LLOYDS BANKING GROUP PLC – 2023 HALF YEAR RESULTS – PRESENTATION TRANSCRIPT
(amended in places to improve readability only)

Wednesday 26 July 2023 – 9.30am

LBG:
Charlie Nunn, Group Chief Executive
William Chalmers, Chief Financial Officer

CHARLIE NUNN, GROUP CHIEF EXECUTIVE
Good morning everyone and thank you for joining our 2023 half year results presentation. Another dynamic media morning for us to do our results.

I will begin with a short overview of the Group's financial and strategic performance. I will also highlight some of the actions that we are taking to support customers given the ongoing changes in the macroeconomic environment.

William will then provide the usual detail on our financials, and, following a brief summary, we will take your questions.

Let me begin on slide 3.

SLIDE 3 – CHANGING EXTERNAL ENVIRONMENT, CONSISTENT DELIVERY
The external environment continues to change significantly, with persistently high inflation and higher than anticipated interest rates. Against this backdrop I would like you to take away four key points from the presentation today.

Firstly, uncertainty for our customers has increased given the changes in the external environment. To this end, we have once again stepped up our support for customers, especially for those most in need. I will discuss specific actions we have taken shortly.

Secondly, in line with our guidance, our Q2 profits and net interest margin have stepped down versus our first quarter. This is due to the continued low margins on mortgages, as well as passing on more to our savings customers. However, the Group is performing well, and our financial performance remains robust. As you will hear later in the presentation, we have either reconfirmed or slightly enhanced our guidance for 2023.

Thirdly, we are making good progress on delivering our strategy. We remain on track to deliver the strategic benefits we laid out in February of last year for both 2024 and 2026. This is despite a more challenging environment and, as a result, slower growth in AIEAs. Our performance in other income in the first half shows positive business momentum and is an example of the progress we are making.

And finally, as we look ahead, our capital position and financial strength, together with our prudent approach to risk, positions us well. Regardless of future uncertainties, we are well placed to support our customers, safeguard deposits, support the UK economy, and continue to deliver for our shareholders.

On slide 4, I would now like to highlight how we have delivered for our customers and other stakeholders in the first half.

SLIDE 4 – INCREASED FOCUS ON SUPPORTING CUSTOMERS
We are playing our part to provide proactive and targeted support for customers through a period of increased uncertainty, whilst ensuring we provide good and fair outcomes for all.

Increasing mortgage rates are a notable area where customers across the industry are experiencing challenges. To mitigate this, we have proactively contacted over 200,000 customers most affected to offer additional support. We have also committed to the Government's Mortgage Charter and offer product transfers for all residential mortgage customers, even if they are in arrears.

We are also keen to ensure that our deposit customers benefit from rising rates, with a range of attractive savings options. We have used our significant reach to proactively encourage 10 million customers to review their savings rates through prompts within our mobile app, contributing to 1.9 million new savings accounts being opened in the first half of 2023.

Our proactive support also extends to businesses, providing more than 550,000 customers with guidance on how to build financial resilience. It should be noted that we continue to see significant resilience across our portfolio, with customers adapting to the environment. However, we deem these actions appropriate, prudent, and aligned to our purpose of Helping Britain Prosper.

We also remain highly focused on our broader stakeholder objectives, such as building an inclusive society and supporting the transition to a low carbon economy. For example, in the first half of the year we announced a new goal to double the representation of colleagues in senior roles with a disability by 2025 and we continue to make great strides on our green financing initiatives.

Our continued support for customers and other stakeholders is made possible by our robust financial performance.

On slide 5, I will provide a brief overview of the trends that influenced our second quarter results.

SLIDE 5 – ROBUST DELIVERY IN CONTEXT OF EXPECTED TRENDS

The Group is performing in line with expectations. We reported a net interest margin of 314 basis points in the second quarter, consistent with guidance provided earlier in the year given expected headwinds.

Customer deposits of £470 billion reflect a resilient performance in a competitive market and amid the continued shift in mix across the industry. Our second quarter Return on Tangible Equity of 13.6 per cent was lower than Q1, as expected, but demonstrates that the Group is performing well and provides us with confidence for the full year.

As a result of this confidence, we have today announced an interim ordinary dividend that is 15 per cent up on the first half of last year and represents an attractive return for shareholders.

William will provide more information on how we expect financial performance to develop over the second half of the year, including our enhanced 2023 guidance.

I will now briefly discuss our strategic progress, starting with slide 6.

SLIDE 6 – PROGRESSING OUR STRATEGIC TRANSFORMATION

We are now in the second year of our five-year strategic transformation, and halfway towards our first strategic milestone at the end of 2024.

You will recall that at the full-year, I highlighted that in 2022 we prioritised reorganising the Group and laying the foundations for our strategic success. Having achieved this, we are now building momentum across our strategic initiatives. This is supported by continued investments, with a further £0.6 billion invested in the first half of the year, bringing the total to £1.4 billion of additional strategic investment to date.

I am pleased to say that we are on track to deliver against our 2024 strategic outcomes, and in some cases have already surpassed these. This is translating into financial benefits which will grow more meaningful in future periods. We are on course to deliver the circa £0.7 billion of additional revenues from strategic initiatives by 2024, as well as the £1.2 billion of gross cost savings, a target that we increased at the full year.

On slide 7, I will highlight examples of the strategic priorities we have delivered in the first half.

SLIDE 7 – STRATEGIC PRIORITIES DELIVERED IN H1

Our strategic pillars are focused on driving revenue growth and diversification, strengthening cost and capital efficiency, and maximising the potential of our people, technology and data.

We are making good progress across our priority growth areas. This includes further increasing our unrivalled level of digital engagement. We are now operating with 20.6 million digitally active customers, surpassing our original target of greater than 20 million by the end of 2024.

We have also made good progress in developing our mass affluent offering in the first half, including the roll out of ready-made investments and tiered savings propositions. We are attracting new customers and increasing balances and expect to build greater momentum as we develop the offering further.

Our enablers are critical to both our execution efforts and ensuring that we deliver a more cost efficient and less capital-intensive business. We have now reduced our office footprint by around one-fifth since the start of the plan. Actions such as these have supported the delivery of approximately 50 per cent of our 2024 gross cost savings target to date.

Finally, we are increasing the number of new hires in both technology and data as we continue to improve our ways of working to better unlock the potential of our people.

Turning now to future delivery on slide 8.

SLIDE 8 – STRATEGIC DELIVERY IN H2

Our progress to date increases our confidence in successfully executing our strategic transformation. In addition to our achievements in the first half, we have a clear pipeline of deliverables for the rest of 2023. This includes launching a new, dedicated offering to support our mass affluent ambitions, as well as investing further in our Markets capabilities to improve our competitiveness, support more client needs, and deliver other income growth.

Alongside customer-focused developments, our disciplined approach to cost and capital efficiency will remain unchanged, and we will continue to progressively modernise our technology and data capabilities.

I will now end my opening remarks on slide 9 with a look ahead to future updates.

SLIDE 9 –REGULAR UPDATES ON STRATEGIC PROGRESS

As a reminder, it is our intention to provide you with a series of deep dive seminars over the coming twelve months, focused on our four priority growth areas.

They will provide you with an opportunity to hear more from the respective management teams and to spend more time focusing on our progress to date and our vision for the future. We are really excited about sharing our ambitions with you and hope that you will join these sessions, starting in October with a look at our Consumer franchise.

Thanks for listening and I will now hand over to William for the financials.

WILLIAM CHALMERS, CHIEF FINANCIAL OFFICER

Thank you, Charlie. Good morning everyone and thanks again for joining. Let me start with an overview of the financials on slide 11.

SLIDE 11 – ROBUST FINANCIAL PERFORMANCE

As you heard from Charlie, the business delivered a robust financial performance in H1 and in Q2. Statutory profit after tax of £2.9 billion is up 17 per cent on the prior year. Return on tangible equity was 16.6 per cent. Net income is up 11 per cent year on year, supported by a margin of 318 basis points and growth in other income. Total costs including remediation of £4.5 billion are up 5 per cent year on year, in line with expectations.

Asset quality is resilient. The impairment charge of £662 million equates to an asset quality ratio of 29 basis points. Tangible net assets per share were 45.7 pence, down slightly in H1 given the sharp movement in rates in Q2. Capital generation of 111 basis points was strong and supported our increased interim dividend.

With that, I will turn to slide 12 to look at the customer franchise.

SLIDE 12 – RESILIENCE IN CUSTOMER FRANCHISE

The customer franchise continues to be resilient. Total lending balances stand at £451 billion, down slightly in the second quarter. Retail balances were essentially flat in the quarter as a small reduction in mortgages was largely offset by continued growth in cards, motor finance and loans.

Commercial Banking balances were down £1.0 billion in the quarter. We continued to see net repayments, significantly relating to Government-guaranteed loans.

Total deposits stand at £470 billion. Performance was resilient, with Retail essentially flat in the second quarter and Commercial down £2.9 billion, the latter driven by expected short term placements flagged at Q1. Alongside, we continue to see steady growth in Insurance, with around £1.4 billion of net new money in the quarter.

Turning to net interest income on slide 13.

SLIDE 13 – STRONG NET INTEREST INCOME PERFORMANCE

Net interest income performance was strong in H1. NII of £7.0 billion in the first half is up 14 per cent year on year, although stable on H2 last year. Average interest earning assets are down slightly in the quarter. Small reductions in the mortgage book and Commercial Banking were partly offset by growth in the other lending portfolios.

The net interest margin of 318 basis points in the half includes 314 basis points in the second quarter. This fell 8 basis points from Q1 given the mortgage and deposit pricing headwinds that we called out at that time.

Having said that, Base Rate changes were stronger than we expected then, implying the step down in margin was a little less.

Looking forward, we expect AIEAs for 2023 as a whole to be slightly lower than Q4 '22 as the unsecured growth is offset by lower mortgage balances and repayment of Government guaranteed loans.

We now expect the margin for 2023 to be greater than 310 basis points. We are forecasting a peak base rate of 5.5 per cent, significantly ahead of our previous expectations. This will support the margin through H2, driving stronger hedge income. Going the other way, mortgage margin pressures and deposit mix shift are both expected to continue in the second half.

Non-banking NII was about £80 million in Q2. This is driven by volumes within our non-banking businesses as well as rates. Given the increase in rates seen in Q2 and increasing levels of activity, we expect non-banking NII funding costs to increase slightly from here and the run rate to be slightly higher therefore in the second half.

Now, moving on to the mortgage portfolio on slide 14.

SLIDE 14 – MORTGAGE BALANCES SHOWING UNDERLYING RESILIENCE

The mortgage book is resilient and now stands at £306 billion. The open book is down £1.7 billion in H1, partly due to the legacy portfolio sale in the first quarter. The back book continues to run down and is now around £39 billion. Customers continue to refinance their mortgages given higher rates – indeed, we are actively supporting them in doing so.

Mortgage pricing remains competitive. Front book maturities rolled-off at about 180 basis points in Q2, while completion margins remain at around 50 basis points. We expect margins to remain around this level through the second half, but of course it will depend on swap rate volatility and indeed, margins in other parts of the balance sheet. That said, mortgage lending remains attractive from returns and economic value perspective.

Let me now look at the other lending books on slide 15.

SLIDE 15 –GROWTH IN CONSUMER BUSINESSES AND CIB

Consumer balances are performing well. Balances were up £1.8 billion in the half, including £1.0 billion in Q2. We continue to see credit card spend recovering, although repayments are still somewhat dampening interest bearing balance growth. Motor finance is up £0.6 billion in the half, as industry supply issues continue to ease.

Within Commercial, Corporate and Institutional is up £0.6billion, including client growth alongside FX impacts. As said previously, Government backed borrowing repayments alongside limited customer demand are impacting the net SMB performance. We expect this to continue.

Now moving on to deposits on slide 16.

SLIDE 16 – DEPOSIT FRANCHISESUPPORTING CUSTOMER NEEDS

Deposit performance in the half has been solid. Total customer deposits of £470 billion are down 1.2 per cent in the half, or £5.5 billion. Retail deposits were down £4.9 billion in H1 and essentially flat in Q2, with current accounts down and savings up.

The Retail current account reduction in Q2 was a smaller movement than we saw in Q1. This reflects inflationary spend pressures, offset by wage increases and transfers into savings, as customer behaviours evolve. We estimate around £4 billion of current account outflows, or around two thirds, have been retained within our savings proposition. Supported by this retention activity alongside new money, Retail savings balances were up £3.1 billion in H1.

Commercial deposits were flat across the half, albeit decreasing £2.9 billion in Q2. Notably, while this reflected expected outflows of some short-term placements from Q1, business banking current accounts were much more stable in Q2. Recognising it is a fast changing environment, we continue to expect total deposits to be broadly stable from here, through the second half of 2023. Having said that, the mix shift to term savings is likely to continue.

As you know, the performance of our deposit franchise supports the structural hedge.

I will look at this further on slide 17.

SLIDE 17 – STRUCTRAL HEDGE A SIGNIFICANT TAILWIND

Our structural hedge remains a significant tailwind to earnings. Today, the structural hedge capacity remains around £255 billion. The notional balance is fully invested.

As you know, we manage the hedge prudently and maintain a buffer of hedgeable balances outside of the approved capacity. Given the deposit movements highlighted, this buffer has reduced. Accordingly, assuming deposit movements continue in H2, we expect a modest reduction in the hedge notional balance. This will be managed out of upcoming maturities.

That said, the circa 1 percentage point movement in the curve over the last quarter means the expected income effects of this are negligible. The hedge will continue to provide a very material and a consistent income tailwind looking forward.

In H1, we saw gross hedge income of £1.6 billion, an earnings rate of around 1.2 per cent. Looking forward, we expect hedge income will be around £0.8 billion higher in 2023 than 2022, but a similar increase again in 2024.

Now moving to other income on slide 18.

SLIDE 18 – BUILDING CONFIDENCE IN OTHER INCOME

We continue to build confidence in our growth potential in other income across the franchise. Other income of £2.5 billion in the first half includes £1.3 billion in the second quarter.

Retail is seeing improved current account and credit card performance, alongside a growing contribution from motor finance. Commercial other income benefitted in the first half from improved performance in markets and a successful bond franchise. Insurance, Pensions and Investments saw improved performance in life and pensions, general insurance and stockbroking, together driving higher income in H1.

The operating lease depreciation charge of £356 million in the half included £216 million in the second quarter. After two years of low charges during the pandemic, it is now normalising. It picked up in Q2 as a result of higher value new vehicles and lower gains on sale, growth from the Tusker acquisition and an adjustment to take account of recent price declines in electric vehicles.

As we look forward, we expect operating lease depreciation to be broadly stable at the Q2 level through the rest of 2023, with EV prices steadying, but offset by growth in business volumes and normalising car prices.

Overall, we expect other income to continue to develop, supported by our ongoing franchise investments. This is, of course, dependent on activity levels, but the underlying business trends are favourable.

Moving on let me focus on costs on slide 19.

SLIDE 19 – OPERATING COSTS IN LINE WITH EXPECTATIONS

Cost management remains very close to our hearts. Operating costs of £4.4 billion for the half are up 6 per cent, given our planned strategic investment, the costs associated with our new businesses and inflation. This gives us a cost: income ratio of 48.8 per cent.

In the context of persistent inflationary pressures, we remain focused. We are on track to deliver operating costs of circa £9.1 billion in 2023. Alongside, remediation remains low, just £70 million in H1 and £51 million in Q2.

Looking now at impairment on slide 20.

SLIDE 20 – RESILIENT OBSERVED ASSET QUALITY

Observed asset quality is resilient. This reflects our prime customer base and our prudent approach to risk. The £662 million charge in the first half is equivalent to an asset quality ratio of 29 basis points, in line with our guidance.

The first half includes a small charge of £5 million in respect of updated macroeconomic scenarios, alongside the £657 million underlying charge. £419 million in the second quarter includes £84 million for updated economics. Excluding this, the pre MES quarterly charge of £335 million is stable on Q1 and on Q4. Notably this includes both the Stage 1 provision roll forward into a more adverse economic environment and Bank Base Rate effects on recoveries, which do not represent actual defaults. Together, this equates to an AQR of 29 basis points. Again, in line with guidance.

Our stock of ECLs increased marginally in the half to £5.4 billion. This provides coverage of 1.2 per cent across the portfolio.

Away from the assumptions, we are seeing sustained low levels of new to arrears. Importantly, 92 per cent of our Stage 2 balances are up to date. Alongside, Stage 3 balances were broadly stable during H1 and Q2.

Based on our latest projections, we continue to expect the net asset quality ratio for 2023 to be around 30 basis points.

Given the importance of our macroeconomic assumptions to the impairment outcome, let me now briefly look at our updated base case on slide 21.

SLIDE 21 – UPDATED MACROECONOMIC OUTLOOK

Overall, we see 2023 as better than expected at Q1, but slower growth thereafter, partly down to higher rates. We now expect base rate to peak at 5.5 per cent in Q3 this year and for inflation to reduce more slowly than previously anticipated.

We expect unemployment to remain low, but forecast a gradual increase to around 5.3 per cent by 2025. After strong house price growth in 2022, we now model HPI declining 5 per cent in 2023 and see a peak to trough decline of around 12 per cent.

Moving on, let me turn to slide 22 to look at the performance across our lending portfolios.

SLIDE 22 – CONSISTENTLY REASSURING PERFORMANCE ACROSS PORTFOLIOS

Performance across our portfolios is consistently reassuring. We have seen a modest increase in new to arrears in mortgages and to a lesser extent credit cards. However, this is from a very low base. The trends in most portfolios remain similar to, or favourable to, pre pandemic levels.

We continue to see stable trends in SME overdrafts. Alongside, RCF utilisation remains more than 30 per cent below pre-Covid levels. We have a very high quality Commercial portfolio. Around 90 per cent of SME lending is secured, whilst more than 75 per cent of Commercial exposure is to investment grade clients.

We also have a modest and well diversified Commercial Real Estate portfolio. Net exposure, after significant risk transfers, is around £11 billion and lending is focused on cash flows. 80 per cent of the book has interest cover of 2 times or more. The average LTV of the portfolio is 44 per cent, while around 91 per cent have an LTV below 70.

Given the focus on mortgages in recent weeks, let me now turn to slide 23 to give some further insight on the strength of that business.

SLIDE 23 – MORTGAGE PORTFOLIO DEMONSTRATING RESILIENCE

The mortgage book is very resilient. We are seeing a modest increase in new to arrears, but again from a very low level and overall, remaining below 2019 levels. The increase is also focused on the legacy, predominantly variable rate business, originated in 2006 to 2008. This legacy book now has an average LTV of 34 per cent and an average loan size of around £100 thousand. Over two thirds of this book are on variable rate products, so have been dealing with progressively higher rates for over a year now. Arrears remain at low levels and have stabilised over the last couple of months. The rest of the book remains very resilient, with just 0.2 per cent new to arrears.

The average household income in our portfolio is over £75 thousand per year. In this context, average payments for customers refinancing onto fixed rates since October of last year have increased by £185 per month, or £2,200 per year.

Looking forward, in H2 and 2024, an average capital repayment mortgage moving to a 6.5 per cent pay rate, from a fixed rate of 2 per cent, will see the customer paying an additional £390 per month. Our affordability testing in recent years means customers refinancing in 2023 have, in fact, been tested to over 6.5 per cent. Most customers are finding these levels manageable. For any that have difficulties, we will of course support them.

Alongside, our customers have significant equity in their homes. The average loan to value of the portfolio is 42 per cent and 92 per cent of the book is below 80 LTV. Putting this all together, based on our client profile, our lending criteria and security, and testified to by our experience, the mortgage portfolio is well positioned for higher interest rates.

Let's now move to slide 24 and the below the line items and TNAV.

SLIDE 24 – TNAV IMPACTED BY RATES; UNDERLYING AND STATUTORY PROFIT CONVERGE

Underlying and statutory profit continues to be convergent. Restructuring costs of £25 million reflect only M&A and integration costs. The volatility line includes £182 million of negative insurance volatility, largely driven by higher interest rates in the second quarter.

Taken together, statutory profit after tax of £2.9 billion and the return on tangible equity of 16.6 per cent in the first half, constitute as said a robust performance. Looking forward, driven by both income performance and TNAV, we now expect the ROTE for 2023 to be greater than 14 per cent.

Turning to TNAV. Tangible net assets per share were 45.7 pence, down 0.8 pence in the half, including 3.9 pence in the second quarter. The quarterly movement is significantly driven by higher rates impacting the cash flow hedge reserve.

As we look forward, we continue to expect TNAV per share to grow as it benefits from the unwind of current headwinds over the medium term.

Now turning to slide 25 and looking at risk weighted assets and capital.

SLIDE 25 – STRONG CAPITAL GENERATION

We have seen strong capital generation so far in 2023. Risk weighted assets ended the half at £215 billion, up £4.4 billion. This includes a £3.0 billion impact anticipated from CRD IV models and remains in line with our 2024 expectation of £220 to £225 billion RWAs.

Capital generation of 111 basis points in the half was, as said, a strong result. This is after taking the full £800 million fixed pension contribution in Q1. If we deduct the CRD IV mortgage model changes and the phased unwind of IFRS 9 relief in January, capital generation was 75 basis points in the half.

The closing CET1 ratio of 14.2 per cent is also after 21 basis points for the acquisition of Tusker and 44 basis points for dividend accruals.

We have a very strong capital position, well ahead of our ongoing target of around 13.5 per cent. You will also have seen the Group passed the recent stress test, comfortably. The strength of the Group's capital position and prospects enables the Board to announce an increased interim dividend of 0.92 pence per share, up 15 per cent on last year. As usual, we will consider further capital distributions at year end.

We continue to expect capital generation for 2023, even after CRD IV and the phased unwind of IFRS9 relief, to be around 175 basis points. This represents a very healthy level of capital generation from a strong business.

I will now move on to slide 26 to wrap up the financials.

SLIDE 26 – ROBUST BUSINESS PERFORMANCE SUPPORTING ENHANCED 2023 GUIDANCE

In summary, the Group has delivered a robust financial performance in the half. Strong income and resilient credit trends support capital generation of 111 basis points and an increased interim dividend.

Looking forward, we are enhancing our guidance for 2023 and now expect:

- The net interest margin to be greater than 310 basis points;
- Operating costs to be around £9.1 billion;
- The asset quality ratio to be circa 30 basis points;
- The return on tangible equity to be more than 14 per cent; and
- Capital generation to be around 175 basis points.

In a changing external environment, the Group consistently performs well. That concludes my comments for this morning. Thank you for listening. I will now hand back to Charlie to wrap up.

CHARLIE NUNN

Thanks, William. So to recap, the Group continues to deliver in a changing external environment. These changes have increased uncertainty for our customers and in response we have been proactive in providing support where necessary, in line with our purpose of helping Britain Prosper.

At the same time, the Group is performing well. This includes a robust financial performance in the first half of the year which supports enhanced guidance for 2023, and continued delivery on our strategic ambitions. Our confidence in the future is increasing and we expect to achieve both the revenue and cost benefits that we laid out at the start of this plan. This will drive higher, more sustainable returns and capital generation.

Taken together, our Purpose-driven business, financial strength, resilient franchise, and continued strategic execution enable the Group to better support customers, both now and in the future. Thank you for listening, that concludes our presentation and we are now happy to take any questions.

QUESTION AND ANSWER SESSION

Question 1 – Guy Stebbings, Exane BNP
Morning, Charlie and William, thanks for taking my questions. Really around deposits, the hedge and margins. So I come back to the guidance on the hedge contribution this year being unchanged versus prior guidance despite the higher swaps. Can you help us think a bit more in terms of what notional amount of the hedge you are expecting and how this differs with the prior view? I think shortly after Q1 results you were talking quite positively about deposit mix; has that mix shift gathered steam during the quarter have there been more attractive term deposits for offer, etcetera? And in that context, do you see the quantum of outflows of current accounts and commercial deposits in Q2 as a run rate as we look forward or would you expect that to moderate? I don't know if you would be able to share the size of hedge buffer now. And then just a final big picture margin question. Thanks for the headline guidance. Previously you supplemented that with saying no quarter below 300 basis points but has that all moved up at all, alongside the full year guidance, or still sits as it did before. Thank you.

William Chalmers
Guy, thanks very much indeed for the questions. In terms of modest reduction we didn't define the terms precisely of course but modest reduction is single digits, we expect. So see let us see how we fare but single digits I think is a decent guide. In terms of deposit performance, I think overall actually the deposit performance has been pretty pleasing as I said in my comments, solid in Q2. So if you look at Q2 overall it is down about one percent, about £3.3 billion. Within that you have basically have got flat retail performance and you have got a slight reduction in CB. But actually the reduction in CB was very substantially composed of the short term placements that we flagged at Q1 and expected to come off in the course of Q2. Looking within that retail flat performance, as said balances overall flat, we saw PCAs down a nudge, we saw savings up. But actually if you look at the flow of PCAs, the PCA performance in Q2 was slightly stronger than it was in Q1. Both outflows to be clear, but about £2.7 billion in Q2 versus over £3 billion in Q1. So actually a flattening off in terms of PCAs. When we look at that overall, that gives us a view that as we look into H2 and get to the third of your questions, that we will expect to see customers continue to make choices as to where they put their savings in the course of Q2 and we expect movements from PCA into savings to continue in Q2. But overall in the context of fewer bank base rate changes than perhaps we have seen in H1 we would expect to see fewer prods if you like for those customers to instigate deposit movements going forward into the second half. Likewise lots of the money that is likely to move has moved to an extent already, so that works its way through and alongside of course our instant assess rates are getting progressively stronger and better for customers. So all of that means that we continue to expect to see PCA into savings moves in H2. Likewise within savings we are expecting to see moves too. But probably a flattening off in terms of the customer behaviours. And that leads us to, as said, suggests that the structural hedge change will be a modest reduction as we have defined.

It is worth noting just before moving on from that, the structural hedge, the effect if you like from the structural hedge earnings as said in my comments earlier on Guy, any modest reduction is outweighed, in fact, as we stand today probably more than outweighed by the interest rate changes that we have seen. And just to take a moment on that, if we look at Q1 versus Q2 today we have seen the three year rate up over a percentage point higher. Likewise we have seen the five year rate up almost a percentage point higher. These are significant moves in terms of the earnings rates on the hedge at which we will be deploying maturities. So I don't think there is any lack of confidence in the structural hedge. I don't think there is any lack of confidence in the earnings ability of the structural hedge as we move forward Guy. This is more around tweaks around the edges.

Second question, when we look at your, the base rate question that you asked and the floor around margins. As said we have increased the margin guidance today from greater than 305 to greater than 310. That is off the back of bank base rate changes that we have seen being in excess of what we thought would happen at Q1. It is also complemented by deposit moves perhaps being a bit more benign that we had expected at Q1 too, in line with the comments that I just made a second ago. As that flows through into the second half of this year. It is likely to lead to a margin performance for Q3 and Q4, that is a nudge ahead of where we have previously expected it and talked about either at the year-end or at Q1. So in that sense, the improved margin guidance of greater than 310 does indeed flow through to another nudge up in respect of Q3 and Q4 and we would expect to see that play out.

Guy Stebbings
Okay thank you very helpful.

William Chalmers
Thanks Guy.

Question 2 – Chris Cant, Autonomous
Good morning thank you for taking my questions. If I could just have a quick follow-up on the previous question then I have another one. The follow-up is specifically thinking about what you have been seeing so far during July. Has there been any change in the pace of behaviour change you have seen, or has it really being a sort of steady as you go so far from the first quarter?

The other thing I wanted to ask about was the controversy that I think you are referring to with your very initial remarks Charlie. So do you see de-banking as an issue potentially becoming a conduct problem for the UK banks. There is obviously a lot of political focus on this at the moment. I am very conscious that a lot of the decisions that you may have made in respect of customers may have been done for AML or other reasons, but there does seem to be some political steam building up behind this issue and I am just wondering whether you see any potential conduct risk around decisions you may have made in recent past? Thank you.

Charlie Nunn
Thanks Chris, maybe William will build on the first question and then I will take the second one.

William Chalmers
Thanks Charlie. Chris the short answer to your question is no, no behaviour changes in July there were of any note. I think if anything actually it is probably tilting marginally in favour i.e. customer behaviour changes that are slightly better than we had expected from a deposit point of view. The reason I say that is because as per my comments earlier on we have seen probably better deposit performance in Q2 as a general matter. As we go into June and July actually we are seeing some beneficial effects of some of the salary changes that we have seen feeding through into our PCA balances which is a nudge ahead of perhaps where we have previously thought. So it is a little too early to call that but nonetheless I think in July there is no noticeable changes with that slight you know bit of context around it. I will perhaps stop there and hand over to Charlie.

Charlie Nunn
Yes just one build on that. As William said we have seen increased wage inflation in the range that we were all expecting which is kind of the 6 to 8 per cent increases. When you look at how customers are adapting their spends we know inflation has obviously been higher for spending on all of our current accounts and cards have also been in that kind of 6 to 8 per cent range. So that is why I think partly why we saw the stability in Q2.

And just on your de-banking issue or when we look to exit customer relationships. It is a good question Chris. I think the simple answer is no I don't see that at this stage. I can't talk for all UK banks but I can talk for Lloyds Banking Group and we have always had a clear policy and obviously I have gone back in the last few weeks and checked how our policy is being implemented. We don't look at customers' personal or political beliefs either at the point of onboarding or when we do periodic reviews, as we do with PEPs, or if there were a decision to exit customers. So I think in the specific issue where there are strong political sentiments, obviously we are going to have a discussion with the economic secretary later today and there will be some regulatory oversight around this. I don't think that's an issue and as you say we exit customers today for very specific reasons. One of the examples is economic crimes, so anti-money laundering, fraud and sanctions. There are very specific obligations we have around that. So for Lloyds Banking Group I am comfortable our policy doesn't expose us to this risk. Obviously what is in the mind of the regulators or Government, or what other banks do, I can't comment on Chris. But thank you.

Chris Cant
That's very helpful, thank you.

Charlie Nunn
Thanks Chris.

Question 3 – Edward Firth, KBW
Good morning everybody, thanks very much for this presentation this morning. My only question is to pick up on the comments around wage inflation. You are clearly running ahead of perhaps what you are expecting this year and what we were expecting anyway. I am just asking in the context of the consensus cost point. It still looks about a 1 per cent cost growth for 2024 and 2025 which feels like it would be a very impressive performance in this current inflationary environment. So I just wondered if you could comment what your thinking is about that and if you agree that's where the risks are and how do you think that might develop as wages increase. Thanks very much.

William Chalmers
Yeah, thanks Ed, perhaps I will take that question. On the wage inflation that we are seeing, as said that has been benefiting PCA balances. It is also composed not just of regular wage inflation but also back payments don't forget. There is a lot of that going on right now and that clearly overall benefits balances. Your question was about how that feeds into our cost base going forward. As you know we have two cost targets out there right now. £9.1 billion in respect of 2023 which, as said in my comments, we expect to achieve and £9.2 billion in respect to 2024 which of course stands. When we look at inflation in the costs over the plan period we obviously took a look at this at the close of 2022 before coming to the market to present the full year results. We see cost inflation in a variety of areas, we certainly see it in wages and that is a big part of our overall opex, around 40 per cent. We also see it in terms of technology suppliers, in terms of utilities, in terms of third party services provided to us including consultants. So there is a wide spread of cost inflation sources. It comes from a number of different places in addition to our overall wages bill. We also have a number of tools to try to offset cost inflation as a general matter. And you will be familiar with these whether it is a regular matrix cost management structure that we deploy, whether it is forward hedging of things like commodity prices and utility expenses. Whether it is some of the strategic initiatives that as you know we have had a target of £1 billion out there, we have now increased that target to £1.2 billion. These are all ways in which we try and tackle cost inflation Ed. Let's be clear it is tough, it is demanding but the organisation has a good track record of doing it. As said that is what allows us to give the cost targets that we have given and that is what allows us to continue to be committed to them in the environment that we are in.

Edward Firth
Great. Thanks very much.

Question 4 – Jonathan Pierce, Numis
Morning both. A couple of questions please. The first, just coming back to the structural hedge. There's a lot of focus on that, the size of the hedge notional. Just so I try and understand this properly, if you decide in the second half not to reinvest single digit amounts on a maturity coming through, but the deposit base itself remains pretty stable, you are simply going to be essentially reinvesting those maturing hedges into floating rate assets rather than fixed rate assets. So the notional hedge size drops but the immediate effect is the positive impact of the overnight rates, currently above the five year swap rates. So just want to check that thinking is correct.

The second question is on the TNAV. I mean obviously the cash flow hedge reserve weighed down appreciably in the second quarter but it looks like and we don't have detailed enough disclosure to be sure of this, but it looks like the pension remeasurement was pretty big in Q2 as well, a big negative. Could you help us think about movements in TNAV going forwards. What is the big driver of the pension remeasurement, is it simply rates as well? So as we see rates start to come off in the third quarter, TNAV will get a bit of a kicker and maybe this is supplementary to this. How much of the TNAV drop in Q2 is behind the ROTE improvements or would you have been improving the ROTE to circa 14 per cent today even if that TNAV hadn't come off so much in Q2? Thanks very much.

William Chalmers
Yeah thanks Jonathan. Three questions there I think, one structural hedge, one on pension remeasurement and relationship to TNAV and then one on the source of the ROTE improvement. In terms of structural hedge, a couple of comments to make. One, as said, modest reduction means single digits. We have around £20 billion of maturities in the second half of this year, around £40 billion of maturities next year. So as you can see maturities very significantly outweighing whatever adjustment around the edges that we might make to the overall hedge balance.

I think that is one point. The second point to the topic you were raising there, Jonathan. It depends upon what happens, the deposits that we take out of the structural hedge. On the assumption that the deposits stay with us, then as you say we are going to be putting them at a bank base rate for the sake of argument which is currently around 5 per cent, which as you know is actually ahead of the five year rate right now, which is more like 4.8 per cent. So there is a marginal earnings improvement in putting those funds into the base rate as opposed to a five year swap. Now having said that if it goes into a fixed term deposit we are clearly going to be swapping against that fixed term exposure. And therefore while we will make a margin on the fixed term deposit for sure, we are making the margin off the difference between the customer pay rate versus the swap in which we invest the fixed term. So we should be clear about that. It depends on where the money goes. If the money sits on the balance sheet and just adds to the buffer which has been the pattern to a degree so far, it earns base rate. It's a net neutral in fact almost net positive change. If the money goes into a fixed term deposit that is determined by the margin on the fixed term deposit.

Second point, on the pensions remeasurement and how that plays into TNAV. As you know we saw a TNAV reduction of 3.9 pence per share over the course of the second quarter of this year, a marginal reduction over the course of the first half. A number of factors played into that TNAV adjustment. A significant part of which was the rates, so if I just focus on the 3.9 pence per share in Q2 for example, about half of that was the cash flow hedge reserve adjustment for rates. And then you have got other effects including the dividend being paid out for example, but including the one that you mentioned, which is around the pensions remeasurement. And to come back to your question there Jonathan the rates impact is the primary mover of the pensions remeasurement. There are other pieces at play, gilts is clearly one of them, obviously that relates to rates. But also credit spreads likewise. These factors all go into the pensions remeasurement in any given quarter, but rates is, I would say probably the most important and maybe the most consistent mover of the pensions remeasurement in any given quarter.

Your third question on TNAV and the relationship of that to ROTE improvement. In short, we have seen some reasonably significant income additions and indeed earnings improvements to the business over the course of H1 and projecting into H2 versus what we might have expected at the beginning of the year. That is the R part of the ROTE equation clearly. Now it also happens that as you have seen in Q2 and H1 some of that return improvement has been offset by below the line volatility. Which means that the share of R component in improving the ROTE guidance has been somewhat dampened by that volatility component. The TNAV meanwhile as we just discussed has gone down a fraction over the half, 3.9 pence in the quarter and that contributes the ROTE improvement.

So Jonathan the short answer to your question is that both returns and TNAV reductions have contributed to our guidance of in excess of 14 per cent ROTE for this year. But on balance it is probably a little bit more than TNAV reduction versus the earnings enhancement because of that volatility point that I just mentioned.

The final point I will make Jonathan is that these TNAV changes that we are talking about, they should unwind and they will unwind for two main reasons. One is because as you know, the rates projections that we have suggests at some point a little further out than we thought at Q1, but rates are going to come down. That is going to unwind the TNAV effect. The second is as the structural hedge matures you will see a lot of those balances repriced from 1.2 per cent which is roughly what they are right now to something like the 4 or 5 per cent rate environment that we are seeing. And as those structural hedges mature, again, £20 billion second half, £40 billion next year, that is going to rebuild the TNAV. So there is a pretty automatic unwinding process at play there. It is just that it is hard to predict exactly what happens to anything in the given quarter in a period of interest rate volatility.

Jonathan Pierce
Brilliant, very comprehensive. Thanks a lot William.

William Chalmers
Thank you Jonathan

Question 5 – Aman Rakkar, Barclays Capital
Good morning Charlie, good morning William. Thanks very much for taking the questions. I want to labour the questioning around the hedge. Can you just clarify, I think something has gone on with the size of the hedge maturity profile in Q2 and H2. I think as at Q1 you talked about £35 billion of maturities and, forgive me if I am wrong, but I thought the best part of £30 billion was coming in H2. But obviously now that looks like it is more like £20 billion that is coming in H2. So it seems like there is some trading of the structural hedge that may have taken place in Q2. So could you clarify if that is the correct read of the situation because presumably you have pulled forward some of the benefit of the hedge maturity gains into this year's NIM. And I guess as a related question, I am just thinking about the tailwind of the structural hedge in 2024. So I think you talk about £800 million in 2023 and a similar number in 2024. That to me sounds quite low given the maturity profile you are calling out, £20 billion run rate into next year and the £40 billion that you are calling out. I would have thought that hedge tailwind could be 50 per cent higher than that £800 million that you are calling out. So can you help us understand what is going on there and I guess, just to close this off, that I feel like your structural hedge is a really, really important driver of your medium term earnings and longer term earnings. You are clearly going through a period of adjustment around that interest income right now, there is uncertainty around your deposit dynamics near term. But the thing that presumably gives you confidence longer term is this really quite substantial hedge tailwind. So any kind of colour you can give us around your confidence around the size and the income profile would be great. Thank you.

William Chalmers
Thanks Aman. I will, there are three questions there around what happened to hedge maturities over the course of this year, around the tailwind looking into 2024 and around the structural hedge drivers going forward. I will answer all three but I will turn to Charlie actually on terms of the deposit dynamics on the third in particular to add further context.

Aman, on the first question around structural hedge maturities, as said it is maturities around £20 billion looking into H2 as we stand today. I think at Q1 I probably talked about H2 maturities of around £25 billion, something like that number. What has gone on to reduce that £5 billion, it is effectively pre-hedging Aman. So we manage the structural hedge according to principles of income stability in order to produce a predictable earnings profile which in turn allows us to make predictable distributions to shareholders, a source of value. And the second principle being one of shareholder value. And so when we see opportunities to manage at the margin if you like, then we will lock in some of the hedges in accordance with that. And that is what we saw in the period during Q2. And as a result, the hedge maturities in Q3 and Q4 have gone down from circa £25 billion to more like £20 billion as we have sought to lock in the shape of the curve in the interests of securing income on a stable basis to the group going forward. So it is pre hedging in-short Aman.

Second of your questions, the structural hedge tailwind going into 2024. As you say we put forward a circa £800 million further tailwinds for the group looking in 2024 as a result of the £40 billion of structural hedge maturities that we expect to see. So those hedge maturities, I won't give you a precise number, but it will be a little bit in excess of the 1.2 per cent and will be around that zone for the 2024 period. That suggests that based upon the rates that we looked at as of the 30 June, that £800 million tailwind is what makes sense. Generally speaking we manage this reasonably conservatively so that we can predict with confidence what we are going to deliver to you. That in turn is then subject to the volatility of markets at any given point. And so if we overlay a kind of market implied analysis, if you like on top of the hedge analysis that we give you, there is probably a little bit of conservatism built in there. But it is not 50 per cent to be clear Aman. So it isn't going to be a question of delivering £1.2 billion versus £800 million based upon market implied analysis. It might be a nudge higher than £800 million but not of the order of magnitude that you are indicating.

Third point, the structural hedge drivers. Let's be clear what we are talking about here is around the edges. We are talking about a marginal reduction, a modest reduction as we have termed it, in the overall context of the structural hedge of £255 billion. As I said earlier on, we have seen rate changes in between quarter one and quarter two for the three year rate for example, relevant obviously to the three and a half year weighted average life of the hedge, of over 1 per cent. If you take that as a proportion of what the rates were as of Q1, that is 25 per cent of the rates at Q1. So it has gone from roughly four and a quarter to roughly five and a quarter over that time period. That's a very significant, in fact I would say an overwhelming, adjustment versus the type of modest reduction that we see in the overall size of the hedge.

So that is the context to put it in and then just the final point before handing over to Charlie on this on Aman, is that again the deposits picture, it feels pretty robust. When we look at that as I mentioned earlier on, the PCA performance in Q1 versus Q2 down from over £3 billion outflows to around £2.7 billion outflows. And then Chris's question earlier on, some healthy signs during the course of the last few weeks or so. Looking forward, we are likely to have fewer bank base rate changes. Looking forward, much of the money that was going to move off the back of higher rates probably has moved or is moving over the course of quarter 1 and particularly quarter 2. We are nudging instant access rates up a little bit. Looking forward, the forward curve is likely to be a touch lower and so the competitive offers will have to reflect that. Again looking forward, we have got inflation on salaries and seeing them so far we will continue to see them going forward. These are all reasons I think why we have confidence in the deposit base going forward which in turn leads us to the guidance that we have on the structural hedge today. So I am going to pause there and hand over to Charlie.

Charlie Nunn
The only thing I was going to add William, but thanks for the question Aman, just on the investment thesis over the next three years. Definitely the structural hedge, and we have confidence around that as William just laid out. The two other things that I would still mention which are really important. First of all as you know we are committed to £1.5 billion of additional revenue linked to our strategic initiatives. You know it is better to be lucky than good sometimes. We got going on that before Russia invaded Ukraine and we went through a rates cycle and I hope what you can see today, and we will give you another update at the end of the year, we have got momentum. The other operating income we think shows increases off that and that is a reason to believe that we will navigate the next three years very strongly. And then the second one is, none of us can sit here and predict what the economy is going to do or what will happen to rates, but we know as rates go up and down what you need to deliver for shareholders and customers through that cycle is a balance sheet that is well leveraged, is well diversified and has a mix of assets across commercial and retail and secured and unsecured. And we have got the best balance sheet in the UK. So if rates were to come down we will be able to continue to compete and generate capital returns based on our assets. So we have got the structural hedge giving us a strong driver underlying the business, as William just laid out. And we have committed to and we are re-confirming our strategic revenue growth initiatives. So that is why we feel confident about the capital return that we have laid out over the next few years.

Aman Rakkar
Thank you very much Charlie. Thanks very much William for your answer.

Question 6 – Robin Down, HSBC

Good morning. I am not going to ask about the structural hedge here. Can I ask about the other income line. It looks quite an improvement in the first half. I was just wondering whether you can give us a little more colour on the moving parts, particularly on the Retail side and your expectations for H2 on that other income line?

William Chalmers

Yeah thank you Robin and thank you for the question not being about the structural hedge. Actually I should add, OOI, as I said in my comments earlier on, has been a source of decent performance in the first half. So what is behind it is your question and how we look at H2 in that respect. When we look at what is behind it in respect of H1, it is contributions really from all of our three main business areas. So I look at retail for example, and that has seen contributions during the half from a combination of customer activity in respect of PCAs, consumer finance business, the motor finance business including not just Lex, the business that we already own, but also the acquisition of Tusker, especially in Q2. Those businesses all contributed to a decent performance. If you look at H1 last year verses H1 this year it is up around £150 million. If you look at commercial, a similar comparison up around £125 million, what is leading to that, it is a combination of financial markets i.e. flow driven business, together with a developing capital markets business, in particular bond financing business over the course of the first half of this year. To be fair, a touch stronger in Q1 than it was in Q2 but nonetheless a really decent performance during the half.

Moving on, Insurance, Pensions and Investments, a number of moving pieces there. The three that I would point out in respect of the half year performance are first of all the unwind of the CSM, that as you know has been an IFRS 17 adjustment, between 2022 to 2023. The CSM now stands around £4 billion pre tax, around £3 billion post tax. That CSM in addition to a further £1 billion of risk adjustments, unwinds over time into our earnings. And that has led to a stronger contribution during the course of the first half of 2023. Alongside that Robin, the general insurance business is doing better, the combined ratio is now below 100 per cent within the general insurance business. And that together with the absence of weather events has allowed us to see decent, in fact improved performance in the general insurance business. Obviously the weather events have previously fed into a combined ratio which is higher than we would like to see it on a long-term basis. Now it is adjusting back down.

And then finally the return on free assets, Robin, is a further factor. As we moved into a higher rate environment, the return on free assets in the insurance business has strengthened and that has led to about a £90 million increase versus last year. So across each of those three elements we are seeing some decent progress. There are always underlying elements. Second point there are always underlying elements Robin, within OOI. We like to strip those out internally and take a look at what is going on underneath the hood as it were. When we look at that on an underlying basis, first half this year versus first half last year, we think we are seeing around a 7 per cent underlying growth rate after stripping out any of the anomalies that you might see at any given quarter or any given half. So that is the overall picture, albeit that growth rate was less than 7 per cent if you look at Q2 versus Q1 and that is for the reasons that I mentioned around one or two of the individual business lines right there.

When we look into H2, the second part of your question Robin, we would expect the growth to continue as a function of two points. One being activity levels in the businesses that I described a second ago and two is the gradual effect of some of the strategic investments being built into the overall operating performance of the business. We haven't guided on OOI so I will be a bit careful about what I say in respect of the full year's expectation for that number. But I think we would expect to see continual, let's say measured growth going into the second half of this year even if it is not quite as strong as the 7 per cent year on year growth that I mentioned in H1.

Robin Down

Sorry and just to clarify, when you say growth, do you mean growth versus H1 or growth versus H2 of last year?

William Chalmers

I mean well, I mean growth verses H2 of last year Robin but overall it's the comparison, the weighting between H1 and H2. That growth expectation if you like, maybe slightly more heavily weighted towards H1.

Robin Down

Great, thank you.

Question 7 – Raul Sinha, JP Morgan

Morning Charlie, morning William, thanks very much for taking my questions. Just given some of the recent rate hikes, you have a 50 basis point rate hike within this quarter. I was wondering if I could draw you a little bit more on the profile of the NIM in the second half of the year. And I guess within that I was looking for a little bit more colour in terms of how much deposit beta you have seen in terms of what you pass through so far and what you expect to pass through in terms of your assumptions. And if we think about the broader picture of NIM. You know on one hand you have got the

mortgages showing headwinds, on the other hand you obviously have got maturities on the hedge coming back. How far would we be from a flattish margin trajectory in the second half of the year? Thanks very much.

William Chalmers
Thanks Raul. To give you some thoughts on that, as you know we saw the margin come down in Q2 from 3.22 per cent in Q1 to 3.14 per cent in Q2. There were a couple of things going on there really. In terms of tailwinds first of all, a little bit of a tailwind from funding and capital, but frankly not very much. And as you know the absence of the hedge in Q2 meant that not much was coming from there either. The headwinds that brought it down, as I said in my comments earlier on, predominantly mortgages and then the deposit pass on, turning to your question. And that is what makes the 8 basis point reduction in Q2. Now when we look forward to the remainder of this year, as you know we have increased the margin guidance from greater than 3.05 per cent to greater than 3.10 per cent. That is partly off the recognition of what was achieved in H1 being a little bit stronger than we had expected. And it is partly recognising what we think is going to be achieved in H2 is also going to be a little stronger than we expected. The headwinds and tailwinds looking forward Raul, first of all the tailwinds perhaps. The structural hedge starts to kick in, as said £20 billion of maturities less whatever modest reduction we might see, but nonetheless a significant tailwind going into H2 of this year.

Second, the headwinds as we look at them going into H2. Again continued expectation around mix shift within overall deposits alongside the mortgage refinancing that we expect to see. We might see a bit of compression in margins in some of the other retail and CB. But again it is basically those two. Deposit mix shift number one and mortgage refinancing number two. Those are the mix. What will that produce? We expect it to produce a margin that is slightly higher than we have previously indicated. At the year end we talked about a floor that I think Guy mentioned in his earlier question of around 300 basis points. We expect it to perform a little bit better than that now going into Q3 and Q4. The beta in that mix, Raul, we haven’t put a number on the beta in that mix. As you know the pass on decisions are basically determined by what offers the best value to our customers, particularly in the context of Consumer Duty clearly. What is the competition doing and how should we best respond to that and what are the funding needs of the business. Those three are the criteria to assess the pass on decision. It is safe to say two things I think Raul, one is that so far we have been very much in line with the sector in terms of the overall pass on decision. Two is as we look forward and, consistent with what I think Charlie and I have always said, we do expect the pass on to increase as we get into a higher base rate environment and indeed we expect some of the pass on to continue even after base rate changes have stopped. And so that will increase a little bit beyond where we are today. At the moment we are below 50 per cent but we do expect it to increase towards that level as we go forward consistent with the comments I have just made. So I will perhaps pause there, I hope that answers your question and let me know if it doesn’t.

Raul Sinha
Thank you, that is really helpful William. I have got an unrelated question on the buy to let arrears profile. I don’t know if you are seeing anything specific. I think you flagged the 2006, 2008 vintage and did some helpful disclosure on the slides. But I guess my question is specifically around buy to let, if you are seeing any specific arrears trends within there. Could you give any colour in terms of that business going forward? Thank you.

William Chalmers
I think the short answer is no ,Raul. As we look at the buy to let portfolio it obviously is one of our portfolio businesses. It is not seeing arrears trends significantly different to what we are calling out in the materials that we have provided today. As you know today we called out a mortgage portfolio that is performing well inside of our 2019 new to arrears experience. The heritage portfolio is a little different from that, not terribly much so. But the reason why I put the slide in is just to provide further colour if you like on that point. Buy to let isn’t a particular portfolio that we would call out as being any different to anything else that is going on. The one point I would make Raul before concluding is more of a flow point actually. We are seeing buy to let as a proportion of new business on the portfolio going to very low levels and so it is much more about the residential portfolio right now than it is about the buy to let new to lending as buy to let is much smaller than it used to be.

Raul Sinha
Got it, thank you.

William Chalmers
Thanks Raul.

Question 8 – Rohith Chandra-Rajan, Bank of America
Hi good morning. Thank you very much. I had a couple please. The first one was just a follow-up actually on the deposit beta. So you said historically you thought over time a combination of pricing and a mix would move towards 50 per cent and it sounds you just reiterated that, William. But obviously we are now talking about materially higher policy rates than

we were all expecting previously. So that implies a much wider deposit spread and you might have been anticipating. Just wondering if that is the correct read of that, or whether actually over time you might think that deposit beta could overshoot the 50 per cent. And so that was the first one.

And just coming back to the TNAV and thinking about the short-term. If I look at five year rates today versus the end of June, that would imply something like a third of the cash flow hedge reserve impact in Q2 might actually flow back in Q3. So I just wanted to check if that was the right way to think about that, as well as the maturities you talked about before. Thank you.

William Chalmers
Thanks Rohith. I will answer both but Charlie will want to add I think on the deposit point in particular Rohith. So let me just start on that, hand over to Charlie and then come back on the TNAV afterwards. In terms of the deposit beta, it is worth first of all just saying that this is a cumulative number that is given. So when we talk about 50 per cent deposit beta, it is cumulative over time. What that means is that in the early stages of rate rises, as you know essentially all banks rebuild the margin from what had been a very compressed level during the zero interest rate period. Not that much of the initial rate rises were passed on. As those rate rises have increased, so the cumulative beta has moved up. There is still a little way to go as I indicated in my comments Rohith before we necessarily hit the 50 per cent mark. As to whether it then exceeds it over time, I would leave Charlie to try to comment further. But at the margins it is not impossible. I think we have to see how things develop. But we are a little way off that right now so that is not a concern for now, it is not a concern I suspect for this year. And indeed our expectations are deposit beta are fully built into our margin expectations for this year, which as you know and by the way and importantly to your question, have just increased from a greater than 305 basis points to greater than 310 basis points. That partly I think answers your questions so I am going to pause there and hand over to Charlie and then I will come back on TNAV.

Charlie Nunn
My experience from having managed big deposit businesses through multiple rate cycles in the last ten years is that you typically end up with people valuing liquidity at the start of a rate cycle i.e. when there is more uncertainty they want instant access. And there is then more confidence around the economic environment, being willing to shift some of their savings into fixed products. What you typically see is across the whole deposit base, is about a two hundred basis points spread between the bank base rate and the deposit base. So as we have been going through this the last couple of years I think we've said a couple of times the 50 per cent pass through which would take two or three years for our customers to adjust where they have got deposits, has always been what we thought made sense as we were thinking about rates at three or four hundred basis points. The reality is we are now looking at rates which are a bit higher. The real question is how long will they stay at that rate and what are the expectations around it. And especially as you start to think about time deposits, that is obviously priced based on the one or two year curve. And actually when we look at our forecast for rates, we are not going to stay at these highly elevated levels or higher levels for long. So I think the answer is we are building towards 50 basis points. As William would say, we have got some way to go, that is because customers' value liquidity. And we have got such a strong retail franchise and strong transactional capability. We should continue to expect that to shift. If we think that the rates and the yield curve and customer behaviour are going to push us up to about 50 per cent, we will tell you if we get there. I think what is good about that from our perspective to the shareholder, is if we are in that environment we are going to always find a way of optimising our NIM and that is what William just said. Despite the higher rates, we are guiding to higher NIM.

William Chalmers
Moving back to TNAV Rohith on the second part of your question, you can go ahead if you would like to carry on?

Rohith Chandra-Rajan
Excellent, just going back to that very briefly before we move on. So mechanically if we are expecting rates to go from pretty much zero to 300, that would have been a 50 per cent pass through, would have been a 150 basis points spread. At 5 per cent that is 250. I think Charlie, what you are telling us is that because you don't expect rates to stay at that very elevated level for a significant period of time, that actually the fixed rate spreads would be lower than that. Is that the right way to think about those contents?

Charlie Nunn
Rohith, I know we are not being as specific as I think would be helpful. The reason is that we are going to have to see how the competitor and customer behaviour develops. What I can say is I have managed businesses like this through rate cycles over the last ten years in other countries. And the broad theme I just laid out, which is at least 200 basis points of margin, it takes two to three years for customers to decide how they move their deposits and for the competition to play out. And you know, when the landing points of rates is about 4 per cent, that 50 percent is a good assumption. Bluntly, I will give you an example in Mexico when it was 7 percent. The 2 per cent compared to more like four and a half, five percent pass through after three or four years

of that cycle. So yes, you interpreted it right. We are not going to fill out a very, very detailed forecast around it because it is going to be down to customer behaviour and competitive behaviour. But our assumptions to date have been pretty helpful I think for you. We said people don't typically start moving money until they get to about 3 per cent base rates, which is what we saw happen last November. And then we have guided that we will end up towards the 50 per cent pass through and our NIM guidance includes those assumptions around churn and pass through. So it is very hard to be more specific than that Rohith and so it is not us trying to be unhelpful. But I do hope that you feel we have some track record here and we have some confidence for other experience that is helpful to you as you develop your model here.

Rohith Chandra-Rajan
Yeah thanks that is helpful thank you.

William Chalmers
Rohith, your question around TNAV. Again just to repeat some of the inputs to that. As you know the TNAV was down a fraction, well about 0.8 pence in the course of the half, 3.9 pence in the course of the second quarter. As said in the discussion with Jonathan, the cash flow hedge reserve is responsible for about half of that. We have one or two other elements going on, notably the dividend. And then the offset and the impact between the buyback going out and number of shares being reduced. That also is a modest net negative contributing to a 3.9 pence per share down before you get to the pensions fund. Now as we move forward your question is about how does that evolve. A couple of points to make there. One is the sensitivity which I think we disclosed at the full year. It is around £17 million, £12 to £13 million post tax for a one basis point change in rates. So that will enable you to do a sensitivity based upon your expectation as to where rates will go. When we look at our expectations as to where rates will go, over the course of this year we have given them in our forecast. We do, as your question suggests, see quite a significant untick in the context of the TNAV and particularly the cash per hedge reserve in the second half of this year. Based upon that, based upon profitability, based upon our expectations as to the buyback, the pension, we would expect to see the TNAV per share by the end of this year, won't give you a precise number but much closer to 50 pence from where we stand today. Now I don't want to be held captive by that remark because of course we can't dictate interest rates and exactly where they go. So based upon our forward look with the inputs that I have just given you, we are looking at a number that is much closer to 50 pence.

Final point on the TNAV which I think is worth stressing Rohith, is that none of this has anything to do with capital or distributions to you as shareholders and the market more generally. Whatever movements are in TNAV, appreciate they have been slightly volatile over the course of this half. But none of it has anything to do with capital generation or capital distributions. And I think that is just important and worthwhile for people to remember.

Rohith Chandra-Rajan
Thank you very much.

William Chalmers
Thanks Rohith.

Question 9 – Martin Leitgeb, Goldman Sachs
Yes good morning. Can I have a follow-up on the outlook for net interest income. And I was just wondering if you would be willing to comment on the trajectory for net interest income going forwards. Obviously multiple moving parts, margin comments earlier, the comments on deposits migration somewhat fading as we progress. And also the impact of the hedge tailwind and even some hedge roll over late in the year. Would it be fair to assume from your perspective that net interest income continues to build in absolute terms from here?

And the second question I was just wondering with regards to the health of the UK consumer. Your disclosure on slide 23 in terms of average impact in terms of mortgage payment being up £200 a month so far. But eventually rising closer to £400 per year. But you also disclosed that the average income for this mortgage holder would have to be well above average for the UK of £75 thousand. Is the message here that you see the UK consumer holding up well, as their wage growth in these categories, could potentially more than offset somewhat the headwinds from higher mortgage rates and the outlook for the UK consumer overall being fairly benign. Thank you.

William Chalmers
Thanks Martin. What if I take the first of those two questions and then Charlie perhaps takes the second on mortgage payments. When we look at NII for 2023 we don't guide to a particular number in respect of NII. What we do is give you a sense as to what we think average interest earning assets are, what we think the margin expectations are going to be and then allow you to draw your own conclusions around the NII contribution. So I won't breach that line as it were, I won't go beyond that. Safe to say that when we look at the NII expectations, net interest income expectations, it is those factors as given to you that are at play. I would

also highlight the non-banking interest income as part of this. We talked about it at Q1 clearly. It has gone to about £80 million versus I think of £74 in Q1 so £80 million in Q2 versus £74 million in Q1. As said earlier on, because our activities are increasing and by the way that does generate income in OOI amongst other lines. But as those activities increase, the volumes of those activities increase number one, and as rates increase and therefore the cost of funding them, number two, that will nudge up non-banking interest income a little bit in Q3 and Q4. Not terribly much but we will see a slight movement in non-banking interest income in accordance with that. And those factors are at play in determining the net interest income over the course of this year. And today is obviously not the day to give guidance into 2024. But hopefully that is useful without breaching too many of our guidance guidelines.

Charlie Nunn
Great, and thanks for the question on mortgage customers. First thing, we included this slide because we thought and we had heard that some of you would be keen just to get a forward look on mortgage customers given that we have seen a step up in mortgage payments and the intent of this slide is to give you confidence that we think our mortgage customers can withstand the higher payment. One thing which is probably more for media than for you, Martin, but just be clear I am not saying that it is easy for our mortgage customers. I am just saying that we are confident they have the financial resources and the capacity to absorb the kind of difficult up-tick in monthly mortgage costs that we are talking about. Now what is the reason for that as you said? Overall household income is significantly above the average and you can do the maths relatively quickly although we are talking about for many customers three to five thousand pounds post tax with incremental payments that people are able to make choices to offset other discretionary payments. We have done the stress test, all the affordability tests for our customers over the last ten years at above 6.5 per cent so we know they have the capacity to absorb this. And bluntly our experience you can see over the last nine months, we have elevated mortgage rates post the mini budget, has shown that customers can absorb this cost. So not easy for our customers by any means. We also have a view as you would expect from us and given our business model for those customers that have a more significant shock on their interest to income payments. One of the levels that we have looked at historically is about 40 per cent, when the mortgage payment goes above 40 per cent of their income. We know that is a moment in time that they sometimes are looking for support. We have a very modest percentage of our portfolio today in that level and interestingly when we model that going forward for the next two years, it doesn’t grow very much as a proportion of our portfolio and that is because a lot of those customers are on standard variable rates so they have already experienced 5 per cent of what we think will be a 5.5 per cent base rate. So not easy for those customers, but we think the customers are well placed as to make the difficult choices to deal with it.

One other thought and you can see this in the data. Obviously a mortgage is as you know very expensive in the context of UK consumers and that is why the average income is £75,000. We also know that for that end of the market in the UK, people have broader financial resilience and one of the indicators, as you know, we have talked about is the incremental savings that we have in our customers since Covid. We talked during Covid, that peaked at about £70 billion of growth in savings. We still have over £60 billion of those incremental savings and that will tend to be for customers in the higher deciles of the wealth income distributions. So we know these customers have financial resilience and that is then validated by the spend behaviour we are seeing more broadly.

Question 10 – Andrew Coombs, Citi
Good morning. I have some questions on mortgages please. Firstly looking at the movement in the mortgage book, perhaps you could just comment on what you are seeing in terms of people paying down on SVR. But also are they taking advantage on the 10 per cent window taking on the fixes. Are you seeing greater pre-payments and how does that then feed through into your EIR assumption for the mortgage NII. And then the second question, previously you have given some colour on the split between product transfer and new business margins in that 50 basis points, anything you can say on that would also be interesting. Thank you.

William Chalmers
Thank you Andrew I will make a couple of comments, Charlie may want to add. On the SVR book, the SVR book as noted in my comments is now down to about £39 billion. That has seen as proportion of the book, some relatively high repayments. So I think we quoted a number of around 30 per cent in the course of Q2. But actually if you look at the absolute number of repayments that is much more stable. So what you are seeing is the absolute number is staying relatively stable, in fact maybe even coming down as such. But because it has got a smaller denominator, as a percentage it is accordingly a bit more. So what that means is that in absolute terms, Andrew, the pace of the SVR run off if you like is reducing over time. As I think customers value in the SVR product the ability to repay whatever it is they want to repay at any point in time. And in the context of the SVR book which by the way have pretty low average balances of less than £50 thousand. The incremental interest costs to them is not necessarily that much when you compare it to the convenience that they have derived from being on an SVR that allows them to pay back again whatever it is they want to pay back, whenever they want to pay back. We do keep in regular touch with our customers on the SVR book and make sure that they are aware of all of the opportunities to refinance or indeed pay back at any given moment.

And there is no concept if you like of mortgage prisoners or anything like that in the SVR book and customers are free to do what they want. Hopefully that gives you a bit of a sense as to what is going on there.

You asked about EIR. I am not quite sure whether I caught the question or not, but if it is relevant to what went on recently in the EIR market, when we look at our EIR first of all, the asset is less than £200 million. Second is when we account for EIR, we do not take account of or accrue for any benefits that we might see off the back of the customer staying on SVR after they have come off the fixed rate deal. So all of our EIR is accounted for up to and only up to the point at which the fixed rate deal stops. That means in turn that we are unlikely to see, in fact I think it is conceptionally impossible for us to see, the type of issue that came up in the market most recently.

Your second question Andrew around product transfer versus new business. Yes you are right to point it out. We have a completion margin that is 50 basis points. That 50 basis points is a blended average based upon new business and based upon product transfer. Just to give you some idea without putting too precise numbers on it. New business is materially ahead of that 50 basis points completion margin. So quite a bit ahead of it. Product transfer, typically we have seen it around 35 to 40 basis points, in that zone. The issue with both of these numbers, both new business and product transfer, Andrew, is that in a time of swaps volatility the spreads go up and down in line with the swaps, so you have a price out there that then gets affected by the swaps. Even though obviously we are hedging our exposures as best we can to make sure that we are not exposed. I think what we need Andrew in order to figure out what is the true equilibrium pricing within the mortgage market, is a period of swaps stability that then allows people to price with a degree of certainty as we go forward, which in turn will give us some insight as to what a true swap add mortgage equilibrium margin looks like. As you know in the past we thought that it is north of 50 basis points. I think we continue to think that in part because actually the 50 basis points completion margin is produced at a time of tremendous and mostly upwards swap volatility, which has compressed margins. So we continue to adhere to the view that over time if we do get that period of stability we should see margin spreads moving out from the 50 basis points that we are seeing. But to be clear we are not banking on that in the guidance that we are giving you for group margins as we stand today.

Charlie Nunn
Just to build on William, I know you said a couple times but it is just worth reinforcing in this context about product transfers for existing customers. We understand their risk, we can look therefore at the relationship and we see good economic returns at the kind of rates that William's talking about. And so we are very comfortable with the returns on this margin. But I think the opportunity with that stability that we should see starting to come around the swaps, let's see what happens. As William said, it is on the upside. Thanks Andrew.

William Chalmers
I think there maybe one more question and then there is one comment I would like to make actually before we wrap up and let's take the question first.

Question 11 – Joseph Dickerson, Jeffries
Hi thank you gentlemen for taking my question. You have provided a very strong return on tangible equity guidance of greater than 14 per cent this year. And I think your existing ROTE guidance for next year's greater than 13. Is that stale at this point or could you discuss the moving parts as to how we go from 13 and 14. And greater than 14 down to greater than 13. Is this a normalisation of TNAV, is it lower rates and the impact on NIM. What would be the drivers of that or is this likely to be updated in the future? Thanks.

William Chalmers
Yeah thanks Joe. A couple of points to make there. First I'm afraid it is a bit predictable which is to say that today we are not going to comment further on 2024 expectations beyond what we have already said. So we won't give precise guidance on 2024. I don't think that will surprise you. Second, our ROTE guidance that is extant for 2024 as we announced at the beginning of this year is actually just to be clear circa 13 per cent rather than greater than. So a small point but perhaps just worth mentioning. Third just give you a bit of a sense of direction as we move forward into 2023 and therefore kind of set the stage I suppose for 2024. We have talked about the expectations for ROTE during the course of this year. That is a function of some of the banking earnings trends that we have mentioned. The margin, the AIEA contributions, together with things like operating lease depreciation normalising. Those in turn are likely to continue as we go into 2024 in terms of patterns. Again we will leave the guidance to the end of the year as we normally do. And then secondarily we talked a lot about TNAV on this call and TNAV is going to build in the second half of 2023. That's our expectation. That gives you a stronger starting point for 2024. So, Joe, I apologise that's not very detailed but hopefully it gives you a bit of a sense as to the trends that we expect to see continuing into the next year.

Before we wrap up I mentioned that I just wanted to add a very small point. Robin Down asked a question as to whether or not OOI was expected to grow off the back of HI of this year or the back of H2 of last year. I just wanted to clarify looking back at the numbers Robin, to address your question. The answer is both. So I think I answered your question as to H2 of last year. In fact looking at my numbers, the answer is both.

I think that’s it operator, so thank you everybody for attending the call and taking the time.

END

FORWARD LOOKING STATEMENTS

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