**NatWest Group plc**
**Q1 2024 Sell-Side Update Transcript**
**8th May 2024**

**Management Presentation**

**Katie** Good morning, everybody. Thank you for joining us in the room here and also for those of you who have joined virtually. Today, as you can see, I'm joined by Donal, our Treasurer, and Peter Norton, our Director of Finance, and also Claire Kane, our Director of IR, as well as most of her team, I think.

So anyway, before we open up for questions, I just remind you of some of the key messages from our Q1 results.

We are very pleased with a strong start to the year, delivering a return on tangible equity of 14.2%. We delivered another quarter of lending growth across our three businesses, making this our sixth consecutive year of lending growth. Of course, deposit balances were up in the quarter, despite the seasonal tax payments. And all of this meant the income increased across our three businesses in the quarter, excluding the impact of one fewer day in the quarter.

Q1 was also a first quarter of stable net interest margin, following three quarters of decline and the easing of the headwinds from deposit migration and mortgage margins. And also, the tailwind from the structural hedge gives us confidence as we look forward to our 2026 targets. And with that, I'm very happy to open for questions.

**Perlie** Yes, Perlie from KBW. I just wanted to ask about SME lending, because I guess the Treasury Select Committee yesterday had a recommendation about potentially changing the SME factor from Basel.

So, if that were to happen, how would you think about it? Would that just be an arbitrary benefit, in which case more capital returns? But that seems to be a little bit at odds with the motivation of doing it.

And it's obviously the reason why they're doing it. It's because they want you to lend more to SMEs. So just wondering how you would think about that.

And I guess a slightly wider question is that this rate rise cycle has in some ways given everybody a little bit of a surprise in terms of credit losses and even in terms of deposit migration, which seems to have stabilised at a level, I mean, hard to call it done, but it's stabilised at a level that is materially higher than with more sort of instant access deposit than pre-2008. So, I guess just what have you learned from this cycle in terms of customer behaviour and how does that inform your lending and pricing decisions going forward?

**Katie**

Yeah, sure. Thanks very much. So, I guess if we look at the SME factor and Basel, I think one of the things that we would have been campaigning on was to do some work on the SME factor, because what we felt was that given an increase in that factor, it would make lending more difficult.

If they were actually to ultimately reduce the factor, I think it would probably just maintain the status quo. I think within the SME space at the moment, what we are more interested in is the demand. It's an area that is very liquid.

Many of them still have the bounce back loans and the various COVID loans that they had and still a quarter of them have not been touched, they're still sitting there. So actually, in the short term, we're probably looking to see demand to come back to that space. There's some early signs of that, but it's not significant.

But if they were to reduce the factor from what their plan was, I think it would maintain the status quo rather than change. Our guidance for the 200 billion of RWAs by the end of 2025, it does consider some management actions. If they were to publish the Basel 3.1 guidance, and it was materially different from what they had said, we would give you an update as to what we think at that time, once we had had time to digest it as we go through that. But at this stage, we'll look at the 200 billion as the best guidance we have at the moment. And certainly, if it's materially different, we'll give you guidance. But I would say the 200 does include various management actions, which in reality, they do make sense, so we continue to continue to look at that.

I think one of the things is this is our sixth year of consecutive loan growth. We view lending growth as fundamental to what we do as a bank.

So certainly our aim is to always meet demand while managing the return and the allocation of the capital that we're using in that. If I look at the rate rises, look, it's quite interesting at the moment in terms of where we are. I think there's two things going on.

From the credit loss piece, you're absolutely right. It's been very stable as we've moved through this period. And really, it feels like it's been very stable for eight, nine years.

It's not even just since COVID. I think it's even since Brexit. We were expecting, if you go all the way back and look through our various kind of plans of where we put on PMAs for economic uncertainty, we kind of started with a very small Brexit one, we took it off, we then put on COVID.

It's actually, it's continued to kind of work. So that I think that it’s almost rate insensitive, but that I think has been to do with the high levels of deposits that we've seen. I mean, what we're guiding you to below 20 for the year, we're very comfortable with that.

It's not dependent upon releases per se of PMA to kind of hit that number, though they will be a feature, I would think, of the year. And it's important when you look at deposits pre-2008 to kind of think there's a few different things going on within that. One, I think, as you just do a quick comparison of percentage to percentage of what was in current accounts compared to instant access/notice accounts and then term accounts.

Because pre-2008 current accounts paid interest, they were more classified into the second bucket rather than the first. So, I think it's not as simple as just kind of comparing one percentage with another percentage. What we have seen, what the March data then has also confirmed, is that slowing down into term.

I think that we are watching rates very closely at the moment because we know that customer behaviour seems to change around 5%. We are currently paying about 4.6 on our term accounts. I think if all of a sudden it would start to go back up again, would that mean people would put more away?

Or have they already put away the portion that they want to have put away? There's lots of different questions within there. But we did see that 5% mark as something that was really critical in terms of when people seem to save more and when they seem to borrow less on the retail side.

So, I think we've learned a lot. But I don't think that necessarily means we have a crystal ball. It just means we have some different things that we know how to pool or when to expect to see reactions.

**Raul** Raul Sinha from JP Morgan. I've got three questions, if you don't mind. The first one is just to go back to the mortgage growth trajectory.

Just given the last two quarters, the group has undershot the flow share quite significantly relative to the stock share and relative to what you want to build. So just wondering if you've got any comments around seasonality and how we think about the phasing of growth through the year. And also, if you could perhaps give us a little bit more colour within that 200 billion guidance of RWAs.

What is the sort of natural rate of growth you assume in your mortgage balances? So, we can kind of use that to flex. The second one is on dividend.

Just a kind of broader question on the pay-out ratio. But on the dividend pay-out, obviously, you know, we are in an environment just linking back to the previous question where credit charges are quite low, you've got a pay-out ratio for the dividend. Potentially, you might want to revisit that given where the dividend is after the retail placing.

So just wondering what your thoughts are around the board's flexibility to relook at that on a sort of annual basis, whether 40% still makes sense or whether there's some flexibility there. And then I've got a third one, but I can come back. The third one is just when we look at the cost investment, when we try and benchmark you in terms of cost investment across the sector, we find that NatWest tends to come out at the bottom end of tech spending relative to overall costs compared to some of the peers.

Obviously, these statistics are difficult from the outside because they might not be apples to apples. So, I was just wondering if you might be able to give us a sense of where you think you're benchmarking on investment and whether or not you feel you might be under-invested relative to all the costs.

**Katie** Sure. Let me go through and if I miss something, then come back. So, mortgage growth. We don't feel that we undershot.

Clearly, it was a number that was lower than our market share, but it was very deliberate. And I think it's really important for us that we don't run the business by the market share percentage. We run it by the return on equity we're receiving.

As you know very well, when you write a mortgage, it takes three to six months before it comes on the book. So the stuff that was coming on in Q1 were things that we were writing at the tail end of Q3 and then to Q4, when actually if you look at the competition in the market and where people were pricing, it was at a level that we weren't willing to price down to that level. So we naturally took a smaller market share as an outcome of that decision.

Very, very comfortable with that. So that does mean there's been two quarters. And I think what we've tried to say is, I think we're a different beast now than we were, and also rates are behaving differently than they did.

But it was unusual that you would be talking about [margins] that were below 60 or 50 basis points. And that just wasn't a place that we wanted to kind of go. So we are writing at around 70 basis points.

We see the market has been slightly better in the last few weeks and months than we had expected at the beginning of the year. I do see the rates beginning to creep up a little bit. So that might have an impact of slowing people's appetite down.

We're happy with what we've taken in that time. It will ultimately come on the books in Q3, end of Q2, Q3, Q4. And we do still think this is a book that we can grow.

But I'm very comfortable that the growth is a multi-quarter and it can roll over into other periods just to make sure that we continue to make sure we're managing it for value and not just growth to get that percentage up. Given I do think that the margins have been much more competitive in the market and where you can see people making decisions that they're using other bits of the balance sheet to subsidise that, we haven't felt that in the round that was the right thing to do. On the 200 billion, on the natural rate of growth, and I've not given you that today, I'm not going to give it to you this morning, but there's a number of things going on.

There's obviously the CRD4 changes which are coming through, which I accept have been very difficult for you to predict, because they've been very difficult for us to predict, because they've been very long drawn-out conversations with the regulator as well, and that has been frustrating. Basel 3.1, we believe they're about to publish their guidance, and that will be really helpful.

We'll give you an update as to what all of that means. There is some growth within there. At the same time, there's also the natural shrinkage because of Ireland coming off, which is now really not a big feature of our books as we go through.

But we're happy to continue to see the growth in the lending book. We'd expect to continue to see that as we go through, but I'm not going to give you any particular percentage on that piece. If I look at the dividend pay-out ratio, our pay-out ratio is around 40% of total profits.

That's what we accrued at Q1 and what we accrue each quarter. What I would say on the dividend is that it's not completely mechanistic. You know that last year we paid out 38%.

We could pay 42 another year, so the number moves around a little bit. We're very mindful, particularly with the retail offering, that there's a view of what the dividend would be. And while we don't have a progressive policy, we do try to manage it, noting that people do pay attention to the absolute level of the dividend per share as well.

In terms of when we might re-look at it, we've had this conversation a lot with investors over the years. What we've definitely said to them is that we believe, and they've guided us to this as well, that the view is that it's better for us to focus on direct buybacks rather than increase the dividend. You know, we're coming to a point potentially that the Government may no longer be such a significant part of our register.

I think at that time we might have a little bit of a look, but we've no plans at this stage or no plans to change in the short term. But it's something we do look at and we know when we compare ourselves to some others, they have around 50% pay-out ratio, others are progressive dividends, we’re very comfortable we've got the right policy today. But it's something that the board can look at if and when it's appropriate to do so. But there's no timeline on that, I would say, at this stage.

In terms of the cost of investment, look, I think it's hard to work out what we're spending on tech versus others. What I do know and what we can see is that we capitalise far less than other people do. I'm very keen that we keep that capitalisation level kind of as low as feasible, and that would give you the impression that we have less tech going on the balance sheet, but probably we're dealing with more of it in our core cost line, so that we don't have the drag that ultimately comes from capitalisation.

But I'm very comfortable in terms of the spend that we spend on tech. And if I look at our, it's also very difficult I think these days as to what is tech and what's not tech, because every piece of money we spend is touching tech in some way or another. But we know what we're spending, we know that we're giving the right investment.

There's not somebody who's asking me for significant investment that we've said no to, because we're trying to hold back the investment on the tech piece. I'm comfortable we're in balance, but it is hard to do that kind of benchmarking. I know when I've done it internally, knowing what I know about my numbers, I can see that I capitalise proportionally less than some other people.

And that works for us. And there'll be people who have other reasons of history to what they do for themselves. Perfect.

Anyone else?

**Alvaro**

One, you already addressed this in the call, but I wanted to pick your brains again. In Q4, when you gave all your guidance, all the colour around NII, I realise the guidance on revenues, you expected that second half to be higher than the first half. Slightly higher.

After Q1, I think everything looks better from stable deposits, mix shift, no competition, rates higher for longer. And after Q1, you said that actually might be more stable now.

Can you go through the full process? Because I don't think if things are better, how come it's...

**Katie**

A couple of things. One, obviously, in our assumptions, we still have a rate cut due tomorrow. We'll know tomorrow if I'm right or I'm wrong.

You'll have some views on that, as probably the team around the table has some views on that as well. So when that comes through, what you see is that starts to hit us immediately, and then there's obviously delays in terms of pass-through time. So that would certainly have an impact.

I think the comments I made around customer behaviour movements, they seem maybe not quite as rosy as they were when we spoke a few weeks ago. But the same point of them not being as rosy means the rate cut is more unlikely. So where do you kind of cut off from one to the other?

Because as I see, if I look at mortgage rates and they're rising, we know that that 5% kind of level can often be impactful in terms of customer activity and then what it might do on savings. I'm not overly worried by that. I would agree with you overall that I think things seem a bit better than when we talked in February.

But for me, it's really that kind of rate cut shape, given that that's our continuing assumption. You'd see that immediately kind of come through. You'd then see the impact of that.

But we also, at the same time, expect deposits to stabilise. We've seen the mortgage margin churn. It's worked its way through the system now.

So you would expect the second half to – what we had said in February was it's going to be slightly higher. But given Q1, they're going to be a more even. So that would say, well, actually, what she's really describing potentially is a small dip into Q2 and then recovery from there.

But I think it's all going to be very dependent on rate changes.

**Alvaro** And kind of different question. On the government placing, I don't know how to call it.

Could you add any additional colour? There was an article talking about that there would be a 10%...

**Katie** Yeah, I think there's going to be a lot of articles.

**Alvaro** The two questions related is, I realise it might not be sort of, they might not even, they have it clear. But the two question relates to that. If there's any stake left, is there still a place for directed buybacks or maybe they can get the whole thing done? I don't know.

And, related to that, which I think might be more relevant, or you could say a bit more. I'm thinking about where that money is coming from.

And a lot of those, a part of that will come from deposits, presumably. Some of your clients could reallocate deposits to buy your shares. Will that be a relevant number? Can that upset some of the stability? I mean, they're not big numbers, but maybe a couple of billion.

**Katie** I mean, if you think a couple of billions shared across many banks, I'd love to think our customers would be more excited about it because they bank with us.

**Alvaro** But the 2 billion could come from your deposit base. Is that something we should ignore?

**Katie** I mean, that's really hard to comment on. I mean, I think it's, because I bank with you, I'm going to automatically buy your shares. When they can buy your shares today is quite. There's a discount.  But, you know, there was a better discount nine months ago, you know. So there's been heavily discounted shares.

I think we'll have a share of it. So, I'm not at the moment thinking that we'll have an out of balance share. And I think a 3 billion movement or whatever, two or three, whatever, across the whole market. Yeah, we'll comment on it as will others. But I don't think it will be overly meaningful. I think in terms of the article, I think they're doing a bit of [speculating]. I don't know what the discount is.

I'm expecting to know before anybody else, because we have to write it on the front page of the prospectus that we're publishing. It's a decision that will absolutely be made by the Government. They are definitely debating at the moment what they might do.

And I suspect there's been a few things tied together, but we'll wait to see how they might do it. I think what's interesting, you know, if they decide to launch it, and when it's launched, I think the discount is as much to pull people in and how they might structure that is something that they're clearly hotly debating at the moment.

**Alvaro** But you think there'll still be a substantial stake remaining?

**Katie** No, I mean, Jason wrote a lovely note the other day on the maths, which needs to be commended on. They were saying it was 27% and a little bit of change, when they've done dramatically well this year already. One can't believe that that can carry on for the next three or four months, but they can even at a lower level, they can still see that continue to fall.

We would hope to do a directed buyback. If you look at the price today and the price they've done historically, it would be unimaginable if they didn't try to pursue that as their earliest opportunity. I would expect that to happen.

So that takes, as you know, about 3% off, not the 5% because of the cancellation of the shares and things like that. And then whatever size this might be, there could be a bit of an institutional placing [per the article]. I think it will move down significantly.

I think then what becomes interesting is when they've always talked about trying to be out by 25/26. So, we do our direct buyback now. And then next year, we'd be able to have capital to do more.

We wouldn't by then, because of the changes in the UK, LA rules, be limited just to 5%. So might be structured that slightly differently. It feels that the end is coming, whether it comes with this offering, I'm going to be a little surprised.

But if that's just because I mean, 27% is still a big stake in kind of pound terms. So let's see if they can continue to dribble out the way they have been. I think we'll see that number substantially lower by the end of the year one way or the other.

And what's interesting for me is when do we view as a collective investment community, that we're not that interested. Is it below 10% or below 5%? You're going like, well, at that point, it's effectively zero, it's just there but for the passage of time. But I think we'll get the feedback on that from our investors and who's willing to invest.

**Alvaro** You mean from the Q&A next quarter.

**Katie** We will. We might know by then. So, who knows?

**Aman** Hello, it's Aman from Barclays. Two questions. One is a follow on.

So, can you help us work out what levers you have at your disposal to reduce your RWAs? You're obviously doing work to mitigate the effects of reg inflation. But is there something else?

Because your CET1 ratio at Q2 could be very low. When I say very low, I mean, right towards the bottom end of your range. And you know, even intra-quarter, which I guess is maybe a futile concept, I'm not sure.

But if you don't verify your profits intra-quarter, could be, you know, a very low CET1 ratio. Because this DBB, if it happens, 23rd of May or whatever the 12 month expiry is, it's quite expensive now, given the re-rating in your shares. So you are consuming a lot by doing the DBB.

And if RWAs, you know, aren't moving in the right direction, your cap ratio can be low. So, what do you have to offset that? Is there something that you can point us to?

And presumably, you're comfortable with that, right? So, if, in some scenario, you printed 13.0 at the end of Q2, that is within your range. You've said you're looking to operate dynamically within 13 to 14. Presumably, as a management team, you're happy with that?

**Katie** We're completely and utterly happy printing a 13.0. So, it's a range. We've said we're happy to operate within it. I think we've done a 13.0 print as well when we finished the DBB last time. But we're very comfortable. So, I mean, if you think of what happens below that 13.0 in terms where we have buffers and things like that. So, our range is 13 to 14. It's not the midpoint of that. It's not the bottom or the end. It is that range.

So we're very comfortable within that range.

**Aman** Is there anything on RWAs that you can have to kind of help you?

**Katie** There's obviously what you might do in terms of just the normal capital management actions of where you're allocating who's consuming RWAs in any particular period. We can deal with that. Obviously, you can get into a technical argument if you've got unverified profits, and then you have pro forma adjustments and pro forma adjustments of that.

But I mean, we're comfortable that we have the capacity to direct a buyback should it come along. And so we would seek to execute it.

**Donal** Okay. I'd probably say within that as well, we don't feel there's any material reduction in RWAs to free up that capacity, given the capital generation that will feed through in Q2. And what Katie said around being comfortable to operate at the lower end of that 13 to 14% range.

**Aman** And then the second question. I guess it was a broader question around the impact of liquidity in your business, right? So I've got the first question.

Do you target, or do you have a leading term aspiration for the loan to deposit ratio? And within that, what are the implications for the liquidity buffer on the go forward? And the reason why I'm asking this question is, you know, the drivers of average interest earning asset growth from here, conceptually, is it lending? Is it deposits? And, you know, I think that answer sometimes changes depending on where we are. Because that was one of my main takeaways from results, actually, that you potentially are talking more constructively on the volume of average interest earning assets in the medium term, or, you know, through this year and beyond, principally driven by lending.

But I think it's that deposit liquidity piece feels a little bit less clear to me, because that, I guess, can bounce around a bit, right? So if you were casting your gaze 12 months forward, is your liquidity buffer the same size or smaller than it is now?

**Katie** So there's lots of different questions in there. And I think one of the challenges is that people use loan to deposit ratio to estimate the liquidity buffer, but actually, they're two quite different things. One's very simplistic, and doesn't take any notice of liquidity value.

And actually, for us, the way that we look at it, and when we compare ourselves, it's often a factor of the history from where you've come, and then the fact of how much wholesale funding that you have, in terms of lifting that number much more so than doing additional lending, or obviously, having less deposits would impact it, but we're not seeking to actively take them down. I mean, Donal, this is your world, do you want to talk a little bit, and then move on to the growth at the end?

**Donal** So loan to deposit ratio, we don't have a specific target on loan to deposit ratio. And as Katie said, it's very simplistic. So it's going to be nuanced.

And even on a peer comparison perspective, it's going to be driven by the composition of your business. So higher retail composition, you're going to run with probably a higher loan to deposit ratio. I think one big advantage when we think about liquidity, we have a very strong liquidity position.

So an LCR of above 150% at the year end, we have minimal dependency on wholesale funding within the ringfenced bank. So that does free up plenty of capacity to grow lending as we look forward. In terms of LCR, it's not something we target, because I'm very, very happy, as I said previously, to run a much higher LCR ratio, if it's all income accretive deposits that we're growing within our NatWest Holdings.

And the one advantage we have is that the large percentage of our majority of our deposits sitting within the ring fence bank are all income generative. So, in effect, it's very hard to give, you know, all else being equal, we'd be very comfortable running at a lower LCR. But saying that if we continue to grow deposits and they're income generative, then I'm happy to grow that as well, if that helps answer the question.

**Aman** Thank you.

**Katie** Perfect. Thank you.

**Guy** Guy from BNP Exane. A couple of questions. So the first one's on deposit pricing.

Last time we sat around this table after Q4 results, you laid out sort of a scenario of possible multiple rate cuts, very short space of time and maybe lumping together deposit cuts passing through.

**Katie** As a scenario, yes.

**Guy** As a scenario. If we're now looking at a scenario where they're maybe a bit more spaced out, should we think about you kind of judging rate cuts in isolation and reacting accordingly?

**Katie** I mean, yes, but I would encourage you also to think that it's not just the rate cut that could necessarily cause us to change. The rate cut changing is the easiest thing to cause you to change. But I think if we saw particular activity in the market, then market competition would cause us to make a change that was off cycle.

But the rate cuts are going to be the big trigger. I mean, I think what's been interesting for me is just how [rational] the deposit market has been really this year already. No one's going particularly out of line.

I was interested in some of the articles over the weekend that NS&I is falling out of favour. I think that can change quickly if they need to [raise funding]. But there's not been huge competition in that space.

But, certainly, if they are a bit more spaced out, logically, you would imagine you would see things a little bit more spaced out as well. But ultimately, it really will be rate cut timing and market dynamics.

**Guy** And then on Other Operating Income, and there's some noise in central, some seasonality in NatWest Markets. But if you look at from divisions excluding central, we're annualising about 3.2 billion in Q1, and perhaps outside some of that seasonality from NatWest Markets. Is that sort of the base we should expect to grow from?

And can you help us at all in terms of how we should model Other Operating Income within the central division? Or should we just assume zero?

**Katie** As you know, we guide you to total income. So, I won't confirm or deny your knowledge of the 3.2 billion number. But the way that we think about the centre is to think about it as roughly zero, since we seek to allocate that out to the business.

What we can see, though, is that we see volatility between NII and Non-Interest Income really as a result of various bits of treasury activity or hedge accounting that happens. So NII in the centre Q1 was 55 million, which – I wouldn't say it would – although I'm saying go to zero, I wouldn't necessarily reverse it completely in that one quarter. But over time, that's kind of what you would expect.

But when you see changes in that centre in NII or Non-II, you generally see a compensating item on the other income line, which is why we try to guide you up to total income and why we don't guide on NIM, because obviously, those compensating items can then have a bit of an impact on the NIM as well. But the way that I look at it is to try to look at how is the business doing across the three businesses, ignoring this side sort of noise. And actually, what we saw there was really good development across the Non-Interest Income line, particularly in the quarter.

We saw about 6% growth coming through. And then on the NII line, we're kind of comfortable as well. So, I think it's – I accept it's an annoyance. It's an annoyance for me too. But it's one of those things that just is volatility and decisions that we're making at any one particular time, which all make the right economic sense, so they're the right thing to do, but it does make it – It means that you can have little kind of flip outs in terms of your estimations.

**Guy** Can I sneak in a quick third? I think in response to Alvaro’s questions, you mentioned customer behaviour being not quite as rosy in the last few weeks. Can you just clarify that?

**Katie** So then, as I said, I thought it was going to come back to bite me. So the way that I look at it, and I've got my customer pricing tables for mortgages sitting in front of me, which you'll have all these tables at your desk as well.

And what we've seen is rates of mortgages have just started to creep up a little bit. We know that when we believe from our experience over the last couple of years, when they hit 5%, that mortgage applications start to slow a little bit. I've not really seen that yet, but the rates would suggest that actually swap curves improve a bit.

You would see that have an impact. What I would say is deposits, they're stable, they're behaving the same way. We've all seen the market data coming through.

Mortgages, at the moment, they're going a bit better, but probably I've got one eye there going, they're just going to be a bit close to that magical 5%. Is that going to be something that's going to make me worry? So, nothing really in the underlying, but as I look forward and think, actually, if the rate cut doesn't come, which the market is expecting, so swap rates are continuing to rise, might that have a little bit of an impact on it?

So it's more the worry of the future rather than underlying. It's the same sort of activity that we're seeing, but I'm watching those rates quite closely.

**Guy** Ok. Makes sense.

**Katie** And then accepting, of course, they won't then land on our books now till late Q3 into Q4, even if it did change, which is this time lag that you have.

Oliver, do we have anything on the line?

**Operator** No, Katie, we don't have any virtual questions at the moment. However, just a reminder for those that do, you can raise your hand and then we'll bring you through to ask your question.

**Katie** Perfect. Are there any others in the room? Otherwise I'll bring it to an end.

Okay, thank you very much for your time. A pleasure as always. We look forward to interacting. I know we've got a number of sales forces and things in the different banks over the next few weeks and let's see what the rest of Q2 brings. Thank you very much indeed.