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

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LBG:
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William Chalmers
Thank you operator and welcome to the call today. I hope everybody had an enjoyable summer and thank you for joining us this afternoon. We thought it might be worthwhile just kicking off with a few key messages before we begin the call and then open it to questions in whatever order, and on whatever area makes sense.

So with that, key messages from H1. First of all the Group is delivering, and continues to deliver, pretty much in line with expectations. I'd like to say a statement about customer support; as you know we continue to deliver support for any customers adversely affected by cost of living measures, but at the same time for the business as usual that we see going on.

Second, strategic transformation continues to make progress. Our business unit initiatives have launched, and cost benefits are being realised. Then third, financial performance continues to be robust in H1 and indeed in Q2. £2.9 billion PAT in H1, up 17 per cent year on year. 13.6 per cent RoTE in Q2, 111 basis points of capital generation in H1. And that outlook continues to be robust as we look into the second half. So as you know NIM guidance has been upgraded to greater than 310bps. Costs reaffirmed at £9.1 billion for 2023. AQR likewise reaffirmed at 30 basis points. And the RoTE guidance now upgraded to greater than 14 per cent. The dividend in that context we put up by 15 per cent year on year, as of the half, to 0.92 pence per share. So if you add together the customer support, the Group delivery of strategic transformation and the financial performance, overall we believe it is a very reassuring picture. So perhaps that is a good place to start the discussion, and happy to throw it open to questions as said in whatever area is most interesting to you.

Question and Answer Session

Question 1 – Shrey Sribastava – Citi
Thanks you very much. A few from me please focused around deposits. Firstly, you highlighted a flattening of the PCA outflows in the second quarter. However, some of your peers that highlighted an accelerating mix shift from non-interest bearing. My question is why do you think PCA balances have been sticky at Lloyds? And are there any differentiating characteristics of your book versus the industry? Also relating to this, how do non-interest bearing deposit volumes look in Q3 so far? And connected to that do you see any further risk to the structural hedge notional? And to end with a short one. When we look at your pass-through on instant access relative to the industry, it seems somewhat towards the lower end. Why do you think this is has been? Thanks.

William Chalmers
Thanks Shrey. When we look at deposits over the course of Q2, just taking the deposits as a whole for the moment. As you know, down one per cent over the course of Q2 and that consists of retail movements down £0.6 billion alongside Commercial Banking movements down £2.9 billion. Within that, we did continue to see some movement from PCAs into Savings. So if we look at the quarter as you will have seen from our numbers, we saw about £2.7bn outflows in PCA over Q2, so we were not immune from PCA trends.

I can't really comment on others' performance in that respect, you've seen our numbers, you have seen others' numbers, I will allow you to draw those conclusions yourself. But we are seeing some PCA movements as described, and then within that we are seeing some retail savings movements from instant access into fixed term just as other banks I think have seen.

In terms of Q3 we expect, over the course of the half as a whole, not necessarily in any specific quarter, that because of fewer bank base rate changes, because some of the money that is going to move is likely to have moved already, because we are increasing instant access rates and indeed because we are seeing other offsetting flows such as inflationary wage settlements for example, we may start to see some tapering off in terms of some of the deposit movements over the course of the half. But it is worth saying that the market is relatively dynamic, and as you can see headlines are changing on a daily basis. And so we just have to see. I think at the moment without commenting too extensively on Q3, it is basically tracked in accordance with our expectations. So we have to see how the rest of the quarter develops and we will report back in due course on that.

On the structural hedge, we've identified single digit reductions in the structural hedge for the course of this year, and again that remains very much on track as we speak today. As to future developments, clearly that will depend upon developments thereafter and we will comment on those again at the appropriate time.

You asked about pass-through Shrey; our pass-through is determined by a combination of customer value, funding alternatives for business, and as we see those dynamics change, we pass on value to customers. I think that we are basically in the pack is my sense on that.

Shrey Sribastava
Thank you very much, it's very helpful.

William Chalmers
Thanks Shrey.

Question 2 – Rohith Chandra-Rajan – Bank of America
Thanks very much and good afternoon William. I would just like to follow-up actually. You alluded to some of the pricing dynamics in the answer that you have just given, so we have obviously seen NS&I with a fixed rate bond at one year fixed at 6.2 per cent, and one of your competitors coming out with some quite punchy instant access rates very recently. Given that pricing action, it doesn't sound like so far that has particularly changed your view of how deposits progress. Where are expectations in terms of how that pricing activity evolves, and do you think that will be more disruptive in terms of the market than you might have thought say a month or so ago?

William Chalmers
Yeah thanks Rohith. I guess a couple of comments really. One is, as we've said before, this is a dynamic market and of course we are facing rate increases and a curve that we haven't seen before. So I think anybody who predicts with complete confidence how things pan out is probably going out on a limb somewhat. Having said that, the performance of the business has been very much in line with expectations as I mentioned with Shrey a second ago. And it is worth saying that pricing is pretty volatile, that is to say when we see our own prices and we see competitor prices, they will change any given moment. So for example, we had a 6.5 per cent rate out to new money for fixed term savings. I don't know whether that is on the market today or not, but it is an indication of the fact that our prices will go up and down. We will respond to the economics as they present themselves in the moment Rohith. It is fair to say in a higher rate environment it is likely to be a more competitive market. On the other hand, the franchise is a good one, I think it has proven it so far over the course of this year, and we offer value to customers in many ways other than price. You know whether that is distribution, whether it is access, whether it is security of deposits given the strength of the business and franchise. It is up to customers to decide, but so far so good.

Rohith Chandra-Rajan
Thank you. Could I just follow up very briefly just behind that, to understand the economics behind that 6.5 per cent rate that you mentioned. Will that just have been a reflection of where swap rates were at the time, and obviously the competitive environment?

William Chalmers
It's a combination of things Rohith. Swap rates is certainly an element. So is the franchise, so is the relationship that we have with customers who are attracted to, or rather using that fixed rate, in terms of the customer routes it is marketed to.

Rohith Chandra-Rajan
Okay thank you.

William Chalmers
Thanks Rohith

Question 3 – Miruna Chirea – Barclays Capital
Good afternoon William, thank you for taking my questions. I just have to ask about the hedging strategy please. Firstly you are currently hedging around 95 per cent of your current accounts which seems like a very high proportion, particularly if I were to compare it to Q3. What do you think is the right proportion to hedge of current accounts, especially if it is in a higher rate environment, current accounts could turn out to be less sticky than they were in the low rate environment in the last circuit?

And secondly related to that, you are also hedging 25 per cent of savings and actually probably more like 50 per cent if I am to remove term deposits. So what do you think is the right proportion of savings to hedge, and is this at all impacted by the rising deposits passed through assumptions that you are using?

William Chalmers
Thanks for the questions Miruna. We don't really look at it like that actually. We look at it in the context of the buffer that we run against the hedge, and the context and maturities that are coming up on the hedge. That is what gives us security about the level of the hedge at any given moment, and indeed our ability to respond should those circumstances change. As you know we have got a £10 billion buffer as of H1. We also look at maturities over the course of the next three months, we add those up and that is what gives us the comfort on the structural hedge. As for current account levels, we have seen some movements of the type that I described earlier on. But number one we are seeing customers choose to keep more money in their current accounts, I guess that is a function of a volatile environment number one. And number two the types of changes that we see are pretty slow, £2.7 billion for example in the context of Q2 is an illustration of that Miruna. That is what gives us comfort and we can respond to any movements that we might see in an appropriate way, without losing any value to our shareholders, but at the same time maintaining value to our shareholders while we have deposits in the structural hedge.

Miruna Chirea
Thank you very clear.

William Chalmers
Thanks.

Question 4 – Alvaro Serrano - Morgan Stanley
Hi William. It's a follow-up because I am not sure I fully understood the answer; you said about stabilisation of the flows in the mix shift because at least my observation is that it in late June the term offers started to get more competitive among the majors. We have seen Bank of England data for July out last week. The mix shift if anything accelerated, it looks like the delta month-on-month in term deposits was definitely higher than any other month this year. Is there anything that you would call out in that data to July, a particular sort of seasonal month, or anything you would call out that would clarify that because the data so far seems like it has accelerated not tapering. I don't know if I am missing something. How would you describe the overall competition, you touched on the Santander one but you also have a lot of the bigger players now offering five and a half and above which is unusual, certainly wasn't happening prior to June. Thanks.

And then I have got one on the mortgage market on any updates there on competition of the mortgage market, and fifty basis points spread. Thanks.

William Chalmers
Sure thanks Alvaro. I think in terms of the deposit movements and pricing, I think it is important to look at the periods rather than any movement within any given month. Because if you do that there is going to be a certain amount of noise inevitably within any given month. Now that is not to say that the deposit market isn't competitive, it is competitive and in the context of rates movements of the like that we have seen, you will see some price movements for sure. That will come off of bank base rates changes, that will come off of curve movements. Now to give an illustration of what I mean by that Alvaro, having made that point it is a competitive deposit market in the context of upward rates revisions, either curve or alternatively base rates, you will see deposit prices go up. But as an illustration of saying don't look at one month, look at periods. We saw probably a little bit tougher picture in deposits in July and we saw a little bit better picture in August. But at the same time, the closing date or rather the closing day of any given period itself makes a difference. So for example we saw a difference in August because of the bank holiday in August, because of the closing day at which we measured the balances. So my point is Alvaro certainly look at the monthly data, they are going to be interesting. But don't get too distracted by it, you really ought to be looking at the quarters, or even better the halves for the trends that you should be making out. And that is where I think you get the real picture, as opposed to the particular spot month on month abnormalities if you like.

On your second question on competition within the mortgage market, competition continues to be pretty tough in the mortgage market. We said at the second quarter that we had a completion number there about fifty basis points, a little bit higher in terms of new business, a little bit lower in terms of product retention. I think what you have seen over the course of a period since then is the continued pattern of relatively low new mortgage margin business. And so that squashes business into the product transfer category which is where you have got a touch lower margins. So as we speak today, we are still looking at completion margins in Q3 and Q4 of circa 50 basis points. Might be a touch above, or might be a touch below. But I think it is safe to say that the competition in the mortgage market continues to be pretty strong in line with those comments Alvaro.

Alvaro Serrano
Thanks William.

William Chalmers
Thanks Alvaro.

Question 5 – Fahad Kunwar – Redburn Atlantic
Hi William thanks for taking the questions. I have only got one really just on the housing market overall. I think buy-to-let is about 20-25 per cent of the stock and the flow of the housing market and obviously economics of that have changed pretty significantly, and you yourselves are a decent sized buy-to-let lender as well. How do you see that market impacting the housing market? At the moment the housing market has been stagnant but it has not been awful. Just looking at the next year how do you see that occurring? And then my second question is on the balance sheet in general. Should we expect the balance sheet to be flat to shrinking now? Is that a realistic scenario given lower mortgage approvals, commercial lending has still got some bounce back loans to pay off, and not a lot of consumer lending. Is there something I am missing in that? Thank you.

William Chalmers
Sure, thanks Fahad. On buy-to-let there is no doubt that the mortgage market is going through a period of change in respect of buy-to-let products. You've seen government changes there, there is obviously a question about rising interest rates as well and what that does to buy-to-let probability. In short for us it means that buy-to-let as a proportion of new flow has fallen quite significantly. At the moment there is obviously stock of buy-to-let in the business which is itself relatively modest, but it has fallen to around 4 per cent of new volumes. So you are not seeing much flow in the context of buy-to-let and certainly 4 per cent of new volumes would be around a quarter of what the stock share of buy-to-let is that we might see in the business. And so you are seeing that happen. Now having said that from an asset quality point of view, which I know is not the direction of your question, but nonetheless we feel very secure on that front. It is very low LTV typically around the 46-47 per cent mark. It is very well seasoned, we have limits for new borrowers with a very modest maximum loan eligibility on buy-to-let. So the market is going through a change and that's fine, that will happen from time to time, perhaps from people realising that there is a shortage of rental properties, some of those Governmental changes might reverse and off the back of that the buy-to-let market might come back. Let's see. But as I said the asset quality question which is again somewhat related, even though not the point of your question perhaps, we feel very secure on.

In terms of the balance sheet Fahad, no I would not see it as a shrinking balance sheet. I think you have got a couple of different components going on right now. As you will be aware the open mortgage book shrank by about £(0.7) billion in the course of Q2. That is off the back of the mortgage trends that I mentioned earlier on, but as you know a lot of that was offset by unsecured and motor growth. And we are very comfortable with the quality of that unsecured growth alongside motor, which as you know has traditionally been a strength. We are continuing to see that develop in a positive way and alongside that I think we are consolidating the mortgage position. So I would not see the balance sheet as shrinking on retail. Commercial dynamics are slightly different because of the payback of Government loans, bounce back loans as you highlighted. And at the moment at least that bounce back payment is in excess of any organic demand that you might get from the regular book. So you are seeing some pressure on particularly the SME business and Commercial Banking area that we have seen. C&I business continues to remain pretty solid. Overall Fahad the balance sheet should not shrink then.

Fahad Kunwar
Thanks William and I just thought on the housing market question, it is 16 per cent of your volumes, but a bit higher for the market. What are you seeing of the housing market itself right now, do you think it struggles to digest the change of buy-to-let being 20 per cent of stock and let's say 4 or 5 per cent of flow in general?

William Chalmers
First off just on your numbers there Fahad, we are not 20 per cent stock on buy-to-let markets. My numbers as I was trying to advise just the second ago puts it more like 15 to 16 per cent. So just as a numerical point highlight that topic. I think the extent that you have seen buy-to-let shockwaves impact the rest of the market, you should have seen it already Fahad. These buy-to-let changes that we are discussing now have been characteristics of the year to date. We are seeing some housing price weaknesses going on. It is very consistent with our forecast which show around a 5.5 per cent reduction in our HPI over the course of 2023. That is nothing dramatic particularly given the house prices have risen by over 20 per cent since the start of the pandemic. But nonetheless you are seeing a slacking up in the housing market and hence HPI indicated off the back of that. As I said it is happening but it is relatively gradual.

Fahad Kunwar
That's grand, thank you very much.

Question 6 – Perlie Mong - KBW
Hello, thank you for taking my question. And just two, one is on cost and I know you have a twenty-four target of £9.2 billion and consensus if I look at Visible Alpha's, it is pretty close to that. But even that is set at a time at the beginning of the year when maybe there was an expectation that core inflation might come down, as energy prices come down. But I think recent data's shown that core inflation has been higher and stickier. So not asking you to comment on the target itself, but if you were to hit the target in 2024, would you think of it as a good outcome or would you think of it as a standard outcome?

So that is the first question - and the second question, again taking it back to deposits, the consumer duty rules have been around for about a couple of months now and the sector has responded in terms of the pricing and you have also commented on how you see the commercial dynamics over there. Do you have a sense that the regulators are satisfied with the where the sector is, or do you think there is more to go?

William Chalmers
Yeah thanks Perlie. On costs a couple of points really. As you know we have got the guidance out there for £9.1 billion in 2023, £9.2 billion in 2024. We remain committed to that guidance. There is no doubt, having said that, any time that we achieve our cost targets as I said before, that is tough, not easy; it is made harder by the inflationary environment that we are in. But we are very focused on it, and as a result through a combination of our regular cost management approaches, whether it is dealing with suppliers, whether it is a matrix approach that we adopt internally or a host of other BAU management techniques, or whether it is a function of the strategic initiatives that we are engaged in. That is what helps us deliver on the cost targets that we set out. Perlie, I wouldn't want to suggest that any time we achieve cost targets that it is ever easy. If it was easy we would go further. But what we are committed to doing is delivering the targets that we have out there.

On the consumer duty point, it is a good question and an important point. I think the best way to look at it, is that consumer duty effectively requires us to do the right thing by customers and in particular to have a value framework for how we deal with customers in place; how do we relate the pricing that we give customers alongside all of the other value based offerings that we give customers, whether it is distribution, whether it is service and whether it is access, how does that all stack together. And in that sense consumer duty is really just codifying something that we do within the business anyway. That is the way in which we run the business, that is the way in which we figure out what the appropriate pricing decisions are for customers. The latest manifestation of that, Perlie, is the Savings Charter. And the Savings Charter committed people to having just that, i.e. a customer value framework in place which of course we will do. As well as making sure that customer notifications were doing the right thing. And again a big part of that is what we do on a BAU basis anyway.

So you know consumer duty is in its early days. I think we all work with the FCA, the regulatory generally to ensure that it lands in a sensible way and a sustainable way going forward. As we stand today it is very much as said, codifying what we do within the business. And we'll do our best to ensure that it continues that way.

Perlie Mong
Okay, that is helpful. Thank you.

William Chalmers
Thank you.

Question 7 – Benjamin Toms - RBC
Afternoon, thank you for taking this session. A couple of short ones for me, firstly on the structural hedge. I think you noted that at H1 you closed some swaps out early in the structural hedge. I was just wondering whether there is material one off loss that went through the corporate centre in relation to closing out those swaps early? And then secondly on the structural hedge - when I run the numbers it feels like based on current swap rates you could be running slightly ahead of your £0.8 billion incremental income guidance given at H1 for next year and the year after. Is that a fair assertion? And thirdly, I have something like £30 billion of TFSME re-financing with a bolt due for repayment at the end of 2025. Would you look to repay any of that early and net-net at the moment do you see that repayment as a potential material headwind? Thank you.

William Chalmers
Thanks very much Benjamin. Three questions there. First of all on the structural hedge; no, there were no swaps closed early. As said earlier on in response to a question, we very much manage the structural hedge in a sensible way taking account of (a) a buffer and (b) upcoming maturities which ensures that we do not have to close out any swaps prematurely and indeed that protects the P&L from any impact of doing so. What it might be that you are referring to Benjamin which did come up in the call I think at the half was how did we change the amount of maturities that we have in 2H, or rather why did that number of maturities change

in 2H. And the reason for that was because we were taking advantage of effectively diversifying any concentration around reinvestment of securities in the hedge by essentially doing some forward hedging for maturities as we go forward. So we took some of those maturities in 2H and effectively put in place a forward dated hedge which then reduced the number of upcoming maturities that we have in the second half. That is what we do, we do it for value, we also do it for diversification or reducing any concentrations of maturities. And from a shareholder point of view I think they would encourage us to do that for sensible prudential financial management.

The swap rates Benjamin that you raised. again its an important point. If you look at the effect of market implied guidance, today you will probably end up with something that is marginally ahead of our £800 million. It won't make a huge difference but at the margin it will probably be back fractionally ahead. One point that came up at the half which is worth underlining is when we look at the maturities for 2024 and indeed the remainder of 2023, and we apply the rates against them, why does that not give us much more income than our £800 million guidance for 2024? And the very simple reason for that, the single biggest reason for that, is simply because those maturities are spread out over the course of 2024. This question came up at the H1 conference call, and it is just when you look at our £800 million guidance and when you look at the maturities and when you look at forward rates, it is just important to remember that those maturities span the breath of 2024.

There is one other point on swap rates I want to make which is important and it goes back to some of the earlier conversations that we were having. Don't forget that while we might be seeing some deposit movements over the course of H1 going into Q3, at the same time those deposit movements are being caused by rate movements that underlie them. The rate movements that underlie them, are actually contributing to net interest income and margin. So it is important to look at the issue in a balanced way. Sure rate movements cause the rate deposit movement. At the same time it's also benefitting existing deposits that we have. So look at it in that balanced way I would encourage.

And Benjamin I apologise, I didn't catch your third question?

Benjamin Toms
It was just around the TFSME financing?

William Chalmers
That's it, TFSME financing. Yes, we have around £20 billion in 2025. We have around £10 billion in 2027. Those will cause over the course of time an incremental cost of funding, as we shift out of TFSME and into wholesale funding, deposit funding, whatever it might be. That is in the plans and that is reconciled to the guidance that we have given you when we look at what we have given you for 2026 in particular, which we gave you in February 2022. So yes those are coming due, but yes those are figured into or included within the guidance we have given you for 2026, as we stand today.

Benjamin Toms
And would you look to refinance any of that earlier from the dates that they become due?

William Chalmers
We typically aim to remove concentrations in our funding schedules, Benjamin. So we may well look at some of 2025 in the context of 2024, really with the objective of removing concentrations. It is something that we do on a regular basis anyway, it will apply to TFSME.

Benjamin Toms
Thanks very much, very clear.

William Chalmers
Thanks then.

Question 8 – Chris Cant - Autonomous
Hi William thanks for taking questions. I just wanted to come back on costs if I may, and I appreciate it is meant to be about post Q2 results, but given that we are some way after Q2 results, I just wanted to invite you to comment on the longer term future of costs. I think about when Charlie landed, we saw cost expectations for the three year period, 2022 through 2024, went up significantly. And a lot of that was due to what you at the time talked about as being a temporary increase in investment spend of about £500 million per annum. When we think about costs beyond 2024 where obviously you have guided, are you still expecting that £500 million to taper away into 2025, 2026? Obviously going back to the original 2021 strategic planning targets, there was an expectation of a 2 per cent kicker to the RoTE across 2025 and 2026, and part of that was revenues coming through, and part of that was these costs tapering. So how should we be thinking about that piece? Because when I look at consensus, consensus just has costs increasing again to 2025 vs

2024. I am wondering whether that is just a bit too cautious given that you have this additional investment spending over and above what you were already doing as an institution prior to Charlie's arrival? Thank you.

William Chalmers
Thanks Chris. Maybe a couple of points to make there. First of all in respect of the current year, 2023 continues to be on target for £9.1 billion of costs. In respect of years thereafter, as you will remember without commenting too specifically on 2024 because as you say this is a half year call, rather than what we'll do in February of next year. When we looked at the £9.2 billion guidance that we gave at the beginning of this year, we have previously had in place £8.8 billion of guidance. We saw upwards pressure of around £600 million. We chose to absorb £200 million of that and pass on £400 million of that, hence £8.8 million became £9.2 million. That was based upon a set of inflationary expectations which, were probably at touch below what we have seen, but within the same ballpark, so not hugely different. Now when we look further out, a couple of things I think are worth commenting on. Generically the thing you picked out there Chris remains true. And what I mean by that is that the investment is going through a steep period right now. It should flatten off in the periods thereafter. It will flatten off partly because the new investment itself will flatten off, i.e. some of the 'investment needs' need to be fixed once rather than twice or on an ongoing basis. But it will also flatten off because we are achieving change efficiencies, and that in turn makes any given investment pounds going further. Alongside of that we would expect to deliver some of the saves that the investments are currently focused on. And that together gives us some confidence in achieving operating leverage within the business, very much in line with what we laid out in February 2022. So that sematic to your question Chris, remains the same.

Alongside that the income picture has clearly improved materially. And so if you think about this in the context of operating leverage or cost: income ratio type analysis which is what we encourage you to do as you look at 2026. That dynamic operating leverage leading to cost: income ratios as described, that dynamic continues to be very much the theme that we plan the business on.

Chris Cant
Okay that's helpful. I guess to come at it in a slightly different manner. In terms of 2023 being the peak period for the investment budgets through the P&L, and I think that was always the case when originally you gave us £8.8 billion to 2022, £8.8 billion for 2024 and didn't tell us anything specific about 2023 other than it was always going to be a bit of a hump in the profile. How much of the £9.1 billion for this year is that incremental investment budget over and above what the institution would normally be doing? What's that number this year, it was expected to be £500 million in 2022 and implicitly £500 million in 2024 back in 2021 results, and I appreciate there has been inflationary pressure. But I think you were expecting at that point to hold BAU cost stable at £8.3 billion on the new definition. And so implicitly it was £500 million, £500 million. What is it this year? Presumably it is £600 million, £700 million , £800 million. There was always anticipated to be a hump in that profile I think.

William Chalmers
I am not sure we have given precise numbers on that Chris. To give you some sense of how we look at it right now, a couple of data points that might help you mix it together. Number one is we have got this £3 billion of incremental investment plan which is over the course of the strategic period as we described before. Number two, within this year we have got around a £9.1 billion cost target. Within that we have got Opex of around £6 billion and investment of around £3 billion. That is roughly how it splits out. And as you combine those two data points that I just gave you, I think it probably gives you insight as to how much of that is BAU investment, how much of that is incremental investment, and allows you to build a profile that you are asking for.

Chris Cant
Okay alright I'll have a think about that. Thank you.

William Chalmers
Thanks Chris.

Question 9 – Raul Sinha - JP Morgan
Good afternoon William. Thanks very much for doing this follow-up session. I have got a couple of follow-ups if I may. The first one on AEIAs. I was trying to reconcile your answer to Fahad's question that the balance sheet won't shrink further with your guidance as of Q2 of AEIAs being slightly down compared to Q4 2022 level. Is there anything I am missing in there, perhaps you could try and find that, that would be really useful? And the second one, I don't know if you want to do that first than like to take the second one?

William Chalmers
No go ahead Raul.

Raul Sinha

And the second one is just on the shrink, coming back to retail current accounts and the shrinkage of the pay set is the shrinking. You know I think if we look at the first half of this and just taking to your half yearly framework and not getting obsessed about monthly movements. I think the retail current accounts are down roughly 5 per cent in the first half of the year. And obviously that was an acceleration on trends we have seen previously. Now your expectation seems to be that this will obviously improve in the second half, despite July being slightly worse and August as you pointed out being slightly better, because of the closing point of the month. I am trying to understand, is that really what you are seeing, that instead of the 5 per cent shrinkage it's going to be a little bit lower, or a lot lower than 5 per cent shrinkage on a half to half basis. I am just trying to understand why you think that is the case given if we look at the proportion of retail current accounts versus time deposits, where they are now versus any other time in history when rates were so high, the proportion of retail current accounts was significantly lower and the proportion of term deposits actually higher. So is there something I am missing in terms of what gives you that confidence for the second half?

William Chalmers

Yeah thanks Raul, both good questions. On AIEAs, no I don't think you are missing anything much, and we have talked 2023 AIEAs down slightly verses Q4 2022. That is the guidance that we gave at the half, and indeed that continues to be the expectation. I think what we expect to see is a pretty flattish balance sheet. It will be a touchdown as indicated with AIEAs at the quarter of £454 billion. Maybe we will finish at or around that level. What is going on underneath that? The point that I was trying to make is that within Retail we are basically seeing mortgages offset by unsecured and motor. So is that a shrink of our balance sheet? No, not within Retail. Within Commercial we are seeing BBL reductions for sure. C&I growth fluctuates, because C&I growth is typically trade facilitation, SPG and other ancillary revenue sources. So that is going to go up and down and it is correspondently relatively hard to predict. But that sort of thing is what I was trying to draw. The AIEA guidance if you like Raul, we gave at the half, continues to stand.

On current accounts it is a good question; I don't think you are missing anything frankly. What we have seen in the course of Q2 as said is a £2.7 billion reduction in current accounts down to £107.8bn. We are going to most likely see some continuing current account erosion through the course of Q3 and I suspect going into Q4 too. Having said that, we think that the pace of erosion might start to abate, and the reason why we think it might start to abate are the reasons that I gave earlier on. Now clearly because rates are moving around so fast there is likely to be volatility in any given period of the pace of erosion. But don't get me wrong Raul, I don't think you are missing anything. That current account shift from current accounts into savings accounts, most likely into fixed term, that is going to continue for sure. The question is the pace at which it does and what the landing spot is. There is a further point here which you alluded to in your question, which is we are seeing a period of high rates. Yes we are, and the pace at which those rates come down is going to be indicative of, or a factor in, not just the pace of PCA slow-downs but also the eventual landing point. Therefore, if we wind back to anything like the Bank of England's target rate for example, I suspect we end up with materially higher current accounts then if we end up with a terminal rate of more like 4-5 per cent inevitably. And you know we will manage that and we will manage profitability accordingly. But that you know is the important input.

Raul Sinha

Thank you, that is really helpful and I appreciate the colour. I don't know if you have got time for me to maybe ask one follow-up on this point on retail balances, retail mortgage balances or retail AIEA? Some of the other banks have talked about this dynamic where people with excess deposits are paying down mortgage balances. And that might be a pro-active basis where you are allowed to make mortgage repayments, or it might be at the point of refinancing of the mortgage, which from a financial perspective would make a lot of sense given savings rates and mortgage rates are on a post tax basis. Is that a dynamic that you are also seeing happening across your book, or do you think this is a dynamic that might be paying off for certain lenders, but doesn't really impact your overall business given you are such a large diversified lender?

William Chalmers

In the mainstream books, particularly obviously the fixed book, Raul, it is not a pattern that has been particularly marked with us. Where we have seen it though is in the SVR book, and you will have seen the SVR book has gone down, about £2.5 billion in Q2, which is equivalent to about a 30 per cent attrition rate within that SVR book. Currently stands at around £39 billion thereabouts. But as my comment just highlighted it is attriting relatively fast. What is going on there Raul is that the absolute amount is basically remaining steady but obviously as a denominator declines, that becomes a higher percentage of the denominator. So we are seeing it in the SVR book, but I think we are seeing it less in the regular book.

Raul Sinhal

Got it, thank you.

William Chalmers
Thanks Raul.

William Chalmers
Well just maybe make the invitation once again if there are any further questions that people would like to ask. No, in which case I would just conclude with a couple of comments again, some of which will repeat my opening points. As said I think the business continues to deliver very much in line with expectations. Customer support is strong, future transformation is progressing and financial performance is robust. On that a lot of the discussion today has been around the movements in deposits and what might be anticipate going forward. And it is of course a relatively uncertain environment, given the fact that we haven't seen it's light for 10 plus years or so. Having said that I do think it is important to see the holistic picture here, which is to say yes we will see deposit movements for sure. But on the other hand, there are significant compensation factors in the form of the interest rate environment that we are operating in, which more than make up for those deposit movements. And off the back of that you can expect to see ROEs and the capital return performance which way exceeds anything that we saw during the difficult years of zero interest rates.

I will stop it there, safe to say as always thanks a lot for joining the call, and I am available as ever to take your questions going forward. Thank you.

END

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