NatWest Group plc

Q1 2023 Results – Sell-Side Update

9th May 2023

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Alexander Holt
Head of IR

Good morning and thank you to all. Thanks to all of you for joining us today. For those of you in the room and also our colleagues joining us virtually. We have one hour for this session. So, we'll begin with a quick introduction from Katie and then we'll hand over to Q&A. Once the Q&A starts, we'll start off with a few questions in the room and then we will play tag with the virtual questions coming in as well.
So, with that, Katie, over to you.

Katie Murray
Group CFO

Good morning. Thank you very much for joining me. It's a pleasure to see so many of you in the room as well. But of course, welcome to those on the call. I think, you know everyone who's here with me, but just to remind you: Donal Quaid, our Treasurer, Peter Norton who is our Director of Finance, Matt Waymark, who is very well know to many of you and Stuart is on the line in Edinburgh. In what looks like a lovely room, but I've heard them all moaning before we started on how it's got no windows and it barely works. Thank you for suffering the indignity. So, before we open up for questions, I'm just going to make a few small points.

First of all, I do think we have very strong financial performance in Q1. ROTE of 19.8%, we built our All-weather balance sheet with a lot of focus. LDR of 83% and the LCR of 139% on a spot basis or 151% if I looked to the 12-month average, so I think spot is more relevant. CET 1 ratio of 14.4%. As we said on the 28th April, we continue to reaffirm our 2023 guidance. So continuing to expect income excluding notable items to be around 14.8. NIM of about 3.2%. And group operating costs excluding litigation and conduct to be around 7.6 billion. Delivering an improvement in the cost income ratio to below 52%.

We anticipate a loan repayment rate in the range of 20 to 30 basis points. So, we may get to it, but I would agree with many of your thoughts given where we are at seven basis points, there needs to be some acceleration to get into that, but we'll talk more about that number as we go through. And together this will lead to our return on equity at the upper end of a 14 to 16% guidance for the year.

That's really all I was going to say. Very happy to move into questions. Perfect.

Guy Stebbings
BNP Paribas Exane

Thanks. Just around mortgage spreads and completion spreads. You referenced during the call a slightly higher number than one of your close peers. I just want to check in terms of definition, that is new to bank and remortgage. And within that, are you seeing more remortgage activity than normal at the moment? And then sort of take a step back, we think about where completion spreads maybe settle over the next 6-12 months, etc., how much is mix having an impact right now in terms of lower LTV, maybe there's less buy-to-let demand out there and just in general less demand. And is the competition compressing that spread, or do you think really what we're seeing today is something that's probably going to stay there for quite a while yet? Thank you.

Katie

Yeah, sure. Thanks very much, Guy. So, what we what we talked about on the call was 80 basis points for the first quarter. So that's kind of average. What I'm trying to run the book as is kind of 80 basis points over time. That's going to move around a little bit. You know, it'll be around that number depending on what's happening at any one time.

So, you will see some movement on that, but I like to avoid getting into point. But we were happy with the 80 basis points. It does cover everything in terms of that piece. It's not a subset of any of the information. I will leave William to talk about how he calculates it, and I don't particularly views on that, but I'm conscious that he gave you some actual points and I gave you an average for the quarter. Which is probably a little bit of a difference in terms of that.

I think the question of where will it land over the next 12 months is a really hard one. If I answered that question at any point over the last two years is where they run through the next 12 months, then I would have been wrong on every single one of them. In terms of how much it went up, then it came down over the last two years, what's happened with swaps, I think has been really interesting for all of us.

I think we're not really into predicting what a 12 month number would be. The challenge is given to the retail businesses that we'd like you to run that book at around 80 basis points over time, accepting that sometimes you'll be lower and sometimes you'll be higher. I mean, Stuart, do you want to talk a little to the mix that we're actually seeing on the ground and how that's kind of impacting the number.

Stuart Nimmo
Finance Director
Retail Banking

Yeah, I don't see mix right now from an LTV perspective as being a major impact. You know, we've got operational limits around the LTV business that we write and we are sort of in line with those, which is where we typically are. So, I don't see any major impact from that. We did clearly have a higher proportion of tracker business over the past probably six months now, but that's normalised again.

So that tracker typically is a little bit lower margin, but again, that's normalised now. So, again, I don't see that being a big impact. On Buy-to-Let we have seen one peer in particular be very, very competitive in the way they manage affordability. And also their fees in the pricing structure which has seen our share dip a little bit. But again, we've responded to that.

So I don't see mix as being a major driver of our margin outlook from here on any of those dimensions. I mean, maybe just a little bit to elaborate on the difference between us and the key peer in Q1, as Katie said, I don't think we can do a very detailed, side-by-side, but one key difference I would call out is we clearly grew the book in Q1 by the best part of £4 billion. And that peer shrank. And I think they did say that switcher margins are quite substantially below front book completion margins. So, I think you can see our mix had a higher proportion of front book completion business within it, which would be part of the explanation as to why there was a differential there.

Katie To be fair, while we try to manage of that 80, there will be pressures at times that will be in there as well. We would certainly average 80 for the quarter.

Alastair Thank you. Been allowed in, so I'm going to cause trouble.

Katie We got the message this morning you were coming, so we were expecting nothing else. I'd be disappointed if you didn't.

Alastair So I'd like to ask about liquidity because you're awash with, you know, deposits. I mean, you couldn't have imagine this when you set out ten year, probably 15 years ago, but just with what's happened externally. So, it's kind of open season for regulator, academics, stability board people to talk about re-imagining these concepts and the way of tightening them.

Just you know, you're obviously at 139. It was supposed to be a hundred and you were allowed to use in that hundred, a lot of government bonds, right. You didn't have to be in cash at all. It could be other assets. So just want to get a sense from you whether you might imagine 139 would be a number that you could run a lot less than you sort of 12 or 18 months ago.

Have you changed that so that, you know, sort of cushion on a cushion on a cushion is now more embedded in your thinking.

Are you kind of more cash focused within that than other securities or other eligible securities just because of the sensitivity? And then finally, does that give regulators a leg to stand on in looking to reconsider these things? It feels like there's been an awful lot of cash trapped in the banks already beyond what you felt you needed to run the bank. So that, you know, talking about buffers on buffers? So starting from a very good place, but how have those things shifted as you're thinking.

Katie I'll start, I don't know if, Donal, you want to jump in afterwards.

Donal Quaid
Group Treasurer There was a lot of questions.

Katie So I think we have a lot more cash. I think we talked about being sort of 80 to 85% cash. One of the reasons for that is also the pressure on the leverage ratio in terms of holding all the government bonds and then it pushes our leverage ratio in a direction that - while there isn't a leverage ratio - we're not all held to a certain number. It does get a lot of focus. You know, we obviously have the regulatory levels that we run to and we are way above that. But we manage that by making sure that we don't have too many government bonds in there. You know what's interesting is if I look back through COVID times, not so much on liquidity, but on capital, the regulators were very public about the fact that people should use their buffers in terms of those piece when they were there to use that.

We're obviously some distance from there. But the hundred plus narrative that you hear just now and the reimagining doesn't suggest that they actually really want you to use the buffers of liquidity would be my interpretation. I've not had any of those conversations kind of with that. In terms of that piece, I think one of the things that anything they would change would have to go through Basel.

So that feels a long time coming in terms of any particular changes we would need to have. We've just, you know, that we do our internal ILAAP [Internal Liquidity Adequacy Assessment Process] documents. We're very comfortable with where we run. I think one of the other things that's probably changed a little bit when we don't talk about it publicly, so much, just because we're not asked about it a huge amount – I mean the information is there - is the running at different levels of the group. So obviously with ring fencing, we also run liquidity at the NatWest Holdings element as well and it requires a certain amount. So it's where most of the liquidity is and how we manage it within there. But I think that does put another layer. You need to make sure you've got the right number there and the right number elsewhere.

So we're very comfortable on the 139. I think we watch what all the academics are saying, internally, you could imagine I have a question from my board saying Katie, we want you to have an extra 30% or an extra 50% and we wouldn't do that tomorrow because I mean that would cause an absolute collapse of the system. We're very interested when we look at people's leverage, sorry, when we look at people's liquidity both pre and post TFSME as to what actually they will do with TFSME in terms of the repayment of that, because as you see the kind of structural reduction in liquidity in the system. We are, we're pretty low on TFSME, in terms that we only have 12 billion and it's a '25 and '27 kind of payback.

Others have far more, which is why we see this, you know, bigger push for deposits elsewhere. How are they going to deal with that, I think is going to be incredibly interesting. And Donal and I would probably privately say we expect them to make some changes to repayments kind of levels because it's something all out at once.

While the liquidity is also shrinking in the kind of systemic world which we saw again in the Bank of England data last week, they actually we know there's less liquidity. So we need to adjust to that as well, which isn't something that we've had to over the last number of times. But I would say we listen to the academics. We wait to see what you guys write about. I think we will see. It doesn't feel like change is coming quickly, but you could imagine if you've got ILAAP through our board the last couple of weeks we've got we talked about it more than we have the last few years as more people have kind of naturally focused on it with the events of the last number of months.

And those events continue. But we do know that we have a strong liquidity, we've got good customer interactions, but I think nobody can relax about it, you need to make sure that you're absolutely on it in terms of making sure that you're maintaining that kind of strong position. Donal, I'm sure you've got something to add.

Donal

I think you covered a lot of like. I don't think any banks would focus on trying to run towards 100% LCR because you'll have your internal risk appetite and that Pillar 2 to take account of it. So you will always have kind of a prudent element that you will you'll run well in excess of that.

I think in terms of change in regulation I think Katie's right. I think any change in regulation we've already heard some comments from folks on. Andrew Bailey and outflow assumptions etc., etc.. I think that has to be multiyear if there is any changes there, especially as we touched on, right, what we've seen some contraction and liquidity over the last couple of months. But also in terms of the TFSME repayments.

So the only way you can build those cash buffers up is obviously to gain market share in deposits or to issue more funding externally, right. So that takes a while. So, I do think it will be if there are any changes that it will be European wide. And I think the other thing I would say in terms of cash. The primary reason why we're sitting on so much cash in our liquidity portfolio is because we took a decision, probably two years ago to just the richness of gilts. We felt they needed to be significantly repriced, given QT.

So in effect, we sold out most of our gilts holdings into cash and we’re still sitting in a lot of cash and you know, for example, two year gilts…

Katie

But that didn't move us from like 30% to 80%. It moved to like 65 to 85.

Donal

Yeah, because we were always kind of prudent in terms of the amount of cash we hold. That's probably just been accelerated over the last two year. In that time we have seen a material repricing gilts. So, two year gilts were trading slightly at -130 probably, you know, nine months, 12 months ago. I think they're now about -30.

So, you know, I think as kind of Q2 unfolds, there's probably an opportunity where gilts become more attractive and you see some reinvestment of cash back into gilts. But I don't think you're ever going to see a flip where you're holding, you know, 80, 90% of the portfolio in securities and 10% cash, it will be quite balanced.

Alvaro Serrano
Morgan Stanley

There really two related questions in terms of obviously there will be long term reforms as you mentioned - multi year -but in terms of anything the supervisors can do short term. I'm thinking the LCR ratios in terms of the denominator. What do you think about what are operational deposits with certain haircuts, Is there a lot of leeway in terms of what's operational what's not operational, where a supervisor can tighten the screws and the different LCR ratios that feels more short term, if there is any leeway there, or if it's subject to interpretation. That's one question.

And second, if the picture is to build more liquidity for TFSME round the corner, you'll have to prefund, etc., etc.. How do I tie that up with the confidence all the banks try to give around the deposit mix is going to get a bit more incremental increases in term deposits and also the rate hikes, it's over. How can you give us in the context of what we're discussing, more reassurance around your confidence on deposit mix.

Katie Yeah. So, I'll do the first, then you can come back on the second. I'll do the second and you can do the first.

Donal I will do the first.

Katie So I guess I think one of the things that was important that we didn't say that after rate hikes, it was over. We do think as rates continue to go, you'll see that more pass-through happens. I think you'll also start to see that actually passthrough will happen independently of rate hikes.

And in some ways I think you're seeing that a little bit already. I f I pass through seven weeks after a rate hike is that because of the last rate hike or is that because of what I'm seeing in terms of the customer dynamics and what I’m seeing my competitors doing. And was that because of the rate hikes?

I think that it's already I think we're in the we're in the stage now that we're managing our book, looking at what deposits we want to keep, which deposits are economical for us to want. I think that's also important. I don't mind if my deposit number falls for the right reasons. I mind if it falls for the wrong reasons.

I think we've already seen a little bit of a bifurcation from rate rises. So rate rises definitely have an impact. If I look at what we see happening here and what we see happening with competitors, it's quite hard to say that's always because of the rate hike that happened six weeks ago now. Because if it really was that it would be faster. Particularly in some of those areas like commercial where you actually you can’t reprice really quickly in terms of that piece. So I think one of the things that we know is that when we look at our book, that we take action at the right price. We know that our customers response rates. We were very public that we didn't have a fixed term offering at the year end. That was frustrating. But what we know is that when it went in, we could see that our customers took it very quickly. We can also see that they transferred funds from other accounts that they had outside of our banks and put monies in. And you can also see how much they were taking from instant access and what they were taking from their current accounts.

So, if you've got the right products out, which I think we now have, you now have to make sure that you've got the right communications out with your customers. And then therefore, we kind of manage it a little bit better. I think one of the things that we don't really know, and we talked about our NIBBs and our IBBs being mainly around for 40% non-interest bearing.

So, it went to 41, it's gone to 39. We still kind of around that 40% in terms of what that looks like in a year or two years time. I guess I don't personally believe we're back to the pre-financial crisis when it was at 20%. I can't believe we're still at 40% though? I do think when we talk about our guidance, it is probably the one area that is the area of most uncertainty.

But I do know that I have the right products. I know I'm paying the right price. I know when I take the right actions, my depositors behave in the way I would expect them to. So, it's to make sure you really are managing it appropriately in that space. And what I also think is that if I go back to October or November, I think a couple of the smaller Challenger banks moved very quickly, very well and they got a little bit of kind of first mover advantage, which allowed them to amass deposits.

When you look at the most recent results from the banks, that first mover advantage, I think, is gone. But what you're seeing is the banks are managing their different pools as we go into that. Donal, do you want to talk about.

Donal

I think in terms of the supervisory rhetoric, I think there's always things they could do if they want to. They can do whatever they want, in fact. So, you know, in terms of Pillar 2 add-ons, in terms of looking at that, some of the as you touch on operational, non-operational, there is there is subjectivity around that.

We have very, very strict criteria that we go through the regulator with an ongoing basis as part of our ILAAP process. They've never had an issue with our approach to date. So that's not saying that they can, you know, they can probably change the rules and request a lot more liquidity. I think the issue you have is even if they want to implement it today, you're still faced with the same problem, that you’re asking banks to go and raise.

Either you accept that you're running to a lower LCR or you need to go and replenish the, you know, the extra HQLA [High Quality Liquid Assets] that you need through either again, raising deposits in a very, very competitive market or going to raise external, if you want secured, probably secured unsecured funding at a time when banks are, you know, actually looking at the refinancing of TFSME.

Now, again, as Katie said, not a huge issue for us because we only have 4 billion of TFSME maturing over the next two years, a further raise two years beyond that. So, you know, if I look at kind of historically, kind of going back three, four or five years ago, secured funding issuance from our ringfenced bank, NatWest Bank entity, would have been a much more kind of stable part of our funding base. We only currently have two covered bonds outstanding. A total of about 2 billion. So, plenty of capacity to replenish liquidity over time. But it does take time because you can't go and issue covered bonds over a huge amount of covered bonds over 3 to 6 month period at a time when every other UK bank is going to be doing the same.

Alvaro Presumably covered bonds will be the instrument for that

Donal Depending on where the funding gap is. But from a NatWest Bank perspective if you think where our core deposit base is, that would be the most attractive avenue. And I think the last covered bond we issued was 2019. So, it just hasn't been required. I would not be surprised to see a significant increase in covered bond or MBS issuance from UK ring fenced banks over the next 12-24 months.

Katie I think where we are going because we haven't had issues with those for quite some time, it gives you another lever to pull and that we've got good capacity for if we want to pull it.

That was very neat. We're just working very steadily down the right hand side there. Yeah, you're going to have to be waiting a very long time to get round to you.

Chris Cant Autonomous Just a quick follow up on that actually, in terms of covered bond funding, there hasn't been a lot of issuance. We think about that as a new funding source with banks. What sort of spread do you think you can realistically issue that at going forwards and I appreciate that is kind of guessing how much supply is going to come from others, but just in terms of thinking about how this might impact margins. Net interest income.

Honestly, I just don't really know what to look at the moment because they're just not that much of it around in terms of where issuance spreads would be.

And the other question I had was unrelated to that completely. Group Centre. I know this is kind of a boring modelling question, but you've now got a very negative NII number in the Group Centre and it seems to be persistent. You've got quite positive other income number increase and it seems to be consistent. In the past you've always sort of indicated, well, you know, it's going to be kind of edging towards zero.

Katie And you indicated that a lot, but I've never seen it myself. But yes.

Chris You know, that was always the indication you gave use from a modelling perspective, as in, don't assume that there's being puts and takes within the group setting consistently. How should we be thinking about this because I guess it's also quite important where we are in terms of 320 NIM guide. If the Group Centre is chugging away at the negative run rate it is now on NII, that matters in terms of what the 320, how do we interpret the 320. And are those revenue items demonstrating the same degree of persistence, should we think of it as netting off between those two lines or is the other income going to drop away and there's now suddenly a persistent negative NII Group Centre we need to start thinking about?

Katie I will start with that and you can keep thinking of your covered bonds. Okay, so when you look at the centre, just to remind you, there's three things in there at the moment, which is slightly different from previously. We've got Group Treasury function, we've got Group Services, and then we also have the Ulster piece. That will diminish relatively quickly, but it doesn't disappear probably completely until 25. There will be a little bit with there but most of the assets and the liabilities will be gone. So, your NII impact should be dealt with largely within that.

So, in Treasury, we kind of work to the principle that we allocate out as much as possible. So, we kind of agree that the funding historically we've kind of worked this idea that if with the number left over was always about 200 billion or less, we wouldn't mind leaving that at the end of the year, rather than calling Matt, Stuart up at the end of November when we're about to sling you a large number. And we kind of work round around that. It's not a hard and fast rule. We're trying to obviously do the funding dynamically so that you don't have bits left in that. But there are some lag effects which obviously do impact the balance of that.

So, within Treasury, we actively, we're managing liquidity and the currency balances through the central bank placements and also through our short dated FX transactions.

The FX transactions are not subject to hedge accounting. So, you do see some more volatility with the coming through from that and the Net Interest Income more than offsets through Non-Interest Income. So, I wouldn't worry to say that there is a drag within that space. You get a little bit of an accounting blind mismatch. So that accounts for the majority of the negative 80 million Net Interest Income in Q1 and it's been broadly similar in the last number of quarters.

So, because of the FX not being allowable for hedge accounting, what we see is that it causes more volatility through Net Interest Income and that's more than offset in the Non-Interest Income in terms of that piece. And that's the 80 million we talked about.

The FX management activity relates primarily to surplus US dollar funding proceeds that we then swap into other currencies. That shouldn't be surprise given the funding that we do. This reduces Net Interest Income with an offset from the FX swap that comes through Non-Interest Income. We don't budget any contribution for this activity into our 2023 income guidance of around 14.8 billion. However, it does tend to have a small positive impact in terms of its contribution. We have incorporated the expectation of the ongoing NII drag through 2023 into our NIM guidance of around 320 basis points.

Chris

So basically the NIM guide is assuming Group assistance, but from a modelling perspective, we shouldn't be assuming the other income is all one off. It's all a netting item and then when we think about this into '24, looking to that, presumably assuming those kind of netting items take them.

Katie

So Ulster were largely it's kind of a non-event. A distraction more than anything. In terms of the tapering, it's quite hard to say that emphatically because it also depends what issuance we're doing and how we're kind of then dealing with that in terms of kind of swapping that out into other currencies. So, I think it's one of those things it doesn't because of the lack of hedge accounting over time, it will kind of sort itself out.

I would be hesitant to say that it would taper entirely because I think different activities would push it in a different direction.

Donal I suppose, the compression of rates between Europe, UK and dollars could have an impact as well because if you think you're swapping dollar balances that were, you know, earning a higher return at custodian banks versus the offset through the FX line. So, depending on how kind of differential in rates that's going to have an impact on how it will move over time as well.

But as Katie said, the key element is, you know, it's income beneficial across the two lines. It's just it's volatility across different breakdown. In an ideal world we'd be able to find a hedge accounting solution for it, which would mean you wouldn't have that volatility.

Chris Okay. No, that's really helpful because I think the run rate in there versus say 2021 is worth about minus 8 bps on your NIM this year. So, it's quite material in terms of 320. And, I guess, I'm just saying for the sake of argument that's going to be the system. I guess is the best.

Katie I would be anxious about saying that it would disappear. It would move around a little but I think I think we come back to the conversation about persistency and rather it just tapering off. Corporate bonds?

Donal Yes, corporate bonds. So, I don't think there's any doubt of the supply that is going to increase. I suppose that's probably been untested because we haven't seen all UK banks actually have this core part of their stable funding base for a number of years. There's also a few different nuances that we need to consider. There's still a question mark around the eligibility of UK covered bonds from an LCR perspective in Europe and in a post-Brexit world. So, you know, that's one I think some investors will want clarity on and will probably look for clarity on as well. And then from a pricing perspective, you know, I think you know, cover bonds kind of 60 to 80 seems to be the range at present. So, you know, depending on the amount of supply we just have to see how that evolves.

Katie I'm going to go to Rohith and break the cycle of going down the line and then Mark. And I can come back to you afterwards.

Rohith Chandra-Rajan Bank of America Thanks very much, Katie. I had a couple on deposits, please. Sticking on the liabilities side of the balance sheet. I was just wondering whether, in terms of volumes, whether seeing what the other banks reported, and also the March system data, have changed your perspective at all in terms of understanding the scale of the outflows that we saw in Q1. And so that was the first question. And then the second, just in terms of rebuild, your plans to rebuild those deposits through the course of the year. Is that just natural flow or are you taking specific actions to target deposit rebuild? Thanks.

Katie

I think as we look at the data in terms of the outflows that we saw in Q1. For me clearly there were three things, and we did talk about them. One was the tax piece. It was important for us in terms of that outflow. And the reason it was important is when I look at the numbers that come out of the Revenue as to how much tax that they took, they I look at my market share of main current accounts then I look how much I know my customers paid - there was a piece of delta in that number that was about 2 billion more than we would have expected to pay. An interesting if I look at the private bank, they talk to me about they normally pay x percentage out of opening balances and tax at the beginning of the year and they paid x plus two or three this time. I'm not giving you 'x' because you'll all ask a question about it for the next number of years. So we're saying that that tax difference was about £2 billion more that went out than we expected.

And what really interested me is: I'm a good chartered accountant, so I pay my taxes round about the 27th of January every year. If you're if you're a wealthy customer of Coutts, you don't do that. So actually the amount of tax flow that happened during February and March was significant enough. So, when Alison spoke at the Morgan Stanley conference, she talked about deposits being down was interesting as we saw somewhat more kind of tax talk coming out of that. So, it was an important piece.

The other bit that was important as well was system liquidity. So, we did see it tightening. That was the same for us as it was for any of the other banks. And then also in terms of the competition piece, we had been very open about some of the accounts that we have or didn't have. What was nice is that when those accounts went live we saw a natural kind of stabilisation. I think in terms of how we go from here, Rohith. If I look at the different bits: Retail or Private, it always comes down in Q1. And if I ignore 2020 and 2021 or 2022 and go back into sort of '16, '17, '18, that's what we see happening.

This is this down and there's a natural kind of build up from there. I think what we're really interested in is how much of that natural build comes this year. You know, if I look at some of the credit card industry data, there's a suggestion that people are beginning to pay down their balances a little bit less. So, I think that where people are saving, I can see that that everyday household is saving a bit less and that they're using their savings to support their lifestyle.

So actually, of that build up, how much can we be naturally assured of this year? So therefore I do think it is about other actions that you need to take. You know, if I look at deposits over the last couple of years: went down in January, it came back up. You know, we collect deposits easily. That's why we're sitting looking at these huge liquidity pieces.

I think what you would see us doing now is much more actively pursuing different deposits, whether that's making sure our customers know that there's fixed term accounts available or that our commercial customers understand the notice accounts, we've done a few. We are doing more managed rates with the high-end commercial customers than we were historically. So that's very much around managing that.

It's not fundamental, but it does make a difference in terms of that piece. You know, we are very conscious of things like whether the ISA rollover is happening in the year to make sure that our customers know that actually we've got a very good ISA product and that they should be thinking of moving their back book. That these are all things that everybody else is doing.

Historically, we didn't have to do them because there wasn't that particular need. I do think in terms of the competition that we see and you all see the headlines when a particular rate goes out, some people will move quickly. In terms of that of that piece, we know that in last October, November, there was big moves out to Nationwide and Santander.

And actually it's like we need to be ready this October November when they when they roll that there are customers that they will back naturally to us rather than staying where they are elsewhere. So, I do think it is a muscle that we're managing the same way that we manage mortgages and that we manage other kind of lending to actually go what's the margin we want, who are the customers we want to keep, who are we very happy to lose?

Because actually paying up for this one that either cannibalises the book or actually they're not a commercial customers that I make enough money with across the piece. So actually, take your deposits is not a problem for me. So, things have definitely changed in that space. And I think that's what gives us confidence. And Rohith, I kind of go back to that comment earlier, I can see when I do the right interaction with customers, I get the right results.

So therefore, I know I'm paying the right amounts, you know, more or less. It's just to make sure that you're doing that at the right time and for the right customers. And that you're not kind of reacting because 'X' bank has done this. Their actions may have no impact on me, no matter what they do in terms of that piece. So, there is definitely much more activity than there has been historically.

Rohith

Thank you.

Martin Leitgeb
Goldman Sachs

Could I just follow up on corporate deposits. And I was just wondering if you could provide a bit of colour in terms of what you have seen in terms of deposit migration but in corporate deposits. So is this a similar experience to what you have seen on the retail side in terms of switching from non-interest bearing to savings or time deposits or if there's reason to believe that they could be a bit more sticky in terms of performance. So, so no matter how the go, the migration flows through it.

Katie

Sure. I mean, I love the way that Jane from Citi spoke about it. You need a root canal to get rid of some of these deposits out of my base. So, I think in terms those deposits, because they're so embedded in that. Matt, do you want to talk a little bit about what you're seeing on the on the ground in that space?

Matt Waymark
FD, C&I

We're seeing a little bit of migration, but not huge still just around 40%. A stable 40% is NIBBs. And we have seen a little bit of instant access to term/notice. Probably more people going to term than notice, so 90-day, four month, etc., etc., terms generally. So that's going from a very low level to say 3 to 5% of deposits.

Katie

It's important that the terms are much shorter than on the retail side, which you will be aware of.

Matt

And then on the notice period we got, 35 day and 95 day. I'd say that not a huge amount of migration into that. That's probably an area we're looking at. Do some targeted work in the coming weeks. So, there's not a huge amount of migration, probably not dissimilar to what we would have expected at the start of the year.

Martin	Fantastic. 20% you mentioned earlier, pre-GFC, is a common challenge for commercial to work for you.
Matt	Yeah, I think if you go right back to 2007, it probably would have been around 20%.
Katie	Yeah, but I mean, what's funny to me is that how slow, particularly at the bottom end, and the smaller to mid end. People are happy to put their money into term and notice accounts. And that, from a financial balance sheet means that they're behaving more rationally now. I mean, the fact that the operational hasn't really moved is important.
Matt	And it is in our operational accounts. And they also look at the wider cost of the overall accounts, the repayment costs, money, etc.. So, for them, the credit interest rate is part of the overall cost of the account that they look at. It's not the only thing. Thank you. Great.
Alexander	We're about to go to audio for Omar, please.
Operator	Omar if you'd like to unmute and go ahead, please. We'll see if we can get Omar on a little bit later for you.
Alexander	Any further questions from the room please?
Benjamin Toms RBC	I've read quite a lot recently in the press around the average duration of the first-time buyer mortgage increasing from 25 years to more like 30 years. I was just wondering, I haven't run the numbers yet. From a profitability perspective, I think about return on Risk Weighted Assets, I think you pay something like 50% more interest on a mortgage over time if you extend that duration. Is it much more lucrative? These products for first time buyers moving to 25 to 30 years because they can no longer afford the 25-year product.
Katie	So I'll let Stuart have a think about it and I'll answer just to start with. So, I think what's really important is when we look at any of our customers, is to think about their retention rate and you talk about, you know, that we have a kind of average retention rate of about 75 to 80%. What's really interesting is in that average, your first retention is lower, and then every time you get your second and your third, it becomes much more they just automatically renew. So, logically somebody is longer, you actually you get longer renewals the cost of renewal is clearly much, much lower in

terms of that piece. But I'm not sure it would be much more lucrative from a first time buyer for 25 to 30 years. By the time you get to the end of that you're at such a low LTV in terms of that. Stuart, how would you think of that.

Stuart

Your last comment, just given the way customers tend to switch post-deal, and we have to clearly account for the behavioural life of the customer? Not necessarily the full contractual life, even if it out to 30 years, whether it is 25 years or longer? I think the key the key thing, of course, is the affordability can improve for the customer and therefore within loan to income limits, etc., the customer can avail themselves of a slightly higher loan, than they would have otherwise being able to.

But I'd agree with Katie's point. It's not a major factor in the profitability of the transaction. And of course, you know, we did make a move to extend our max terms last year and as with any move into adjacent addressable market, it's literally a risk and reward trade-off for us to get the balance right.

Katie

Anything on the left hand side of the table. Thank you. I thought you wouldn't let me down of.

Ed Firth
KBW

Yeah, I suppose I'd like to ask, I suppose a slightly theoretical question, but I guess we're increasingly starting to think about interest rates falling. And I know that for a lot of the market outside our sector, they are all banking on that to save them. So, if we get into an interest rate falling environment, to what extent do you think your current margins defendable?

And I'm thinking particularly in terms of, obviously betas have been very low on the way up, does that cause you a problem if we start to see rates falling or do you think you can defend the margin? And I guess the other question is in terms of profitability, this 14 to 16%, if we do start to see that, if we just reverse the margin out back to what it was or half of it or whatever, then obviously that you're going to struggle a bit on profitability.

So where else on the P&L I mean, your costs, I think they're up 13% in Q1. I mean, can you reverse any of that or is that now sort of new embedded cost base that we're stuck with it. So, I guess that's the key question.

Katie

Yeah. So, if I look at our 14 16%, so before we said that number and many of you have asked me that question in reverse and said, Katie, when you talked about 14 to 16% rates at two and a half. So, while you know, not talking about 18 to 20% in terms of that piece, but I guess the thing is to think about what are the different things that are happening as to why we stuck it to 14-16% and how believable some of those would be.

So one of the things is we do think rates will fall, you know, whether they are this year. We know our current numbers are that they will start to fall into next year and whether that's a little bit later. But we do think and we've talked about that number 14-16 to be sustainable with rates kind of falling. We also think that with rates falling that you'll see inflation coming down so that we'll have some help on the cost base.

You know, we're talking about costs of risk. We always talk about through the cycle number of 20 to 30 basis points. Although we're guiding you to that for this year. That in a three year cycle basis would be relatively higher year charge, because normally if I go back, my numbers have been much closer to kind of 70 to 80, 90, and that also includes Ulster, which was a bit more expensive at times.

So, you would see at any one year, while you might go through the cycle year number of 20 to 30 that you that you could be slightly lower in that point. So, we see some benefit in that side. I think the other thing also is to think about what's happening to our denominator as we're continuing to do buybacks and things like that.

So, in terms of that ROTE calculation, what's happening within there. So, we are comfortable on the 14 to 16 in rates that are lower than this. I do think one of the debates that we have with the businesses a lot is around, ok we're putting rates up, you know how quickly can you pull them down on the way down would be one way to look at it.

I do think we think that they might be a bit stickier in the short term than they might otherwise be because of all the conversations we've had on deposits and actually do start to see more managing between the asset liability side, I think you're starting to see that a bit more now than we did, say six months ago.

I don't think people thought enough about actually how the two of them were interrelated. And it that's kind of developed. I mean, overall, we're comfortable with the 14 to 16 at a rate level that is lower than this because we also believe other economics will come through.

On the cost piece, [they're up 12.5%], we always know it's lumpy. It's going to be lumpy again next quarter. So next quarter is going to be another number. You're going to go how she ever going to hit 7.6 billion. I'm comfortable that I will. But I also know, of course, what costs landing in different quarters. So, on the lumpiness of Q1, we're one of things we paid our staff just shy of £60 million extra.

That's not baked into ongoing costs. That was a kind of cost of living kind of allowance. We also had Ulster costs coming through as well. And if I compare that to Q1 of the previous year, I think that's about £40 million higher. Again, that's not going to be in the base. So, I think those I get to a kind of a cost increase in the quarter of about 6%, so a little bit higher of the all-in 4.1% we talked about.

But not as concerning on that piece. But I do think the lumpiness is important, but at the same time, I'm comfortable. I mean, we had a session on Friday going through the costs of the 7.6 billion. And I mean, if you're off track, you're kind of held pretty hard to account at that point.

So again, I'm comfortable that there are things where I see areas of pressure. I can see benefits kind of dealing with them in other areas as well. So, we kind of get to get to that place. But I do think one of the things we're modelling is actually how quickly do what we pay out, how quickly does it come down compared to the rates as well.

But, you know, I don't want to speculate on that. But we in that 14-16 there's something we have we have thought about quite a lot.

Ed

But is there a sort of concern or danger? I mean, if interest rates could be cut by, say, 1%, you still got about a half, I guess, of your mortgage book to roll to new lower rates? That would be happening at the same time, as you were seeing, pressure on your deposits because obviously all your non-interest-bearing, your instant access, all of that would be… you couldn't reprice down by 1% because they're not even at 1%.

Katie

They're above 1% but yes. There's definitely going to be a timing piece, but what I would probably say the mortgage book doesn't roll quite as quickly as that even, it probably on our average life is if I look at mortgages just now, we're selling about 75% five year.

So actually, it's really extended quite a lot in terms of that piece. So actually, it is a bit more sticky. We do actually have a lot of deposits are paid much more than 1% in terms of that piece of there some manoeuvrability within that. But it's something that we will all have to manage our way through in terms of that piece.

And when we say it's the 14 to 16, we worked out, lots of different scenarios. One of the scenarios we did in our ILAAP this time around and we're getting to do more work is the speed of reduction of the interest rate and how quickly could we realistically take down what you're paying the depositors?

I do think there'll be a lot of competition for it. I mean, Peter, this is an area you and I talk about a lot, is there anything you would add?

Peter Norton
Director of Finance

Yeah, I just emphasize both sides of the balance sheet. I think we're moving from a period of kind of 12 years of near-zero rates, very little income on the deposit side, even with a kind of a percentage point off of base rates today, you still got a much more normalized base rate environment and both sides of the balance sheet in play.

I think we're also shifting to a space where you've got a different liquidity environment. So, I think the competition on the asset side will be very rational in the context of what's happening on the deposit side, which gives you comfort around the returns that you can generate across the piece.

John Cronin
Goodbody

Just in an interrelated context on that question as it is related to mortgage spreads evolution, again, I mean, you're talking about us looking at this through the mortgage growth, more integrated asset management, which obviously makes a lot of sense.

Similarly for your competitors, I suspect, like if you do that, this dynamic where deposit rates decline in the short term are a little bit sticky and that kind of the further out when and if rates start coming back in and also taking that together with the fact that you're rising by 75%, five year fixed. Now like in that kind of backdrop, given that that's where the market is obviously skewed much more heavily towards five-year-fixed from the perspective that as well.

Taking all of that together, it is harder to get the deposit costs down the short term if rates start dropping, like would you expect that to lead to a kind of a growth environment where we see a potentially significant increase in market spreads to compensate? And also, how do you think about the, you know, pressure you faced from piece as well as the FCA getting in on the act with its kind of impacting a consumer to see legislation in the context of your ability to really put deposit rates back down went full pass through clearly.

Katie So 35% of new is five years, 66% of the book is kind of five years. So, this kind of lots different numbers in play there. What we would expect to see is probably asset pricing going up in terms of that to try to compensate for the fact that your deposit pricing wasn't necessarily coming down. Because you manage both together in terms of that space.

If we get to that theoretical, and I think the difficulty is the speed at which you get to that theoretical as well and how long it kind of takes. But it is something we're definitely looking at.

In terms of the government pressure. So, certainly there is a little bit more than there was. I would probably say that I was surprised that there was so little to begin with. In terms of that piece, I don't think that we price necessarily in reaction to government pressure, per se I mean, it's not we don't worry about, well, what might happen. We have long conversations with the regulators. We're much more looking at what our customer behaviour is and what's happening there in terms of what's driving that piece.

I mean, obviously, we're not absent that. We don't see the regulator making moves that they're going to start to control pricing when we've seen them in the past do. If I look at what they did on overdrafts where they moved to sort said to percentage charge rather than going to fixed daily rate, you know that was something that took some time to kind of come through.

Customer duty I think is interesting. I think it's really important that our customers know what's available to them, but it can be perfectly logical that they pick lower returning instant access because they want access to their funds rather than higher return to get it lock up. We've got to make sure that customers kind of understand the options, but we shouldn't assume that we know what the right answer is for them as individuals in terms of that piece.

So, I think I think it's something we're just going to have to manage our way through. And we do think we've got levers that we can use to put on it. And I guess that's why for us we've resisted a lot of the pressure that we felt from many of you to go higher than 14 to 16%, because actually, as I look further forward, I want to be working to a number that I really do believe is sustainable.

And I think given the various macros we see as of today, the various scenarios now as we see those as of today that's why we're kind of quite firmly holding onto that 14 to 16 and not trying to go that year will be better and that year will be worse. I think that's a far more complicated message.

Chris

I will chuck in another one if no-one else wants to. So, on the £14.8bn, I'm just trying to think through the numbers and what you just said. I'm struggling to see how you get to that. If 320bps applies on the sort of type of interest earning asset number you're running with in the first quarter. And then on the other income side, the income that's coming through the centre doesn't kind of severely drop away after several quarters because that's a few hundred million swing.

So, is there something else you're expecting to drop away quite sharply within other income? Because I'm kind of struggling to see how I get back to the 14.8 if I'm assuming the assistance within the other income line.

Katie

So the thing is as I look at the other income lines, a couple things I think about is that Natwest Markets had a good first quarter. I expect them to have a good first quarter. Historically they haven't always had good first quarters. I wouldn't take their NatWest market somewhere and multiply it by four. In terms of that piece, I mean I think it's 259.
I've given you guidance of 800 - 1billion so you might go. Yeah, you said 1 billion. So, 259 times four is quite reasonable. But I think for me the billion is probably got bigger first quarter in it than we've had because we know that, that's way to do that. I'm really pleased with what we've done. I think the rates number, the 75 that they delivered. If we compare that to the 40 they did for all of last year, they've kind of the model that we've built up. They showed it's working. It's doing what it's meant to do. So, I'm happy about that. I probably see a little bit of a fall off in that that kind of space. In FX is pretty constant. Capital markets will depend a little bit on what's happening in capital markets and we know it's been a bit more open the last week. We know a couple of weeks ago it was quite closed. So that that obviously has impacts within there.
And then I just I think in terms of what's happening on customer activity, is interesting. We had a nice first quarter. It's often a bit quieter. I think as you see that kind of had that that kind of rolls, but I'm not sitting there going, well, there's that number there that I'm really worried by or I mean, I know I've got a big negative in there.

They'll be small things that move around it. If we decide to do an FX offer, that's something that costs us like 20 million. But I mean, they're not big numbers in terms of they're going to move the dial of the outcome in terms of that piece.

Chris And then on the RoTE discussion I understand what you're saying about expecting rates to come down. If rates didn't come down next year. They stay in full class. Would you expect to be above 14-16 range?

Katie Right. I think what we've always said is that I would like to think the 14 is a floor, but not that a 16 as a cap in terms of that piece. So, if we had rates that were higher, I suppose it's behaved in a way that was logical. So therefore they didn't go particularly low, or we weren't doing a particularly higher kind of pass through.

There are scenarios which you could see that you would be up that piece and we'd happily take them and kind of, you know, actively pursue them in terms of that piece. But I think what we're trying to give you in that 14-16 is a number that is sustainable over a number of years in terms of that piece. So there definitely are scenarios you would see us above the that number.

Chris Just in terms of reconciling that so the NIM guide this year and your comment around potentially expecting deposit pricing to be a bit stickier in a falling rate environment. If your base cases rate is 4, are you willing to take more deposit outflows short term in order to sustain lower pricing so you don't run into a problem with cutting pricing later on?

If you're expecting rates go up to four and a half, come down towards three, do you say, well, actually I'd rather see three quarters of modest deposit outflows this year than price up and get stuck there?

Katie I think it's really important there and I think we talked about this at the staff call that not all deposits are equal sort of thing. So, I think really what's really important for me is I'm happy to lose deposits if they're the right ones to lose.

But if they are deposits that I value deeply for liquidity value, you know, they are important to me on that basis, you know, I wouldn't want to lose them because the problem is to win them back will ultimately cost me more. So, I think holding on to what you've got is important. Not all costs and expense by trying to be very clear of if I lose them, the marginal income I'm getting on them is so small or even negative, I don't mind.

But these ones, I mean, marginal income might be smaller than I would like, but actually I value it deeply for my liquidity value. And so therefore I'll make sure I pay up a little bit on that. So, it's really it's a kind of a hard question, Say, what if when rates are falling by 100 million, that you don't know what's happening with deposit rates you might do to make sure you retain them? I probably get too many ifs in there to give you a really cogent answer.

Donal Probably add to that, Katie, we need to give consideration where we started the conversation around potential changes to regulation around your refinancing coming up as well, because that does come into your thinking. That's it. Okay. Thanks.

Katie Lovely. So as ever, thank you very much for your time and your support. Our team are always here, and I know I'm meeting many of your sales teams as well as is Alison over the next the next number of months also. And we will talk more formally again at the end of July, which thankfully doesn't come quite as quickly as the end of Q1 does. Thank you for your time this morning and thanks to those on the telephone.