NatWest Group plc
H1 2024 Results Call Transcript
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Management Presentation

Paul: Good morning and thank you for joining us today. I'll start with a business update. Katie will take you through the financial performance, and then we'll open it up for questions. You will have seen that it's been a busy first half. We announced our acquisition of a mortgage portfolio from Metro Bank today, our transaction with Sainsbury's last month and we've also grown our customer base organically by over 200,000.

We are closing our hub in Poland as we continue to simplify the business and our directed buy back in May further reduced the government shareholding, which has almost halved to less than 20%. These are good examples of our progress that I'll come back to later. At the same time, we have been working hard to support our customers and this activity underpins our strong financial performance.

So let me start with the headlines. We have had a strong first half with significant growth quarter on quarter. Income was £7 billion and costs were £4 billion, resulting in operating profit before tax of £3 billion with attributable profit of £2.1 billion. Our return on tangible equity was 16.4%. Given the strength of our performance, together with our updated economic forecast, we are upgrading our 2024 guidance, which Katie will talk about later.

Improving consumer and business confidence is reflected in good customer activity across both sides of the balance sheet. Customers are increasing their savings with deposit growth across our three businesses of more than £6 billion pounds. Whilst we attracted record inflows to ISA accounts, the overall mix of term deposits was stable. We've seen good activity in Commercial and Institutional banking where lending grew by £3 billion, excluding Government schemes.

We provided £16 billion of Climate and Sustainable Funding and Financing, bringing the total to £78 billion since July 2021. Our target is to reach £100 billion by the end of 2025.

Customers are also absorbing the impact of higher interest rates and arrears remain low. Our disciplined approach to lending is reflected in an impairment charge equivalent to three basis points of loans.

We remain focused on generating capital in order to reinvest in the business and make shareholder distributions. Our CET1 ratio is within our target range at 13.6%. And we increased capital through earnings as well as active management of risk weighted assets, which added 140 basis points during the first half. As a result, we're announcing an interim dividend of 6 pence today, up 9% on last year.

This is in addition to the £300 million on market buy back announced in February, which completed this week, and a directed buy back of £1.24 billion in May. I'd now like to outline our approach to creating long term shareholder value.

We serve 19 million customers, meeting a wide range of needs across our three businesses: Retail Banking, Private Banking, Commercial and Institutional. By putting customers at the heart of our business, we create value for all our stakeholders.

We are targeting disciplined growth by focusing on areas with attractive returns, and by striking a careful balance between volume and margin. This growth, together with managing costs and capital, allows us to invest in the business and make attractive distributions to shareholders. We announced £1.7 billion of distributions during the first half, and the lowest share count from buybacks has resulted in higher dividends per share.

You can see on the right how the dividend has grown, while the number of ordinary shares has reduced from 8.9 to 8.3 billion year on year. This has supported a 16% improvement in Tangible Net Asset Value per share to 304 pence, and we expect continued growth into 2025 and 2026.

Turning now to our three strategic priorities. disciplined growth, bank-wide simplification and active balance sheet and risk management. I'll talk about each one in turn. We have continued to build on our strong market positions through both organic and inorganic activity. The growth in new customers of over 200,000 has contributed to growth across the bank: Lending in Commercial Banking to mid-market customers grew by £1.8 billion; assets under management and administration are up 11% to over £45 billion, and our share in credit cards grew half a percentage point to 9% due to our investment in technology to make us more competitive on price comparison websites.

We are accelerating this organic growth by making acquisitions where we have opportunities to add scale in our target areas at attractive returns. We announced today that we are acquiring a £2.5 billion portfolio of prime UK residential mortgages from Metro Bank, and we expect the deal to close in the second half of this year.

Our Sainsbury's transaction is expected to complete in the first half next year, adding around a million new customer accounts with about £2.5 billion of unsecured loans and £2.6 billion of savings. On completion, this transaction should increase unsecured balances in Retail Banking by 17% and grow our credit card share from 9 to 10.6% on a proforma basis.

We continue to simplify the bank to increase efficiency and improve customer experience. For example, we have three strategic hubs in the UK, India and Poland, which we are reducing to two by closing our operations in Poland. And the number of telephony systems we use across the bank has come down from 20 to 5 since the year end. We are also accelerating our digital transformation. I'll share just a few examples from many across the bank.

We continue to digitise customer journeys to make it easier and simpler to interact with us. This year, we have transformed 11 customer journeys on our digital channel for Commercial customers, Bankline. This includes the management and tracking of international payments online, which should free up our colleagues from thousands of inbound calls each year. We have also reduced onboarding times for clients who want to carry out Foreign Exchange transactions from seven days to one. As a result, our Foreign Exchange business serves an additional 300 customers from our commercial mid-market segment.

To help both retail and business customers, we are enhancing our chatbot, Cora, which handles over 10 million customer interactions a year, by introducing generative AI.

Our third priority is to allocate capital dynamically and maintain strong risk management. We reduced our flow share in mortgages at the end of last year in a competitive market with considerable pricing pressure. But we deployed additional capital in Commercial and Institutional banking, where first half lending grew by £3 billion, excluding government schemes.

During the second quarter, we then increased the capital allocated to mortgages again following improved market conditions, reflected in a growing share of applications.

In addition to disciplined origination, we are actively managing our risk weighted assets and have delivered a £4.3 billion reduction in the first half, using a range of means, including Significant Risk Transfers and Credit Risk Insurance. By focusing on disciplined growth, improving efficiency and managing our capital dynamically, we are driving capital generation in order to optimise shareholder returns.

The positive momentum and progress made during the first half reflects the ambition across the bank to deliver its full potential, and we feel increasingly confident about the outlook. We continue to expect a Return on Tangible Equity greater than 13% in 2026, whilst operating within a CET1 ratio of 13-14%. And we are targeting a payout ratio of around 40%, in line with our commitment to return surplus capital to shareholders.

With that, I'll hand over to Katie to take you through our performance in the second quarter.

Katie: Thank you, Paul. All my comments use the first quarter as a comparator. Income, excluding all notable items, increased 5.2% to £3.6 billion pounds. Operating expenses were 2.3% lower at £2 billion pounds. We made an impairment release of £45 million or 5 basis points of loans, which included post-model adjustment releases of £117 million. Together, this delivered operating profit before tax of £1.7 billion.

Profit attributable to ordinary shareholders was £1.2 billion and return on tangible equity was 18.5%. I'd like to talk now about our updated assumptions. Overall, the UK economy has performed better than we expected at the start of the year, and we are pleased to see consumer and business confidence returning. This means the Bank of England has not yet started to reduce interest rates.

We initially assumed rates would start falling in May, reaching 4% by the end of the year and 3% by the end of 2025. We now assume rates will start to come down in the third quarter, reaching 4.75% by the end of the year, with a further five cuts in 2025 to 3.5%. Of course, the actual outcome may be different.

The headline rate of inflation is now 2% in line with the Bank of England's target, and we assume it will stay around this level. We continue to assume moderate real GDP growth and some increase in unemployment.

I'll turn now to talk about our income performance. Income, excluding notable items, of £3.6 billion pounds was up 5.2% on the first quarter with growth in both net interest income and non-interest income. Across the three businesses, income grew by £147 million, driven by higher deposit income and fees.

All three businesses delivered higher deposit income as the tailwind from the structural hedge more than offset deposit mix changes. In Retail Banking, the pace of reduction in mortgage income slowed as the book has now largely repriced. Commercial & Institutional generated higher lending and financing fees, as well as payment service fees, and Private Banking reported higher investment management fees following growth in assets under management of £2 billion, or 4.6%.

Group Net Interest Margin was 210 basis points, up five basis points from the first quarter. Given this positive performance and our updated economic assumptions, we are raising our guidance for 2024 total income, excluding notable items, to around £14 billion.

Moving now to lending. We continue to be disciplined in our approach and focus on deploying capital where returns are attractive.

We are pleased to see ongoing demand from our Commercial mid-market customers, together with an improvement in gross mortgage lending. Gross loans to customers across our businesses decreased by £1.9 billion to £358.6 billion. Taking Retail Banking together with Private Banking. Mortgage balances fell by £0.8 billion as customer redemptions more than offset new lending. The pace of reduction slowed in the second quarter, with gross new lending increasing over 20%, reflecting stronger market volumes and stable retention levels.

We expect the book to return to net growth in the third quarter, given both stronger market volumes and an increase in our share of new applications during the second quarter. We have also announced the acquisition of a £2.5 billion prime mortgage portfolio from Metro Bank, which we expect to close in the second half. We continue to be disciplined in our approach to the mortgage market as we manage the business for returns.

Unsecured balances increased by £0.3 billion to £16.1 billion, with growth in credit cards partially offset by lower personal lending. We continue to grow our share in unsecured lending, and the Sainsbury’s Bank transaction supports this. Within Commercial and Institutional lending to mid-market customers grew by £1 billion, driven by demand in social housing, asset financing and invoice financing. Balances in Corporate and Institutions decreased by £1.9 billion, partly due to customers taking advantage of stronger capital markets, which is reflected in the performance of NatWest Markets.

I'll now talk about deposits.

Across our three businesses, these were up £5.2 billion to £425 billion. Migration from non-interest-bearing to interest bearing deposits continued at a slow pace, as expected. Non-interest-bearing balances were 32% of the total, compared to 33% at the end of the first quarter, and term accounts remained around 17%. In Retail Banking, there was strong growth in savings, driven by record ISA inflows.

In Private Banking, there was good demand for instant access savings, including some short-term transitory inflows. In Commercial and Institutional, both non-interest-bearing balances and savings grew, driven by our Commercial mid-market customers. Turning now to see how this has translated into the cost of our deposits.

For the first time in two years, the average rate of interest we pay on our customer deposit funding has stabilised.

It remained at 2.1% in line with the first quarter. This stabilisation reflects modest changes in mix and limited adjustments to deposit product rates. As UK Base Rates come down, we expect to pass through reductions on our customer deposit rates, but clearly the quantum and timing of this is subject to competition as well as contractual terms and conditions. We have updated our illustrative interest rate sensitivity disclosure on the right of the slide.

The managed margin is the more relevant sensitivity for changes in the base rate and deposit pass through. Based on our first half balance sheet, a 25 basis point downward [parallel] shift in the yield curve would reduce annual income by £125 million pounds. This is mainly driven by our unhedged deposit balances and assumes a pass-through of around 60%. Turning now to the structural hedge.

Many of you are familiar with our structural hedge and our mechanistic approach to managing it. It is an important driver of income, so I will recap a few key points. £175 billion or 41% of our deposit base is part of the product structural hedge, where yields are depressed relative to current rates. The yield in the first half was 1.58%.

Our product structural hedge has an average duration of two and a half years, which means it takes a full five years to reprice. And we reinvest maturing balances at the prevailing 5-year swap rate. As we show in the chart, before further reinvestment is taking into account, more than 90% of income is already written for 2024, and product hedges already written will deliver income of 2.9 billion in both 2025 and 2026.

The actual income from the structural hedge in coming years will reflect any changes in notional balances, as well as differences between the redemption and the reinvestment yield. The product notional reduced by £10 billion during the first half, which reflects our 12 month look back at average eligible deposits. We continue to expect around £170 billion by the end of this year, based on a static balance sheet.

Overall, we expect the product structural hedge to deliver higher income in 2024 than 2023, and for this to deliver a more significant income benefit in 2025 and 2026.

Turning now to costs.

We remain on track for other operating expenses to be broadly stable compared to 2023, excluding the increase in bank levies of around £100 million and the costs associated with a potential Retail Share Offering of £24 million.

Other operating expenses of £1.9 billion for the second quarter were slightly lower than the first, as a result of the Bank of England Levy. Severance, branch and property exit costs increased in the first half as we accelerated our work on simplification. The second quarter includes costs relating to our announced exit from Poland. I'd like to remind you that our investment spend, and cost savings are not evenly spread across the year, and you should not make run rate assumptions based on a single quarter.

Turning now to impairments. Our diversified prime loan book continues to perform well. We are reporting a net impairment release of £45 million for the second quarter, taking the first half charge to £48 million, equivalent to three basis points of loans. In Retail Banking, a charge of 12 basis points reflects broadly stable stage 3 inflows, partially offset by a further Post Model Adjustment releases.

Commercial and Institutional reported a release of 28 basis points, driven by Post Model Adjustment releases, as well as a reduction in stage 3 impairments. Our balance sheet provision for Expected Credit Loss still includes £302 million of PMAs for economic uncertainty. We have also reviewed and updated our economic scenarios, which drove a £17 million release. We have included the economic forecasts and weightings in our Appendices.

Stage 3 charges have remained low in the first half, and as our economic scenarios are relatively stable with little sign of deterioration, we now expect a loan impairment rate below 15 basis points for the full year.

And turning now to capital. We ended the second quarter with a Common Equity Tier 1 ratio of 13.6%, up 10 basis points.

Capital generation was especially strong given our impairment release and active RWA management. We generated 63 basis points of capital from our earnings, and 41 basis points from lower RWAs. RWAs decreased by £5.5 billion to £180.8 billion. Active capital management accounted for £3.9 billion of this reduction. This activity is in line with plan and with a number of actions successfully completed in the second quarter. And while it is an important capital management tool, it should not be considered the run-rate.

We currently expect around £200 billion of RWAs by the end of 2025, but the journey will not be linear. You need to bear three things in mind. First, continued disciplined growth, including the Metro Bank and Sainsbury's Bank transactions. Secondly, further RWA management, and finally, ongoing regulatory headwinds.

We are awaiting the PRA publication of the Basel 3.1 rules. We are also liaising with the regulator on CRD 4 model changes, where we expect some further inflation in the second half and through 2025, though timing and quantum remains uncertain. Overall, we believe around £200 billion by the end of 2025 is an appropriate basis for planning. We will continue to operate with a CET1 ratio in the range of 13-14%.

And finally, turning to guidance. For the full year, we now expect income excluding notable items, to be around £14 billion. Other operating costs to be broadly stable with 2023, excluding additional bank levies of around £100 million, and the Retail Offer costs of 24 million. And our loan impairment rate to be below 15 basis points. Together, this delivers an expected Return on Tangible Equity of greater than 14%.

And with that, I'll hand back to the operator for questions.

Operator: Our first question comes from Raul Sinha, J.P. Morgan. Raul, please go ahead.

Paul: Hi, Raul.

Raul: Hi, good morning, Paul. Good morning, Katie. Can you hear me well?

Paul: Yes, we hear you well.

Raul: Thank you. Could I have two, please?

The first one just on the deposit margin, which is up very nicely, six basis points in the quarter. And I guess the overall deposit performance of the franchise. I was wondering if you could perhaps unpick that for us a little bit and talk about how much of that might be sustainable as we head into the second half where there might be a little bit more rate volatility.

That's the first one. The second one is on capital management, which I thought was a nice positive surprise today. £3.9 billion through RWA management. It’s a pretty good outcome again. And within that, I guess you have had some benefit from SRTs. Could you talk a little bit about how you manage that, how we should expect further scope for this going forward?

And I guess related to that, does that play, does that have any bearing on how the government might think about exiting their stake eventually as you do have a much bigger buyback authorisation for next year? Does that have any bearing in terms of how the government also faces its exits? Thank you.

Paul: Okay, thanks, Raul. There's a few in there. Katie, I'll start with the deposit piece, but maybe you can follow up on some of the margin specifics, and then make sense for you to talk about the RWAs and the SRTs.

So Raul, on deposits, as you say, it's a strong quarter and a strong half year. You'll probably recall I spoke last October around managing deposits for income and liquidity value. So it's pleasing this quarter to see the deposits up by just over £5 billion.

And when you dig down into the details, I'm sure you've done, you can see that we've got growth in all of our three customer businesses. So £1.5 billion in Retail, £2 billion in C&I and £1.7 billion in private. So good broad balanced growth from the three businesses.

The other part of your question really was around the outlook there. Obviously we don't give specific guidance on deposits, but pleased with the positive growth in half one and probably encourage you to think about it that we'd expect our deposit balances to trend pretty much in line with the sector. And you can also see that the term deposits have stabilized at 17%.

We indicated, we thought that would be the customer behaviour as we came through the half of this year, but quarter on quarter was stable at 17. So that's a nice mix effect, which has obviously supported the performance. And obviously we're working hard to retain those deposits, but in a way that manages the liquidity value and income.

So Katie, do you want to talk specifically about that?

Katie: I'll add a little bit on margins. So again, Raul, the way I would think about the deposit margin in H2 is clearly there's going to be an ongoing benefit from the hedge, which we expect to continue to offset deposit mix changes, which as Paul says are slowing. Then you need to consider the Base Rate cuts, one in Q3 and one in Q4, which will slow the pace of growth that we saw in Q2. But overall, I would say both of these things are factored into our full year 24 income guidance of around the £14 billion.

And then if I just go on to SRTs, it's something we've talked about over time and it's good to see them coming through. So £3.9 billion in the quarter, £4.3 billion in the half. There's probably three different things I would highlight there. I mean, Raul, you probably haven't got to page 11 of Pillar three yet this morning. If you have, I'd be terribly impressed.

But what you can see within there that when we look at that RWA management of that £4.3 billion, £1.2 billion of it is SRT transactions. We then have a portion, which is in relation to [Credit Risk Insurance]. And then we have probably more or less about half of the balance, which is actually RWA management actions.

Now there's a raft of different things. I'm not going to go into huge detail as to how they all might work, but we've done a little bit of debt sales. We do quite a lot of credit limit management and all of those things together for this half have brought us to £4.3. We did talk about it was an area we were particularly focusing on. So it's good to see them kind of coming on onto the ticket. I wouldn't take that £4.3 as a kind of half rate run rate. They'll continue to move as we do different transactions and different management actions.

But what it does do is, it supports our capital generation, particularly so in this quarter and obviously our distribution capacity over time. And I would say you asked about the Government. There's no direct link of that at all to the Government sell down.

This is really about managing the capital to make sure we're getting the best return for our shareholders.

Paul: Right, thanks Katie. Thanks Raul.

Raul: Thank you.

Operator: Our next question comes from Alvaro Serrano from Morgan Stanley. Alvaro, please go ahead.

Paul: Hi Alvaro.

Alvaro: Hello, hopefully I've unmuted correctly and you can hear me.

Paul: We can, we can hear you.

Alvaro: Thank you. Just on the hedge, I had a quick question. Hello, both of you. A quick question on the hedge and then on the guidance.

On the hedge, the redemption yield, I think it's lower than Katie flagged in previous results. So I just want to understand what's driving that and if we could see any changes going forward, what should we look out for?

And then on the guidance, I think I've understood Katie on your comments just now to Raul's question, that NII should be growing in Q3, Q4, albeit that the cuts will mitigate that growth.

But if we do think about that growth, the £14 billion does look reasonably conservative after a pretty strong beat. So I wonder if I'm missing something on your comment, misunderstood on non-interest income or there's anything else to bear in mind.

And related to this, is the 2016 sort of guidance, is it not the time to update that, or you still think it's current? Thank you.

Paul: Thanks Alvaro. I'll deal with the 2026 guidance and targets and then Katie you can dive into the detail on the hedge.

On 2026, pretty simple Alvaro, we only shared those targets in February, still a fairly long way off.

What I would say is, I and we are increasingly confident about the outlook for ‘26. So it's a very conscious reaffirming of our return target for ‘26 today. And I would remind you that it's always been and continues to be greater than 13%, but it feels very early to be changing that.

So that's where we are on ‘26. Katie on the hedge.

Katie: So if I take the hedge first in terms of the specific point on the redemption yield. So you know, Alvaro, we operate a very mechanistic approach and we take to the managing of that product hedge.

And what that does is, it results in the execution of pay fixed swaps, which reduces the nominal of the hedge while maintaining the average duration of two and a half years. So that has the impact of reducing the net income in the applicable redemption periods. And hence the respective yield when expressed as a percentage of the nominal hedge goes outstanding.

So we'd always talked about 80 basis points previously. What we've seen is we've been reducing that hedge down to the 175 at the end. At the moment that that takes you to 40, the impact of it into 2025, it takes the 50 we historically talked about down to zero and then in 2026, which clearly there's been a lot less feathering happening at this stage in 2026 – it’s much further out. You know, at the moment that's still sitting up at 40.

So hopefully that helps, but I think these are good redemption yields for you to use for your modelling at this stage.

If I then look at the £14 billion of income, so H1, £7 billion strong start, really supported by customer activity on both sides of the balance sheet. And obviously the absence of rate cuts as well. We were pleased to see the margin expansion across the three businesses. When I think about the income outlook into H2, it does imply a broadly stable versus H1.

And there's four things that are probably in my mind as I look at it. The first one, base rate cuts. We've got two base rate cuts of 25 basis points, one in Q3 and one in Q4.

So you know that that will bring some pressure in those quarters, particularly in the period as we're waiting to kind of pass that cut through. I think the second thing is customer behaviour. You know, volumes have been positive in H1, but I think we still don't quite know how customers might react as you see those rates fall and importantly, how the market might react. So that's something to think about into the second quarter. You know, there's always some seasonality in C&I. I think we've been very pleased with the performance of our Markets business in this first half, but we do expect some seasonality there.

And I guess the last thing to end on a bit of a positive is that we have seen the mortgage book margin stabilisation. You know, the book's now around 70 basis points. We're writing at around 70 basis points, so that drag has kind of gone.

But overall, I think, you know, strong guidance as we go into the second half, really reflecting the strong activity of our customers. Thanks.

Alvaro: Very clear, thank you very much.

Katie: Thanks, Alvaro.

Operator: Our next question comes from Andrew Coombs of Citi. Andrew, please go ahead and unmute.

Andrew: Good morning. I guess a couple of questions. Just firstly, if you could discuss standard variable rate mortgages, what you're seeing there in terms of repayment trends and how you expect that to develop going forward as we've seen a stabilisation potentially decline in base rate cuts, or base rates.

And then secondly, just coming back to capital management, I mean, I know you said not to necessarily extrapolate the capital management that's been done on the RWAs this quarter, but you are still reiterating the RWA guidance for end ‘25. And that's even with the Metro Bank and Sainsbury's Bank portfolio acquisitions. So I guess my question would be, when you're thinking about capital return or capital usage going forward, you haven't announced another ordinary buyback today, despite the stronger quarter one ratio, but you have got these two portfolio acquisitions.

So how are you thinking about the inorganic growth potential versus the ordinary buyback and directed buyback potential?

Paul: Great, thanks, Andrew. I'll take the capital one, Katie, maybe you follow up on the SVR mortgage piece if that works for you. So you're right, Andrew, whilst we're very pleased with the kind of active capital management activity and the benefits that we're seeing from that in the half year, but particularly the second quarter, we're continuing to guide around £200 billion by the end of 2025.

As you alluded to, we've announced the two inorganic transactions, which we expect to add around £3 billion of RWAs. So we remain comfortable with that existing guidance, so unchanged from that perspective. There's a number of things that we're weighing up.

Obviously we await the final PRA publication of the Basel 3.1 rules and also the clarity around the implementation. And on CRD4, we've still got some model changes to come through, and that would give us some inflation in half two. The timing of that, the quantum of that, we're still uncertain.

On the broader question linked to that, which I think is around how are we thinking about distributions? No change in our approach, I would say, Andrew. We prioritise the ordinary dividend. We want to pay out around 40% of profits. We're very pleased to announce the 6p interim dividend today up 9% on prior year. Then we'll prioritise the directed buyback we executed obviously this year in May. We've just completed literally this week the existing 300 million on market buyback. And we'll take a look at the end of the year in conjunction with the board in terms of future distributions. Katie, SVR?

Katie: Yes, sure, absolutely SVR. So I mean, Andrew, SVR is not a significant part of our book. It's around 3% and it stayed at around that 3%.

And you can see a little bit more detail on slide 33 in some of the Appendix slides, which gives you a bit more of a story there. But we typically don't have long-term SVR customers. It's something we've worked really hard on over a number of years.

So it's really not an issue for us as we move forward from here. And there's nothing particularly to mention on SVR per se. Thanks, Andrew.

Paul: Thanks, Katie. Thanks, Andrew.

Operator: Our next question comes from Jason Napier of UBS. Jason, please unmute and go ahead.

Jason: Thank you for taking my questions. I guess a really simple one on the hedge and then, Paul, perhaps a question around strategy. Just, Katie, the decline in redemption yield on the hedges is obviously welcome and it suggests really good tailwind into next year. Some of that will probably be offset by the five rate cuts, the accumulated consequence of that.

But I wonder whether you could just talk in general terms about the size of the tailwind, sort of this year, next year, and the year after, to give a sense as to how that accumulates or doesn't.

And then, Paul, I think the capital beat today has gone down really well in the market and sort of acquired growth through Metro and perhaps to a lesser extent Sainsbury's. It's also expected to be good for EPS and RoTE. It doesn't change, however, the mix of revenues between NII and non. NII is going great at the moment, but I wonder whether you'd talk a little bit about whether the mix is where you'd like it to be and if it isn't, what it is that the bank needs to do to get it to where you'd like it, to be honest, through the cycle basis.

Because clearly buying loan books is very accretive, but it doesn't actually change the mix of profits for the firm. And some of those assets are probably in runoff anyway. So if you could just talk strategically about the kind of revenue mix that you think is ideal for a bank like NatWest, that would be helpful. Thank you.

Paul: Thanks, Jason. Katie, do you want to go with the hedge?

Katie: Yes, sure, I'll go with the hedge first of all. So I mean, slide 14, what we've tried to do here is to set out for you is how much of the hedge is already locked in. And you can see obviously ‘24, 90%, 70%, and then 50% in 2026.

I've talked previously already on the call about what happens with that redemption yield and why it's moving. And you would expect as we manage the size of it. So we're expecting the hedge today is 175.

We're expecting it to get to 170. We have talked about the deposit level is stabilizing. So that could make you say, well, actually it's relatively stable as we go forward.

You know, it's a five year hedge. So a fifth of it matures kind of every year as we move forward from here. So I think the way that I think about it as you model it, if you're looking into ‘25 and ‘26, obviously you get full year benefits of the previous year, and then the averaging effect.

But when I look at ‘24 into ‘25, I would think that it will enhance my income over where we end the end of this year by about £800 million. And then it will continue to grow from there into 2026. So clearly a strong growth coming through from the hedge. And we're very comfortable with the levels that we've got locked in into that as well. Thanks, Jason. Hopefully that answers your question.

I'll hand back to Paul.

Paul: That's great. Thanks, Katie. It's a broad question, Jason, on the strategy piece, but let me take you through, some of how I think about it.

So picking up on on the order of the points you raised. So yes, we're pleased with the two acquisitions. As you say, they're both EPS and RoTE accretive in year one.

So they feel like attractive things to do, both to build scale, but returns immediately for shareholders. In terms of the kind of financial North Star, I'm very much managing the business and running the business for RoTE, as I hope you would expect. And then once you get beyond that, obviously we do think about NII and non-NII.

It's probably worth remembering that given the size and position of our commercial bank and the deposit base there, that's very helpful for income and returns, but does inherently mean we're more weighted to net interest income than maybe some of our comparators. However, notwithstanding that, you can see that we have grown our non-NII in the quarter. It's up, you'll see a number as 9%, but the underlying is closer to 4.5% [across the three businesses].

We're pleased with that. You can see growth in payments, in our lending fees, in our FX and our assets under management. So strategically, I definitely want to continue to grow our fee income. That's an important area of focus for us. The areas I touched on that are growing this year are the areas where we see strategic opportunity.

What I am also very clear on is that if we're to grow in that area, I think we have to do it organically, which we're doing. But if we're to look at inorganic opportunities in that area, I've said it before, they're relatively expensive. So from a shareholder value perspective, I'm very clear-eyed. If we're going to do something around fee income, it needs to work strategically, but also from a shareholder perspective.

So as it stands at the moment and the relative valuations, we're very focused on growing that line through organic activity. And I'm pleased with the momentum we've got quarter on quarter. So if you take a big step back, if we're doing acquisitions, they need to be obviously EPS and RoTE accretive.

RoTE is the North Star. We're focused on NII, but not at the expense of value. Thanks Jason.

Jason: Very clear, thank you.

Operator: Our next question comes from Aman Rakkar of Barclays. Aman, please unmute and go ahead.

Katie: Morning Aman.

Aman: Good morning. Good morning, Paul. Good morning, Katie. I've got two questions. Please.

I think one thing that's missing from a lot of your forward-looking guidance and statements to the market is any real view on the kind of organic growth that we can expect in your business. And I am a little bit frustrated because it isn't actually embedded in your £200 billion RWA guidance that you've given us for a while now, but it's difficult for us to kind of unpick what's regulation, I guess we can work out the kind of inorganic that you've already signalled.

But you clearly do have a medium-term view of the kind of underlying organic growth, be it loan growth, be it deposit growth in your business. So can you tell us perhaps what you think we might expect, you know, low single digit growth in average interest earning assets over the coming years and where that might be coming from? Because I think it's an important point.

The market will want to kind of, take NatWest beyond simply just the sugar rush rate hike. So anything you can kind of give us around what volume growth to expect and what you're assuming out to 2025, it'd be really, really helpful.

And then I've got a second question on the structural hedge. So I think your updated disclosure is excellent. Thank you so much for that. And clearly the reinvestment pickup on that is amazing.

There's just one thing I didn't quite get on slide 14 then. So in terms of the hedges that are already written, you've locked in £2.9 billion of income from the structural hedge across the three year period, which is surprising to me, given I would have thought that that would be falling, you know by virtue of this being an amortizing structural hedge.

So I wonder if it's because of the offsetting swaps that you put in place, but could you help us just understand the support to the structural hedge income that's coming from hedges already written, which the reason I'm asking is presumably we're adding quite meaningfully on top of that, right? By virtue of these hedges that are maturing from here. So kind of anything you can help round out that picture on the hedge would be really helpful.

Thank you very much.

Katie: Shall I start with the hedge?

Paul: Go for the hedge.

Katie: Perfect, great. Thanks very much.

So if we look at it, £2.9 billion in each year, I would say don't be distracted by the fact it's all rounding to the same number. If I looked at it on decimal places, you'd see that it was kind of rounding.

What you've got happening is although that the hedge itself has shrunk in size, the differential in yield where we've put the rates on, is basically making up for that. So what you see coming through is, as we talk about a fifth of it maturing every year, obviously we've shrunk it a little bit in the last couple of years, we think it's stabilising. So what we've done in the last couple of years is basically put those numbers back on at the prevailing five-year rate at that time.

You know, when we spoke in February, Aman, I talked about expecting the average to be 3.1 in terms of where we put that rate on. Today, I'm giving you, they're expecting probably 3.7 for the year, but if I was putting on today, which some of the team will be doing, it will be ~3.9. So you've had this huge kind of pickup where actually the roll-off yield is so small that although the absolute size of the hedge has shrunk, the differential in yield more than makes up for that.

And that really is what's happening. It's not, I mean, the feathering makes a bit of a difference in the year, but that's not what's impacting the £2.9 billion out in 2026. That's two years away, you know, where it's just the flow through of the hedge kind of coming through and the strength of the mechanistic approach that we have coming through on that.

So, you know, we've got locked in already £2.9 billion for this year. Clearly, we'll add a little bit more as we go through the rest of the year, we're only halfway through onto that number. And then I said earlier, you know, you'd expect our year-end result this year to be growing year on year by about £800m and then growing further year on year as we go into 2026.

So it really does benefit from the very mechanistic approach we've taken on it over a number of years now.

Paul: That's great. Thanks, Katie. And then Aman, to come back to your first question on organic growth. I don't want you to be frustrated, so I'll try and answer for that. I think, first of all, we don't guide on the individual lines, you know, that obviously, but what I would say is I've been very clear since February, we set out three priorities. The first priority was growth, but disciplined growth.

You can see in the results for the half year where that growth is coming from - it's broad based on the deposit side. You know, market shares are relatively stable to up, across the three businesses, so you can see where it's coming from. On the lending side, again, I said we'll be disciplined and manage for returns. You can see the growth of £1.8 billion in our Commercial mid-market business. We're very pleased with that. You can see the growth in our unsecured, especially our cards business. We moved whole of market to the latter part of last year. We're very happy with the kind of risk reward terms and the credit quality there.

Obviously, growth will also come from the acquisitions, you touched on that and the addition of the Metro mortgage portfolio. We will increase our unsecured borrowing on the back of the Sainsbury's acquisition by around [16]% and about over [1.6] percent on a pro forma market share basis. So that's where it's going to come from. What I would say is, when you think about the bank we are and the business mix that we are, on the deposit side, I think it's reasonable to expect us to grow in line with market.

But we are a bank on the lending side that's proven that we can grow ahead of market. So that's probably a good way for you to think about how we think about growth, but it will be in a disciplined way and we'll be allocating capital dynamically to different products and different asset classes to make sure we get the returns that we're comfortable for. so that we can deliver the RoTE and the capital generation for everybody. Thanks Aman.

Aman: Thank you so much. Appreciate it.

Operator: Our next question comes from Benjamin Toms of RBC. Benjamin, please unmute and go ahead.

Ben: Morning both. Thanks for taking my question.

One of your peers spoke yesterday about some mortgage spread compression for the rest of this year. It doesn't sound like you're expecting to see the same dynamic. Is that a correct way to think about the half two?

And then secondly, we saw some news yesterday around that the Government's now looking at institutional sale of shares rather than retail sale. Just from your perspective, are you relatively agnostic to those two different approaches? Presumably the only difference is you don't incur costs in relation to an institutional sale.

Thank you.

Paul: Thanks Ben. I think we can knock them both off pretty quickly. On the mortgage one, it's very simple.

You know, the book margin, we hit around the inflection point. The book margin is 70 basis points; on new business flow it's around 70 basis points. So we feel very good about that.

And obviously it's something that we trailed last quarter. On the Government shareholding, we're very pleased with the momentum so far in ‘24. You know, it's come down from 38% to just above 19%.

So we're pleased with the momentum. Ultimately any further sales or decisions for the government, as you say, we're relatively agnostic. What I'm clear about is returning the bank to private ownership is in the interest of all stakeholders. So we're very focused on that. But ultimately it's a decision for them, the timing of that, the mechanics of it and the structure. Cheers Ben.

Ben: Thank you.

Operator: Our next question comes from Chris Cant of Autonomous. Chris, please unmute and go ahead.

Chris: Hello, can you hear me? Sorry, the unmute option seemed to lag in the Zoom app. Could I come back please on the £14 billion? And then I also have a question on your hedge slide.

So the £14 billion implies sort of a levelling off of total income into the second half. And I guess if I think about what you're telling us on NII dynamics, particularly your last comment about the mortgage book reaching an inflection point in terms of that source of asset spread pressure and the fact that you're expecting to roll, I guess, a bit more of your structural hedge implicitly in the second half, given £170 billion sort of year end expectation.

What else is going on within the revenue dynamic to sort of offset the upwards trend that you're otherwise seeing? Is it literally just the rate cuts and you're expecting big negative pricing lags around the impact of those in terms of that £14 billion?

I mean, I have had one investor comment this morning that your guidance looks stale even though you've already given it. So just to give you some context on how people are thinking about that. That would be the first question, please.

The second one is on that hedge slide. Am I interpreting it correctly that when you say £2.9 billion in full year ‘26 is 50% of income, does that mean we just double 2.9 to get to the correct answer for the hedge income? Are you expecting £5.8 billion of gross hedge income in 2026 up from something like £3 billion in 2024? And so it's about £2.8 billion headwind.

Is that the right way to interpret what you're presenting to us there? I mean, I know that your reinvestment yields for ‘25 and ‘26 still look quite low relative to forward swaps, but in terms of your assumptions is that what you're trying to tell us?

Thank you.

Paul: Katie, do you want to take it?

Katie: Yes, absolutely. Thanks, Paul. So I'll go with the hedge first of all.

I think it's a little bit simplistic just to double it. When we've talked about the 50%, if you think of our hedge, it's got a five-year life. We try to have it average as a two and a half year rollover.

So 2026 is about two and a half years away in terms of that. So about 50% of it is written at the moment. So obviously we'll have the maturities this year, next year and into 2026 we'll be there.

So I wouldn't just simply double it. You've got to think of those maturities and the timing of the reinvestment and averaging in the ‘26 is important because people often forget to do that when they do that maths. What I did say in terms of trying to help out a little bit on the guidance was to say, we've got a little bit more to come in this year. Obviously it's a little bit higher than the 2.9. We'll be about £800 million higher next year and then it'll be stronger again into 2026. But I think if you doubled it, you'd be a little bit disappointed by the time we came out at the other end. So I wouldn't go quite as far as that, but still, it's a very strong force coming through.

Chris: So when you say percentage of income already written, should we interpret that more as the percentage of the total portfolio of swaps, which is written today and will have to churn by then? Is that the better way? Because it's just the fact that you said percentage of income, which...

Paul: That's the best way to think about it, Chris.

Katie: Yeah, I think that could be a good end on our slide, Chris. Thank you for the build on that real-time. So very, very happy on that piece thank you.

So then if I go back to income, we're talking about income of around £14 billion. We're comfortable with that number. We build off a strong start. I guess it really is a story of, we've got two base rates coming. We know that will bring a little bit of pressure into it.

We do have a lag effect as we price those base rates through. It's a bit shorter in Retail, but in some of them we have, in Commercial, we have a 60-day contractual notice period for most of our Commercial savings accounts. So that does have an impact as the rate comes through. So that's what we're considering within there.

And then obviously I talked about customer behaviour already and seasonality and C&I mortgage book. I think we've spoken about a lot on the call already, but overall that around 14, I would say it's a really good guidance to use from here. And we're very comfortable and confident around that number. Thanks, Chris.

Paul: Thanks Chris.

Chris: Thank you.

Katie: Thanks for the edits as well.

Operator: Our next question comes from Guy Stebbings from BNP Paribas Exane. Guy, please unmute and go ahead.

Paul: Hi, Guy.

Guy: Hi, morning. Thanks for taking the questions. I had one on the hedge again and then one on costs.

So on the hedge, thanks again, actually, for the disclosure. It is incredibly useful and there's a lot of detail there. I guess a lot of that detail is specific to the product hedge, which makes sense, given it's the lion's share of it.

But I just want to check, when we think about the equity hedge component, sort of maturing rates there and reinvestment rates, could that move the needle much or should we really just focus on the product hedge? Just any kind of really on the equity hedge would be very helpful too. And then on costs, really just in the context of a revenue trajectory, which is incredibly encouraging.

I mean, £14 billion this year is clearly a lot stronger than you were originally anticipating. You'll understand we're not revising medium-term targets just yet, but the base is strong. You're talking to some very supportive facts as we look forward.

I just wonder, does that change at all how you think about investment, capacity to invest in the business, perhaps more than you previously envisaged? I guess I'm really just trying to work through whether the better top line flows down the P&L or if it provides you additional capacity to invest beyond the inorganic actions you've already talked to. Thank you.

Paul: Thanks, Guy. Do you want to take the equity hedge, yeah?

Katie: Yeah, sure, absolutely.

So I think, Guy, probably the best place to look is we've given you our sensitivity on page 28 in the pack. So it is important, it's now increasing in yield. It's at 195 in H1 versus 187 for the full year 2023. The size is not as large, obviously, but it's definitely a contributor to that income tailwind. And I guess we talk more of the product hedge because that is the one that is more impactful as we go through from here.

But it's definitely one that you shouldn't ignore as part of the income tailwind. Thanks.

Paul: And then on the cost piece, Guy, so the guidance for ‘24 is unchanged on cost, broadly stable, excluding the one-offs. You'll probably remember I spoke in, I think in March at the quarter one about, we front-loaded some of the property costs, branch closures, severance, et cetera, into half one. And the philosophy is I like to form that restructuring from the core cost base.

So that's how we're thinking about it. I'm very keen to create capacity for investment, but to do that from the existing cost base. So that's the philosophy that we're working to. Thanks, Guy.

Guy: Okay, thank you.

Operator: Our next question comes from Edward Firth of KBW. Edward, please unmute and go ahead.

Katie: Morning, Ed.

Ed: Yeah, morning, everybody. Thanks very much. I think most of my questions have been answered actually, but can I just check some of the maths?

And I'm sorry to go on about the hedge, but I guess your disclosure is quite interesting. You mentioned £800 million a year of tailwind from the hedge, I think. But if I look at your chart on slide 14, unless I'm misunderstanding something, the maths is quite simple, isn't it?

I mean, you've got about a fifth of the hedge rolling off, which is £35 billion. Then you're rolling off at zero and putting on at 3.1, which is like £1.1 billion of tailwind. So am I missing something in that?

Or is that oversimplifying? I guess that's the first question.

And then the second question is, is it possible, I don't know whether it is, but is it possible in some way to quantify the sort of short-term impact of a rate cut?

Because I remember when rates went up, we had this sort of boost to margin, and then it tailed off as a sort of deposit pricing catch that caught up. And I guess you'll have the same on the way down. So in that sort of £125 million of year one impact, in the first two months, is there a sense as to how much of that will be sort of front-loaded before you can reprice the deposits?

Any sort of sense of the sort of volatility, I guess, that we might get in a Q3 or a Q4? Thanks very much.

Paul: I think we can – Katie, go for it.

Katie: We can indeed. So just on the hedge, so it's a little bit more complicated than you're saying.

It needs to be considered the timing, because obviously it doesn't all mature on day one in a year, so it's not as simple to go 35 billion times the differential. What I was trying to help you with is to say, the difference in income from our end position in 2024 will be an increase in income of about £800 million into 2025, to try to help you a little bit on the maths.

If I look at the kind of difference in the, what happens when, as we do the repricing, I've given you in the structural hedge, it sort of talks about a 25 basis point reduction with a 60% pass-through, would have £125 million impact on our income for a whole year. So therefore, if you look at it now, whether you go August or September, that's going to be five months or four months of that kind of income. So that does assume the time lag, and it does assume a 60% pass-through. Clearly, our pass-through could be different from that.

The timing when we do it could be slightly different, but that's, I think, a good way for you to think about the kind of the gross impact from a hedge cut and a rate cut and how it will pass through.

Thanks, Ed.

Ed: Sorry, the £125 million is for a whole year.

Katie: Yes.

Ed: In the first couple of months, it's obviously going to be much more than just one sixth of that, because you've got this 60-day time delay in the corporate world and a shorter one in the retail world. And I just wondered if you could give us some sort of sense as to what the front-loading is, because obviously in the first quarter, you publish a number with a rate cut. It may look a lot more than just a quarter.

Katie: You'd certainly see a little bit of pressure in that moment. I'm probably going to let you do the maths yourself, I must admit. So if I look at it, I've got unhedged deposits of £178 billion, and that will help you work out how that goes through as we kind of take it forward.

Ed: Fantastic. Thanks very much.

Katie: Lovely, thanks very much.

Paul: Thanks, Ed.

Operator: We're now going to take our final question from Amit Goel of Mediobanca. Amit, please unmute and go ahead.

Amit: I have just two follow-up questions.

One, just in response to the previous questions, I think you said it's a bit too early, obviously, to update on the ‘26 targets. So I was just curious when you think, it could potentially make a bit more sense. Would that be full year ‘24?

And is it really realistic to see 2026 profitability below 2024, especially given some of these product hedge tailwinds that we've spoken about?

And then my second question, you saw another two bps NIM benefit from funding and other. A peer called out yesterday that they may continue to see these kind of tailwinds this year.

Would you also expect to continue to see those tailwinds? Thank you.

Paul: Okay, thanks, Amit. Katie, I’ll let you pick up the NIM piece.

On ‘26 targets, Amit, we're not going to update today on when we will update, but I would reiterate, we're reaffirming the return target for 2026.

And as I stressed earlier in the call, which is part of your question, I remind you, it's greater than 13%. So we're confident we can deliver both the strengthened ‘24 guidance that we've shared today and the 2026 targets. But we're not pre-announcing any date change or anything similar.

Katie, on NIM?

Katie: Sure, absolutely. So, in terms of that funding and other, I wouldn't put them as a kind of constant repeat number. You can see in our walk, most quarters there could be a number there or not.

It really depends on some of our treasury activities as we go through with them. It's not something I would lock in, certainly. What we are comfortable with, and we've talked about on the call is that with the benefit of the improved guidance we've given you today, we do expect to continue to see some NIM expansion, which has been driven from the businesses, which I think is really important.

And then with the rate cuts coming through, it could moderate that expansion a little bit, but it's certainly expansion from here. Thanks very much, Amit.

Paul: Thanks, Amit.

Operator: I'd now like to hand back to Paul for closing comments.

Paul: Thanks, Matt. And thank you everybody for the questions. We appreciate you joining and asking them.

As you'll have heard, we're pleased with the performance and the positive momentum during the first half. It reflects my and the management team's ambition for the business, and it does give us increased confidence about the outlook, which is obviously reflected in the upgraded guidance for the year. So, look forward to speaking to you all soon, and I wish you all a very good weekend.

Thank you.