UK Banks

Rates rollercoaster

Price Objective Change

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Equity
United Kingdom
Banks-Multinational/Universal

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Lower earnings, low multiples, selective opportunities

If recent sharp falls in market interest rate expectations play out, they will accelerate deposit spread compression in 2024E and moderate subsequent margin expansion but also support volumes and asset quality. We cut 2024E earnings 7-12%, with bigger reductions for 2025E (Exhibit 12). Our earnings are at or above consensus (Exhibit 13) for Buy rated Lloyds and NatWest where we see low-mid teens RoTEs (Exhibit 18) and sustained mid teens yields (Exhibit 16) at or below the European Bank sector's inexpensive 6.7x PE (Exhibit 20). A shallower margin decline, more non interest income support and a substantial Q4 buyback make Lloyds our top pick. In contrast we see weak profitability and capital distributions from Underperform-rated Barclays.

Margins dipping in 2024

Current market expectations are for policy rate cuts to start in 2Q24, with rates at 3.75% by the end of 2024. That's 150bp of cuts, compared to 25-50bp implied by the market at the end of October (Exhibit 8). Deposit rate cuts will lag policy rates, adding to spread erosion from deposit migration (Exhibit 26) and accelerate deposit spread compression to pre financial crisis levels by 2025E (Exhibit 33), As a result, we expect domestic UK banks' net interest margins to continue falling to 3Q24E (Exhibit 10), with Lloyds the most resilient.

Margins rising from 2025

Deposit spread pressure should ease from 2025E while structural hedge income continues to grow (Exhibit 34). Market expectations are for swap rates c1% lower than anticipated at the time of Q3 results (Exhibit 9) so hedge yields will rise less than previously anticipated (Exhibit 35). Mortgage back book spreads (Exhibit 41) near the front book and latest pricing indicating some widening (Exhibit 39) should mean that mortgages are a reducing margin drag. Lloyds is the exception, where wider back book spreads mean that the headwind lingers into 2025E (Exhibit 38). Overall, we expect margins to expand from 2025E (Exhibit 11).

Volumes, non interest income and provisions help

After lacklustre 2023 loan growth (Exhibit 48), there are signs of improvement. Mortgage rates have been falling and house prices (Exhibit 43), and housing sentiment (Exhibit 44) modestly improving. The strongest business confidence in six years also looks supportive of credit demand. Non interest income can help to offset margin pressure, particularly for Barclays where it contributes 50% of income and for Lloyds where we expect continued high single digit growth (Exhibit 50). Overall, we expect 2% YoY revenue decline in 2024E (Exhibit 51). Lower rates should also reduce loan losses and our provision estimates are below consensus across the four banks (Exhibit 15).

Exhibit 1: Buy LLOY, NWG, Underperform BARC
Stock rating and price objective (p)

Stock	Rating	Price objective Old	Price objective New
BARC	Underperf	150	165
LLOY	Buy	58	59
NWG	Buy	290	290

Source: BofA Global Research estimates
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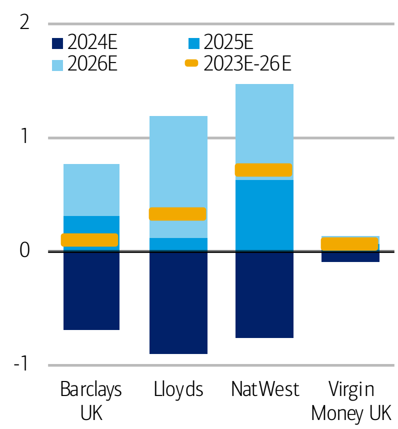
Exhibit 2: NII lower in 2024E, recovering from 2025E
Annual change in net interest income (£bn)



Source: BofA Global Research estimates
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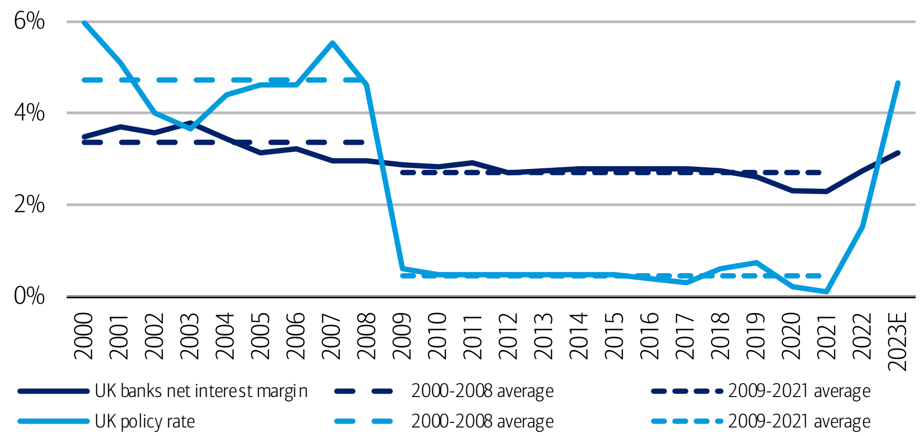
Timestamp: 05 January 2024 12:00AM EST

Lower rates, margins dipping

Bank of England data indicates an aggregate UK bank net interest margin of 3.15% for 2023E, above the 2.7% in the decade when policy rates averaged 0.5% but below the 3.4% when interest rates were last at a similar level.

Exhibit 3: Margin typically wider in this interest rate environment
UK banks net interest margin and policy rate



Source: Bank of England, BofA Global Research

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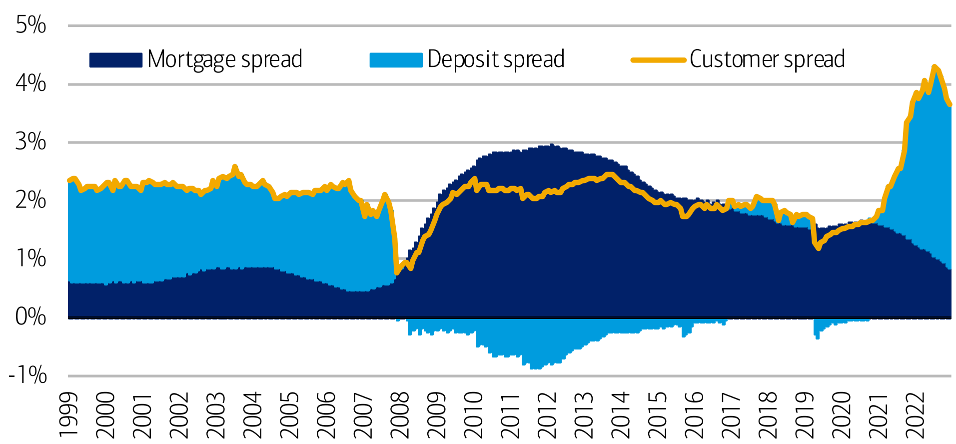
Deposit spread at historical highs

Exhibit 4 shows how the main constituents of the margin have changed. Pre financial crisis, 50-60% of the customer spread came from deposits. These have been loss making for most of the past 15 years but, after a rapid hiking cycle, deposit spreads are at an historical peak and currently contribute c75% of the margin on the stock of mortgages and deposits.

Exhibit 4: UK customer spread coming down from an historical high of 4.3%
UK customer spread on stock of mortgages and deposits



Source: Bank of England, Bloomberg, BofA Global Research

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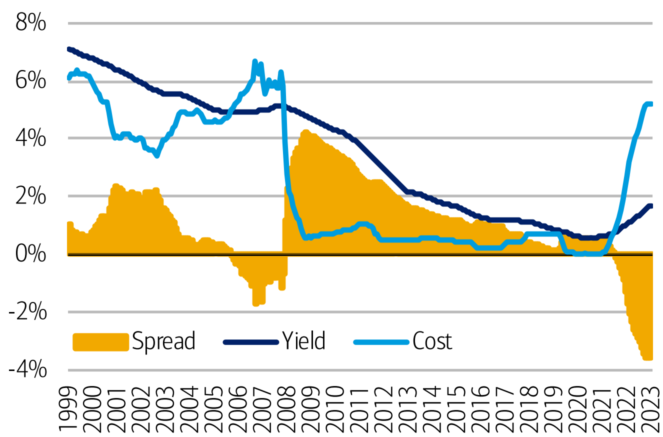
Structural hedge smoothing

This customer spread is moderated by the structural hedge, where banks currently earn c1.7% on rate insensitive deposits, compared to a 5.25% floating rate if unhedged (Exhibit 5). This equates to a 60bp drag on the current deposit spread, but supported it through the period of very low interest rates and has made the deposit spread less sensitive to interest rate fluctuations over time, as Exhibit 6 shows.

Exhibit 5: Structural hedge supported margin through low rates, now a drag
Typical structural hedge - receive rolling average 5 year swaps, pay floating



Source: Bloomberg, BofA Global Research

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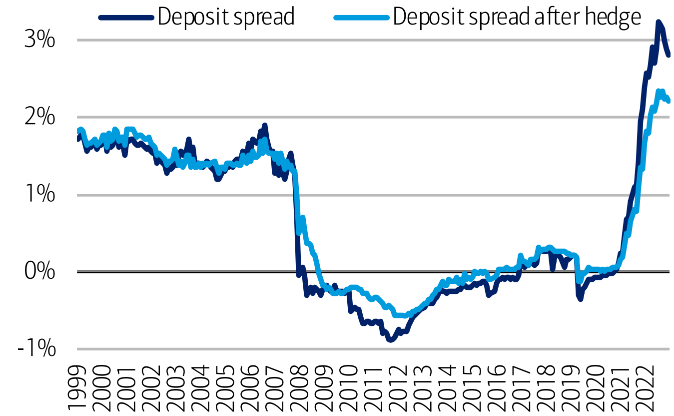
Exhibit 6: Structural hedge currently a 60bp drag on deposit spread
Adjusting the deposit spread for the structural hedge



Source: Bank of England, Bloomberg, BofA Global Research

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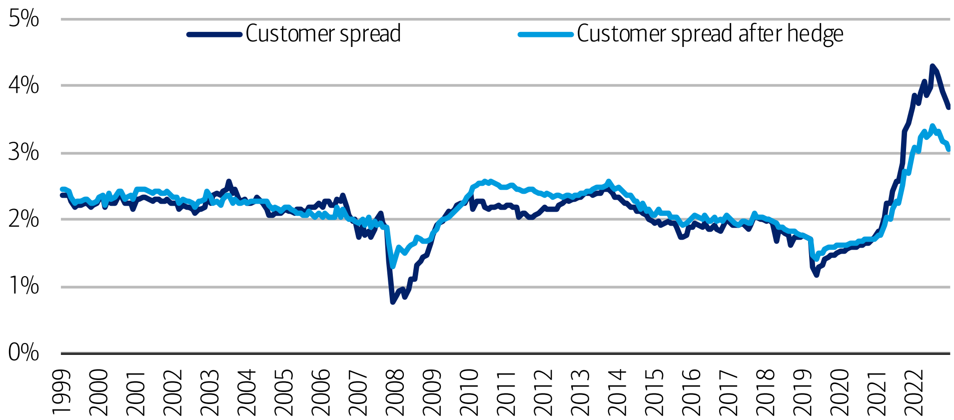
Exhibit 7 shows that the structural hedge has had a similar impact on the customer spread.

Exhibit 7: A similar impact on the customer spread
Customer spread on stock before and after structural hedge



Source: Bank of England, Bloomberg, BofA Global Research

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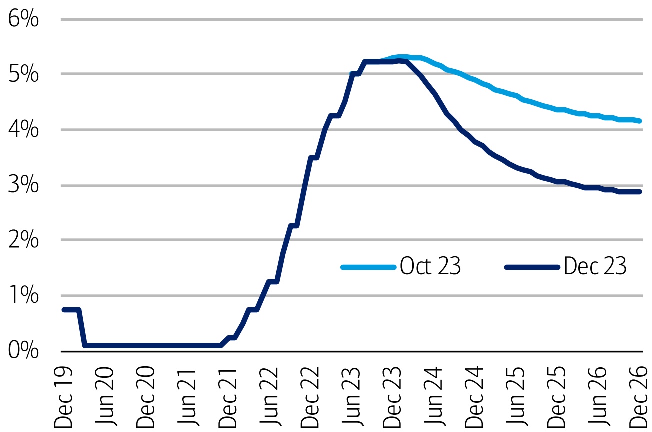
Market anticipating rate cuts

The market now anticipates the first Bank of England rate cut in 2Q24, compared to late that year at the time of banks' Q3 results, and policy rates near 3% by the end of 2026, compared to 4% previously (Exhibit 8). Lower rates are likely positive for mortgage spreads but could exacerbate deposit spread compression from currently wide levels, particularly given the negative effect of deposit rates lagging policy rate cuts. However, unless policy rates fall back to near zero, which we don't expect, UK banks should be able to support margins by managing both asset and liability pricing. Forward swap rates have fallen 1% (Exhibit 9), lowering the reinvestment yield on structural hedges but keeping it above current yields, so still a margin tailwind.

Exhibit 8: First cut expected 2Q24, c3% by end 2026
Market implied UK policy rate



Source: Bank of England, Bloomberg, BofA Global Research

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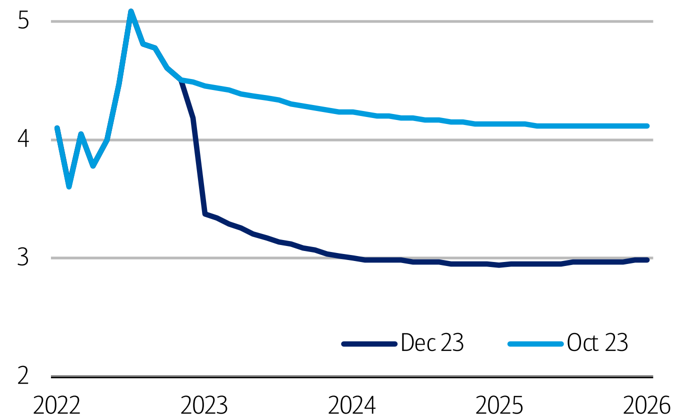
Exhibit 9: Hedge reinvestment rate 1% lower than end October
UK 5 year swap rate (%)



Source: Bloomberg, BofA Global Research

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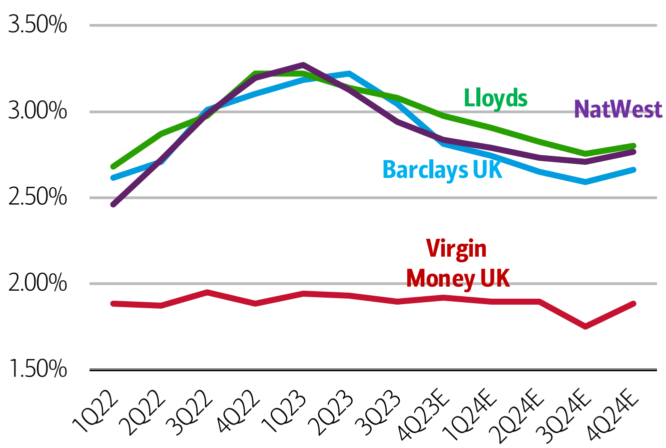
The rollercoaster

Having risen sharply through 2022, UK bank net interest margins have been under pressure in recent quarters as deposit migration and mortgage spread compression have outweighed the benefits of reinvesting structural hedges at higher yields. Easing mortgage spread pressure should moderate this trend into 2024E, with fading deposit migration also helping. On the negative side, rate cuts are likely to exacerbate short term deposit spread compression and reduce the tailwind from structural hedge reinvestment. As a result, we expect Q4 margins to be lower YoY in 2024E, with better deposit management but more persistent mortgage pressure smoothing the trend at Lloyds (Exhibit 10). Beyond 2024E, Exhibit 11 shows that we expect margin widening as hedge reinvestment more than offsets ongoing deposit spread normalisation and mortgage spreads stabilise.

Exhibit 10: Lloyds more resilient through 2024E
Domestic UK banks net interest margin - quarterly



Source: Company data, BofA Global Research estimates

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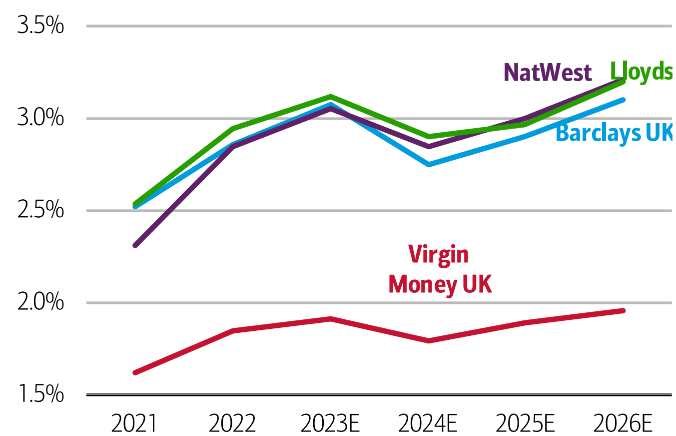
Exhibit 11: Margin widening in 2025E and 2026E
Domestic UK banks net interest margin - annual



Source: Company data, BofA Global Research estimates

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Buy Lloyds and NatWest, Barclays Underperform

After cutting earnings on less net interest income, with some offset from lower provisions our estimates are in line to above consensus for Lloyds and NatWest and below consensus for Barclays and Virgin Money UK. We see consistent low-mid teens profitability for Lloyds and NatWest, facilitating superior capital distributions at attractive valuation multiples and reiterate Buy ratings. In contrast, we see weaker profitability and lower capital distributions from Barclays not fully reflected in consensus or valuation multiples and maintain an Underperform rating.

Cutting earnings on lower net interest income

A 10% EPS upgrade for a Commercial Banking provisions writeback at Lloyds is our only material change to 2023E estimates. 7-12% cuts to 2024E EPS reflect lower net interest income partly offset by lower provisions, with bigger reductions to 2025E EPS as provisions normalise.

Exhibit 12: Cutting earnings on lower net interest income, lower near term provisions a partial offset
Estimate revisions

		2023E			2024E			2025E			2026E		
		New	Old	Change	New	Old	Change	New	Old	Change	New	Old	Change
Barclays	EPS (p)	23.1	23.2	0%	27.7	30.0	-8%	33.4	37.8	-12%	40.8	45.3	-10%
	Capital distribution per share (p)	15.7	15.7	0%	12.3	12.3	0%	13.3	13.3	0%	18.0	18.0	0%
Lloyds	EPS (p)	8.0	7.2	10%	7.0	7.9	-12%	8.2	9.6	-15%	10.8	11.8	-8%
	Capital distribution per share (p)	7.2	7.2	0%	7.9	7.8	0%	8.6	8.5	0%	9.3	9.2	1%
NatWest	EPS (p)	42.0	41.5	1%	38.9	41.7	-7%	45.5	50.1	-9%	56.4	57.2	-1%
	Capital distribution per share (p)	37.3	37.3	0%	30.5	30.5	0%	33.5	33.5	0%	35.5	35.5	0%

Source: BofA Global Research estimates

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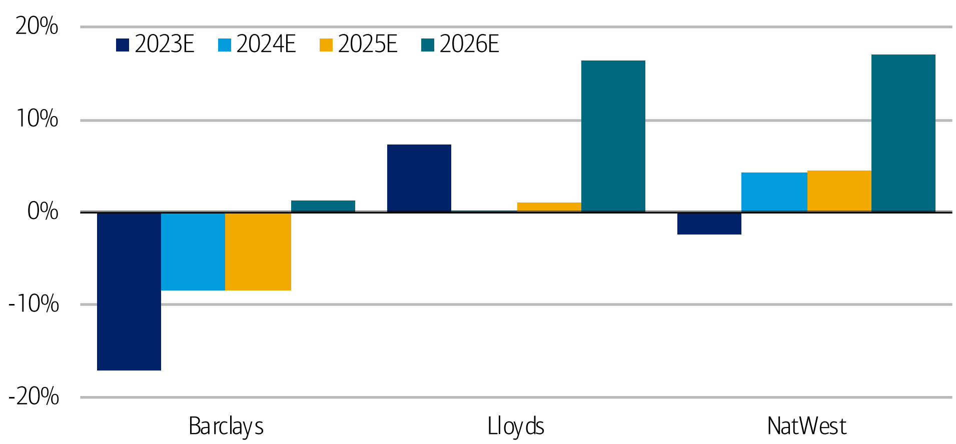
Barclays below consensus, Lloyds, NatWest above

Exhibit 13 shows that our EPS estimates are below consensus for Barclays and generally above consensus for Lloyds and NatWest.

Exhibit 13: EPS – Barclays below consensus, Lloyds, NatWest above
EPS – BofA vs consensus



Source: BofA Global Research estimates, Visible Alpha consensus

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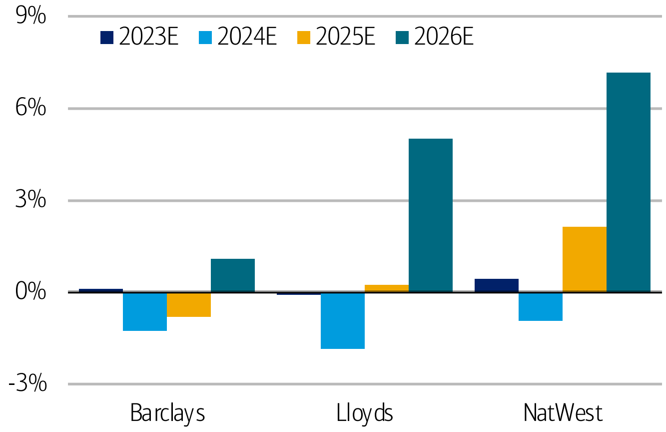
Our 2024E income forecasts are below consensus for all three banks but we expect a stronger recovery for Lloyds and NatWest (Exhibit 14) while our provisions are below consensus (Exhibit 15) on lower interest rates and a benign UK economic outlook.

Exhibit 14: Income – 2024E below consensus, better subsequent recovery for Lloyds and NatWest
Income – BofA vs consensus



Source: BofA Global Research estimates, Visible Alpha consensus

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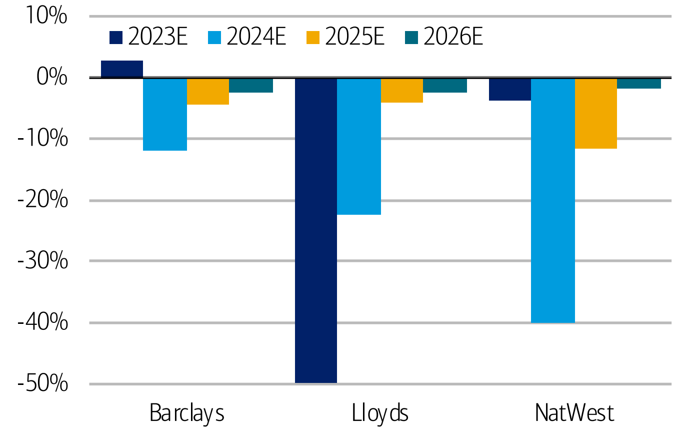
Exhibit 15: Provisions – all better than consensus, substantial 2023E writeback for Lloyds
Provisions – BofA vs consensus



Source: BofA Global Research estimates, Visible Alpha consensus

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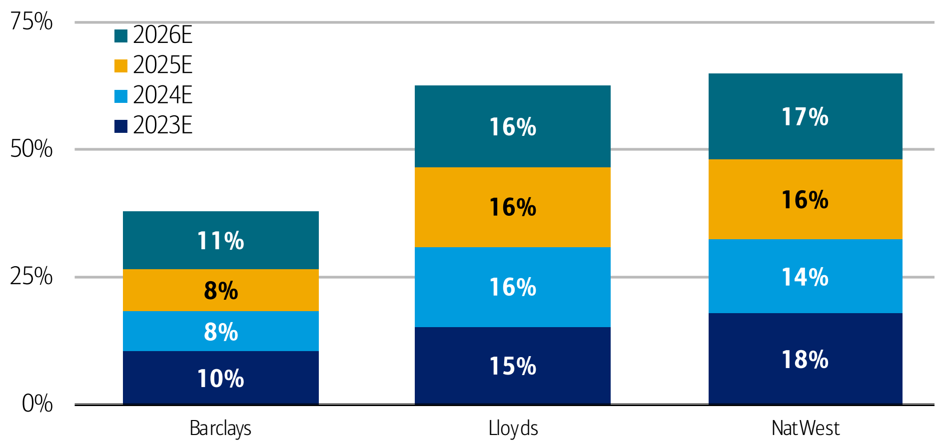
Consistently attractive yield from Lloyds and NatWest

We anticipate attractive capital distributions from all four banks but see Lloyds and NatWest ahead of a strong European Banks sector (Exhibit 16). Barclays distributions are lower reflecting weaker profitability, the related need for further restructuring and a more capital intensive business mix.

Exhibit 16: NatWest and Lloyds particularly attractive yield
Capital distribution % of market capitalisation



Source: Bloomberg, BofA Global Research estimates

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Buy Lloyds and NatWest, Barclays Underperform

We set price objectives between the Gordon Growth model based fundamental and PE relative valuations shown in Exhibit 17. Lloyds is our top pick among domestic UK banks and we also maintain a Buy rating on NatWest. There's limited upside to our 165p Barclays' price objective (from 150p) and we reiterate Underperform.

Exhibit 17: Buy Lloyds, NatWest, Underperform Barclays
Valuation per share (p)

	Barclays Underperform	Lloyds Buy	NatWest Buy
Gordon Growth based valuation			
2026E RoTE	10.4%	15.5%	15.4%
CoE	16.0%	13.0%	13.0%
Growth	1.0%	0.0%	0.0%
Book multiple	**0.6x**	**1.2x**	**1.2x**
Book multiple discounted to 1 year from now	0.5x	1.0x	0.9x
2023E tangible book value	311	51	279
Value pre capital distributions	**142**	**48**	**259**
Present value of dividend	26	10	59
Present value of share buybacks	13	14	36
Fundamental valuation	**181**	**72**	**354**
PE relative valuation			
1 year forward EPS	28.2	7.1	41.8
European Bank sector 1 year forward PE	5.8x	6.6x	6.6x
PE relative valuation	**164**	**46**	**274**
Price objective	**165**	**59**	**290**
Previous price objective	**150**	**58**	**290**

Source BofA Global Research estimates. Barclays PE relative based on 11% long run discount to European Banks sector

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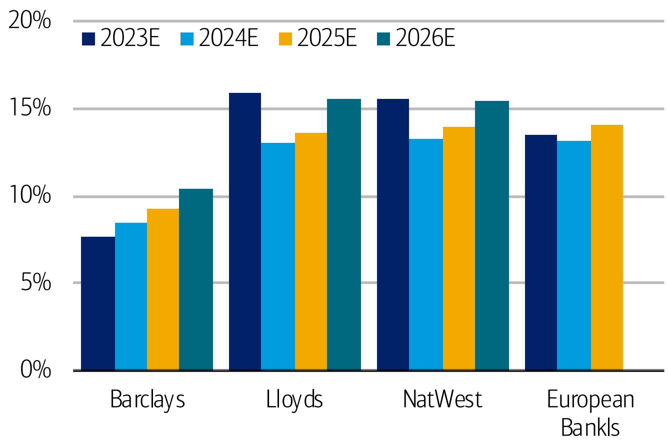
We expect Lloyds and NatWest to deliver an RoTE broadly in line with the European Banks sector (Exhibit 18) for a similar price to book multiple (Exhibit 19) but significantly lower profitability from Barclays.

Exhibit 18: NatWest and Lloyds superior profitability
Return on tangible equity



Source: BofA Global Research estimates, Bloomberg

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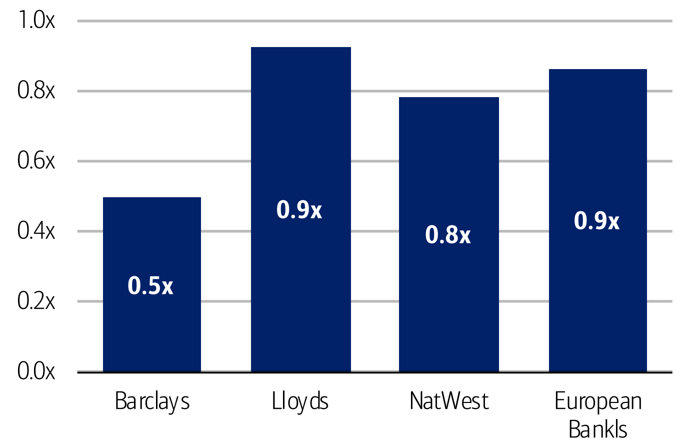
Exhibit 19: Undemanding valuations
Price to tangible book value



Source: BofA Global Research estimates, Bloomberg

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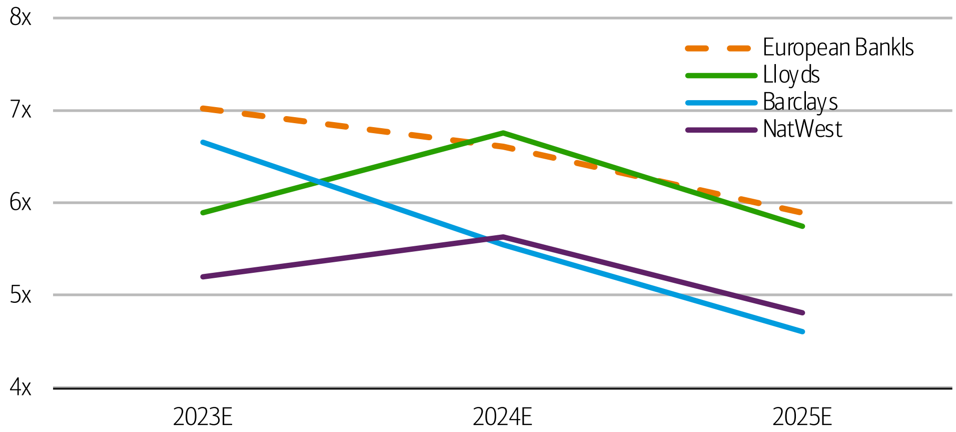
PE multiples are below the European Banks sector for NatWest and Barclays and in line for Lloyds.

Exhibit 20: Price to earnings ratio
UK banks generally below an inexpensive European Bank sector



Source: BofA Global Research estimates, Bloomberg

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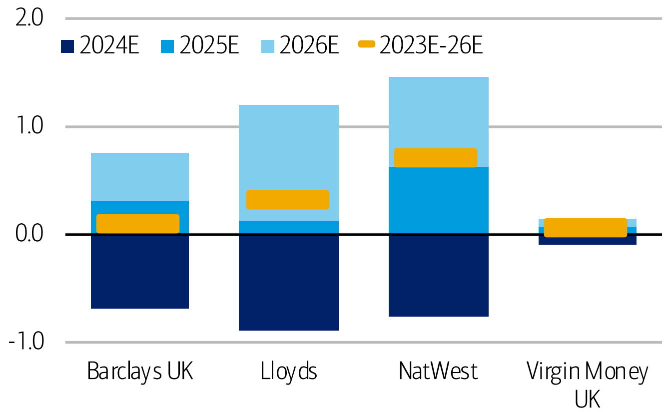
Net interest income lower in 2024E then recovering

Exhibit 21 shows that we expect net interest income to fall in 2024E but to be at least offset by increases in the two subsequent years. This cumulative increase is most significant for NatWest, while we expect little overall change for Barclays UK or Virgin Money. By 2026E, we expect structural hedge reinvestment to at least offset the nearer term drag from mortgage and deposit spreads (Exhibit 22).

Exhibit 21: Net interest income falling in 2024E, rising from 2025E
Annual change in net interest income (£bn)



Source: BofA Global Research estimates

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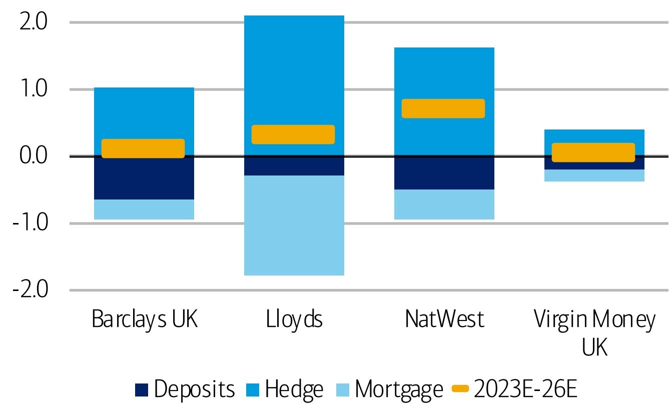
Exhibit 22: Net interest income flat to higher 2026E vs 2023E
Cumulative change in net interest income 2023E-26E (£bn)



Source: BofA Global Research estimates

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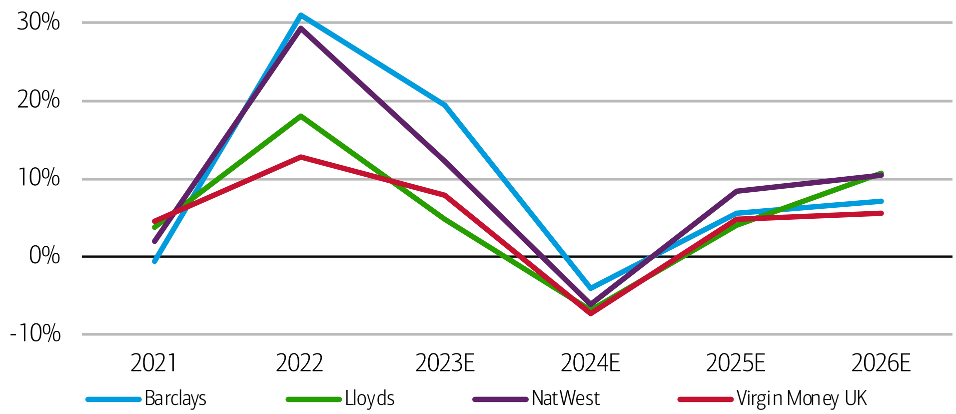
With the return of some volume growth, we expect a mid single digit fall in net interest income in 2024E, followed by strong growth in the subsequent 2 years.

Exhibit 23: Modest net interest income decline in 2024E, before returning to growth
Annual net interest income growth



Source: Company data, BofA Global Research estimates

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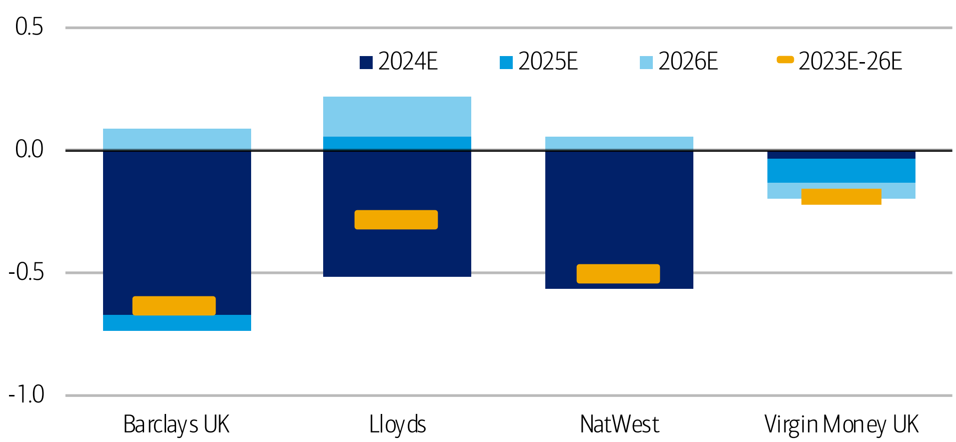
Deposit drag

Having been the main driver of margin expansion from 2022 to mid 2023, we expect deposit spreads to be a significant source of compression (Exhibit 24). This is likely to be concentrated in 2024E as customers continue to migrate to more expensive products, there's a negative gapping effect as deposit rates lag initial policy rate cuts and spreads begin to compress on like for like products.

Exhibit 24: Deposit income under pressure to 2026E, particularly in 2024E
Annual change in deposit income (£bn)



Source: BofA Global Research estimates

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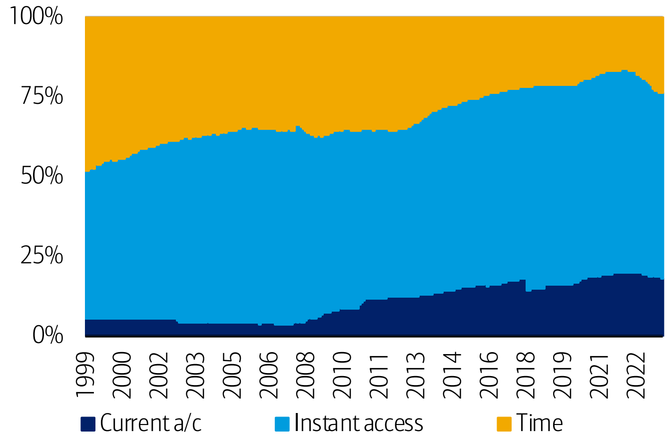
More mix shift to come

Exhibit 25 shows the mix of UK deposits. Time deposits have increased from 17% to 24% of the total but are still some way below their pre Financial Crisis level. However, the clearing banks dominate current accounts and instant access savings and have a smaller share of time deposits, as Exhibit 26 shows.

We expect some further mix shift from the larger banks in 2024E, stabilizing once the market adjusts. Virgin Money grew time deposits ahead of the big banks, when new business spreads were wider but we expect a renewed shift towards time deposits as the most price elastic source of deposit funding, as we discuss in relation to refinancing Bank of England funding below.

Exhibit 25: Time deposits 24% vs 35-40% pre financial crisis, clearing banks typically lower
UK sterling deposit mix



Source: Bank of England

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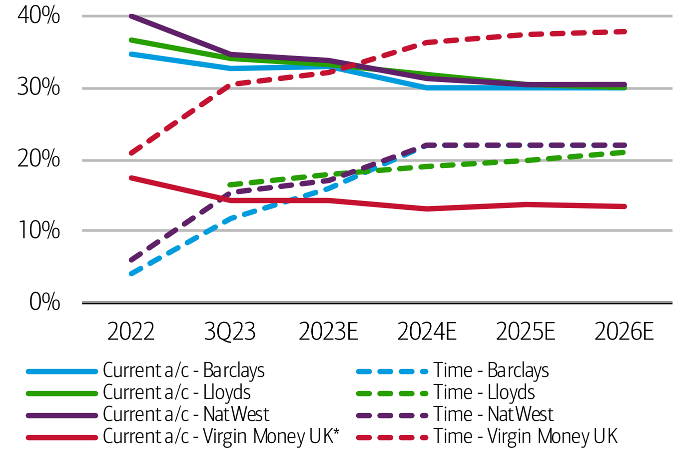
Exhibit 26: Further deposit migration but likely slowing
UK domestic banks deposit mix



Source: Company data, BofA Global Research estimates

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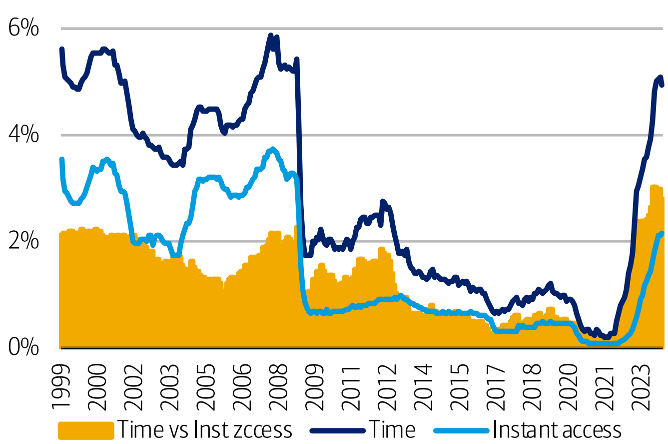
With time deposits paying 3% more than instant access savings, customers haven't had more incentive to move their money (Exhibit 27). However swap rates have begun falling, moving below policy rates (Exhibit 28) and falling time deposit rates should reduce the pricing differential to instant access.

Exhibit 27: Time deposits 3% more expensive than instant access, a historical high
Interest rates on new time deposits and instant access savings



Source: Bank of England

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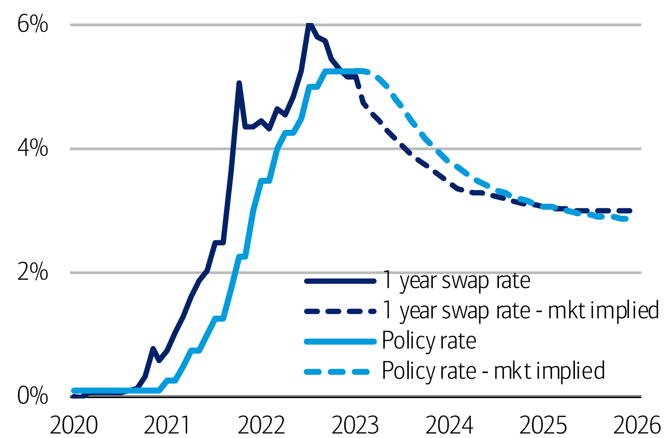
Exhibit 28: Lower rates should reduce the incentive to switch to Time
UK one year swap rates



Source: Bloomberg

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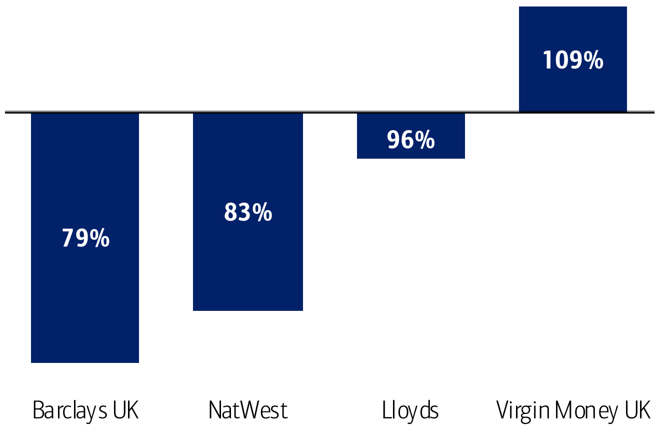
More competition for time deposits a concern for VMUK

We expect the move towards time deposits to be over for the big banks in the coming quarters but anticipate it continuing to be a very price competitive segment. Larger banks have a stock of surplus deposits, with loan to deposit ratios below 100%. This tends to be less the case for smaller players like Virgin Money (Exhibit 29). These smaller participants have the added pressure of needing to refinance cheap Bank of England funding, typically equivalent to 10% of their deposits, twice the proportion of the clearing banks (Exhibit 30).

Exhibit 29: UK clearing banks have surplus deposits, VMUK deficit
3Q23 loan to deposit ratio



Source: Company data

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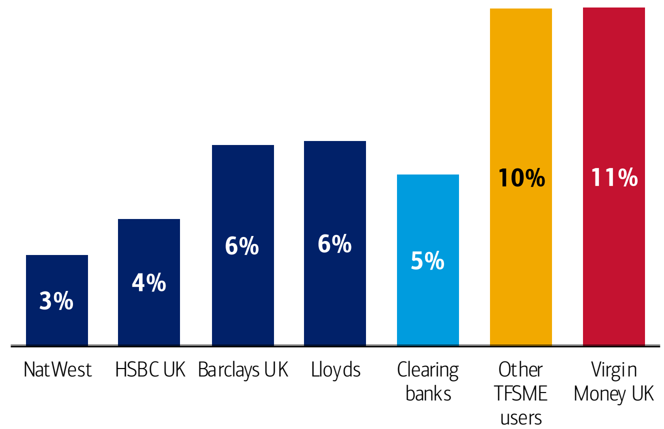
Exhibit 30: Smaller institutions heavier users of Bank of England funding
TFSME borrowing % of UK deposits



Source: Bank of England, company data

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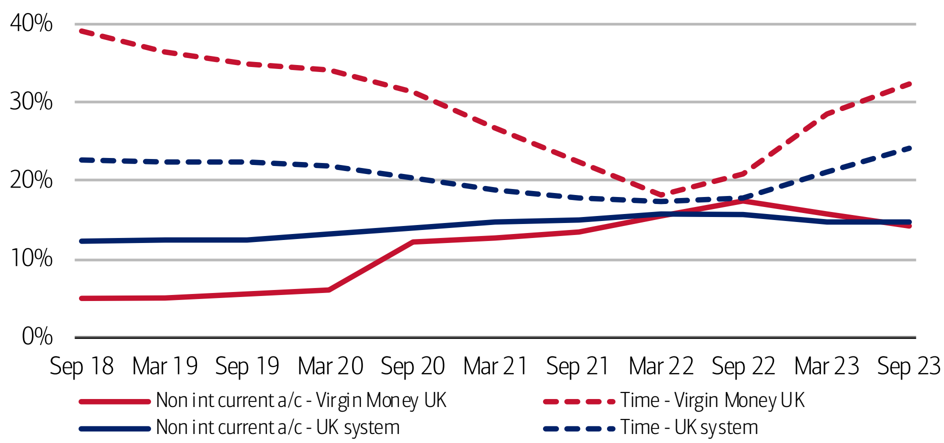
Exhibit 31 compares the recent evolution of Virgin Money's deposit mix with the broader market. After targeting a lower cost deposit mix at its June 2019 capital markets day, the company was successful in reducing its proportion of time deposits faster than the overall market as policy rates were cut to near zero. It's also grown faster than the market over the past year, as rates have risen. We believe that its funding needs will see it continue to compete for low spread time deposits.

Exhibit 31: Virgin Money UK's deposit mix weaker than the market
UK deposit mix



Source: Bank of England, company data , BofA Global Research

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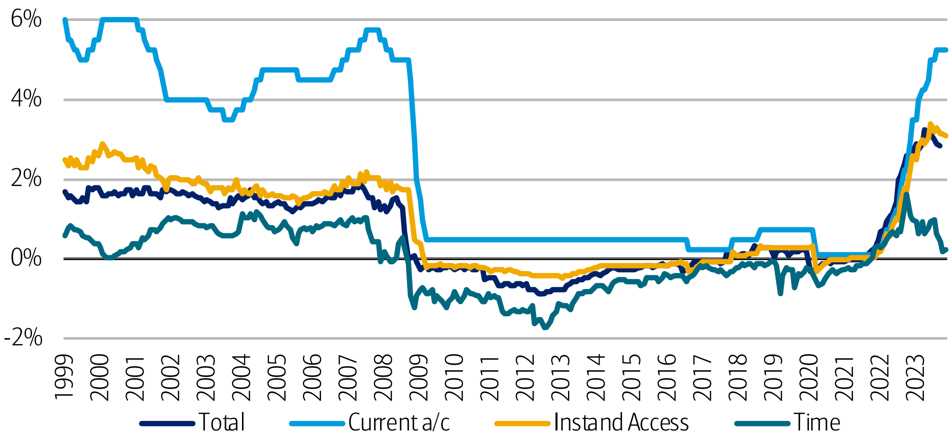
Mind the gap and normalisation

We highlighted earlier that deposit spreads are coming down from historical highs (Exhibit 4). This mainly results from instant access spreads reaching well in excess of 3% in mid 2023, as Exhibit 32 shows. Spreads on new time deposits peaked at 1.6% in late 2022 and have fallen to 20bp.

Exhibit 32: Deposit spread higher than history. Time under pressure. Compression to come
UK banking system new deposit spread



Source: Bank of England, Bloomberg, BofA Global Research

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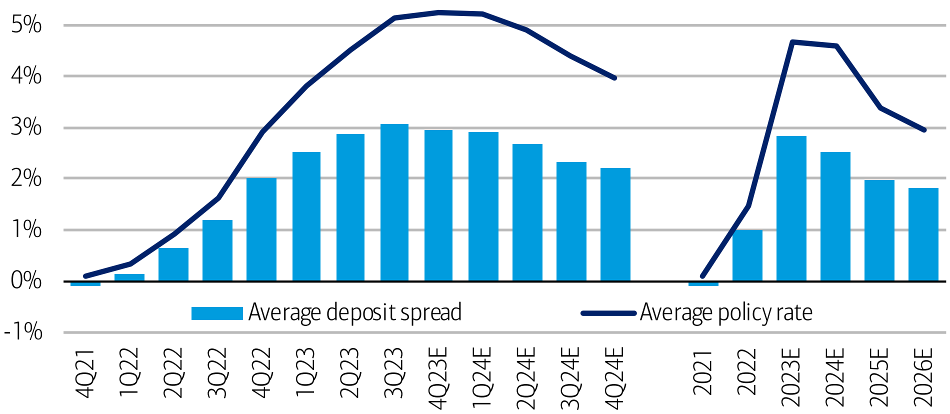
We expect these trends to continue, accelerating in 2024E as policy rate cuts begin and instant access deposit rate reductions lag, falling to its c2% pre financial crisis average by 2025E (Exhibit 33)

Exhibit 33: We model UK deposit spreads reverting to pre financial crisis levels
UK policy rates and deposit spreads



Source: Bank of England, Bloomberg, BofA Global Research estimates

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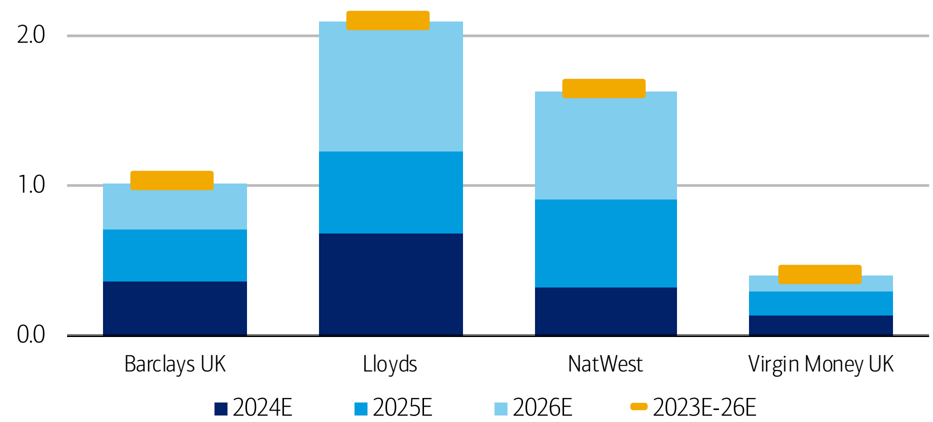
Cumulative hedge support

Structural hedges are yielding well below floating rates but will provide additional income in each of the next three years as they are reinvested.

Exhibit 34: Structural hedge income growing each year
Annual change in gross structural hedge income (£bn)



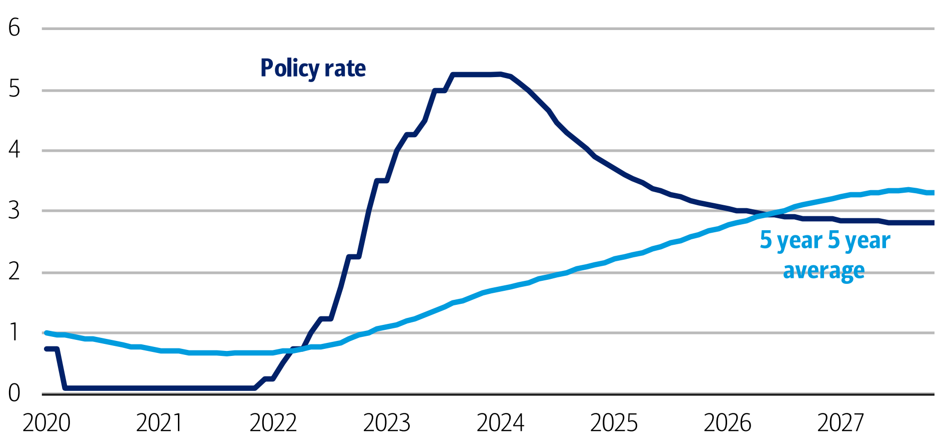
Source: BofA Global Research estimates

BofA GLOBAL RESEARCH

Rising hedge income even as rates are cut

We showed earlier (Exhibit 6) how UK domestic banks typically use 5 year interest rate swaps to smooth the income impact of interest rate fluctuations. Exhibit 35 uses the 5 year rolling average 5 year swap rate as a proxy for a structural hedge yield. This is the income that the bank makes on the hedged proportion of its rate insensitive liabilities. From a 2021 trough of 0.7%, it has risen to 1.7% and, based on current forward rates, will reach 3.4% in 2027.

Exhibit 35: Hedge yield rising steadily but below policy rate until 2026E
5 year swap rate, 5 year rolling average (hedge yield proxy) and UK policy rate



Source: Bloomberg, BofA Global Research

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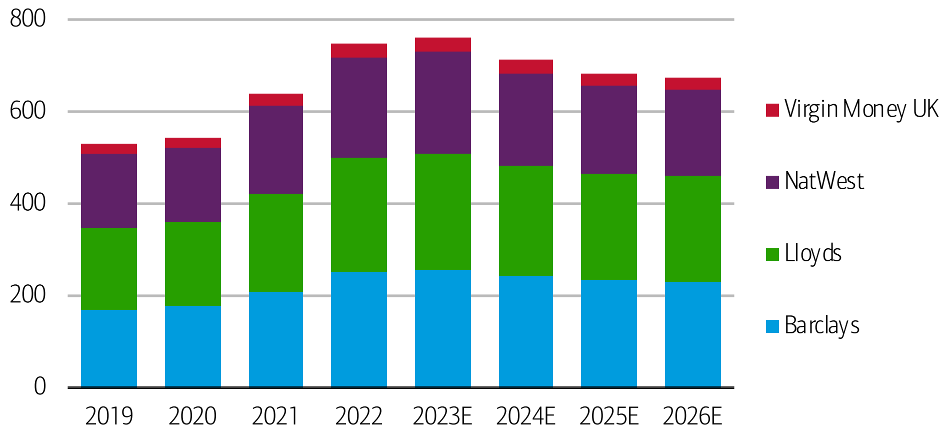
Size matters less

Hedge notionals are primarily determined by the volume of rate insensitive deposits (current accounts and some instant access savings) and tangible equity. This is overlaid with a behavioural analysis to determine the stickiness of those eligible deposits and a further haircut applied in case outflows are bigger than anticipated.

Exhibit 36 shows that hedges have grown significantly in recent years, reflecting inflows into current accounts and instant access savings (Exhibit 25). A reversal of that trend is already leading to a reduction in hedge balances, which we expect to continue.

Exhibit 36: Declining structural hedge size
Average structural hedge notional (£bn)



Source: Company data, BofA Global Research estimates

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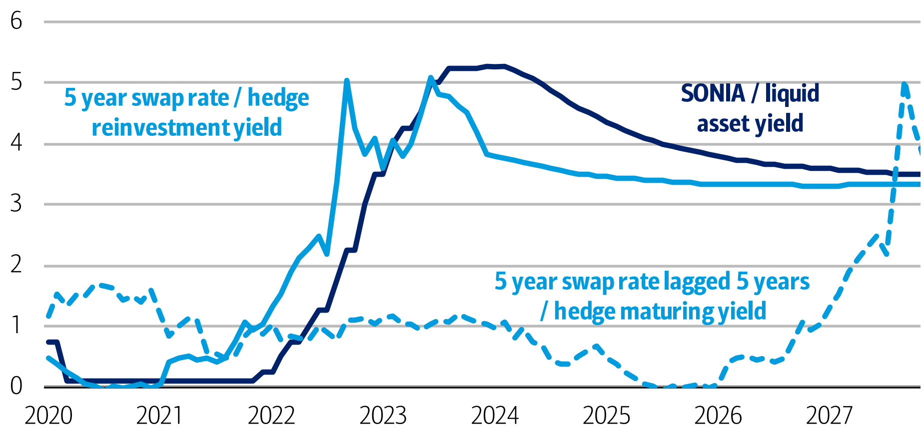
This means that maturities will not be fully reinvested. Those that are reinvested will earn the current 5 year swap rate, averaging 2.6% higher than what's maturing over the next three years, with that yield locked in for five years. Deposits where the hedge is not reinvested will revert to earning the floating rate, which current market expectations have at 0.6% above 5 year swaps over the next three years, as Exhibit 37 shows. So, unhedged deposits will be invested at higher yields than hedged deposits. However, these are invested at floating rate and will lack duration and, if deposit migration is the driver of smaller hedges, then those deposits will cost more.

Exhibit 37: Hedge reinvested below SONIA but with duration
Hedge reinvestment and liquid asset yield



Source: Bloomberg, BofA Global Research

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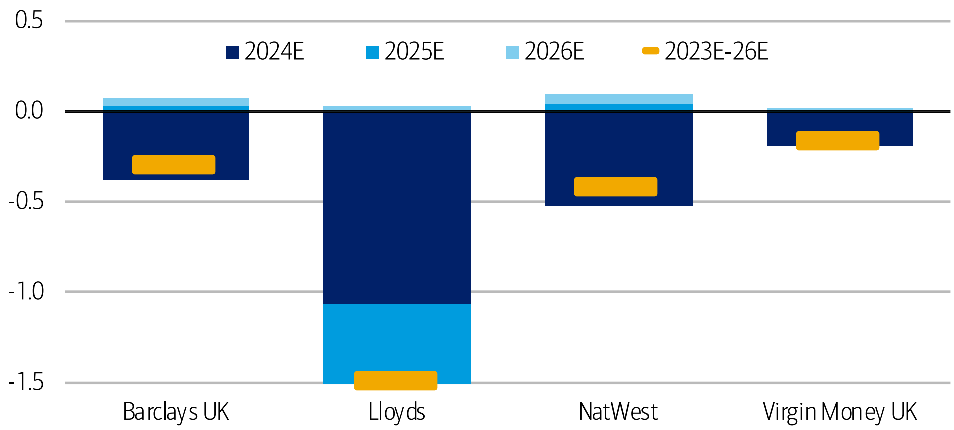
Signs of mortgage profitability recovering

Mortgage spreads have been falling since 2021, initially coming from high levels and recently under competitive pressure as a result of a lack of mortgage demand and a refinancing dominated market. We expect mortgage spread compression to ease for most banks in 2024E, turning mildly positive from 2025E, with Lloyds the main exception as current back book spreads are higher.

Exhibit 38: Mortgages still a significant drag for Lloyds
Annual change in mortgage net interest income (£bn)



Source: BofA Global Research estimates

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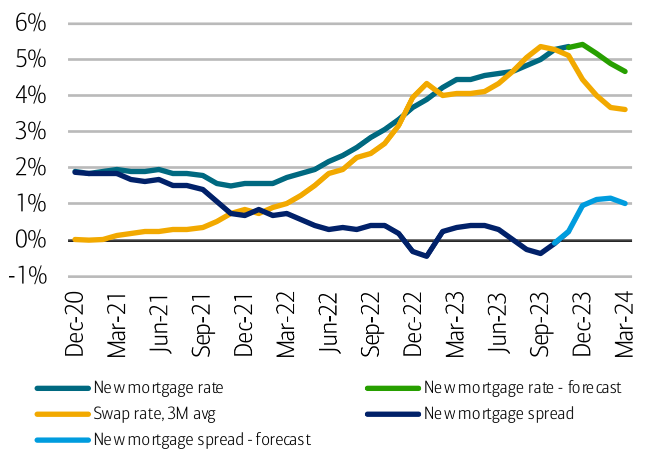
Most nearing back book / front book equilibrium

Spreads on new mortgage lending have been under sustained pressure since their c200bp high in late 2020 / early 2021 (Exhibit 39). This is partly due to swap rate volatility but also competition for sparse volumes. Recent pricing demonstrates more discipline, we think. After a brief spike, we factor in new mortgage spreads trending back down to 70bp in our bank earnings estimates (Exhibit 40).

Exhibit 39: Mortgage rates lagging swaps, spreads recovering from late 2023
UK new mortgage spread to swap rates



Source: Bank of England, company data, BofA Global Research estimates

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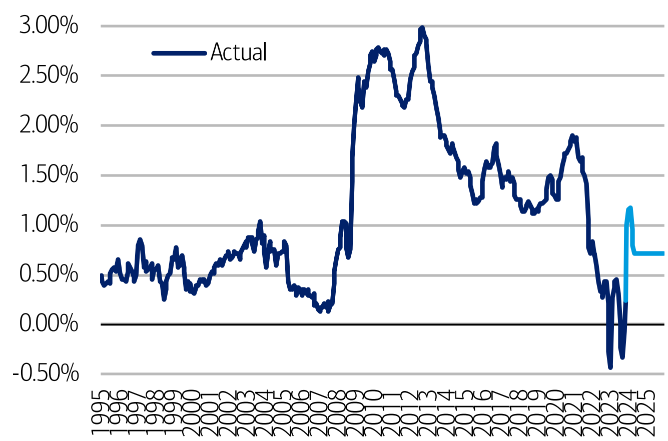
Exhibit 40: We assume spreads on new mortgages settling at c70bp
Spread on new mortgage lending



Source: Bank of England, DataStream, BofA Global Research estimates

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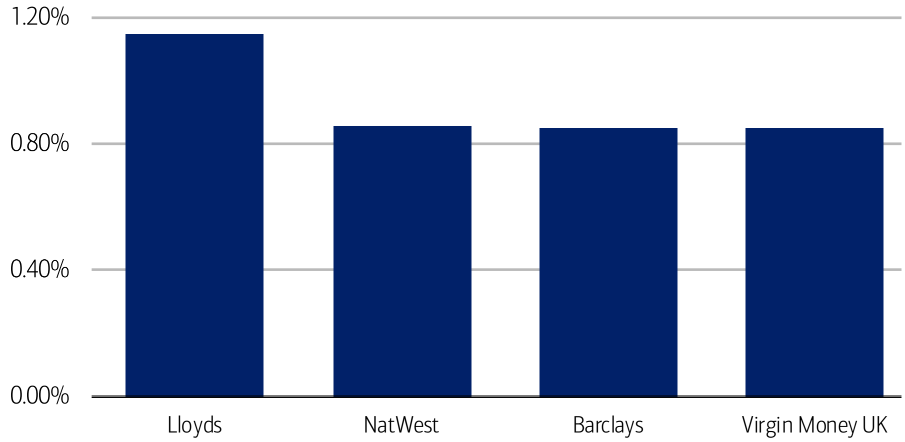
Most banks have mid 80bp spreads on their mortgage books, suggesting that margin attrition from mortgage pricing should work through in the next quarter or two, Lloyds is the exception, where we estimate a 115bp back book spread, resulting from higher historical pricing and a bigger proportion of wider margin standard variable rate lending. This likely takes a year longer to work through than other banks.

Exhibit 41: Lloyds mortgage back book spread c115bp , others c85bp
Spread on mortgage stock, 3Q23



Source: Company data, BofA Global Research estimates

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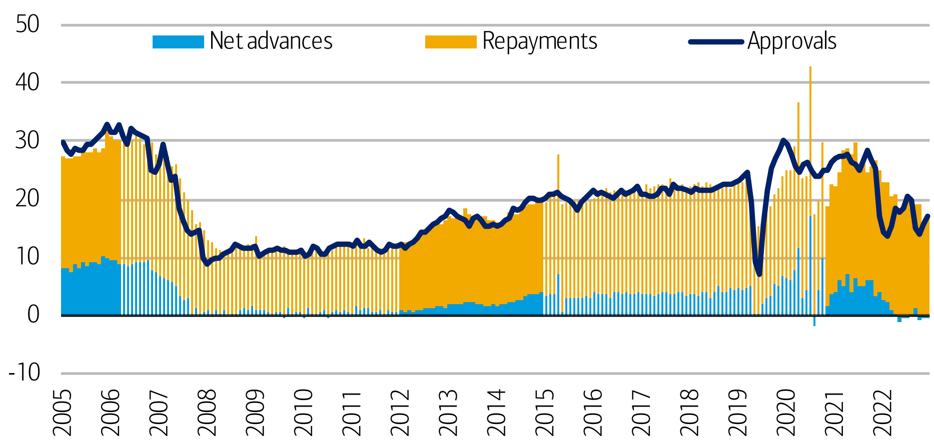
Potential for some pickup in lending

The return of some mortgage market activity should also be positive for pricing. Exhibit 42 shows that there's been virtually no net lending since March 2023 but that approvals for new lending have begun to pick up.

Exhibit 42: Virtually no net lending since March, recent pick up in approvals
Mortgage lending volumes (£bn)



Source: Bank of England, Refinitiv Eikon, BofA Global Research

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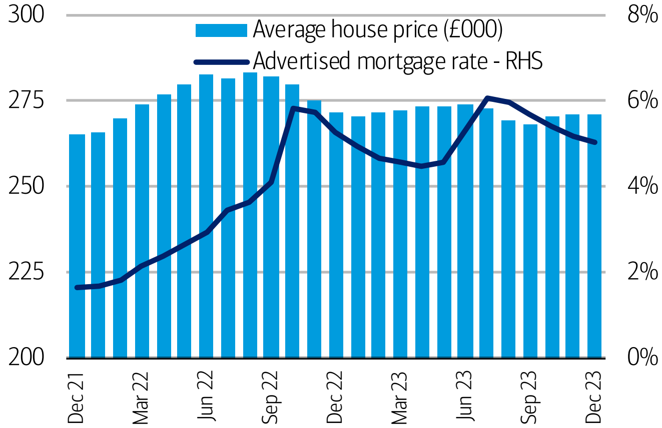
There are signs of some recovery in housing and mortgage activity. Exhibit 43 shows 3 consecutive months of house price growth. This lags the reduction in mortgage rates which we expect to continue declining from a July peak of a little over 6%. Surveyors are now beginning to report improved housing market expectations (Exhibit 46).

Exhibit 43: Falling mortgage rates, modest recent house price growth
House prices and mortgage rates



Source: Halifax, Nationwide, Bank of England, company data

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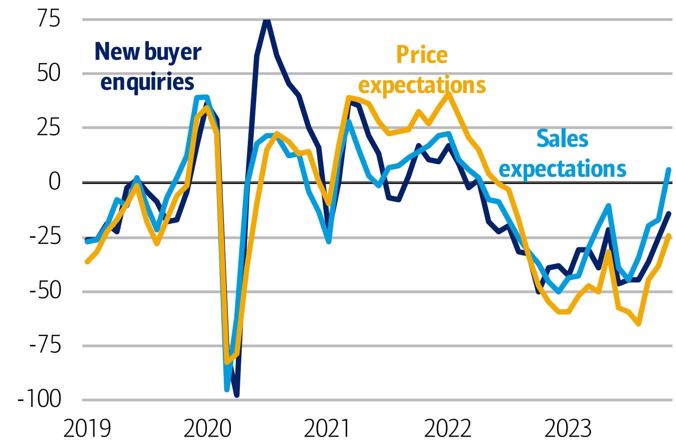
Exhibit 44: Sales expectations turned positive, new buyer enquiries and price expectations less negative
RICS housing market survey



Source: Royal Institute of Chartered Surveyors

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Real wage growth has turned positive (Exhibit 45) and mortgage approvals have ticked up from a very low level (Exhibit 46).

Exhibit 45: Real wage growth as inflation has slowed
UK real wage growth

Source: Office for National Statistics

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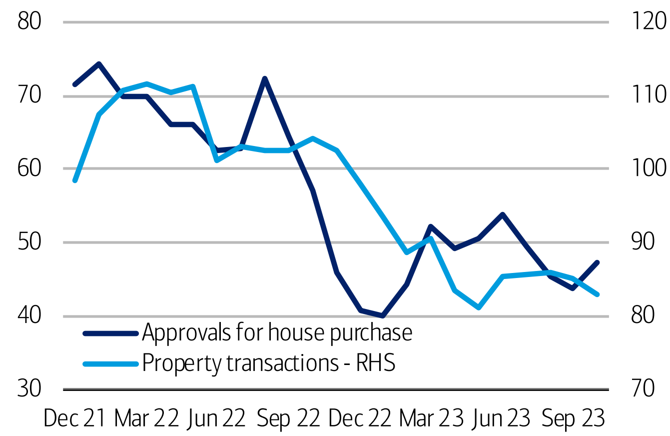
Exhibit 46: Recent uptick in mortgage approvals
Mortgage approvals and property transactions (000)



Source: Bank of England, Office for National Statistics

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In addition to a little more mortgage activity, conviction that interest rates have peaked could encourage some businesses to begin borrowing again, particularly with business confidence the highest in six years.

Exhibit 47: Business confidence strongest since 2017
Expected business activity next 12 months

Source: Bloomberg, Lloyds Business Barometer

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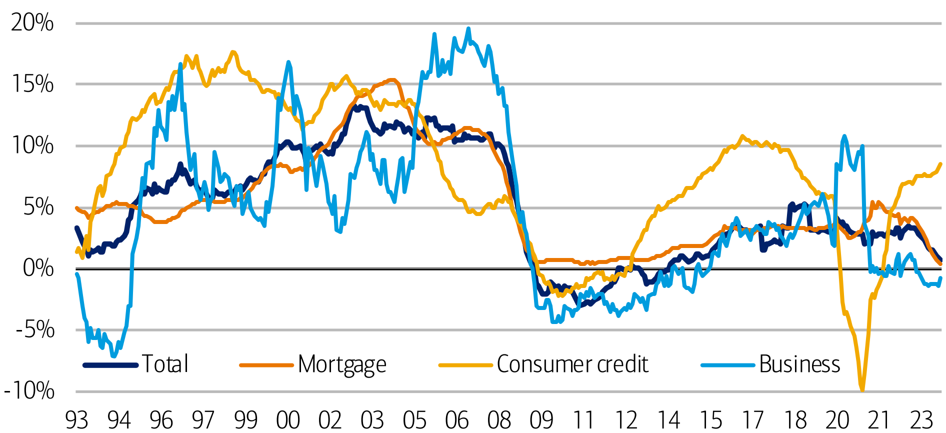
This should support some pick up in loan growth through 2024E, after almost grinding to a halt in 2023.

Exhibit 48: Loan growth stalled
UK private sector loan growth



Source: Bank of England, BofA Global Research

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Revenue resilience from non interest income

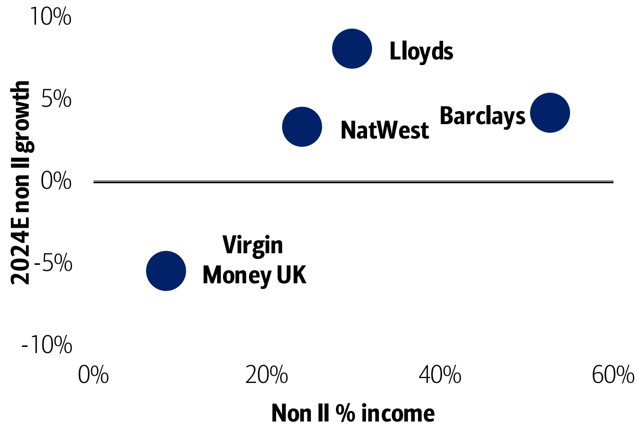
Diversification, particularly through non interest income, supports revenue sustainability, especially when margins are under pressure. Barclays has by far the biggest proportion of non interest income at half of revenues, compared to 30% and 25% for Lloyds and NatWest and less than 10% for Virgin Money (Exhibit 49).

Barclays' Corporate and Investment Bank, where we expect a recovery in deal flow and resilient trading income in 2024E, contributes 80% of its non interest income. At NatWest, 70% of non interest income is from Commercial and Institutional Banking and a recovery in trading performance supported strong growth in 2022. We factor in low single digit non interest income growth for both companies in 2024E.

Lloyds non interest income is distributed across its banking, wealth and insurance businesses. We anticipate high single digit growth in 2024E, a continuation of the normalisation and diversification benefits demonstrated through 2023. We expect the impact of Consumer Duty regulation-driven changes to fees to weigh on Virgin Money in

2024E but see future years supported by diversification initiatives, although growing from a very low base.

Exhibit 49: Barclays biggest proportion non interest income, Lloyds fastest growth
Non interest income % revenue and annual growth 2024E



Source: BofA Global Research estimates

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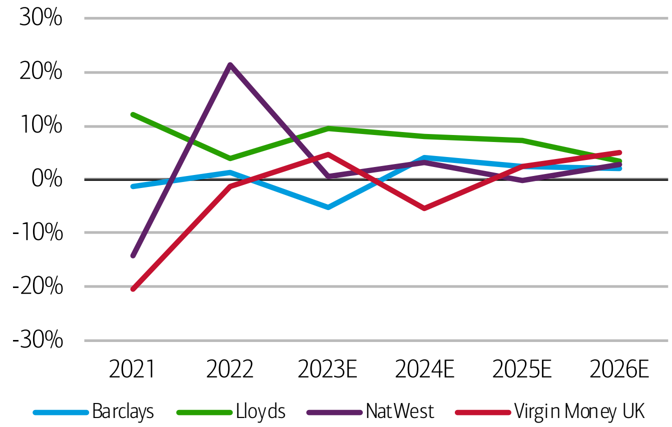
Exhibit 50: Non interest income growth most consistent at Lloyds
Annual non interest income growth



Source: Company data, BofA Global Research estimates

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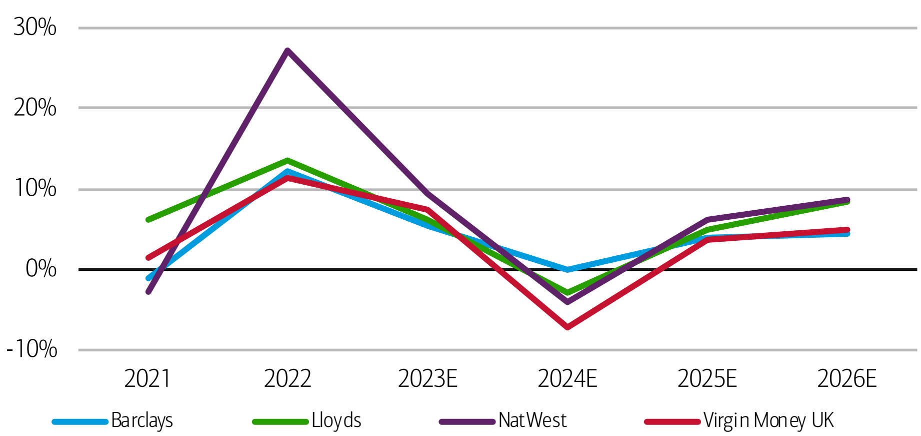
2% revenue decline in 2024E, growth from 2025E

Overall, we estimate a 6% reduction in net interest income and 5% non interest income growth to result in 2% lower revenues for this group of banks in 2024E. This ranges from flat revenues for Barclays to a 7% fall for Virgin Money with 3-4% declines for Lloyds and NatWest.

Exhibit 51: 2024E income 0% Barclays, -3% Lloyds, -4% NatWest, -7% Virgin Money, then growth
Annual revenue growth



Source: Company data, BofA Global Research estimates

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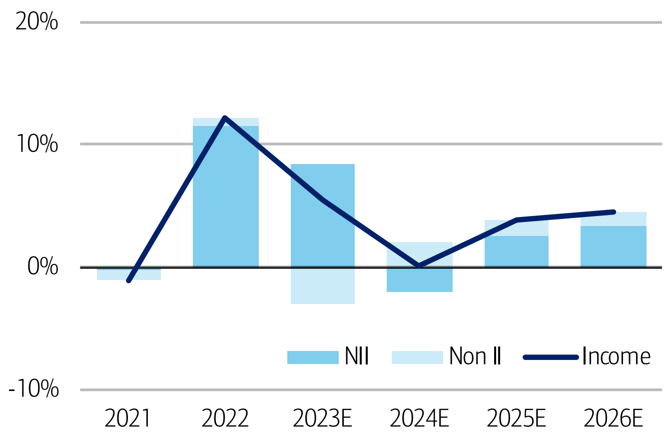
Exhibit 52 - Exhibit 55 show the drivers of each bank's revenue trends.

Exhibit 52: Barclays revenues most resilient in 2024E then mid single digit growth
Barclays annual revenue growth



Source: Company data, BofA Global Research estimates
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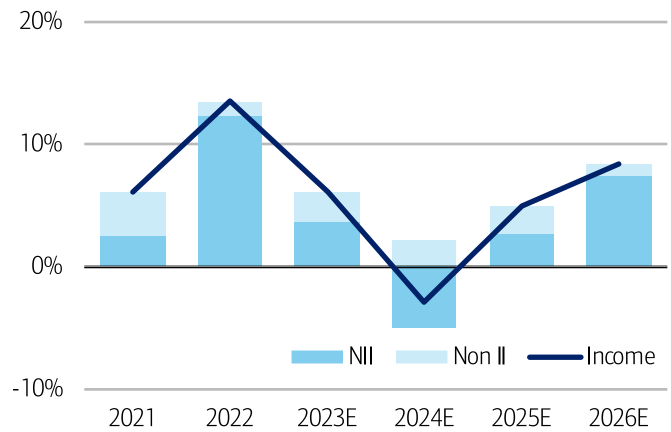
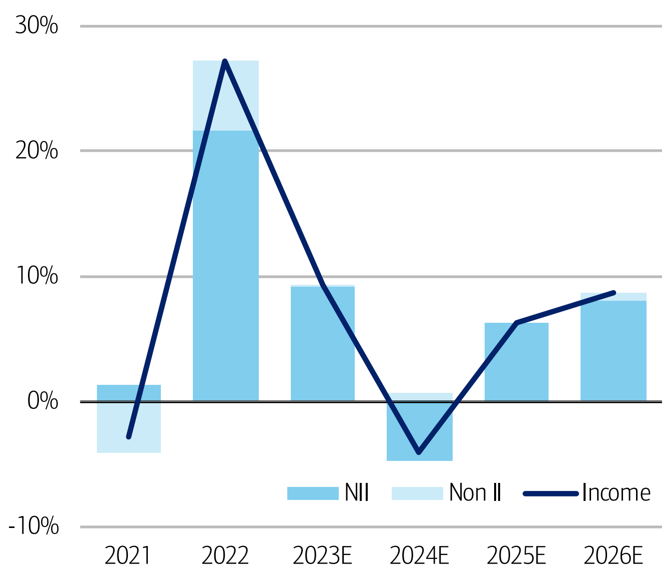
Exhibit 53: Lloyds non interest income growth helps to offset weaker margin trends
Lloyds annual revenue growth



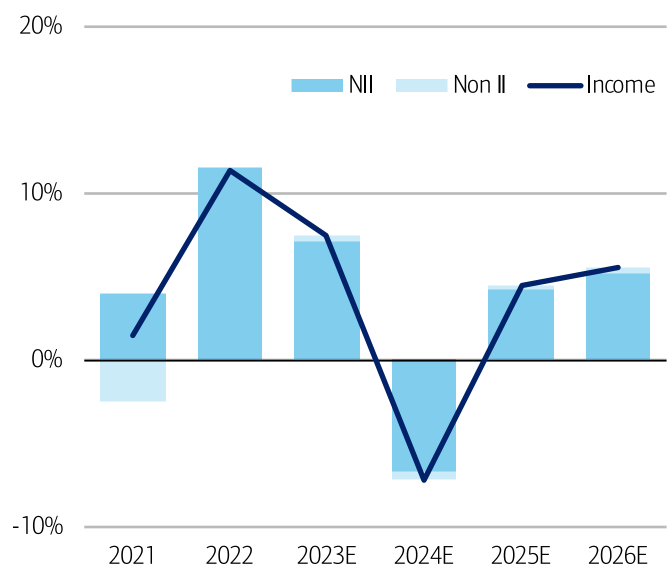
Source: Company data, BofA Global Research estimates
BofA GLOBAL RESEARCH

Exhibit 54: NatWest modest revenue fall in 2024E then mid-high single digit growth
NatWest annual revenue growth



Source: Company data, BofA Global Research estimates
BofA GLOBAL RESEARCH

Exhibit 55: VMUK weakest 2024E then mid single digit recovery
Virgin Money UK annual revenue growth



Source: Company data, BofA Global Research estimates
BofA GLOBAL RESEARCH

Stocks mentioned

Prices and ratings for stocks mentioned in this report

BofA Ticker	Bloomberg ticker	Company name	Price	Rating
BCLYF	BARC LN	Barclays	155.58p	B-3-7
BCS	BCS US	Barclays	US$ 7.87	B-3-7
LLDTF	LLOY LN	Lloyds Banking Group	47.565p	B-1-7
LYG	LYG US	Lloyds Banking Group	US$ 2.38	B-1-7
RBSPF	NWG LN	NatWest Group	220.1p	B-1-7
NWG	NWG US	Natwest Group PLc	US$ 5.63	B-1-7

Source: BofA Global Research

Investment Rationale

Barclays

We see uncertainty on restructuring and the dominance of CIB weighing on profitability and capital distribution capacity, even with additional cost reductions. This limits upside relative to other inexpensive European banks with a better risk-reward.

Lloyds Banking Group

More normal interest rates and a strategic focus on increasing customer wallet share are positives and should sustain a low-mid teens RoTE even with significant mortgage and deposit pricing pressure. A combination of strong profitability and limited capital consumption from volume growth should support an ongoing capital distribution yield in the mid teens. The current stock price undervalues this level of profitability and capital return, in our view.

NatWest Group

NatWest's focus on growth, clear commitment to cost reduction and strong balance sheet see it well positioned for a UK economic recovery. We see this driving above cost of equity profitability and facilitating attractive capital distributions, not reflected in the current valuation.

Price objective basis & risk

Barclays (BCLYF / BCS)

Our price objective for Barclays is 165p (US$8.34). Our primary valuation methodology is a Gordon Growth model based on the outer year of our forecast period to which we add the present value of expected capital return. We then cross check this against sector PE multiples and our economic scenario analysis and adjust accordingly. We use 2026E as the base year for our model. With a 16% cost of equity assumption, this suggests a 2026E price to book multiple of 0.6x, reducing to 0.5x when discounted to a year from now at our cost of equity. Applying this to 2023E tangible book value of 311p gives a value of 142p pre capital return. To this we add the present value of dividends and share buybacks that we forecast through to 2026E.

Upside risks are a stronger economic recovery, which could benefit the macro/rate outlook and reduce tail risks, lower cost inflation and a more constructive pricing environment. Downside risks to our price objective are weaker earnings than anticipated from higher impairment losses if the UK economy performs worse than we presently expect, a weaker interest rate outlook, a need for additional cost or capital investment to support growth, tougher regulation, and increased competition.

Lloyds Banking Group (LLDTF / LYG)

We value Lloyds using a Gordon Growth methodology using 2026E as a base year and a 13% CoE. We add to this valuation the present value of our forecast dividends and share buybacks through to 2026E discounted at the cost of equity. This is then cross checked against sector PE multiples and our economic scenarios analysis to arrive at our PO of 59p ($2.98).

Downside risks to our price objective are weaker earnings than anticipated from higher impairment losses if the UK economy performs worse than we presently expect, a weaker interest rate outlook, tougher regulation and/or increased competition. Upside risks are stronger UK growth fewer interest rate cuts and a more constructive pricing environment.

NatWest Group (RBSPF / NWG)
Our price objective for NatWest is 290p (US$7.33 per ADR). Our valuation uses a Gordon Growth model based on the outer year of our forecast period, to which we add the present value of expected capital return. We then cross check this against sector PE multiples and our economic scenario analysis. We use 2026E as the base year for our model. With a 13% cost of equity, this suggests a 2026E price to book multiple of 1.2x, reducing to 0.9x when discounted to a year from now at our cost of equity. Applying this to 2023E tangible book value of 279p gives a value of 259p pre capital return. To this we add the present value of the dividends and share buybacks that we forecast through to 2026E.

Downside risks to our price objective are weaker earnings than anticipated from higher impairment losses if the UK economy performs worse than we presently expect, a weaker interest rate outlook, more significant restructuring, tougher regulation and/or increased competition.

Upside risks are a stronger economic recovery, including interest rate and growth prospects, offering revenue upside and reduces credit risk. A more constructive pricing environment would be a further positive.

Analyst Certification

I, Rohith Chandra-Rajan, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

EMEA - Banks Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	Allied Irish Banks	AIBRF	AIBG ID	Alastair Ryan
	Bank of Ireland Group	XBOIF	BIRG ID	Alastair Ryan
	BFF Banking Group	XBBZF	BFF IM	Antonio Reale
	BNP Paribas	BNPQF	BNP FP	Tarik El Mejjad
	BNP Paribas	BNPQY	BNPQY US	Tarik El Mejjad
	CaixaBank	CIXPF	CABK SQ	Antonio Reale
	Credit Agricole	CRARF	ACA FP	Tarik El Mejjad
	Danske Bank	DNSKF	DANSKE DC	Tarik El Mejjad
	Erste Bank	EBKOF	EBS AV	Alastair Ryan
	Erste Bank	EBKDY	EBKDY US	Alastair Ryan
	HSBC	XHSBF	5 HK	Alastair Ryan
	HSBC	HBCYF	HSBA LN	Alastair Ryan
	HSBC -A	HSBC	HSBC US	Alastair Ryan
	Intesa Sanpaolo	IITSF	ISP IM	Antonio Reale
	Intesa Sanpaolo	ISNPY	ISNPY US	Antonio Reale
	KBC Group	KBCSF	KBC BB	Tarik El Mejjad
	KBC Group NV	KBCSY	KBCSY US	Tarik El Mejjad
	Lloyds Banking Group	LLDTF	LLOY LN	Rohith Chandra-Rajan
	Lloyds Banking Group	LYG	LYG US	Rohith Chandra-Rajan
	NatWest Group	RBSPF	NWG LN	Rohith Chandra-Rajan
	Natwest Group PLc	NWG	NWG US	Rohith Chandra-Rajan
	Nordea	NBNKF	NDA FH	Tarik El Mejjad
	Nordea	XSABF	NDA SS	Tarik El Mejjad
	Nordea Bank Abp	NRDBY	NRDBY US	Tarik El Mejjad
	Santander	SAN	SAN US	Antonio Reale
	Santander	BCDRF	SAN SQ	Antonio Reale
	Societe Generale	SCGLF	GLE FP	Tarik El Mejjad
	Societe Generale	SCGLY	SCGLY US	Tarik El Mejjad
	Unicredit	UNCFF	UCG IM	Antonio Reale
	Unicredit	UNCRY	UNCRY US	Antonio Reale
NEUTRAL				
	ABN AMRO	ABMRF	ABN NA	Tarik El Mejjad
	Banco Bilbao Vizcaya Argentaria	BBVA	BBVA US	Antonio Reale
	Banco BPM	BNCZF	BAMI IM	Antonio Reale
	Bankinter	BKIMF	BKT SQ	Antonio Reale
	BBVA	BBVXF	BBVA SQ	Antonio Reale
	Commerzbank	CRZBF	CBK GY	Rohith Chandra-Rajan
	Handelsbanken	SVNLF	SHBA SS	Tarik El Mejjad
	ING Groep NV	ING	ING US	Tarik El Mejjad
	ING Groep NV	INGVF	INGA NA	Tarik El Mejjad
	Monte dei Paschi	BMDPF	BMPS IM	Antonio Reale
	StanChart	SCBFF	STAN LN	Alastair Ryan
	StanChart	XCHBF	2888 HK	Alastair Ryan
	Svenska Handelsbanke	SVNLY	SVNLY US	Tarik El Mejjad
	UBS	XUHJF	UBSG SW	Alastair Ryan
	UBS	UBS	UBS US	Alastair Ryan
UNDERPERFORM				
	Banco Sabadell	BNDSF	SAB SQ	Antonio Reale
	Barclays	BCLYF	BARC LN	Rohith Chandra-Rajan
	Barclays	BCS	BCS US	Rohith Chandra-Rajan
	Deutsche Bank	DB	DB US	Rohith Chandra-Rajan
	Deutsche Bank	XDUSF	DBK GY	Rohith Chandra-Rajan
	DNB	DNBBF	DNB NO	Tarik El Mejjad
	DNB ASA	DNBBY	DNBBY US	Tarik El Mejjad
	Mediobanca	MDIBF	MB IM	Antonio Reale
	Permanent TSB	ILPMF	PTSB ID	Alastair Ryan
	Poste Italiane	PITAF	PST IM	Antonio Reale
	Raiffeisen Bank International	RAIFF	RBI AV	Alastair Ryan
	SEB	SVKEF	SEBA SS	Tarik El Mejjad
	Swedbank	SWDBF	SWEDA SS	Tarik El Mejjad
	Swedbank AB	SWDBY	SWDBY US	Tarik El Mejjad
	Virgin Money UK PLC	CBBYF	VMUK LN	Rohith Chandra-Rajan
	Virgin Money UK PLC	CYBBF	VUK AU	Rohith Chandra-Rajan

EMEA - Banks Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst

Disclosures

Important Disclosures

Equity Investment Rating Distribution: Banks Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships R1	Count	Percent
Buy	100	49.75%	Buy	84	84.00%
Hold	54	26.87%	Hold	41	75.93%
Sell	47	23.38%	Sell	35	74.47%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships R1	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

[R1] Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

FUNDAMENTAL EQUITY OPINION KEY: Opinions include a Volatility Risk Rating, an Investment Rating and an Income Rating. VOLATILITY RISK RATINGS, indicators of potential price fluctuation, are: A - Low, B - Medium and C - High. INVESTMENT RATINGS reflect the analyst's assessment of both a stock's absolute total return potential as well as its attractiveness for investment relative to other stocks within its Coverage Cluster (defined below). Our investment ratings are: 1 - Buy stocks are expected to have a total return of at least 10% and are the most attractive stocks in the coverage cluster; 2 - Neutral stocks are expected to remain flat or increase in value and are less attractive than Buy rated stocks and 3 - Underperform stocks are the least attractive stocks in a coverage cluster. An investment rating of 6 (No Rating) indicates that a stock is no longer trading on the basis of fundamentals. Analysts assign investment ratings considering, among other things, the 0-12 month total return expectation for a stock and the firm's guidelines for ratings dispersions (shown in the table below). The current price objective for a stock should be referenced to better understand the total return expectation at any given time. The price objective reflects the analyst's view of the potential price appreciation (depreciation).

Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster[R2]
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

[R2]Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

INCOME RATINGS, indicators of potential cash dividends, are: 7 - same/higher (dividend considered to be secure), 8 - same/lower (dividend not considered to be secure) and 9 - pays no cash dividend. *Coverage Cluster* is comprised of stocks covered by a single analyst or two or more analysts sharing a common industry, sector, region or other classification(s). A stock's coverage cluster is included in the most recent BofA Global Research report referencing the stock.

Price Charts for the securities referenced in this research report are available on the Price Charts website, or call 1-800-MERRILL to have them mailed.
BofAS or one of its affiliates acts as a market maker for the equity securities recommended in the report: Barclays, Lloyds Banking Group, Natwest Group PLc.
BofAS or an affiliate was a manager of a public offering of securities of this issuer within the last 12 months: Barclays, Lloyds Banking Group, NatWest Group.
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