H1 Results 2021 Sell-Side Update

5th August 2021

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Katie Murray (KM)

0:00:03.8

Thank you very much Dave and good morning and thank you for joining us today. I'm joined today by Donal Quaid our Group Treasurer but before we open for questions, I'll just make a few comments on some of our interest rate sensitivity, where we are in the go forward of AT1s and some of the regulatory changes to RWAs. Very much reflecting some of the conversations we've had with some of you over the last couple of days, we're just keen that you all hear the same conversations together.

0:00:31.5

So, if we look at slide 36 of the results presentation. I'll just share the explanation with all of you. You can see that there's a change in the managed margin sensitivity in H1, relative to full year 20 and a plus 25 basis points upward shift in the sensitivity has increased in year 1 but decreased in years 2 and 3. This reflects 4 things. The change to consensus yield curve, our base case yield curve assumptions, our expectations of pass through and our expectations of customer behaviour in a rising rate environment.

0:01:06.8

At full year 20 in line with consensus we had assumed base rates of 10 basis points in year 1, falling to zero and remaining at zero. At H1 21, our assumption is 10 basis points in year 1, 25 basis points in year 2 and 50 basis points in year 3.

Our sensitivity disclosure reflects a difference in each year between the base case forecast which is derived from the market rate and yield curve and the shock scenario, with base rates 25 basis points higher.

0:01:39.7

As a result, its only in year 1 that the disclosures both at 10 basis points for base case are in the same basis. At H1 21, higher rate sensitivity in year 1 reflects the increase in balance sheet size, and liquidity to relative to full year 20.

In years 2 and 3 the higher level of interest rates in the base case affected estimates of the extent to which base rate rises are passed through to the managed rates deposits.

0:02:10.4

We assume that we will need to pass through more of the base rate increase when interest rates are higher in part to reflect customer behaviour, i.e. more interest-bearing deposits and savings.

I mentioned last week that we called one of our most expensive AT1s following successful Stirling and Dollar AT1 issuances during the first half. Given favourable FX, this will generate 8 basis points CET1 benefit in Q3 and result in significantly lower coupon payments going forward.

Taking into account the coupon savings in the second half of the year, we now expect the cost to be around £320m for the full year 2021 including preference shares, but for full year 22, with the full run rate benefits of our actions, we expect the overall cost to be around £250m.

0:02:57.3

I said last week in terms of RWAs that we expect the regulation to reduce our CET1 ratio by around 350 basis points, through to 2023, this includes all the impacts referenced on slide 31. Our RWAs specifically, the changes we expect on January 1st 2022 are, mortgage rate inflation to around 15%, equivalent to around £15Bn higher RWA, based on the book at H1, and model changes including the standardised approach to counter party credit risks with low single digit billion impact.

0:03:35.2

These changes are included in the updated guidance for group RWA where we are now expected to be at or below the range of 185-195 on January 1st 2022. Overall, we've continued to deliver a very strong performance in the second quarter with good lending growth and ongoing process on our capital reduction and capital optimisation as well.

I'm now very happy to take your questions, thank you very much Dave.

0:04:03.7

Dave – Operator

Thank you Katie. As a reminder, if you would like to ask a question today, please use the raise hand function in the zoom app. If you are dialling in by phone, you can press *9 to raise your hand and *6 to unmute once prompted. Katie, our first question comes from Benjamin Toms from RBC, Benjamin please unmute and go ahead with your question.

QUESTION

Benjamin Toms from RBC

0:04:25.0

Good Morning, can you hear me?

KM

Yeah sure, hi Benjamin, good to see you.

Benjamin

Hi, thanks for taking my question.

First question really is in on Basel 3.1 and your guidance of less than a 5% impact. I'm just conscious that we don't know yet the final rules and that some banks won't give guidance because of the level of uncertainty out there. I'm just curious whether your guidance represents the middle point of a range of outcomes, or whether it encapsulates a worst-case scenario? And then secondly just in relation to the final rules, from your perspective, what are the big topics that we're waiting for certainty on, that could have the most detrimental impact to Natwest Groups RWA base? Thank you.

0:05:03.6

KM

Yeah, sure, so, look it's our best estimate so it's not a make point or a worst case it's our base assessment of where they are. Donal do you want to just talk to the points that we're still looking for finalisation on?

Donal Quaid (DQ)

Yeah well, I suppose given how some of it will be implemented by POAs, its probably an extended time line as well, so even though we know it is quite uncertain, in terms of how timing and how things will be implemented, I think what we're just giving now is where we see, as Katie said, our base case, knowing that, that could change over time.

0:05:34.3

Benjamin

Thank you.

KM

Thanks Benjamin.

Dave – Operator

Thank you. Our next question comes from Alvaro Serrano from Morgan Stanley, please go ahead with your question.

QUESTION

Alvaro Serrano from Morgan Stanley

0:05:46.3

Good morning, hopefully you can hear me ok, my connection is not too good.

KM

Hi Alvaro, nice to see you.

Alvaro

Hi, couple of questions, one, some banks are calling out, mortgage early redemptions, as a positive impact in Q2 and that should gradually fall off in the next few quarters, I don't know if you can comment how you account for that, and if it had a positive impact for you as well in your Q2 NII, and more broadly on going forward, a more sort of philosophical question around competition in mortgage markets, we've seen pricing coming down again in July and competition remaining, when you think about how this evolves going forward, are we still to think that the excess liquidity trapped in the ring fence is going to drive that down?

0:06:45.8

Or you think the fact that we're close to zero rates will temper competition, how do you think as a CFO and think about how competition acts if you think it would be rational or what do you think the, how competition is going to behave given the rate environment and given the excess liquidity.

Basically, what I'm trying to get my head around is the 65-90 basis points we saw 2 or 3 years ago, feasible now the rates are 10 basis points or not? Just your high-level thoughts, because we don't have an answer for it, so just share your thoughts mainly. Thank you.

0:07:27.6

KM

Happy to. So, in terms of the early repayments, in Q2 we did have a small benefit from heightened early mortgage income, we would expect that to normalise over time. I would say that we would have some of that coming through every quarter, it's something that you would naturally expect to see, we had a bit more in Q2 but I would say it was a number that was pretty much in line with what we had in Q1, it wasn't unusual in it's amount, and it was a bit higher than what we would see a year ago but given it's size, if it had been very significant, we'd be calling it out as a significant, one of our notable items, I think we're quite disciplined in doing that.

0:08:06.8

So, I would say, a small benefit but I wouldn't bank it in as a big benefit going forward, so it's not something I would spend a lot of time focusing on myself, it wasn't significant for us as we go through.

Look, in terms of mortgage markets and one of the comments I made in my speech is that we do expect to continue to see it to be a very competitive market, in terms of where it goes through, if I think of the margins that we're at, we're at 145 for, not quite the exit rate, lets call it the average for June, in terms of that number…

0:08:44.7

So, that's what we see in terms of applications, so you'll start to see that come through, but even in July we can see, we took pricing actions, others took pricing actions, so it still continues to be a competitive market. I think one of the things that we shared with you as part of the spotlight session, I've got them on my desk here, in terms of the spotlight session that we did on Retail, if you go into that spotlight, on page 8 of those slides, you can find it afterwards, but we talked there in terms of what the indicative ROE of the business is, and it was over 20% including the uplifts in June, that was worked on a book size of about 145 -150, so more or less, sorry, an exit rate of 145 level, so more or less where we were.

0:09:34.3

So if you think what we're writing today, it's looking forward above a 20% ROE, so very strong ROE, very good business for us to continue to write in terms of that, Alvaro what you can also see there is there's still potential for that number, for the basis points to come down, I'm not going to call out, do I think it will get to 90 or 100 or 120 or where that will be, but what we know is that when we look at it, it's still, because of its richness on the ROE side, although the NIM has been depleted, I think there's still some more, that its going to run on, in terms of there.

0:10:08.3

Alvaro

And when we think about, sorry just to follow up, when we think about the comparison to 2 or 3 years ago, the fact that base rates are materially lower, do you think that makes a difference before you could play with the liability margin, now you don't have any liability margin, do you think competition will be sensitive to that?

0:10:25.1

KM

So, I think it will be a little bit sensitive to that, but I would also, there's also a slight element of, we all have a lot of excess liquidity and I think that excess liquidity today is less of a ring fence bank excess liquidity, that might be interesting for HSBC but for us, this is what we are, we are a UK domestic bank, so it's more that there's such a huge amount of excess liquidity, a lot of that excess liquidity I'm putting overnight in the Bank of England on 10 basis points, so actually there's an element of, you get to actually watch your marginal return.

0:10:59.5

We would always look for this book to be covering the cost of capital of the group without doubt, we're very comfortable it's sitting, what we're writing today is sitting above that 20% sort of level, so we're clearly comfortable on there but I think there will still be some competition, I don't think the fact that there's not a margin that you're making on the liabilities is going to make a huge difference in the next little while, because the reality is, holding on to that excess liquidity and would it earn less than it would if I put it to play at mortgages…

0:11:28.2

Which still have that strong ROE.

I mean Donal I don't know if you have any view on that?

DQ

I think what you said Katie was right, I think the difference from 3 years ago is just the level of excess liquidity we have at a very cheap rate as well, the majority of deposit growth we've seen is coming in at zero, current accounts and MTA's compared to 3 years ago where we were paying, a higher amount for the liquidity even though base rates were higher as well.

0:11:52.7

Alvaro

Thank you.

KM

Thanks Alvaro.

Dave – Operator

Thank you. Our next question comes from Omar Keenan from Credit Suisse, Omar please unmute and go ahead with your question.

QUESTION

Omar Keenan from Credit Suisse

KM

Morning Omar

0:12:06.4

Omar

Hello, I just had firstly a question on the return on tangible equity target and then secondly another question on the mortgage margins if that's ok?

So, just firstly on the return on tangible equity targets, so if we think back to the full year results with the strategic update, Natwest gave the 9-10% target which was based on really nothing happening in Ireland, and a certain level of risk weighted asset assumptions and interest rate assumptions and I guess, since then, what we've seen is that capital efficiency has got better because ratings migrations are probably surprised on the upside…

0:12:53.8

The strategic withdrawal from Ulster, from the Republic of Ireland is progressing quite nicely and the interest rate environment is quite helpful, so I guess when you put those things together then it should imply that the return on tangible equity target will be increasing so, I just want to understand how you're thinking about that, and when you're thinking about updating the market, because things obviously change and should I give my mortgage question or should I…?

0:13:32.5

KM

Yeah why don't we do that one and then we'll come back for, lets do that and come back for the mortgage question.

Look, so look, we obviously chose not to do any updates in Q2 and while I agree with you in terms of that 9-10%, we also did make the Ireland announcement so you could assume that we worked the 9-10% in the background with Ireland going on, with various scenarios of how that might play out, so although it wasn't specifically included, we're comfortable with the 9-10.

0:13:57.6

But look, I would agree with you if I look at where we are today, in terms of thoughts and what might happen with the interest rate environment, where economics are, it would certainly, we feel more comfortable with the 9-10%. I think it's something that I'm sure we'll all talk a little bit about as we get to February and we have another 6 months of hopefully, forward looking momentum, positive forward momentum in terms of what's going on in economics and vaccine recovery and let's talk about it a bit more then, I would say in terms of the 9-10%, but obviously comfortable with that number and would agree with you on the positives.

0:14:34.0

Shall we go onto the mortgage margins?

Omar

Yeah so just on the mortgage question, so the indicative return on equity and mortgages of 20%, so clearly the other side of the coin to that is the very negative returns on the liability side of the business, and I guess if I look at other players in the industry, a kind of more pure play mortgage players lets say, Nationwide, Santander, TSB, they don't make anything like 20% ROEs so, to some extent the 20% ROE figure is a bit of an artificial construct and can somebody really separate that out from the liability margin, so my question is…

0:15:25.3

If you are expecting or happy with looking at mortgages in a very, mortgage margins and a very narrow prism to go down, then, if rates don't go up, then that implies that you're expecting returns in the retail bank to go down as well? So, clearly that mortgage margin, that mortgage ROE, that couldn't exist as a business in itself, so, just wonder how you think about that and I guess the crux of the question I'm getting to is, really, how low are you happy to go with mortgage margins?

0:16:12.2

KM

Yeah so, how low can you go, I'm reminded to school girl days, playing with jump ropes so what we're saying in terms of that, but, look, I would agree with you, it's clearly out of construct and when you look at the retail business overall, what we know is that, that business in it's totality earns and ROE at the end of March it was 23%, at the end of June it was 32%, clearly widely impacted by the write back in terms of impairments, so, but you'd expect there to be a 20s business and so given that mortgages is the predominant product we have in there, it's clearly subsidising…

0:16:51.7

A lot of what the other businesses are doing. So, I would agree you can't separate them out from the other but just to give you an indication of how we look at the number, but Omar I'm probably not going to be drawn on the how low can we go, you know that historically we were happy in terms of where we were, what we're writing, we look at the ROEs, we don't just price purely looking at that number, you can assume that the pricing debates that we have are hot and important debates and they look across the whole segment as we get there as well as alternative uses of capital but…

0:17:24.6

We do see it continuing to be competitive. We know that we need to continue to be competitive, or you lose on volume which is a problem as well, so you don't want to be sitting with a great high margin and not writing any business, which is the alternative, so let's see what the next 3 months bring forward for us I think Omar in terms of that, sorry, not to be able to be more helpful.

Omar

Ok thank you, thank you very much.

0:17:50.7

Dave – Operator

Thank you, our next question comes from Rohith Chandra-Rajan from Bank of America, please go ahead with your question.

QUESTION

Rohith Chandra-Rajan from Bank of America

Hi, good morning, I had a couple please, one was just on your CET1 drivers which is a very helpful slide, I just want to look at the Ulster Bank numbers, so the 40 basis points that you highlight there is just the AIB element, you're obviously in discussions with Permanent TSB and then there's the 40% of loans rump, which will work through over a number of years, so I was just wondering, do you see scope for upside to that 40 basis points over time in terms of capital release from Ulster?

0:18:35.0

And then the second one was, just coming back to commercial banking really, I was just wondering really in terms of what you have seen in July and probably also your conversations with customers, what you expect in terms of repayments and the movement in the loan balances in the second half of this year?

0:18:53.8

KM

Thanks, if I just look at the Ulster bank piece first, I would say, what we've said in Ulster Bank is that we do expect the transactions to be accretive overall, in terms of what we're doing, so you're right that's only the piece that we've signed with the AIB. The PTSB, because it's still obviously a memorandum of understanding it will evolve in terms of the pricing, but we'd expect some positivity to come from that as well, so we do expect to see some continued positives on those numbers as they come through.

As we go further with the transaction and we get to the point where we've kind of agreed precisely prematures and things like that, we'll update you on what those numbers are in terms of how that comes through so I would expect to see a little bit more come through on that.

0:19:38.5

And what we've also just said on dividends, is that we'd expect to start to see as we complete a transaction, and then start to see at that point dividends actually flowing back in terms of hard cash as well so it wouldn't be until the final […] it's not a question of we all wait till the final event, we expect it to come back on stream as we go through.

0:20:03.0

Rohith

Sorry Katie, just on that then, again in terms of the timing of that capital repatriation, is that on completion of the deals or as the RWAs come off because I guess there's a slight timing difference between those two things?

0:20:20.8

KM

So, we've obviously got to have conversations with the regulator in terms of it but I think as we start to see, material asset movements come off, we'd start to have some of those conversations, so if I looked at something like the first AIB piece, as we move materially through that process, if it felt that we're still going to be a long time until it completed I think we'd start the conversation then, if in fact completion was a few months away, we'd probably just wait for that piece to come through, but what I think we'd want to do is be quite significantly coming through those transactions.

0:20:55.4

What we had talked about was that we expected the AIB to complete in 2022, so that would be the trigger for the 22 dividend and then the PTSB we still obviously have to get to a final deal but that would go further into 23 which would be the next trigger, so I think from your own piece, I would think of it as, there's a 22 dividend that we would hope to get and then you'd expect to see a further one in 23, I think they would just be annual events so we'll see how we progress next year and see at what point are we far enough through and feel it's time to have the right conversations with the regulator and authorities there.

0:21:31.6

I think that would be fine.

In terms of commercial, look, what we said last week, I probably wouldn't have any particular update on that given it was on Friday, in terms of the lending there. As we look at the numbers, we can see some very early signs of activity, we can see good performance in the government lending still, that's completed. I think we'll have 3 more months of performance by the time we talk again formally, which I think is going to be really important as to how that's really behaving in terms of the repayment side of things…

0:22:05.2

And if we've drawn on guarantees at all by that stage as well, I think it'll be an important conversation but nothing probably more to add than what we talked about in terms of lending on Friday I would say at this stage Rohith.

Rohith

Ok, thank you very much.

KM

Lovely, good to see you, thanks Rohith.

0:22:19.9

Dave – Operator

Thank you, our next question comes from Christopher Cant from Autonomous, Christopher please go ahead with your question.

0:22:26.9

Christopher Cant from Autonomous

Good morning, Katie, thanks for taking my questions. Two please. So Ulster, sorry to keep going on, on that particular point, but in your release you talk about topping up PMAs to cover the disposal strategy, i.e. I guess your write back, well you would have seen a write back in the first half, were it not for the fact you were planning to sell some of these assets at a mark.

Could you just give us a sense of how big that PMA top up was in terms of the mark you're taking, I'm just conscious that you're potentially, I guess you may already have taken some of the capital negative effectively in relation to the mark you might then take later down the line if you sell for example the tracker book at some point.

0:23:20.7

So, if you could give us a sense of how big that was in the first half, that would be helpful.

And then, in terms of the RWA progression, I completely appreciate the uncertainty around Basil and all the rest of it but when I look at your fixed income deck, all of your debts, indicators, use a £200Bn RWA base in terms of how you're framing your thinking and I struggle to get to that number if we're at the lower end of the 185/195 and then we've got maybe 5% on top and a little bit of growth. I wouldn't be getting back to 200 so, is there, am I missing something there? Or is the 200 just being conservative?

0:24:02.3

If the 200 is being conservative, it looks like maybe you're already above where you would need to be for basically all of your categories of debt (MREl, Tier 2, AT1) at 281, is there any upside in your thinking in terms of allowing some of that debt to just mature and not replace it, given you seem to be benchmarking that higher RWA number? Thanks.

0:24:28.3

KM

And I think the higher RWA number as we move forward is, it's not inaccurate, it's probably more illustrative I think in terms of, and I think we've got the next little bit to kind of wind through, Donal have you got anything you'd like to add in terms of debt, obviously conscious that we don't really give debt repayment or call guidance cos we get in trouble with UKLA if we do that but Donal anything you'd like to add on that then I'll come back to your question on Ireland?

0:24:52.1

DQ

Yeah, I'd be happy to add a couple of things. Chris you're right on the £200Bn, I think historically we have used that for indicative purposes just in terms of our issuance plans and requirements, I think given the guidance we were reluctant to change that at H1, it's probably something we'll look at as we move into the end year and see how RWAs I suppose end up the year given the updated guidance we've given you.

But in terms of how we would look at that going forward, I think very easy from an MREL perspective we have a decent bit of refinancing coming up as we look into next year, so it just means we would have less from an issuance plan next year.

0:25:25.4

Similar in Tier 2, I've talked previously before about the bullets we have that amortise 20% per annum, again, it would just mean less refinancing that we would have to do again, going into next year.

And then from an additional Tier 1 perspective, based on our updated guidance on RWAs we're pretty much complete, probably until 2025 which is our next goal.

0:25:47.9

KM

And then if I look to the Ulster question, I mean, on page 24 of the accounts, Chris we more or less give you the answer, so, if you look at Ulster in there, there are other adjustments in the ECL PMAs went from 26 at the end of the year to 118. In the narrative on page 25 we talked to the increase in other PMAs reflects adjustments that continuing actions on the fee's withdrawal of Ulster Bank ROI from the Irish market will lead to a higher/earlier crystallisation of losses, so I think we're just keeping some back in view of other activities we might do as we exit but the movement in that number will get you pretty close to the number that we've taken.

0:26:30.6

Christopher

Okay that's really helpful. If I could just follow up briefly on the RWA point in terms of the debt issuance. I guess bringing this back round to the 9-10%, presumably that was struck based on the £200Bn and a higher level of debt than you might now need given the potentially lower RWAs, so is that another thing we should be thinking about in the mix, I guess it feels like, rates is a meaningful positive versus where you were expecting to be, NatWest Markets is maybe a small negative versus where you're expecting to be, mortgage pricing I'm guessing may also be a small negative versus where you're expecting to be, in terms of where that might land and I know you're not going to give us a number but I'm just trying to think about, when you're sticking to the 9 for 10, what's kind of in the mix but then I guess this debt point is another potential positive versus what you would have been planning for?

0:27:29.5

KM

The improvement in rates definitely helped and what Donal would tell me in his one to ones is, how well he's out performed his plan on his debt issuance, I would say that he wasn't very good at planning on that basis but look there has definitely been a bit of a positive.

If I think of the very expensive AT1 we would never have expected that to have crystalized as well as it has, so the total wouldn't be there in terms of the positive, but there would be a little bit of positive. I think rates have definitely moved much more than any of us would have expected in terms of where we were talking around the 9s and 10s…

0:28:03.2

I think that there is a fair positive. I'm just Chris looking back if I think of where we were in terms of the margins and things, what I would think on the mortgage margins I think that they went up more than we expected in Q1 and Q2 so that would have been a positive, but they've come down again in terms of there, so how much of a real negative that is, I think what happens from here could be a bit more in the negative rather than where we're sitting today, but we don't really have a view on that, but look, definitely RWAs are performing far better because of the complete lack of procyclicality that we've seen in terms of coming through on that so let's go through.

0:28:48.1

So, look, I think we'll talk more about the ROTE target, I guess we've obviously got increasing comfort but not wanting to give you a new number today, let's talk about it more in February.

Christopher

Ok, no, that's really helpful, thank you.

KM

Lovely, thanks a lot Chris, take care.

0:29:01.7

Dave – Operator

Thank you, as a reminder, if you would like to ask a question, please use the raise hand function in the zoom app. If you're dialling in by phone you can press *9 to raise your hand.

Our next question comes from Andrew Coombs from Citi, Andrew please go ahead.

0:29:16.3

QUESTION

Andrew Coombs from Citi

Yep, good morning, so I'm going to stay with the same theme and then perhaps ask one more as well, so, I have a lot of sympathy for the point Omar raised about thinking about returns holistically but you are pointing us to the individual product returns and obviously people are trying to then back into what that could mean for future margins that are deemed to be acceptable to you. So with that in mind, just coming back to the indicative ROE at 20%, I think when you did the spotlight last year you talked about through the cycle cost of risk being applied to that measure, you obviously talked about 28% tax rate. Can you just confirm that the tax rate you're assuming on your 20% return, is still 28%? And also, what are you assuming that the through the cycle cost of risk on mortgages? So that would be the first question.

0:30:08.8

KM

If the second question is a different topic, rather than me doing a memory test in the middle of it, so tax rate, we haven't changed. Obviously we're all waiting for what happens with the, although there's been an increase in the overall tax rate, obviously in terms of, we've got the banking surcharge on top of that, so, we're assuming that the banking surcharge will adjust in relation to something and I think the spotlight, we only did it two months ago, as well so we would have known some of that information at that time, it wasn't such old information.

0:30:43.6

In terms of through the cycle, cost of risk, I guess I was a bit surprised, I didn't get asked this question, I know last week, I was probably a bit relieved so you've caught me now Andrew in terms of it, so, we've always talked about a 30-40 basis points and if I look at what's happened over the last 10 years, you go, actually Katie that 30-40 basis points piece is actually bang on the button. It's when we pull the last 10 years. I think what we need to have is, to get through this write back period and to see how we normalise land and this is the first cycle as you all know, we've left IFRS9 and I think IFRS9 is volatile, I think the economic recovery has been more volatile than any of us could possibly have predicted as well…

0:31:30.3

So, at the moment I would go with 30/40 basis points through the cycle because I can't give you anything better. I would say at this stage and in fact if I look at the last 10 years, that's almost exactly where we are. Let's get through 21 and even I think lets get through 22 before we really move away from that number at this stage.

0:31:53.1

Andrew

And just on the, sorry just staying on this theme and then I'll go onto the next question, the through the cycle cost of risk, or specifically for mortgages, that informs the 20% ROE?

KM

Yeah so, we haven't given you that, and so I'm probably not going to give you that today.

Andrew

Ok, but we can make an assumption to back out.

KM

You can make an assumption, I think you can see, we certainly give you, in terms of the financial supplement, I'm pretty sure we split out the cost of risk in terms of how that gets applied to mortgages versus other, let me quickly flick into their page to check that, that's the case. I think it is, so you would be able to work that out, but, I'm not keen to get into individual lines across the risk because I feel that will be a dangerous road that you will follow me on for the next number of years, so let's look at the group level on that.

0:32:43.5

Andrew

And just staying on this theme, before we move on, you've given the 20% on mortgages, I think at spotlight you said 10% on personal advances and on credit cards, is that still unchanged as well?

KM
I mean, we did this on the 29th June so I would run with those numbers, they're pretty recent in terms of when we shared them with you.

0:33:05.5

Andrew

Yeah ok, and then my other question which is on NatWest Markets, so, we've obviously seen a year where you've materially outperformed your guidance followed by a year where you've materially underperformed your guidance, it looks to be even more volatile than most of the other capital markets named, and even if we strip out the risk in costs, the revenues look well below the 0.8-1 that you're guiding to, particularly rates looks very weak, what can you give us in terms of reassurance that 0.8-1 is still the right number, what's been abnormal about the last 6 months, that should bounce back in future years?

0:33:47.3

KM

So, let me do that, sorry as you were talking I just flaked, so, if you look at page 28 you can see the loan repayment charges split out by mortgages, personal advances, since Q2 2019, so you've got the last number of quarters there, obviously other financial supplements will give you other history. So if we go to the 0.8-1, look, agree rates was disappointing, I think, lets remind ourselves why that was disappointing, one we know that rates were down across the market, so we had that as well.

0:34:22.9

We were down further and I think that was a bit of an impact of the reshaping of the business, they're doing a massive restructure in there and I think that the rates piece took a little bit of a ding from that as well so I think almost that second piece, is more comforting because actually, you can resolve that, in terms of actually some of the change we're going through, so we're comfortable in there.

I think as I look at it, so the stabilisation of rates revenues from the improved trading, lower funding costs and importantly the completion of the reshaping, I think will help that line. I would remind you that's where we have taken most of our RWAs out, and the out performance of last year, happened very much in the first half of the year while we still had all of the RWAs in a period of massive market volatility.

0:35:09.2

So, it's not quite the right comparison to go from one to the other, but look it was a disappointing quarter. The second thing I would talk to you is we're very much pivoting to growth in terms of capital markets and the currencies business. You can see that we're building nice expertise particularly in the ESG area, and that's in driving, increasing market share in the green, social and sustainable bond issuance, they were up strongly 3.8% up from the first half which is really important for us in that piece.

0:35:42.8

We are continuing to work in the digital FX and increasingly seeing the FX penetration across our commercial customer base, which really, you would think Andrew well surely you had all that already and actually it was quite siloued, a lot of the expertise was very much sitting in NatWest Markets and it wasn't far enough into the commercial base, so I think lets get it into that commercial space and then I think it's a question of actually can you then push it further into other areas of the bank, so that's an important change and we also get a little bit of a pick up of some improved funding costs which will come through in the medium term as well.

0:36:17.9

You know that they would have taken on some expensive debt, we've had ratings improvements, so that will help, which is why we're still comfortable with the £800-£1Bn.

Thanks Andrew.

0:36:29.8

Dave - Operator

Thank you, our next question comes from Martin Leitgeb from Goldman Sachs, Martin please unmute and go ahead with your question.

QUESTION

Martin Leitgeb from Goldman Sachs

Yes, good morning, thank you for taking my question. If I could just ask on the deposit point, just looking at deposit flows in the UK as a whole and increase in deposits, over the recent past, how do you think deposits evolve over the near term, should we think, they will continue to grow and excess deposits continue to build? Or could you see a scenario where some of those excesses come back again as the economy reopens?

0:37:10.4

KM

Deposits were up £14Bn in Q2, versus the £22Bn in Q1, there's a bit of repo activity in there as well, we would expect to see people start to use some of their positions now, we are definitely expecting a decreasing increase if that makes sense, but we're probably still expecting a little bit of an increase from here, for it to completely revert in one quarter, seems unlikely.

But I think it also depends a lot on what funding is used for. Obviously if it's repayment of debt then that takes it out the system but if it moves around, so actually does it move from our retail deposit base into the commercial deposit base and then does it more than offset some of the benefits that,

that commercial space has had, if you think many of them, they're still collecting furlough, though that's diminishing…

0:38:04.0

They've had the ability to manage their debt, they've had their tax bills pushed out, they've had their VAT bills pushed out and quite a number of them have also had things like rent concessions and things, so as those things come back on, we'll start to see some of that burn. So, I think you'll see an element of it moving around which will probably help sustain some of the balances and obviously it depends who your banking in terms of what that happens there, but I think we'll obviously see an element of it leave as it goes through, so, I would say, a slower build is probably where we are at the moment rather than a quick decline.

0:38:37.3

Martin

And from a profitability perspective how do you see those incremental deposits, just from a pure economic perspective, so if I assume you pay close to zero on retail and maybe LIBOR inter bank rate on corporates, and you place that with the Bank of England at term, or it increases the hedge capacity in principle this should be accretive to revenues return, or is there something I'm missing?

KM

No, no, look I think that would be fair and you can see in the results where we include the third party funding rate and you can see it's at, check I'm looking at the right quarter, in terms of where that is, 7 basis points now on retail, in terms of what we have there and then commercial, private, basically zero in terms of where we are, so there's not a lot of payment for there, so you get a little bit of return, I mean, Donal if you would add anymore on that but I think you're thinking about it in the right way Martin.

0:39:42.3

DQ

Yeah no, no exactly the right way because the majority of what we've seen is through, as you've said Katie, is through retail deposit accounts or through in the commercial, it's generally through MTAs as opposed to wholesale corporate deposits which we haven't gone after and we've completely changed our pricing on that as well so the majority of what we've seen coming in is at zero/1 basis points so there is an NII pickup and obviously then that adds to our interest rate sensitivity as Katie opened her speech on as well if we were to see higher rates as well. So, it will be positive on that front too.

0:40:11.6

Martin

Perfect thank you very much.

KM

Good to see you Martin.

Dave – Operator

Thank you, our next question comes from Jonathan Pierce from Numis, Jonathan please unmute and go ahead.

0:40:23.7

Jonathan Pierce from Numis

Morning both, got 3 fairly quick questions I think. The first is on, just a kind of just some clarification over what was just said on the A Tier 1 stack. So, post the redemption in August you had a little less than £4Bn I think of A Tier 1, that's it now is it for the next 3 or 4 years, we shouldn't model any additional A Tier 1 coming in other than maybe to prefund 2025 calls that are clearly quite a way away?

Second question is on the RWA procyclicality and I'm just wondering what you're thinking now into next year, I mean, maybe to ask the question in a simpler way as possible. If your IFRS9 economic models are now in the right place, what sort of RWA inflation might we be looking at, if the RWAs catch up with that over the course of the next year or so…

0:41:26.7

Because as you say Katie, there hasn't really been any procyclicality, so far. The third question is a broader question on all of this cash sat at the central banks, presumably most of it at the Bank of England. It probably isn't a risk in the nearer term but longer term where base rates follow forward curves, possibly even move beyond forward curves, there is this very clear risk that remuneration on those reserves doesn't move up one for one with the base rate, you've got a lot of cash sat at the central bank, is there anything you can do to pre-empt that, maybe moving, I know the system level can't be done, but for you specifically, can you start to move some of that cash into other forms of liquid assets that would track up with short rates for base rates and increase? Thanks.

0:42:20.6

KM

Yeah no sure, thanks Jonathan, it's interesting its like you've been having some of the conversations we've had sitting in this room that I'm in, in terms of that, I mean Donal do you want to talk a little bit about AT1 and what we're thinking about cash and what central bank activities […] will not happen?

0:42:35.9

DQ

Yes, sure, so on AT1 I think given the updated guidance Jonathan of at or below the lower end of £185Bn that would pretty much imply that we're done on AT1, there may be some very small transaction required over the next 12-24 months if RWAs rise on the upside. But, expectations are we're pretty much done there until 2025 refinancing.

On the central bank piece, plenty of options open to us, I've read those comments as well around, I think there's some ex-Bank of England members talking about not paying remuneration on reserves at all which has been ruled out by the Bank of England…

0:43:14.3

But, there are options available to us, we've been managing excess liquidity as BAU through our liquid asset portfolio, obviously yields on liquid assets have been compressed as well over the last number of years so they are at very, very low levels of rates, so at the moment we just think it's central bank cash, is the right place to hold it, but gives us plenty of opportunities if we did see that back up in base rates and higher yields across other different liquid assets we could deploy it, but also you would hope in a rising rate environment that you see further increased demand on the lending side across our core lending franchises as well which would deploy more of the excess liquidity also.

0:43:51.2

KM

Thanks Donal, look and in terms of the RWA procyclicality, Jonathan, if I look at it, I think even if I take what we got in 20 and then we add what has moved in the other direction I think we're at a very small negative in terms of procyclicality to date and if I look, almost separately from the IFRS9 economic modelling to what's actually happening in the book in terms of what we see in defaults, we can see that in Q2 there was our write back in terms of stage 3 movements as well, and that's the thing that will really kick into the procyclicality. So, at the moment we don't think there'll be a lot coming through the second half of this year, and if you think of the guidance of at or below, I don't think there's even a suggestion of whether we see any.

0:44:38.8

I think then once we get into 2022, what we're really interested in, is are we seeing, what is the volume that we see moving over into stage 3 and one would, you could see in our own sensitivities on IFRS9 we've taken most of the economic benefit already, it's actually the uplift to moving […] to 100% on that IFRS9 sensitivities is pretty minimal so it really is going to be the behaviour of the underlying book and just given that there's so little going on in stage 3 and overall we actually have a write back, I think the procyclicality question is one, I so believe it must come, you cannot go through what we've been through and not see more scaring than we've seen but it does feel the protections that have been put in place is definitely delaying it.

0:45:22.1

Jonathan

Ok, thanks very much.

KM

Thanks Jonathan.

Dave – Operator

Our next question comes from John Cronin from GoodBody, John please go ahead with your question.

0:45:33.1

John Cronin from GoodBody

Hi Guys, hi there and thanks for taking my question. A very quick one as a follow up to Martin's question on excess deposits, look just curious around how actively you're thinking about managing that over the coming quarters, that's still a significant drag from a return's perspective. Could acquisitions, could you ramp up your appetite to be more acquisitive, like there'd be more loan books like the Metro book, just to get some sense of your thinking there in terms of trying to recycle some of that excess thanks.

0:46:09.8

KM

Yeah no sure, Donal, do you want to talk to deposits and I'll talk on acquisitions?

DQ

Yeah, so what I'd say John is, we don't really see it as a drag on returns, it is positive to NII, it's obviously a drag on NIM just in terms of denominator in the book and interest earning assets but listen we'd always like to see, increased demand on the lending side to try and deploy it, hopefully we do see a pickup across the commercial business at some stage later on this year or early into next year as well, which will put some of that cash to work, and also then we'll just continue to look at opportunities within the liquid asset portfolio in terms of liquid assets as well to deploy it at higher return levels.

0:46:46.2

Obviously, the majority of that liquidity is in the ring fence bank, so there are restrictions on how we can deploy it as well.

KM

Perfect, thanks Donal and in terms of acquisitions, look, I would say, there's not really a question of ramping up, we do continue to look, the Metro transaction was one that made sense for us, we continue to look at what's out there, we have a think about actually where we'd like to build, either capability or volume in that space so if there were other good quality books, we would certainly be looking at them now, so it is an active piece, but it needs to be something that really makes good value for the excess capital that we've got and for the shareholder, it's a better option than us returning it to them for them to invest at the right kind of value, so we're obviously picky as you would expect but it is something that we do have a team that actively looks at all the time so we'll continue to do that John.

0:47:39.6

John

Thank you.

KM

Lovely, thanks very much.

Dave – Operator

Thank you. Our final question comes from Aman Rakkar from Barclays, Aman please go head.

KM
Morning Aman.

0:47:50.2

Aman Rakkar from Barclays

Morning Katie, morning Donal, good to see you, just a question on the hedge if I may. So, I think your guidance for the hedge impact this year, actually implies a lower hedge impact in H2 than is reflected in Q2 NIM? So, I guess I was interested in your expectations for the hedge in 2022. Forgive me, I actually can't remember if we talked about this one, I'm sure we have.

KM

I'll remind you what we said, don't worry, we talked about it a little bit but in fairness I wasn't too pushed on 2022, so I'll give you a little bit of colour on that.

0:48:29.8

So, no look what we would expect in terms of NIM going forward, given we've had 157 of the 250 we're expecting as the impact for the year, it's come in, at this point, we wouldn't expect as you go from Q2 into Q3 and Q4 a particular impact from that hedge on a relative basis.

As we look into 2022, we would expect the product hedge to be broadly neutral from here, I would remind you that probably at this stage a slight negative on income on the equity hedge given it's got a 10 year life, so in terms of how it's growing but overall it's not a significant impact that we'd be expecting coming through and we'll talk more about it I'm sure as we get into Q3 and Q4 as we move forward from there.

0:49:18.1

Aman

Thanks so much, does that include the additional capacity that you're expecting to put on this year? And actually, just on that point, so I note that end of period hedge notionals increased by £21Bn, I think you signalled £8Bn at Q1, that's already been put on, and then another £15Bn coming through the course of the year, so can I just test my understanding…

0:49:41.9

KM

Let me give you what we expected, so basically, Q1 we said that the deposit balance had stayed flat, we'd expect an additional £15Bn of hedging to take place over the next 12 months, what you saw at Q2 is that the notional hedge increased by £30Bn which was basically the growth, we saw £14Bn growth in our deposits so that kind of coming through, albeit on a 12 month rolling kind of average basis.

If deposits stayed flat from today, we would expect a further increase of £15Bn over the next 12 months, if deposits do rise then that number will increase as we go forward from here. And yes, my comments on 22 reflect the expectations of the £15Bn, they don't reflect the expectations of it being higher.

0:50:29.6

Aman

So, you are actually increasing your expectations for the hedge versus 3 months ago when we spoke to you, it's an additional £12-15Bn.

KM

Yeah well we talked 3 months ago, we were originally talking around £300m, we're now, that's when we went down to around £250m, I think that around £250m is still fair, is what we've seen in terms of the move, although the notionals have gone up, the swap curves came down a bit from where we were and they play off each other, so that they are around £250m is the same kind of number for this year in terms of the impact versus 2020.

Aman

Ok perfect thank you very much.

KM

Lovely good to see you as ever Aman.

0:51:09.0

Dave

Katie that was our last question so I'll now hand back to you to close.

KM

Lovely thank you very much indeed for your time everyone and for your continuing support and for those of you that are taking time off please enjoy your breaks, and Donal you can tell he's in a slightly different location so Donal thank you for dialling in from your break and with that, I wish you all a good summer, take care.