them and say I'm trying to manage the balance sheet here on two different sides. I mean, Stuart, how would you answer that question in terms of I know there's been a lot of discussion of this in the retail space.

Stuart: A very similar way to how you've answered it, Katie. We make every decision at the appropriate time based on a number of factors, movement in the policy rate, but also where we see competition, where we see our balance, concentration risk, obviously there's an aspect of looking after customers at the lower end and prioritising of flow rates.

And I think if you compare us to some other peers, we are in a good place and we also don't have any significant back book balances to speak of that have rates, for example, below 1%, which I know the regulator is keenly focused on. So, similarly to yourself, Katie, no real crystal ball on, or firm view of, where we end up over time.

But you can see what we've done over the past 18 months, at a cumulative levels that we are, as Katie highlighted, in the last few pass-throughs on the retail side have been around 60% and right now I think that's a good yardstick for going forward. And then, I think when we get into policy rate reductions, that's another bridge that we'll have to cross based on the factors I mentioned a moment ago.

Katie: Martin.

Martin: Good morning, Martin Leitgeb from Goldman Sachs. So, could I just go back to the topic of non-interest-bearing share within the deposit side? Obviously a lot of question as to how this should compare to history, whether that's 2012 or 2010 where the share of non-interest-bearing deposits was much smaller than it is now and I was wondering, what is different now compared to then that could justify a higher share of non-interest-bearing deposits going forward?

Katie: I think there are differences in terms of the way that QT has happen now, who's going to resolve QT but ultimately that's timing. It all filters its way down through I think, you know,

because we've gone through this period where you've had the quantitative easing, but it came in in so many different ways, so many different accounts, that money is much more widely spread across the economy.

What we see is that people really value liquidity. You know, one of the things personally that I find creates benefits for us as a bank but, you know, quite frustrating is particularly that smaller end of business that they're not moving their money into 30-day or 90-day accounts, particularly at the very small end where you've got bounce back loans. So, we know 24% of them have still not touched them, but they still want to hold on to liquidity.

We did some testing. We put out some really good rates on 30-day, 90-day and people just didn't move. So what's interesting is I don't know if that's different from what it was in 2012, but they have more money than they had in 2012. And I think that's the difference. But actually, the value of liquidity is something that is seen as really very valuable.

So, I don't have a reason to say I'll never get to that 20%. But we saw this last quarter - and it's a percentage game as well which can make comms a bit more difficult - so we saw private go from 30% to 25%. We've got quite a lot of deposits in private. So that kind of skews the overall kind of balance. Retail only went from 40% to 39%.

You can work that out yourself from the from the Fin Sup. So, I'm not telling you anything you can't see there. But I think the thing is, it took us three quarters even with the deposit rates we were having, to see a move in those percentages. And in terms of where we are in Matt's world, he would see different percentages at the small, medium and large and they will have moved around in slightly different ways.

But I don't have a rationale as to why we won't get to 20 or if we will get to 20% or if we will go further or stay higher. So I think that that's one of the things that we spend a huge amount of time trying to estimate what could happen in terms of where we are on that piece.

I mean, to me, logically, this must be the start of the fall of the percentage. I can't say to you that next quarter will be faster or slower. I can make some assumptions, but my assumptions are not for a really dramatic move from here in terms of that space.

Katie:

Jason, you had a question.

Jason: We went through a period of ring fencing in the Brexit vote where it felt like the incentive sets for some of the bigger competitors were different and given there is so much that we can't know about the mix of deposits and so on, do you feel like the industry is pretty aligned in what it's trying to achieve? Some of the peers are saying we don't really know where the mortgage market's going to settle until it gets there. It all feels a bit fatalistic, like we'll just see how much money we make. Do you feel like the industry is rational.

Katie: So, I think for the mortgage markets in that we all have a floor in terms of where we don't really like to write below. You know, you can see some of the comments I've made in the past when we were at 45 I said that I'm not happy, this will increase. So that may not be my exact floor, but you're going to be within spitting distance of that.

So, I see that as our prices go up, other people bring their prices up. I see, when rates fall. HSBC tried to move first. I know they're trying to grow their book, so that makes sense. But then they're followed quickly by others. So we do kind of move in terms of where we are. I don't think it's completely fatalistic as we have seen people pull back, in terms of that piece. You saw what we do with our rates, that we clumped them all together.

That was a bit of slowdown. If I don't want 2,000 kind of walking through my door at a particular rate sort of things, so you're trying to manage your daily apps. So, I think it's not quite fatalistic. We are really working hard to manage it. I think some of the conversations I with Stuart and Callum who's the particular individual who manages this stuff, we do try to manage it very closely.

I do think overall it is behaving quite rationally. And I also think it's been, if you feel since Covid, it's next release is Brexit. I mean, we have that huge up and then we had the huge down. Then we had this huge up again with little skirmishes in between with the October-fest of politics sort of thing.

So that I think can cause bit of challenge. So, I do think they behave more rationally than fatalistically. I also think though, if I go back to the deposits part of your question, I do think that ring-fencing has had an impact. You know, if I look at some of our peers who've got their commercial bank outside of their core bank, then actually they're trying to raise far more funds there.

They are happier to pass through less. You know, Goldmans can come in and raise 25 billion to fund their investment banking activities. We find obnoxious, you know in terms of that piece, just because I can hardly give them any funding. And I'm very happy that we should be restricted in all of those things. But I think we look for that sort of level playing field.

But I do think it's behaving pretty rationally. But I think on mortgages, I think we've got to not look at one week or even two weeks, but what kind of happened over the quarter. Because otherwise you have these swings that can kind of cloud the picture.

Any other questions in the room? Yeah, perfect.

Aman: So I had a couple of questions. I am reading them off my phone.

Katie: The cricket hasn't started yet. I think that comes a little bit later.

Aman: I had a couple of questions on. So first of all, net interest income, this pull forward of mortgage maturities. So you're talking about early refi, a step up in early refinancing and customers pre-emptively paying balances down.

Katie: At the moment, their fixed rate ends, they're not necessarily doing it in an unusual way outside of cycle.

Aman: Yes. I guess I just wanted to put some numbers on the step up in the redemption that you're currently experiencing, because I wonder if you're kind of frontloading some of the mortgage pain now, right. Because you've got a higher redemption run rate than you would otherwise expect. And the reason I'm asking is, by extension, when I look forward, there's less mortgage margin compression to digest, right?

Because if people are refinancing early now and paying balances down is a bigger redemption. So there can't be as much moving forward. So is that the right way think about it? Should we think about this mortgage? I know you give us the front to back this dynamic, but the actual balances that are refinancing in the next 12 months might be lower?

Katie: So I really cannot find that answer which I had on a random scrap of paper.

I mean also after the call Friday put it all on my desk so anyway, I'll go and then Stuart will come in and correct me when I get it when I get wrong. So I think what we're seeing is we've seen about 500 million of early refinancing. That's about double what we normally see. We're still seeing the book growing. So it's not a question of it's reducing the size of the book, obviously. We had gross new lending last quarter of just over 8 billion and our stock share went from 11.3 to 11.6. So it is a feature in terms of that piece because obviously they're paying down something they would normally continue to pay over.

But because of the growth that we're seeing in the book, it's probably a feature. It's a feature that we can then continue to kind of see go through. I think the other thing that's important, though, and I'll get Stuart to talk a bit more about this, is that the book's currently at 102 and we talk about trying to manage around 80 basis points, though time.

But we do see that that step down probably has only got a couple of quarters more left in it. Then from Q1 next year it won't be parity but rather than these constant 13, 14, 15% basis point falls each quarter that we're getting to the point where they're clearly more balanced. Stuart. Anything I've missed?

Stuart:

Perhaps one point to clarify just on when people lock into a rate early on the application, obviously that doesn't take effect until the end of their existing product term. I think that's well understood but in case not. I think you've covered that you gave the absolute that we saw in Q2 there. I think Katie, relative to what we were seeing about a year ago, which I think gives a good indication of the dynamic we are seeing in the book. Maybe the other point, just Aman to your broader question on the balance sheet is in this type of period as well, you do see typically more customers staying with you because of affordability criteria, etc. If you move somewhere else, you're going to get re-indexed on your LTV or you're going to get stress tested, etc. If you product transferred with your existing lender, you don't. So it's sort of put and takes across people paying down a little bit more, but more people staying with you as well, from a balance sheet dynamic perspective.

Katie, on the churn point, by the end of Q4, by and large, through the biggest impact of that into Q1 and if you cast your mind back to Q1 2022, that of course, was when Katie said she was absolutely unhappy with a 45-bp type margin. So that

starts to come off in 2024 as well to give you an idea of that churn dynamic.

Katie: Shall we go to a phone before we come on, when it comes to screen, they're holding back. Okay, you keep going. And then over to you.

Amman: So, we might have asked a version of this question on Friday, but I guess particularly in the context of what you just said now, so the net interest income trajectory out of this year and into next year, is a really important question that a lot of people have.

Basically, it's this singularly most important question I think I encounter in the investor conversations that I have, and you've guided for a fully year NIM that already implies a step off in Q3 and in Q4 of this year. And that feels like it captures a higher run rate for base rate, but also a deposit beta that's maybe now at a steady state.

I don't know, maybe there's an uncertainty there. I guess ongoing mix shift is a dynamic that we need to think about. But, you know, under the current rate curve, you think maybe you're seeing the worst of it now. And by the time we get to December, that's kind of behind us as a headwind. It feels like mortgage margins are no longer a headwind after the next two or three quarters.

It does feel like the trajectory of the run rate on net interest margin or net interest income out of this year is a positive one. And I appreciate that there's uncertainty around base rate. But if we were just to believe the forward curve as it is right now, where are we wrong there? Why is net interest income not recovering or the NIM recovering out of this year, and into next year?

Katie: So I think, when you've got all the kind of component parts, so views on churn are important, and by that I mean NIBBS to IBBS, the volumes of the balances, but again, we said we think subject to market shrinkage. We think we'll be pretty flat this year. If the market shrinks by a significant amount, we'll take our portion of that. But that would kind of be there. And then the level of pass through, I say those points quite deliberately in order because actually the shape of the deposits are more impactful generally than the level of pass through. When I look at my own numbers against, you know, kind of assumptions we might have had at the beginning of the year.

And then I would agree with you. I think that lending margin pressure kind of improves. We've then obviously got the tailwind from the hedge, which I think is kind of positive into next year. And as I talked about on Friday, I think I'm also more confident on the medium term. I think let me know the next three or four quarters and actually I can see how things are stabilising because we know what's going to happen with the curve a little bit, accepting that the last six quarters haven't been that easy to predict.

But you see that growth as we go out of here. I do think it's worth is talking a little bit about the hedge because I think at the moment, in terms of some of the numbers, I gave you the other day and some of the questions coming back into IR, I'm not completely convinced that we're aligned on that piece.

So I'm going to hand to Donal and get him just to make sure we're all really kind of clear how we should push that through. It is a very positive tailwind for us as well. But I do think we need to get through the next few quarters before we see any particular moves.

I'm trying very hard not to give you a NIM number into 2024 or into 2025, but I'm hopeful that the worst is behind us. But I don't think that necessarily means a massive and we're all on the way up again, but it's something that's very kind of stable. So then you get into what's my hedge doing, what's my deposit balance doing and what's my lending doing to then kind of make sure my AIEAs are kind of working. Donal, do you want to just talk a little about the hedge in line with some of the conversations we had this morning?

Donal:

Yeah. And I suppose what we said on Friday, we do see that hedge been a significant tailwind into '24 and '25. But I think in terms of some of the modelling that seems to have been done, I think you need to take account of what we've guided to in terms of the reduction of the notional and between now and year end. So we've guided you that the product hedge is reducing from the from the 202 billion to 190 billion. That is just feeding through in terms of our 12-month look back terms of those eligible balances and what's happened to date. If we see further reduction in balances and further change in mix, that will drive further reduction in that notional then into '24 and '25. So again, we're not going to guide what we're building in for that mix, but that's just something you need to take account of as well.

Katie: Ed. And then I'll go to the screen.

Ed: Could I just pick up on one of your answers about the mortgage margin stabilising at the back end of this year? I'm just trying to understand how that could be because, you know, during 2019, 2020, 2021, the market was writing a huge amount of five-year fixed rate mortgages at vast margins. And that's all got to still run off.

So I don't understand how we can be stable now. It seems to me that that's going to be a three, four, five-year program.

Katie: Stuart, do you want to just talk to that. Is the point of stabilisation now rather than in two- or three-years' time.

Stuart: Yeah, sure. So I mean, you can look at the book margin that we published on Friday. We're down to, as you quoted, 102 basis points. So even with some higher margin business to roll off from 2019 and the period you mentioned that the compression from year is much more muted. When, if memory serves me right, actually there were there was some volatility in those periods as well. It was around that time that we started talking to the sort of 80 to 100 basis point corridor.

So some of that business is poorer margin than some of the other business. If you take a step back away from the margin and think about the NII trajectory overall, a key part is then the volume that we put on, and we've continued to grow the net balance sheet fairly strongly in the first half of this year.

We're obviously beholden to market conditions somewhat. The last weekly data that I saw a week before last was pretty poor indeed, and that will be subject to, macro and interest rate conditions. But if there is a reasonable market in the medium term, we would fully expect to put on enough volume to offset any further rate headwinds on an absolute NII level.

Katie: Thanks Stuart. Daniel, can we just come to the phone then and I'll come back into the room.

Daniel: Just a couple of questions. Just on the issuance, I know you're broadly in the kind of middle of what you would expect from the HoldCo and I assume lending is probably a little bit slower than you would have thought so. Are you effectively done there for the year? And then at the OpCo, I know you have a little bit more to do, but again, would that be affected by what we're

seeing in terms of growth and then just coming back to NII, and I guess, deposit costs, just where is the pressure on deposit costs coming from? I mean, was that partially internal/political or is it being driven more by competition? Because obviously a pretty big and large deposit base and pretty good liquidity ratios, so just interested there.

Katie:

I'll take the last one and then Donal, I'll come to you for the first couple on issuance. So as we look at it from our own perspective, we have a very strong liquidity base. You know, we're sitting at 83% of loans to deposit ratios. So that gives us good room to grow. I think though, what we could also see was a couple of quarters where we had shrunk. I think in Q1, I think we were pretty honest at the time. We shrunk more than I expected to in terms of that piece.

And part of that, I can tell you it was to do with tax. I can show you all the maths why it was due to tax, but still it still felt like we weren't in quite the right space. I think we'd lost a little bit of time because of not always having the complete product suite in there. So what we wanted very much in Q2 is to say, actually, let's make sure we've got the right product suite - I'm very happy we've done that - and let's actually show that with the right product suite that we're able to actually make sure that we can actually manage some of the deposits appropriately. So we have done that kind of step up on deposits. We also, if you are a Coutts customer, you'll see that we've been we've probably done a bit of catch up there where I think we were a bit slower and that really all came down to competition.

So I would say we're not ignoring the political impact, but the the bigger impact on our own actions is much more related into the competition perspective with our peer group. I would say, and Donal, do you want to take the first couple of questions.

Donal:

Yeah, sure. And in terms of going out, you're probably like we put 2 billion of the three to five guided. So I think what we see in H2 will be primarily driven by what we see coming through in loan growth. I would still expect, even if you saw no loan growth from two, I would still expect another probably 1 to 2 transactions. But the extent of where we land in our 3 to 5 billion will be dependent on that.

And then from a holding company perspective, you're right, we're pretty much done for the year. So I think from here on it's kind of opportunistic. Happy to look at some pre-financing of '24

requirements. So we'll just see how the market dynamics play out.

Guy:

Hi. Morning, everyone. Thanks for hosting this and sorry I can't be there in person. I was just going to ask about non-interest income. I think some of the comments on Friday and what perhaps is implied for non-interest income within the total income guide for the rest of year suggest improvements from Q2. So I was just hoping to get more colour as to what lines within that you feel confident we can see growth maybe with Slide 32 for a bit of context.

I presume trading and other income, you'd hope to see a boost from the Q2 level, but in terms of some of the fee and commission lines, is there anything that gives you particular confidence you can see growth for the rest of this year. Thanks.

Katie:

Thanks. So I guess the line that I'm probably most focused on within there is in relation to FX, and I think it's important when you look at the split of non-interest income across the different areas, which you can obviously see within the pack, is that FX income that's booked directly into NatWest Holdings, so directly into the commercial bank rather than always coming through NatWest Markets is not unusual. So we have it coming in in the two areas. And that's because commercial banking also have their own FX platform in the form of TFX, which is automated for very vanilla FX transactions, low value, high frequency. But important if you see a lot of activity, you'll see that kind of number coming through.

So I know that some of you sort of say oh but Katie your FX doesn't seem like it's fallen that much within NatWest Markets but actually across the piece, I think that we'd expect to see that come back on. The larger, more complex things are all then executed through NatWest Markets. so I think that's one of the main pieces.

As I look at the other lines, you know, there's no one in particular that I would be saying this one I'm expecting to come on more or less. There's obviously different one offs that are happening each quarter they're not in and of themselves that particularly material but otherwise I'd be listing them for you as call outs in terms of that piece.

But I think in terms of general market activity in terms of what we'd expect to see on the other non-FX items and nothing particularly, but it probably is more the FX and the kind of wider

trading activity which we know was lower in Q2 because of things like the market activity, particularly given by things like the US debt ceiling, which is kind of causing things to go.

And as I look at June and July activity within NatWest Markets, I can see it's just been a bit busier. And so that all kind of helps. Thanks very much, Guy. Chris, can I come to you?

Chris:

Yeah. Good morning. Thank you for taking my questions. I had one follow up on other income, please, and then one on NIM again.

So, within other income, central other income, there's sort of been this rather bouncy trajectory of the clean or ex-notables, other income in group centre and I am sort of struggling a little bit with the strength of the implied pickup in other income into the second half to get back to your 14.8. So, could you just talk a little bit about what actually is in that number and how should we think about modelling that? I appreciate it is going to continue to bounce around, but presumably you have a view on what the sort of sustainable level of that is likely to be over the near future.

And then on margin again, obviously, like others, are very keen to try to interrogate the anticipated trajectory of the margin. I appreciate you don't want to give us a 2024 NIM, that's fine. Could you tell us what the exit NIM was at the end of Q2, please? I'm guessing that was a bit below the 3.13 given the shape of the progression over the last couple of quarters. So, if you could if you could speak to that, where was the NIM running at? So, at the end of June. Thanks.

Katie:

Thanks, Chris. I'm sorry. I'm not going to give you the exit of that piece. But, you know, we were 327, went to 313 and so averaging 3.20 and then we've confirmed 315. I'm not expecting the same swings in Q3 and Q4 that I saw between Q1 and Q2. A little bit of down and a bit of up sort of thing, I imagine, and would be so dependent upon what happens in things that are not within my control, but that will ultimately dictate on that piece.

But sorry. And I know that Chris, you'd like me to be more helpful. I'm sorry that I'm not, on that piece. And I fear I'm not going to be terribly helpful on non-interest income either. There's a few different things that just kind of bounce in and

out. If I look at that number, I mean, you can see right over the last couple of quarters, you know, it's kind of moved.

So if it is 35 higher over 18, then 53 and then so it does kind of move about. There's just lots of little bits that get captured in the middle of there. And there's no one thing that I would particularly call out absent anything we've raised on the notable items. So, again, I don't really have a view of the solid level of that.

What I would say is we try to do within there is if there's lots of activity to do with Treasury, we might push it back out more to the centres, even then the number has to get a bit bigger than it is within that piece. So it is just a little bit of a collection of bits that come in at the end. Sorry, Chris.

Chris: Could I just ask on the on the NIM, I mean, you've talked about swings into Q3, Q4. I guess what I'm trying to understand is within the second half, I mean, you talk about ups and downs. Are we down into Q3 and then up again already into Q4. And I appreciate you want to guide on what then happens into '24.

I mean, I tried that question the other day and I think it's been tried again this morning. In terms of the expectation into the end of the year, it feels like you down Q3 and up in Q4. Again, that flat guide or flattish guide.

Katie: I'm probably going to let Q3 and Q4 roll out and then we'll see when we talk again in October. I'm happy with the 315. It will go up and down a little bit and I have some views as to where they will land. And if the base rate decision in a week's time is different, it will be a different number again sort of thing. So I think I'll let you work your way through that. Sorry not to be more helpful, Chris. Thanks, Chris.

Raul: Hi. Morning, Katie. Morning, everybody. Thanks very much for doing this. And apologies, we have got Bank of Ireland today as well. Two questions for me. Firstly, on the hedge, and I suspect these probably both might go to Donal, what with you being a little bit more ahead of your peers in terms of talking about the size and the shape of the hedge and, you know, Lloyds, if you were the first to talk about the shrinking of the hedge, Lloyds have finally following you.

Can I just ask for a little bit more colour around your assumptions around the hedge eligible deposit base? If we try and look at the way we try and estimate your hedge eligible

deposit base and obviously that looks like it is shrinking faster than what the system level deposits are doing. So can I ask for what you assume your hedge eligible deposit base would do and just going back to the comment that Donal made, the 190 billion potentially lower.

If I if I go and do some of the kind of medium term thinking that some of the others have tried, I can see scenarios by which we might be back to 160 billion in terms of the notional over the medium term. Is that something that you would recognise? Or do you think that maybe gets a little bit too far in terms of the shrinkage?

That's the first question.

Katie: Donal, do you want to take that?

Donal: Yeah, sure. I think in terms of 160, it's not what we would recognise. You'd need to see a significant reduction in deposit balances or a significant change in mix from here to get to get to that 160. In terms of the first part of it, in terms of our assumptions, they haven't really changed.

The way we look at it is we hedge a high proportion of our current accounts and a proportion of our savings balances. And then all we do is we look at that eligible balance mix on a look back over 12 month average basis. So, in effect, what you're seeing about what we're saying, the reduction to a 190 year end, is just what's feeding through from the reduction of balances in Q4 and Q1 of this year.

And then the change that we've seen towards fixed term as well. So anything moving into fixed term is obviously rolling out of the hedge and the eligible balances.

Raul: Okay. I might follow up on that, but perhaps for another time. The second one is just on capital. There seems to be a lot of noise around your distribution capacity, especially through last quarter in the market. But obviously you've done exactly as you promised us.

And, you know, paid down 13.5% on the CET1. From here on, obviously, you know, recognising this somewhat more seasonal aspect of earnings and perhaps a little bit more uncertain macro-outlook, is there any change in terms of how we should think about where you would solve down to for, let's say, the full year results? Should we think about you retaining those 70 basis

points of capital for the directed share buyback in reserve, as far as capital return expectations are concerned?

Katie: Yeah. So, we obviously have a capital distribution policy, we've been very open about it. We've tried to be very consistent about it in terms of where we are. We do always want to maintain capacity for the directed buyback, I think we could all recognise the directed buyback has now moved into being a Q2 event rather than a Q1 event.

We will definitely, as a board, consider that when we talk about distributions, and we'll talk about them in earnest in December as we head into that kind of year end piece. So, we've got a range of 13 to 14%. We landed on 13.5. We could have added on 13.4, 13.6 is always a little bit rounding that goes on in this space.

But we're very comfortable with it and we want to make sure that we're able to distribute, we're able to participate in directed buybacks. We do see strategically it's important to kind of continue the government exits. We also are very alive to if there was an organic opportunity that came along, that made good sense for us that was really good value, we'd also look at that as we as we kind of go through. But, I think we've been really consistent since we started to distribute capital, but Raul, you're absolutely right. Now we're in that 13 to 14%, the kind of 50[bps] a quarter that we're kind of generating that's dictating a lot of what we ultimately do. Clearly that's strong.

We've been very clear that we are we are continuing to distribute capital back out, and that will certainly be the conversation I would expect to be taking into the year end. I would say that we do a kind of 18, 24 months look forward as we distribute capital. So I think what happens with Basel 3.1 in the next few months in terms of government consultation and what timeline they're really going for and the date that they're going for on that, that's obviously something as I look into '24, I want to make sure that we've got adequate capital to kind of absorb any of those challenges.

Raul: And if you got any more colour in terms of what you think that the Day 1 impact might be they might have to hold for.

Katie: Not over what I've given you. What we're looking for is the next feedback from all the consultation comments that we went in, and we did a lot of work with the regulator, you know, going

through a lot of worked examples of why we think this approach might be better than that approach.

When I have more of, I'll give you more than we've already given you. But at the moment I don't have any fresher numbers particularly. Shall we go to Seamus. Seamus, you're on mute. Sorry.

Seamus:

Hi. Thanks for taking the question. Thanks for doing this. I suppose I've just two questions. One, is a bit of a tactical, which is second, but just on the hedge again and coming back to them, I know it's been kind of asked a lot, but it just seems strange that the hedge capacity would fall if your models were working correctly.

And I suppose it wasn't the view that was taken by Treasury basically that rates would peak earlier than what they did. So therefore, you're happy to be over-hedged to some extent coming into the end of 2022; sort of happy to run a larger hedge, than what it was on a mechanistic basis, if you know what I mean, on the basis that rates may fall into 2023, 2024. And so therefore over-hedging, I suppose, if that was the case, kind of has proven to be, you know, not correct. And so therefore you had to reverse on the hedge.

On the second question, then, it's just a slightly more technical one. It just relates to [the] note [on page] 80 in your report and accounts and also recognition of hedge through NII.

So if you look at what's actually happened to the cash flow reserve numbers, in terms, there's been a 2 billion growth year on year, which I presume relates to the hedge in terms of the size of the head of the variable line. But I just want to try and understand when we talk about NII, how does that actually get recognised in NII because obviously the variable component is not recognised through NII and I'm just wondering how it's released through equity to earnings basically as we move forward in terms of trying to model this because, you know, at 190 billion hedge and a 4% variable leg it does, I'm just wondering how do we actually think about the modelling of the hedge if we were to try to separate it out from the deposit beta element of it, because obviously it's been the 214 million transfer through the cash flow reserve into NII, I presume, and I just want to if you could give us some colour on that in terms of the recognition of that, that would be really helpful. Thank you.

Katie: I will let Donal go through. We actually spent a lot of time talking with the board about how the cash flow hedge brings into the income statement. So it is a hot topic for us in terms of that piece. Donal, do want to take where we are in terms of the mechanistic and the impact of over-hedging.

Donal: Yeah, let me start on the first question. So it's not in effect what you told me is the over-hedge, that's just the results of the way that would look at it on a 12 months lookback basis of those eligible balances. So, in effect, what you would have seen back in 2021 is when you saw deposit growth increase significantly, that's when you would have seen the hedge increase because in effect that increase was feeding through into that 12 month lookback.

All you're seeing now is a bit of a reversal of that as our balances have reduced down. So, in effect, you could look at it underwriting overheads just as the 12 month kind of look back catches up with the swap position. But we don't put that down to incorrect modelling. That's just the way we approach it mechanistically, if that makes sense.

I think in terms of the second question, in terms of the cash flow hedge and the floating rate is probably the nuance in the way different people look at the hedge. If you look at our disclosure, we will show you both the total income on the hedge, but also the incremental income. And total income obviously is just looking at the fixed leg component of the derivative, because in effect, the way we would view it is the floating leg would have an offset with a corresponding liability of those eligible balances.

And I think probably what you may be referring to is if you look at the incremental income, that's in effect what is feeding through NII on the spot basis, when you look at it in the round. In effect, what that would miss is the income that you'd be generating on those deposits that are placed in the Bank of England, if that makes sense.

Seamus: Yes. So, the net effect of the hedge is recognised through NII is that how we should think about it?

Donal: In effect what you have is the cash flow hedge reserve really is the mark to market of the derivative positions. That will feed through NII in addition to the income you're earning on the assets in the Central Bank over time.

Seamus: Right. Okay. Okay.

Donal: It's only looking at the derivative component, it's not looking at the hedged items.

Seamus: So therefore, in terms of the cash flow reserve, if the cash flow negative reserve was 3.3 billion impact on NAV in the first half of the year, I mean if we get a peaking of the base rate in the UK, then we should expect that cash flow reserve to adjust basically to become a positive position, as we look forward there, so that's an incremental positive to NAV?

Donal: So, in effect, what you should see is if rates have peaked and they move lower, in effect, that should reverse to zero over time.

Seamus: So if base rates stay steady, then there will be reverse of the cash flow hedge.

Katie: And I think, Seamus, one of the things I said on Friday, we've already seen about 300 million a reversal of that up until Friday, as you've kind of seen, the rates move down expectations. So that's already starting to come through. There's no more questions, I think, on the line. Sorry, Rohith.

Rohith: Thank you. Sorry, another one on the hedge. So your expectation is that deposits are relatively stable from here.

Katie: Subject to kind of market changing shape.

Rohith: But if we take that as a given and there's some ongoing mix shift so you have less hedgeable deposits, hedge notional will fall more than the 12 billion that you've discussed because 12 is backward looking.

And so you have a small hedge notional, but you'll actually have the same liquid asset buffer, and you'll actually have a yield pick up as a result. So, it's actually, a smaller hedge is not necessarily NII negative.

Katie: We'd agree. Yes. It's more the mix shift that is the piece. So the guidance you given to get 190 on a kind of static shape from today but clearly if we saw greater acceleration - and it would need to be quite a lot more than you would, - you would obviously have a different kind of base coming through. But given on our lookback today that's kind of our view of what the 190 would actually be.

Rohith: Because essentially you would replace the hedge yield with the liquid asset buffer yield, which is currently higher.

Katie: Which of course, and then we get into a bit of a mess on NIM because of its imperfect nature, because the liquid asset buffer isn't in the denominator. Super. Anything else.

Aman: On capital? Additional draws on capital. I know you talk about Basel, potentially depending on how that lands, pro-cyclicality, any RWA growth.

Katie: I mean, that's what we talked about at the beginning the year was kind of 5-10% growth from that 176, which gets you to kind of 192 or something like that. In terms of that sort of number. You know, that was obviously, we've seen Ulster come down since then, we've seen the some of the RWA growth. It's kind of been paid for with the Ulster fall in terms of that piece. The 5 to 10% in my mind was always mainly pro-cyclicality and Basel 3.1. I think pro-cyclicality, I am intrigued that we still continue to have releases of that in the C&I space rather than at this point I don't have any more guidance for you on that piece. I would still expect to have some more pro-cyclicality.

Basel 3.1 is the main thing and what have I missed out, oh yeah, so we had a small Op-Risk as they do their annual reassessment, they have added about a billion in this quarter, but you've seen that in the notes.

I just say thank you very much for your time and thanks for everyone for joining us on the telephone. And as ever, thank you for your continued support and challenge, we do appreciate it.