



NatWest Group plc

Quarter 1 Results 2022 – Management Presentation

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Alison Rose

Good morning and thank you for joining us today. As usual I'll start with a brief strategic update, Katie will take you through the results and then we'll open it up for questions.

Clearly, since we last spoke, the world has changed considerably. Russia's invasion of Ukraine has led to greater macroeconomic and geo-political uncertainty and our customers now face higher inflation, rising rates and energy costs, as well as ongoing supply chain disruption.

Whilst many of them have built up healthy savings and balance sheets during the pandemic, and we are not seeing any immediate signs of distress, we are acutely aware of the pressures our customers face, so just as we did during the pandemic, we are supporting them as they navigate this period of uncertainty.

For example, we continue to deliver around a million free financial health checks a year.

We help customers to understand the impact of different scenarios on their credit rating and improve their score and we regularly refer our more vulnerable customers to Citizens Advice.

Our business customers benefit from having access to dedicated relationship managers with sector expertise in all of our regions.

As the invasion of Ukraine continues, together with our customers and colleagues, we have donated over £9m to the disaster, emergency committee, Ukraine Humanitarian Appeal.

We are also offering practical assistance to Ukrainian refugees in the UK. For example, we are using one of our Headquarters as a welcome hub and we are providing help with opening bank accounts. We have no operations in Russia or Ukraine and minimal direct exposure to Russia.

We believe that our focus on building deeper relationships with our customers, together with 2 years of strong strategic progress, makes Natwest Group well positioned to deliver sustainable growth and returns in the years to come.

So, let me now turn to the financial headlines.

We are reporting a strong performance with profit before tax of £1.3bn, up 36% on the first quarter last year. We generated attributable profit of £841m up 36% and our return on tangible equity was 11.3%, up from 7.9% in the same quarter last year.

We are delivering on our income growth, cost reduction and capital targets. Income was up 8.6%, costs were down 4.6%, though we continue to expect an annual reduction of around 3%.

And this resulted in positive draws of 13.2%. Our CET1 ratio is now 15.2% which includes £1.5bn of distributions.

As you know we have committed to make annual dividend distributions of at least £1bn this year. Our CET1 ratio includes an accrual of £250m towards that commitment, and we made another directed buyback in March of £1.2bn, bringing government ownership to around 48%, which is clearly an important milestone.

We have also executed £377m of the additional £750m on market buyback announced in February.

We continue to focus on delivering our strategic plan and our targets, despite the macroeconomic uncertainty, we are updating our income target as we now expect to deliver income that is comfortably above £11bn, as a result of faster than assumed rate increases.

As I said earlier, we plan to reduce costs by roughly 3%, both this year and next, taking into account cost inflation and our investment in the business as we continue strong cost discipline.

And we are targeting a CET1 ratio of 13-14% with a return on tangible equity, comfortably above 10% by 2023.

So, let me turn now to other ways in which we are supporting our customers to drive sustainable growth.

We want to deepen relationships with existing customers by serving them at all the key stages in their lives, whether it's to buy a house, save for the future or set up and grow a business.

We are also acquiring new customers, by delivering a wider range of products and services, more effectively across our franchises, for example, by successfully extending our asset management expertise to customers in retail, as well as private banking, we increased our affluence investment customer base by 40% in 2021 and grew assets under management and administration 17% to £35.6bn in the same period.

Total AUMA were down in the first quarter, as they were impacted by market volatility, but net new inflows were up 33% on the first quarter of the last year at £800 m and this included £137 m via our digital platforms.

In Retail banking, we added 159,000 new current accounts during the first quarter this year and we continue to invest in the SME eco system as the leading bank for small and medium businesses, we offer both digital solutions as well as an extensive network and locally based sector specialist relationship managers.

As we build a comprehensive digital payments proposition for these businesses, the number of our customers using our merchant acquiring platform Tyl has more than doubled in each of the last 3 years.

We are also diversifying our income through product innovation, such as our Buy Now Pay Later proposition due to be launched this summer.

Demand for Buy Now Pay Later has grown rapidly since the start of the pandemic and we want to provide a product that is both better and safer for our customers.

Our new proposition will offer a fixed credit limit, clear structured repayments, credit scoring and affordability checks as well as the ability to keep track of payments on our mobile app and like many providers, transactions will also be covered by all the protections customers expect from a fully regulated bank.

Turning to slide 7, this is the second year of our £3bn investment program, 80% of which was being invested in data, digitalisation and technology.

The majority of our customers now interact with us digitally, 61% of retail customers are entirely digital, 90% of retail customer needs are met either online or by a mobile, and 83% of customers in our commercial business, use digital banking.

We continue to make good progress on improving customer journeys, 79% of retail accounts are now opened with straight through processing, 99% of unsecured applications are fully automated and commercial customers made 73,000 digital service requests in the first quarter compared to just 6,000 in the whole of 2019.

Our digital transformation is helping us acquire new customers for example, our digital bank for business customers, Mettle, has gained 50,000 new customers since launch and our acquisition of Rooster Money last year, which provides families with an app that helps children to learn about managing money, added 130,000 new customers.

Improving the customer experience has also resulted in a significant improvement in net promoter scores, with retail at 16 up from 4 in 2019, affluent at 26, up from -2 in 2019 and a business banking mobile NPS of 48.

Of course, this improvement creates a virtuous circle which results in the acquisition of more new customers.

Turning now to capital management on slide 8.

We continue to proactively manage capital at risk and have reduced the capital intensity of the business from 54% in 2019 to 48% in the first quarter of this year.

Our phased withdrawal from the Republic of Ireland is progressing and we are pleased with what has been announced.

We are also managing risk well with a low level of defaults and strong risk profile.

94% of our personal lending is secured and we are growing unsecured in a responsible way. 92% of our retail mortgage book is fixed with an average LTV of 54%, and we have a well-diversified corporate portfolio with limited exposure to at risk sectors that we monitor closely.

We are focusing on capital efficiency in order to maximise shareholder returns and as I said earlier, we have booked total distributions in the quarter of £1.5bn for 2022 and with that, I'll hand over to Katie to take you through the results.

Katie Murray

Thank you Alison, I'm going to talk about the performance of the Go Forward bank using the fourth quarter as a comparator.

We reported total income of £3bn for the first quarter, up 15.8% from the fourth, within this Net interest income was up 5% at £2bn, and Non-interest income was up 46% to £964m.

Excluding all notable items, income was £2.8bn, up 9.8% from the fourth quarter, operating expenses fell 22% to £1.7bn driven by the absence of the annual UK bank levy, lower conduct costs and of course ongoing cost reduction.

The net impairment release of £7m compares to a release of £328m in the fourth quarter. This reflects a continued low level of defaults and an increase in our post model adjustment for economic uncertainty of £69m due to increased cost of living and supply change challenges our customers are facing.

Taking all of this together, we reported operating profit before tax of £1.3bn for the quarter. Attributable profit to ordinary shareholders was £841m, equivalent to a return on tangible equity of 11.3%.

I'll move on now to Net interest income on slide 11.

Net interest income for the first quarter of £2bn was £104m higher than the fourth, as a result of the higher UK base rates and strong lending. Net interest margin increased by 15 bps to 246 bps, driven by wider deposit margins, which added 22 bps. This reflects the benefit of the higher UK base rates which increased to 75 bps on the 17th of March, from 25 bps at the start of the year and higher swap rates on our hedge deposits.

Lower mortgage margins on the front book, reduced them by 4 bps and was partly offset by a positive mix of unsecured which added 2 bps. However as you can see, these impacts were more offset by higher personal deposit margins and Net interest margin in both Retail Banking and Private Banking, as increased in the quarter.

In Commercial and Institutional, changes in loan mix reduced bank NIM by 3 bps as growth was driven by lower margin, large corporates, or smaller businesses continued to repay.

As in Retail, wider Commercial and Institutional deposit margins more than offset this and the C&I NIM increased in the quarter accordingly.

Turning to the yield and cost trends on slide 12.

You will be familiar with this slide but this quarter we have presented the customer loan and deposit rates for our new C&I franchise. I want to highlight 2 key points.

First, Commercial and Institutional loan yields by 8 bps to 283 as the majority of these loans are variable rate with an automatic reprice.

And secondly, deposit costs were broadly stable, we expect deposit costs to increase further in the second quarter, following rate changes taking place in April.

Turning now to look at mortgage margin dynamics on slide 13.

The chart at the top will be familiar to you, however we are now showing you quarterly average metrics for the group and not just Retail Banking.

We have increased average customer mortgage rates by around 30 bps in the first quarter, of course we also recognise there is considerable pressure from the swap curve, the average 5-year swap increased by around 60 bps in the quarter, customer deposit rates however were broadly stable as customer rate changes only took effect in early April.

This led to an increase in customer spread, the difference between what we charge customers for their mortgage and what we pay for deposits.

Of course, higher swap rates are good for hedge deposit income.

As you know, we increase the product and other hedge notional by £39bn to £185bn, during 2021, reflecting growth in customer deposits.

In the first quarter, we increased this by a further £8bn. If we assume that deposits remain at the same level as the first quarter, then we expect this to increase by a further £5bn over the next 12 months.

The structural hedge yield of 72 bps is up slightly to 71 in the fourth quarter.

Moving on now to look at volumes on slide 14.

Gross loans increased by £6.6bn or 1.9% in the quarter to £362bn. In Retail and Private Banking, mortgage lending grew by £2.8 bn or 1.5% and unsecured balances increased by a further £100 m despite typical seasonality.

In Commercial and Institutional, gross customer loans increased by £2.3bn, this comprised £3bn of growth in large Corporate and Institutional customers, as a result of increased capital markets activity, and higher facility utilisation.

As well as an increase of £500m in invoice and asset financing, within our Commercial Mid-Market businesses. This growth was partially offset by the continued repayments on government lending schemes.

I'd like to turn now to Non-interest income on slide 15.

Non-interest income excluding notable items was £740m up 24% on the fourth quarter. Within this, income from trading and other activities increased five-fold to £205m, as we benefited from higher volatility in our Currencies business and good issuance volumes in Capital Markets.

Fees and commissions fell overall by 4% to £535m driven by normal seasonality. I will look on now, to look at costs on slide 16.

Other operating expenses were £1.6bn for the first quarter, that's down £78m or 4.6% on the same period last year, as we continue to work to meet our targets, which, as you know, is in reduction of around 3% for the full year and I'll remind you that this will not be linear.

Turning now to impairments on slide 17.

We're reporting a net impairment release for the Go-forward group of £7m, compared to a release of £328m or 37 bps in the fourth quarter. This reflects a continuing low level of default across the group, we continued to see further improvements in underlying credit metrics in the good book, with positive migration of stage 2 loans back to stage 1, driving ECL releases.

However, we have decided to allocate these releases to our post model adjustment for economic uncertainty, which increased by £69m to £653m.

As we recognise our customers face both increased cost of living and supply chain challenges, that are yet to impact the data.

The economic assumptions we presented in February are unchanged and we include these on the slide appendix.

We will update these in line with our usual practise in the second quarter.

We continue to expect a loan impairment rate to be low 20-30 bps in both 2022 and 2023.

Turning now to look at capital and risk rated assets on slide 18.

We ended the quarter with a Common Equity Tier 1 ratio of 15.2%, down 70 bps since January 1st. This includes £1.5bn of 2022 distributions which reduced the ratio by 83 bps. The redemption of legacy equity preference shares reduced the ratio by a further 14 bps, in line with our guidance.

This will deliver an annual saving of £19m from Q2 onwards, higher RWAs reduce the ratio by 5 bps and fair value movements on our liquid asset portfolio reduced it by a further 9 bps. These reductions were partially offset by a 44 bps increase from attributable profit, net of changes to IFRS9 transitional relief. Our IFRS9 transitional relief is 23 bps down from 39 bps at Q4 as relief decreased from 100% at the end of the year, to 75%.

RWAs increased by £500m to £177bn. This was driven by a higher credit and market risk, partly offset by £1.9bn benefit from our annual operational risk recalibration exercise.

Turning to slide 19 which shows the strength of our balance sheet.

Our CET1 ratio of 15.2% is now 120-220 bps above our 13-14% target range. Our UK leverage ratio of 5.5% is down 40 bps over Q4 and 225 bps above the Bank of England minimum requirement.

We have also maintained strong liquidity levels with a high-quality liquid asset pool and a stable diverse funding base.

Our liquidity coverage ratio decreased to 167% due to the redemption of legacy preference shares and the directed buyback taking the headroom above our minimum to £83bn.

And turning to my final slide, we are making strong progress and now expect to deliver income, excluding notable items, comfortably above £11bn for 2022. This assumes UK base rates reach 1.25% in the fourth quarter and reflects faster rate increases than we had in the plan. We reaffirm all our guidance on expenses, impairments and capital and taking all of this together, we continue to expect to deliver a 2023 return on tangible equity comfortably above 10%.

And with that, I'll hand back to Alison.

Alison Rose

Thank you Katie, we have delivered another strong set of results for the quarter, as a purpose led bank focused on people, families and businesses up and down the country, we are acutely aware of the challenges our customers face and we continue to support them in every way we can in an uncertain environment.

Despite the macroeconomic uncertainty, we remain well positioned with a diversified lending book, strong risk management and an ongoing investment plan in digital transformation that underpins our growth plans.

Our capital strength gives us the flexibility to invest for growth and consider other options that create value as well as return capital to shareholders and we remain fully committed to the targets we have set out today.

Thank you very much, we will now open it up for questions.

Operator

We'll take our first question from Aman Rakkar of Barclays. If you could please unmute and ask your questions.

Aman Rakkar

Good morning Alison, good morning Katie, hopefully you can both hear me ok?

Alison Rose

I can.

Katie Murray

Yep.

Aman Rakkar

Okay great, thanks. I had a question on your revenue guide, first of all and then net interest income if I could.

Could you help us understand the guide around comfortably in excess of £11bn, it sounds firmer than what you were telling us at full year 2021 but I guess it lends itself to quite a wide range. If I was to take 2022 consensus and bank the net interest income, that number should be comfortably above £11.5bn I think, so, any refinement of that guidance would be really helpful.

The second, was on net interest income, you're clearly benefiting from a really rich tail wind in 2022 from rate hikes supporting deposit income, this year, if I could ask you to cast your gaze into 2023, ultimately my question is, do you think net interest income could continue growing in 2023? And as part of that, could you help us understand your expectations for the structural hedge in 2022 and 2023, I think that should be a nice tail wind in 2023 and that's going to be an important defence against mortgage margin compression. Thank you very much.

Alison Rose

Great, thank you, well I'll get Katie to take you through those in a little bit more detail but I guess in terms of comfortably above, we are feeling much more confident in terms of those numbers, but Katie do you want to walk through those questions?

Katie Murray

Yep, sure absolutely, I'll just start by saying that, the interest rate that we're looking at is just one of the factors which we incorporate into our guidance so am I comfortable that total income is above that £11bn? The degree to which it will be above, is driven both by the magnitude and importantly the timing of UK base rate rises. Our guidance of comfortably above 11 includes our assumption of further Bank of England base rate rises this year, reaching 1.25% in Q4'22, we do note the market expectations of further raises are currently above our estimate, our assumptions include 2 further rate rises this year, while this is below the current market assumptions, we are conscious of the increase of uncertainties that face the economy and we remain comfortable at this level.

So, we do look to manage both sides of the balance sheet and we have seen continued deposit increases. There has been quite limited pass through in Q1 which has helped us improve this guidance however I would say of the last deposit rate change that we saw, we saw in April, was equivalent to a 40% pass through there, there are some more attractive deposit accounts around for people as well.

You can see with our interest rate disclosures on the slide, it's unchanged since the full year, this will be updated again at H1, but it gives you a good guide of, as rates come through, if they are above our estimate, what that might mean, but in terms of our estimate, it is around the 1.25.

It won't surprise you Aman to know that I'm not going to give you a precise number, but the way that I would think about it, is the faster pace of rates in Q1, and then the much lower pass through of those rates than expected compared to our expectations when we spoke in February, that's where you're getting your additional revenue guidance as you move through.

If you think of the structural hedge, at this point, what we can say is, it's definitely a positive as we move through, you can see that in this last quarter, the yield moved up, 72 from 71 for the whole piece, a small movement but an important one because what you can see is the benefit that is now flowing through into those numbers.

You can also, when you look at where we're writing and what we're adding on in terms of that structural hedge, compared to where we were before, it's a much richer rate, if you look to a year ago, it was going on about 20 bps, it's now going on over 200, in terms of that piece, so I would say that it is a positive move forward from here.

We added on £8bn in the quarter, we'll add another £5bn on over the next year, if deposits stay as they are and I'd note that we haven't seen that growth in deposits although it's slowed, it hasn't disappeared, so you can take your own views on that, but I would say it will be something as we move forward, it should be helpful to us.

I'll probably not going to get drawn on NII into 2023, I think you can take our interest rate guidance and take it through from there.

Aman Rakkar Sorry for the echo on my line

Katie Murray We can't hear it Aman, so it's fine. Apologies for you.

Operator Thank you very much, and our next question comes from Andrew Coombs from Citi, Andrew if you could please unmute and go ahead?

Andrew Coombs Good morning can you hear me?

Alison Rose Yep, good morning, we can hear you. Hi Andrew.

Andrew Coombs A couple of questions from me. First is a simple one, which is given the, AIB announcement today, with another 6 billion of trackers moving across, does that change any of your guidance on Ulster Bank in terms of withdrawal costs, disposal offers and so forth?

And, second question on capital, you've obviously done the direct buyback already, you've still got a couple of billion of excess capital above the 14% ratio, and you're still guiding to get to 14% by the year end. On slide 30, you blag a couple of moving parts regulation and dividend and pension contribution, perhaps you could just give us a feel for what this implies for buybacks in your view because aside from that, I don't think there's any other major capital charges to come through from here, so can we look at that £2bn of excess capital you have today as our market buyback potential?

Alison Rose Great thanks Andrew, well let me take the Irish question and no change to guidance, obviously really pleased with the announcements today, and I think just continuing progress but our guidance on costs and deposits remain unchanged but I think good momentum now and pleased we could announce that today. Katie, do you want to pick up the second question.

Katie Murray No, absolutely, so, as you know there's 4 ways that we can distribute capital,

it's a combination of the ordinary and special dividends and we've said it's a minimum of a billion for 2022 and 2023, buybacks. We're halfway through the buyback that we announced in February, so we're pleased with the level of liquidity that we've seen in the stock that's enabled us to progress that quite quickly, and I would remind you that we reflected that in our year end numbers, so we like buybacks, they work well, they make good economic sense for our balance sheet and it's something that I think you could anticipate that we would continue to utilise.

Clearly, decisions will be made by the board at the right time, in terms of that piece. We've obviously done the direct buyback with the government so that windows closed now as you all know for the rest of this year.

Operator Thank you very much. Next question comes from Raul Sinha of JP Morgan, Rahul if you could please unmute and go ahead.

Katie Murray Hi Rahul

Raul Sinha Good morning, can you hear me clearly?

Alison Rose Yep fine, we can hear you.

Raul Sinha I was hoping to get a little more colour on your 40% pass through point and I was wondering if you might be able to tell us, what deposit beta assumptions you might have made within the retail as well as the commercial deposits separately, I'm just very interested in your disclosure around the split of the margin evolution between the two divisions and was just looking for some additional colour on how you expect the pass through on the commercial side perhaps to be difference from the pass through on the retail side and what does it look like against that 40% pass through, so that's the first question.

The second one, is just Alison, I think you mentioned that you would look at other options to create value on top of capital return, presumably through acquisitions, and you've been quite clear in past conference calls on this point, but I was just interested based on some of the press commentary about, has there been any evolution in terms of your thinking around potential areas where there might be additional value that you could create and I'm interested in any colour around what areas there might be where you think you could actually add a lot of value by doing some bolt on M&A, thank you?

Alison Rose Great, thank you well look on the M&A, no change to my approach as you know my preference is distribution to shareholders, if there's anything of compelling shareholder value and strategic rationale than we would look at that, I think if you look at what we've done so far, things like the Metro mortgage book, or we recently bought Rooster Money which was aligned with our youth strategy, so there's a pretty high bar of things that we would look at, it's got to be compelling shareholder value but our preference remains at distributions and we have obviously the very strong position we're in that I'm able to invest in the business, with the £3bn investment

program, continue to drive positive draws with operating leverage and have a strong distribution story and then look at other things that are compelling, so no evolution beyond what I've told you before, Katie, do you want to pick up the pass through point?

Katie Murray

No look, absolutely, and it's one of those things as you look at it, it's very dependant upon what's happening in the market, but let me try to give you a bit of a fuller picture than that answer.

So, when we gave you the sensitivity, what we said at the time is, it was built bottom up, incorporating different pass-through assumptions, for different products across all the franchises, and those assumptions changed as the rate increased through those difference levels.

The actual pass through rate will be determined by levels of liquidity and also subject to prevailing market conditions, including the expectation of the pace and number of rate increases, if we look to the first quarter, we obviously have two rate rises, we've put through a rate change in March, which takes impact in April which was equivalent to 40% of that, of the last rate rise, or you could look at it as 20% of the first two, but I think that's an important distinction because as you think about it, actually it does really depend on what's happening in the market and how much liquidity we've got in there.

And then when you look across the book, you have to think, how much is fixed versus variable in terms of there and if you go into the retail banking, the vast majority of our loans, of retail bank are fixed, so they obviously have no impact on that, and the C&I loans, we do see a kind of reference rate which re-prices immediately so we get the benefit but then we move into deposits, almost all of our retail and corporate deposit rates are managed rates, so they don't have any automatic pricing changes due to the external rate changes.

Retail banking deposits £189bn, 40% current accounts, 60% savings accounts, an average cost of 5 bps, for the first quarter, you'll see that go up very slightly in the second because they change, and then in terms of C&I, average costs 2 bps and that will be very much managed as we move forward from here.

If as a consumer you're looking to get a better rate, we've got a very nice digital account, which will pay you 3.25% rates and then also business banking, there's also another opportunity to enhance the account, I think it pays about 40 bps, so there is availability to you, but it is something that we look at as we work through what's happening in the market and what's happening with our customers.

Raul Sinha

That's really helpful, thanks so much.

Katie Murray

Lovely thanks, Raul.

Operator

Thank you and our next question comes from Omar Keenan from Credit Suisse, will you please unmute and go ahead.

Katie Murray Morning.

Omar Keenan Good morning Alison, good morning Katie. Thank you very much for taking the questions.

I've got two questions, one on the big picture question on the interest rate and asset quality outlook and a second one on Natwest Markets.

So just firstly on the interest rate and asset quality outlook. I hear that your assumptions in terms of the revenue guidance are Bank of England base rate of 1.25% at the end of the year, I guess if we look at current interest rate expectations, indicate that the Bank of England rate will probably be around 2.5% in one year and then settle at a neutral rate of about 2% in 3 years and I realise it is quite a difficult question, but at what level of interest rate do you think that starts to put at risk the through the cycle guidance because I get a sense that's where a lot of people perhaps are struggling to think about, what level high interest rates become a negative rather than a positive and the next election might be?

And my second question on NatWest Markets. So, thank you for the continued disclosure of NatWest Markets. I can see now the revenues are higher year over year and it looks like, some of the positive impact in capital management unit and other things like lower funding costs are starting to come through, but revenues in fixed income are still negative.

Could you give us an update on how NatWest Markets restructuring is going and given that, you know, you printed 150 million of revenues, is that something we can expect to continue going forward on a quarterly basis.

Alison Rose Okay. Great. Well, thanks for the question. On NatWest Markets I think you know what I talked about, we would expect to see sort of stabilisation of the, the performance of that business.

On the restructuring of NatWest markets, that's largely complete. We've made all the decisions around products and capital and the business is very much on the front foot now in terms of growing. I think coming into Q1, NatWest markets has had a strong quarter - total income of 219.

I think that the disclosure and as we said we would keep showing you. The performance there shows that both capital markets and currencies had good performance increasing by 64% and 34% respectively.

In terms of the rates business, I would categorise it as the start of the year pre that extreme volatility we saw, created by the geopolitical events. So, it started well and then had a more difficult environment as a result of the volatility from Ukraine and a small loss.

But overall, I'm very happy with the performance of NatWest Markets. And I think if you look at it from the three business lines, it's up 15% versus Q1'21. So, I think we're very comfortable that the business managed well during the volatility and, I'm really pleased with the refocusing. So, I think you would expect that business obviously has different movements through the year.

But I think that stabilisation I talked to the restructuring largely complete, it's performing well.

On your interest rate and asset quality point. I think in terms of interest rate rises and at what point does it become a negative very significantly higher than any of the forecast on interest rates.

And what we can see when we look through the leverage that's sitting with our customers and the level of liquidity, we have no concerns from a credit perspective caused by interest rates at these levels or forecast levels.

I think, you know, as I look at it, our book is largely, largely secured and good quality. You can see our RWA intensity continues to reduce and we actively manage the capital but, we're not seeing the interest rate rises as anything that would cause us a concern on credit events across our book. And so, we're very comfortable with our through the cycle guidance that that we gave you.

Omar Keenan Very Clear. Thank you.

Operator Our next question comes from Guy Stebbings of Exane BNP Paribas. If you could please unmute and go ahead.

Guy Stebbings Hi. Good morning. Good morning, Alison, good morning Katie. Thanks for taking the questions.

The first one was back on the above 11bn guidance. If I take your rate assumptions and the rate sensitivity and where we start from today, I'm deriving an NI figure approaching 9bn this year. Net fees and commissions were up 10% year over year in Q1.

I'm guessing that might moderate call it 5% or so, that's another 2.2. So, you get to about 11 billion just from that and then trading other income with 200m in Q1. One would hope that, you know, that that grows over the year. So, it looks like you could end up nearer 12 than 11bn, even on some pretty conservative assumptions. Am I missing something or is this just conservatism which is understandable given the, you know, the very uncertain environment.

Then a follow up just specifically on NI and sort of managed margin. If I park asset spread compression to one side and focus on the tailwinds you have on your slide 11. I mean the benefits from managed margin look be roughly double in scale what was captured in the rate sensitivity disclosure. I'm just wondering how much we should be tempering that sort of benefit on future hikes as you pass on more to depositors.

I think, I think you mentioned the change in income guidance reflect a lower pass through today and quicker hikes. But, I'm guessing your assumption around possibly some hikes hasn't changed perhaps. Thanks.

Alison Rose Thanks, well look, on your first point, I think, Katie's answered that

comfortably above and the assumptions that we've made on interest rates and the mix there. So, I think we're feeling very comfortable on that number, which is why we've strengthened it a little bit. Katie, do you want to pick up?

Katie Murray Yeah. If I take the next piece, so, the way that I would think about the comfortably above, is we're obviously 125 bps so I've kind of passed through assumptions up until that point, that are already kind of built into there. So, then the way I would think about it, if I was to say, well, actually if I have a view that the forward curve is the one that we're going to land in, so more of those kind of two and a half pieces, then I think we've given you the guidance in the managed margin piece. When we gave that to you in February, we talked a lot about that was already assuming that you were above the 100 bps.

So, you'd kind of got up to a normalised level of pass through. So, I think that's where you can use to take a view as to how much further that could be comfortably above, if our guidance is exceeded, as market consensus would suggest it may be, but let's see how the year progresses on that.

Guy Stebbings Thanks. Could I maybe just come back briefly on other operating income because it was down QoQ and but I think that seasonality which maybe something we kind of overlooked during Covid, just given some of the distortions and it was up 10% year over year. I mean, is 10% maybe going to be tempered because the base gets a bit tougher as the year progresses, but ultimately you are seeing good underlying momentum in other operating income now if we adjust for seasonality, is that fair?

Katie Murray Yeah, no look. Yes, I think what we're seeing is good recovery in the underlying businesses and there is always a little bit of seasonality in that Q1. So, there's nothing to read into that, so I'll leave you to make your own view on the 10%. So, I'm not maybe commenting on that specifically, but if I just look even at the slides on 15, you can see that Q1 is often that little bit lower.

Guy Stebbings Okay. Thank you.

Katie Murray Lovely. Thanks very much.

Operator Thank you. Next question comes from Jonathan Pearce of Numis. Jonathan, if you could please unmute and go ahead.

Jonathan Pearce Hello both. I've got two questions.

The first one is on this pass-through comment again. Apologies to come back to this, but just slightly surprised that you're talking about a 40% pass through on the latest rate hike, if I've understood you correctly. I mean, we can see you've pushed ISA rates up by about 10 bps and the business reserve account by about 10 bps. But, most of the other bigger portfolios look to be unchanged.

Can I just make sure I understand what this pass-through rate is being applied to, you've got £465bn of deposits in the Go-forward bank, you're hedging about 193 of those now, so maybe there's £250bn unhedged.

Is that what you're referencing when you talk about a 40% pass through? So, you pass through 40% of the latest 25bps hike to £250bn of balances. Is that how I should think about it?

Katie Murray Can I just answer that quite quickly Alison, in terms of that, so, I think the one you've missed is the main retail instant saver change and it's up 10 bps in terms of that. So, obviously no change on current accounts and then you saw across our various savings accounts, different changes, the main one you've not picked up on is the retail saver change and that went up.

Jonathan Pearce I may have missed that because on the website, I think it was still talking about one, but that that's gone up to 10, has it?

Katie Murray Yeah, and the reason, I'm not sure about the website, so I'm not sure about that, it only takes effect in April, the early part of April, so it should be updated, we'll have someone follow that point up. But that's the one that you've missed.

Jonathan Pearce Right. Okay. Okay. That that makes sense. Ok, thank you for that.

Can I follow up with the question on the structural hedge again?

Katie Murray Yes. Why not?

Jonathan Pearce Yeah, exactly. I'm, I'm slightly confused as to why the hedge isn't turning the corner more quickly. You added a basis point on in Q1 versus Q4 in terms of the total yields, but the public hedge in the second half of last year was only 57 bps. You've obviously added £8bn net to the hedge in Q1 and the swap curve, you know, most durations is 1.5-2% through the quarter.

You've got the old hedges rolling off again up to 2% during the quarter, except the equity hedges is still a drag, but is there some oddity at the moment in the hedge that's holding the yield back? or are we actually going to see this hedge income start to move up much more appreciably over the rest of the year?

Katie Murray So, if I look at that, there's nothing underline that's kind of holding it back. What I would say is on the capital hedge, it's probably still a little bit of a headwind, but we can see that continuing to improve as we go through, but we would expect to see the hedge income come up.

I know you're incredibly familiar with this Jonathan, as you look at that, those schedule over the one, two and three years, you can see the first year comes through quite gently, and then it kind of it grows as you go into year two and year three as you come up. It can also be a little bit lumpy depending on when you put it on over the last number of years as well.

But there's nothing untoward in there. You will see you'll see it start to move up.

Jonathan Pearce Okay. All right. Thanks Katie.

Katie Murray Lovely thanks for the question, Jonathan.

Operator Ok our next question comes from Ed Firth of KBW. Ed if you could please go ahead?

Ed Firth Morning, everybody. I wonder if I could just bring you back to credit because I guess this is a thing we're all struggling with. I mean, if I look at Sterling, it's at 125. If I look at the share prices, they're all pricing in, I assume some sort of reasonably material downturn, and I hear your comments at the beginning about cost of living and you're worried, you accept that people are stressed.

But, then on the question about interest rates, you seem to imply there's no stress at all, 2, 2.5, 3% doesn't seem to matter.

So, I'm just trying to, I'm really struggling I'll be honest, trying to square, not just you. It's really the whole sector, where all the sector management telling me I've got no worries at all, and yet what I'm seeing in the market, and I just wondered, what is the scenario which does make you nervous? at what point do you start thinking, we could have a credit downturn here? and we do have to start, you know, being more cautious in lending. Raising provisions, etc. I mean, I saw your non-performing loans were up a little bit, even if you exclude the regulatory adjustment. I don't know if that's coming from some place in particular, but I don't know if you can try to help us try to square these two extremes that we seem to be battling with at the moment?

Alison Rose Yep. Let me try and help, so, what you've got, if we specifically at our book, we're primarily a prime book. Our book is largely secured. So, I think shape of book is important. But in terms of the trends in the market and the issues we're seeing, in all of the leading indicators that we would look at, whether that is, calls into our financial health and support lines, requests for deferments, any sort of movement into what we would call heightened monitoring or, increased draw downs on things like credit cards or overdrafts. We are not seeing any of those leading indicators coming through. Now, there is an element of the fact that there's, across the UK economy, £186bn of extra cash that is sitting in people's savings and deposit accounts, that they they've built up during the pandemic, and £26bn less consumer debt, and across corporate balance sheets lots of liquidity sitting there as well.

So, there's no signs of that distress coming through. What we are being very mindful of, though, is all of those concerns around cost of living and inflation and supply chain. So, we're really being very proactive, but we're not seeing any signs of it. And then if you look at the shape of our book, where we actively manage it. The big sort of driver in terms of what the dynamic would be is unemployment.

That really is the issue, unemployment remains very high at the moment. So, I think once you start seeing unemployment rising, that would really be more of an event that would bite into affordability and start migrating into credit migration from that perspective. So, when we think about ECL, the key driver of that is that is unemployment.

When you step back and look at interest rates, at 125 or 2, wherever the consensus is going, that is not going to be a driver of credit impairment and the shape of our book looks pretty good. But it's unemployment that really will feed into ECL. So hopefully that helps. But what you've got is some very different dynamics happening.

We're being very proactive in how we're supporting customers, the proactive support going into them through our Relationship Managers, through our teams and making sure we can address that. But leading indicators, no signs of distress. The area you would focus on would be unemployment. So, hopefully that's helpful.

Ed Firth Yeah, no, it's very helpful. But, so in your internal modelling etc. then, do you have a sense at what level interest rates would have to be, for unemployment to stop going up? Because I guess there would be a correlation somewhere.

Alison Rose Well, I think, when we've sensitised the book, interest rates really are a driver of affordability, so that's going to affect affordability. Unemployment is another driver of affordability, if unemployment goes up and people aren't getting wages in and salaries in, then clearly that's a dynamic. But when you look at the cash buffer that has been built up on, and generally the overall level of liquidity that's sitting across corporate balance sheets and across businesses, it's very high.

If you look, for example, around the amounts, if I think about in our small business banking side, our small business customers. 50% of customers are on fixed rates, you know, things like the bounce back loan, those are all on fixed rates, you know, a high degree of all our mortgages are on fixed so, that interest rate sort of rising will go into affordability.

But unemployment is going to be a much more dramatic side of things. So, we are not concerned about interest rate biting into affordability at this point.

Katie Murray I think Alison, the only one thing I would add is just to repeat our guidance. What we have said to you is we expect our impairment charge to be below our 20-30% through the guidance in 2022 and 2023. So, while we recognise the cost of living crisis, what we think in terms of the level of provisions we have and where we are, it's not something we're expecting to manifest particularly in our impairment rates.

Ed Firth Right. Thanks very much.

Operator Thank you. Our next question comes from Rob Noble of Deutsche Bank. Rob can you please unmute and go ahead?

Rob Noble

Morning all. Thanks for taking my questions. On inflation, so it's the underlying cost base, I appreciate lumpy and this quarter looks particularly good. Is the underlying cost base performing in line with your expectations? or is higher inflation a pressure on your cost target for this year?

And then, I appreciate you're saying that interest rates aren't a concern for credit, but you did take a post model adjustment for, presumably cost of living inflation, so what parts of the books are you worried about? Where does inflation negatively impact your book? And then just leading on from that, and one of the points you just made is that people have a lot of excess savings.

But one of the more cautious arguments in the UK is excess savings are held by wealthier people, and corporates that are in liquid positions. So, what proportion, do you know? Can you see data, what proportion of your customers actually holds the excess deposits?

Alison Rose

Ok, so let me start on the costs question. Yes. Costs are performing as we expect them to, we've taken out £78m or the 4.6% and so we're very comfortable we're on track for the 3%. We obviously considered inflation when we set our cost target, and we remain comfortable with the 3%. I've always said that costs will not be linear. The take-out will not be linear.

I know last year I said that as well, and everyone still times the first quarter by four. So, our guidance is 3%, but the cost performances, performing as we expect it to and we're comfortable with the 3% sort of target we've given you for this for this year.

Katie, do you want to pick up the next question?

Katie Murray

Yep, absolutely. So, Rob I do recognise the juxtaposition of below 20-30% basis points guidance and yeah, Katie you've held back £69m into your PMAs because of cost of living and supply chain, and what I would say, I think that's kind of a step of caution as we see how this rolls through and it's not a particularly significant number but we just felt that given where we are, given what we're looking at, let's just be a little bit cautious on that.

We'll do a full update on economics and everything at Q2 and we will move to much more of our normal consensus kind of base, so we'll see where that is. But at the moment, it's not something we are kind of concerned about. Inflation is clearly in the numbers but it is in our assumptions, but it's one of many different things we look at and as we've kind of done those numbers, we will have tested against where economics are sitting at the moment.

So, comfortable on that. But it was our kind of judgement decision to hold a little bit back. It's not a kind of significant number.

In terms of the excess savings point, they are held by the wealthy, but they're also held across our retail franchise and also by small businesses in terms of that piece. So, there that's where we see that kind of, a slight kind of increase.

I think when we when you think of what happens in an inflation environment, it's the discretionary spend, that starts to get impacted and when you look at the discretionary spend over the last number of years, we've focussed a lot on the retail real estate exposures, our leisure exposures to make sure that they are well managed.

So, if there's impact on those, then we can kind of watch the follow through on that to make sure that we're not at risk in that space. So, we're obviously not immune. People will struggle but those, when we look at our books and we look at the people that we lend to, it's not the people that are going to be having the greatest impact, unfortunately, of the cost of living, impacts on them. So, we need to keep mindful of it. We need to keep coming back to this point, unemployment is the thing you need to look at most closely and at the moment you can see the UK unemployment stats are excellent.

Rob Noble All right. Thanks very much.

Katie Murray Thanks, Rob.

Operator Thank you. Our next question comes from Chris Cant of Autonomous. Chris, if you could please unmute and go ahead?

Katie Murray Morning Chris

Chris Cant Good morning. Thanks for taking my questions. If I could come back to NII please. If I think about your NII run rate, it's about £8.2bn for the quarter, and the average change in rates that we saw that generated something like a £730m benefit based on the deposit margin improvements you show us in the slides. So, if I trim that down for the most recent 25 bps and assume the 40% pass through that you've indicated, even allowing for a bp of incremental mortgage pressure, and I think it was 4 bps on average for the quarter, so maybe another two to get to the end of the quarter, it feels like your NII exit run rate at March coming in to April would have been about £8.5bn and that's before we have any further rate hikes.

Am I missing something there? because I'm trying to think about this in the context of your comfortably above 11, as with some of the other questions.

It feels like it could quite easily be close to 12, if market rate expectations prove to be correct and I appreciate what you said on the 1.25, but just in terms of where you actually were as of March, is that about the right level and a sort of £8.5bn annualised run rate for NII in the Go-forward Bank? and I had a question on markets as well. I can ask that now as well, if that's helpful.

Katie Murray But let me do this one, then we'll come back to the markets one sort of thing.

So, look as we look at it, Chris, comfortably above, consensus is sitting at 8.2, we're clearly just trying to push on a little bit from where we were. We had slightly faster rates coming through. We did a pass through in terms of the interest rate rise into our deposit takers, you're very familiar with what's

deposit and what's current accounts so actually how much that kind of costs us.

We've got two more rate rises in the pipe. We think we'll only get to the last one by Q4. If you look at consensus, that's obviously a bit different. So, I think, think about your timing of where you are, but I guess we think of those words comfortably above 11 quite carefully. So, I'm going to probably leave you just kind of work out well what all of those means and not give you a kind of precise number.

But it is good to see, I think, the positive way that we're viewing the year and the continuing income profit that we're generating across the piece as we move forward. Do you want to do your NatWest Markets question?

Chris Cant

Yeah. So, on markets, rates, you indicated that the sort of volatility I guess caught you offside or something to that degree. Are you expecting the rates business to be a non-negative revenue number for the coming quarters absent any further unexpected volatility? I'm not asking you to forecast a massive positive revenue number, but, is the rates business expected to stop being loss making at any point?

It's had a string of really horrible quarters and obviously you're indicating that the restructuring is now done so, I would presume you weren't going to be keeping that business if you weren't expecting it to actually further some positive revenues at some point? Thank you.

Alison Rose

Thanks. So, I think that the volatility was managed really well by the NatWest Markets team. My reference to the volatility was as a result of the invasion of Ukraine, you saw very extreme volatility in the market, and our team managed that volatility very well. I'm very pleased with the performance of the rates business, as I said to you, in Q3 and Q4, it was a disappointing performance in a combination of market and us doing the restructuring. The restructuring is complete. That business has stabilised. You can see the contribution from NatWest Markets into this quarter and the rates business has continued to trend and perform positively.

So, it is not loss making and I don't expect it to be loss making. So, I think that stabilisation I expect is there. I didn't actually forecast the volatility in the market caused by the invasion, but the team handled it very well and we have a much less volatile business as a result of the restructuring we've completed.

So, I'm very comfortable with how that business is performing.

Katie Murray

And I think Alison, if you look at how Currencies and Capital Markets, increased over £200m of their income in the quarter, I think we're pretty pleased with how they've dealt with volatility has helped them across the place.

Chris Cant

But that's helpful. Thank you. If I could just ask one follow up on the first question.

If I put it slightly differently, what was your exit NIM for Q1 please? The 246 is obviously your period average. What was your exit NIM?

Katie Murray

Yeah. So, guys I gave you a lot of data. I give you all sorts of numbers on exits and things, I think, let's just work with what we've given you. I'm not going to give you the exit NIM from there.

So, the way that I would think about it, if you look at NIM for the whole year, we're expecting it to continue to increase, and if I look at the kind of the rate rises we've talked about, how they've got two more baked in. So, given where the rate rises landed in Q1 and the timing of those, I'd still expect to see some further improvement of them as they come through and we get a full kind of quarter impact of that.

You know, we've got a very strong and growing deposit base, which I think is really helpful. I shared with you how much more we're going to put on this structural hedge, so you can then work out how much more is going to get the benefit in terms of those ongoing rate rises directly, but I'm probably not going to get caught on an exit NIM, because Chris, I feel that will cause me trouble in the quarters to come. But we're very comfortable with performance.

Chris Cant

Okay. All right. Thanks.

Katie Murray

Thanks.

Operator

Thank you very much, and our next question comes from Martin Leitgeb of Goldman Sachs. Speaker, please go ahead.

Martin Leitgeb

Hey Katie, Alison.

Thank you for taking my question and congratulations with a good set of numbers first of all.

I wanted to ask on mortgage pricing, in the release, you stated application margins have fallen to around 44 bps in the quarter, down from around 67 in the trial period.

And I was just wondering if you could comment a little bit on the outlook for mortgage pricing? Are you comfortable writing business at this level? Would you expect some of this pricing normalises and bounces back as banks increasingly pass on to operate? Or could there be a scenario that banks just earn more on the liability side, liability margins and that we could be heading into this kind of new normal here in terms of mortgage pricing? Thank you.

Katie Murray

Sure. Thanks Martin. I was beginning to worry we weren't going to get to mortgages at all on the call. So, thanks for bringing it up.

Let me talk about the mortgages specifically and we can do any follow up if you need more bps. So, as we highlighted in our group NIM, we increased it by 15 bps and our retail bank NIM increased by 16 bps in Q1.

We expected to continue to see that NIM expansion based on the interest rate assumptions and market consensus as well.

Based on the rate sensitivities we've talked about a lot on the call. I guess all of that said, our mortgage application margins at 44 bps for the quarter are not where we want them to be and are below what we consider sustainable levels, despite the overall profitability improvements that you see in retail and the group.

So, I think you shouldn't expect to see our application margins remain at these low levels. We don't have a lot of appetite to write business at this level for sustained periods of time. The market conditions in Q1 were exceptional, with swaps increasing very steeply in the latter part of January and then through the rest of the quarter.

In response to that, we increased our mortgage pricing 12 times in the quarter, increasing customer rates by over 50 bps in Q1 and by over 100 bps since mid of Q4. However, that still was not enough to keep pace in terms of the movements we were seeing in the swap curve, so as I said, we don't see these levels as sustainable for long periods of time, and you should expect to see us continue to kind of price up. If I look at the Q2 application margins, I'm comfortable that they are going to continue to improve as we move forward and we stated viewing more holistically there are clearly large positives to the rate environment, which more than offset this pressure overall.

Not least in roll over the structural hedge, which we've talked about the benefits, the swap increases there. I know that puts pressure on the mortgage application, that combined with the base rate rises is something that's very positive for us, and the business overall earned a 23% RoE even on the basis of the uplifted capital. So, clearly very strong in there, but we would expect to continue to kind of price up to work to a more kind of normalised level, and I think, you know, we are kind of aiming for Q2 margins in the sixties for the group in terms of those applications so you should start to see them come through.

Martin Leitgeb Very clear. Thank you very much.

Katie Murray Thanks for the question, Martin.

Operator Thank you. Our next question comes from Robin Down of HSBC. Robin, could you please unmute and go ahead.

Katie Murray Hi Robin.

Operator Hi Robin, if you could please unmute and go ahead with your question.

Robin Down Good morning, I've got one question, one request. Maybe if I start with the request first, which is obviously with the cost-of-living crisis, I think one of the key elements is that it feels like it's the lower income households who could be most impacted.

And just a request that maybe in future you could give us a bit of a demographic breakdown, maybe of your mortgage book in terms of, income levels and any kind of FICO scores you've got for the credit card book, it might make it easier for us to see kind of where your customer base is positioned, you know, relative to those low-income households.

Come coming on to the question. Can I come back to the 40% deposit beta? I just wonder what the rationale was for raising rates? and I appreciate there'll be a number of factors that go into that but, is that to do with you seeing deposit flow slowing during the quarter? Or do you feel there's some kind of political pressure to kind of raise rates?

I'm just curious as to, what the fundamental drivers were to decide to raise rates because otherwise we haven't really seen that I think, elsewhere from your peers. Thanks.

Alison Rose

Thanks. Well, just on our customer base, one of the things I would say is we're a large lender, so, our demographics largely reflect the UK, but if you look at the diversification of risk on our book, it is well diversified and predominantly a secured book. We're relatively low in unsecured and where we're a prime book and you can see the shape of that.

And also, what we can see is it's been very, very resilient in terms of its performance. So, we're very comfortable with where we sit. We're also very active with our customer base in terms of helping them manage the challenges. But I would look at the diversification on your point around the deposits and passing on interest rates.

Actually, I would say we're not out of line with the market. You know, we've seen that being passed on as well across the market. But Katie do you want to pick that up?

Katie Murray

In terms of the deposit piece? Look, I think it's important. There's been 65 bps of hike here. You know, our deposit franchise is incredibly valuable to us and in reality, we've passed through 10 of that 65 bps of hike that's come through. We think it's the right thing to do.

It's an important franchise and if you look at our cost of funding overall, it's still incredibly low. So, I think there are probably no more comments than that on it.

Robin Down

Can I just come back on the mortgage point? I think, what the demographic data shows is that, the lower income households don't have a great deal of mortgage borrowing, but it would be nice to be able to see that, if you like, within your data disclosures. If we could see medium income levels, for instance, for your mortgage customer base, that would be helpful going forwards.

But maybe it's something we could take offline with the IR guys.

Katie Murray

I mean, look Robin, I'm very happy to have a chat with you on a one to one.

I mean, always happy to look at requests, I think we do, and you recognise this as being good disclosures of a lot of information, but I know you've been doing a lot of work on this, so very happy to have a conversation offline on it.

Robin Down Brilliant, thanks.

Katie Murray Thanks very much, Robin.

Operator Thank you very much and I would now like to hand back to Alison for any closing comments. Alison, over to you.

Alison Rose Great. Thank you. Thanks very much. Well, look you know just a few closing comments.

We're really pleased with a very strong performance in this quarter.

I think what you've seen is strong continuing delivery against our plans. We have growth in income. We're delivering on our cost reduction as planned. We have a strong capital base with a clear plan to distribute capital and a strong ROTE performance.

We are very comfortable with the risk diversification of our book. We're very mindful of the challenges that our customers are going through, but we are seeing no signs of default or distress in our book, and our book remains incredibly well diversified and well managed. We have strengthened our guidance on income a little bit, to give you a bit of comfort on the outlook.

But as Katie and I sit here, we see a strong set of results building on two years of progress, income and profits up, significantly on a year ago, costs down on strong capital, continued growth across a well-diversified loan book. In terms of the strategic capital restructurings that we've done, NatWest Markets, a strong performance in the quarter as the restructuring has completed at the end of the year.

And obviously we've announced continued momentum on our Irish business with now almost 90% of the assets allocated and agreed for sale. So, I think we're working hard with our customers to make sure that they have the right support through the economic uncertainty and challenges. But we believe as a bank we're well positioned to support them, to continue to deliver on our plans and very confident about the outlook.

Thank you very much, everyone for joining.