U.K. Banking Outlook 2025

Entering The Year With Solid Earnings And Balance Sheets

Rohan Gupta

Richard Barnes

Jan. 20, 2025

S&P Global Ratings

This report does not constitute a rating action

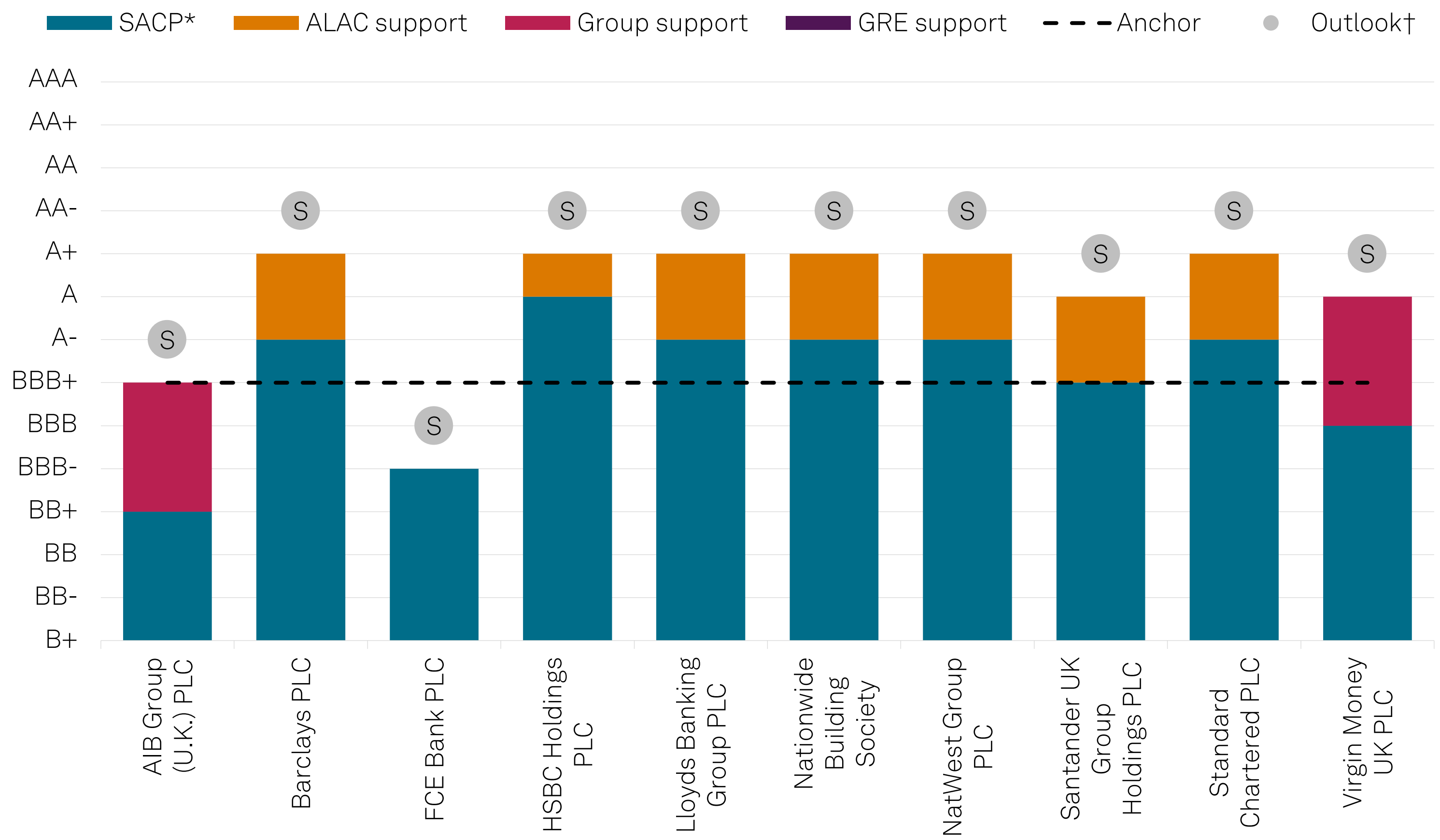
Key Takeaways

- Our stable outlooks on all U.K. bank ratings show that we expect banks to remain resilient over 2025, possibly with limited positive rating actions over the medium term if a more supportive economic outlook and banks' controlled credit risk appetites lead to an improvement in our BICRA economic risk trend.
- Strong earnings driven by stable margins should allow rated U.K. banks to maintain their robust capital positions and prioritize distributions via share buybacks and special dividends.
- Despite mixed reactions to the government's autumn budget, we think the U.K. economy will deliver steady growth in 2025* on the back of expected rate cuts and a strong labour market. These factors should support banks' loan growth and asset quality.
- We expect credit loss charges to normalize for banks, with a steady but manageable flow of lending into arrears and overall cost of risk increasing toward the long-run average.
- Historical motor finance commissions remediation could dent earnings and shareholder distributions for rated banks with material exposures, but we expect minimal impact on their capital ratios.
- We expect rated banks' funding and liquidity metrics to remain stable as deposit migration slows and central bank borrowing is refinanced using existing liquidity and limited wholesale issuance.

*See "U.K. Economic Outlook 2025: Monetary Policy And Trade To Offset Fiscal Impetus," Nov. 26, 2024.

Our Ratings On U.K. Banks

Outlooks are stable entering 2025



Note: Data reflects ratings and outlooks as of Jan. 1, 2025. *Stand-alone credit profile or unsupported group credit profile for rated groups. †Outlook labels: S--Stable. ALAC--Additional loss absorbing capacity. GRE--Government-related entity. Source: S&P Global Ratings.

- The outlooks on all our U.K. bank ratings are currently stable and we see stable trends for economic and industry risk under our U.K. Banking Industry Country Risk Assessment (BICRA).
- Bank fundamentals remain solid, including healthy capital levels, good liquidity, and contained credit losses.
- We could consider positively revising our BICRA economic risk trend and certain outlooks on rated banks, in the medium term, if the economic outlook is more favorable and inflation remains low, while the banking system maintains a controlled credit risk appetite.
- Conversely, we could selectively take negative rating actions if downside risks to the economy crystallize, triggering a materially sharper asset quality deterioration than we currently expect.

Rating Components For U.K. Banks

U.K. banks rating construct

	Core opco long-term ICR/outlook	Business position	Capital and earnings	Risk position	Funding/ Liquidity	Group SACP	Type of support	No. of notches of support	Holdco long-term ICR/outlook
AIB Group (U.K.) PLC	BBB+/Stable	Constrained	Strong	Constrained	Adequate/ Adequate	bb+	Parent	3	N/A
Barclays PLC	A+/Stable	Strong	Strong	Moderate	Adequate/ Adequate	a-	ALAC	2	BBB+/Stable
FCE Bank PLC	BBB-/Stable	Constrained	Strong	Adequate	Moderate/ Adequate	bbb-	N/A	0	N/A
Handelsbanken PLC	AA-/Stable	N/A	N/A	N/A	N/A	N/A	Parent	N/A	N/A
HSBC Holdings PLC§	A+/Stable	Strong	Adequate	Strong	Strong/ Adequate	a	ALAC	1	A-/Stable
Lloyds Banking Group PLC	A+/Stable	Strong	Adequate	Adequate	Adequate/ Adequate	a-	ALAC	2	BBB+/Stable
Nationwide Building Society	A+/Stable	Adequate	Strong	Adequate	Adequate/ Adequate	a-	ALAC	2	N/A
NatWest Group PLC	A+/Stable	Strong	Adequate	Adequate	Adequate/ Adequate	a-	ALAC	2	BBB+/Stable
Santander UK Group Holdings PLC	A/Stable	Adequate	Adequate	Adequate	Adequate/ Adequate	bbb+	ALAC	2	BBB/Stable
Standard Chartered PLC*	A+/Stable	Adequate	Adequate	Adequate	Strong/ Strong	a-	ALAC	2	BBB+/Stable
Virgin Money UK PLC	A/Stable	Moderate	Adequate	Adequate	Adequate/ Adequate	bbb	Parent	3	BBB/Stable

Ratings as of Jan. 1, 2025. In each case, the anchor is 'bbb+'. §The opco ICR applies to HSBC Bank PLC and HSBC UK Bank PLC. *The opco ICR applies to Standard Chartered Bank. ALAC--Additional loss-absorbing capacity. Holdco--Nonoperating holding company. ICR--Issuer credit rating. N/A--Not applicable. Opco--Operating company. SACP--Stand-alone credit profile. Source: S&P Global Ratings.

2025 Expectations | Revenue Tailwind To Domestic Earnings

Worsening		Neutral		Improving

Net interest income	Pick-up in loan growth and rising structural hedge yields should more than offset the adverse impact of interest rate cuts.
Non-interest income	Potential for growth in line with customer and market activity levels.
Expenses	We expect low to mid-single-digit cost growth as wage pressures and ongoing technology investments offset cost savings from past initiatives.
Credit loss charges	We expect credit loss charges to increase toward their long-run average, partly due to lower releases of post-model management adjustments and as debt-servicing costs remain higher than historic levels despite falling rates.
Legal and conduct charges	Uncertainty over potential motor finance redress from the FCA review of fairness and the surprise October 2024 Court of Appeal ruling on disclosures. Among the banks we rate, we see FCE Bank, Lloyds, and Santander UK as most affected.
Capital	Strong earnings will be offset by elevated shareholder distributions as banks look to maintain stable capital ratios, with potential for lower distributions by lenders facing more material motor finance redress costs. Basel 3.1 implementation has been postponed until January 2027 and has a modest day 1 impact.
Funding and liquidity	We think banks will maintain stable funding and liquidity metrics in 2025, largely using existing liquidity reserves to repay TFSME. Debt issuance across the capital structure is likely to focus on refinancing maturities and calls.

Note: Forecast for next 12 months. Source: S&P Global Ratings.

Key Risks

Economic Uncertainty

The U.K. economy lost some momentum in Q4 2024 after a strong first half, and there remains a risk of weaker than expected underlying growth in 2025 if firms and households delay spending decisions. If the economy undershoots our base case forecast, banks could incur higher credit loss charges than we expect as well as margin pressure from faster interest rate cuts.

Significant Escalation Of Geopolitical Risks

Potential for trade frictions have increased following the U.S. elections, and there remains risk of contagion from an uncertain global security situation. The main transmission channels we will monitor are trade and financing conditions.

A Broadly-Scoped Motor Finance Redress Scheme

We think rated banks with motor finance exposures have sufficient flexibility to manage potential redress costs, but a broad scheme could constrain capital generation and question the predictability of the operating environment.

Cyber And Fraud Risk

Rapid digitalization and the evolution of AI present a growing threat as banks look to adopt emerging technologies to support business objectives. Operational loss events could become more frequent as the arms race between cybersecurity defenses and cyberattack sophistication intensifies.

Stable Economic Conditions Could Provide A Boost For The Banking Sector...

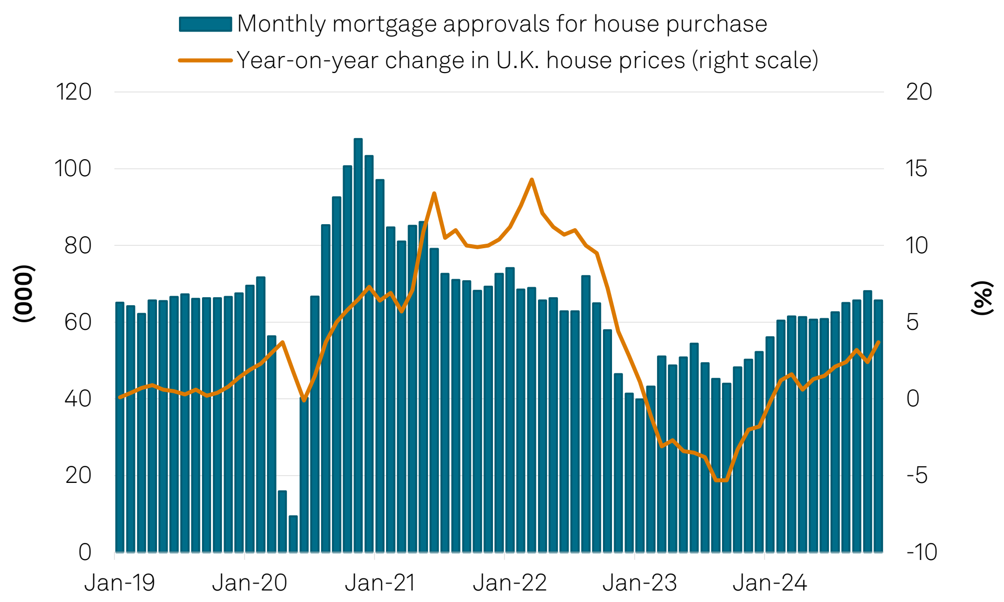
- We believe the U.K.'s economy is seeing a gradual recovery. We expect some pick up in credit growth this year as property prices grow modestly, supported by falling rates and a resilient, albeit softening, labor market. The banking system should comfortably manage this recovery, with banks on a footing of robust profitability, even accounting for rising impairment losses.
- We expect housing market activity to slightly improve in 2025 as house prices continue to rise, with mortgage rates easing on the back of interest rate cuts, and as the FCA potentially eases some mortgage lending rules.

S&P Global Ratings U.K. economic forecasts

(%)	2022	2023	2024	2025	2026	2027
GDP	4.9	0.4	0.9	1.5	1.6	1.5
Household consumption	7.4	0.7	0.8	1.6	1.8	1.7
Government consumption	0.7	0.6	2.4	3.9	1.7	1.5
Fixed investment	5.1	(0.1)	0.8	0.8	2.7	2.5
Exports	12.6	(2.2)	(2.0)	1.8	2.4	2.4
Imports	13	(3.4)	2.6	3.4	3.3	3.1
CPI inflation	9.1	7.3	2.5	2.5	2.3	2.1
CPI inflation (EOP)	10.8	4.2	2.4	2.6	2.2	2.1
Unemployment rate	4.7	4.5	4.3	4.1	4.1	4.2
10-year government bond yield	2.3	3.9	4	4.1	3.9	3.8
Bank rate (EOP)	3.25	5.25	4.75	3.75	3.75	3.5
Exchange rate (US$ to £)	1.2	1.2	1.3	1.3	1.3	1.3

EOP--End of period. CPI--Consumer price index.
Sources: ONS, Bank of England, S&P Global Market Intelligence, and S&P Global Ratings (forecast).

U.K. housing market is maintaining momentum

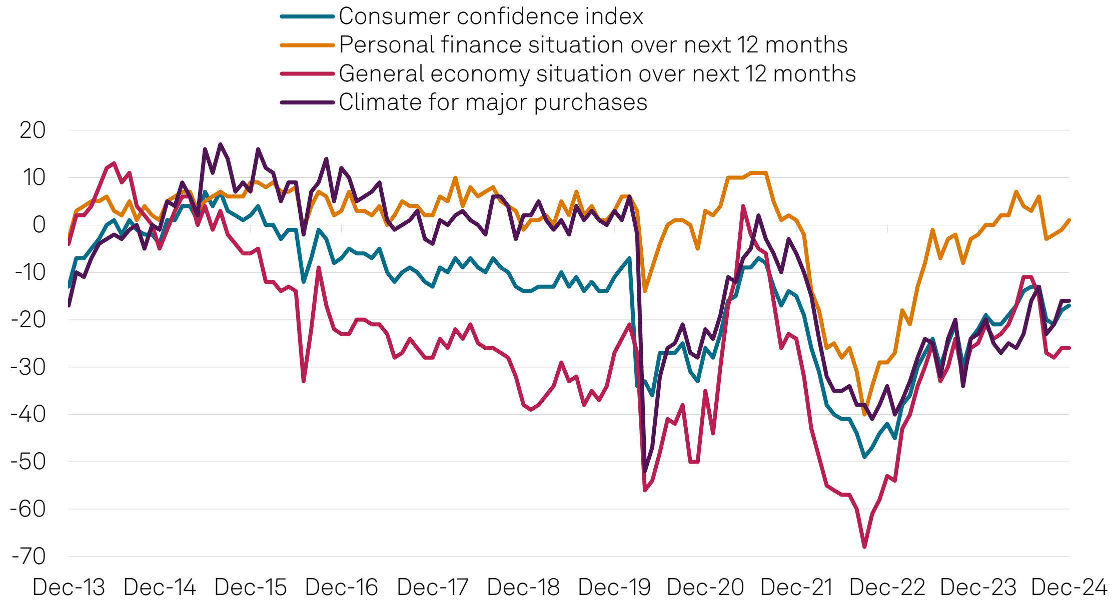


Trend in mortgage approvals and house prices. Seasonally adjusted data.
Sources: Nationwide Building Society, Bank of England.

...But Confidence Remains Subdued Following The Government Budget

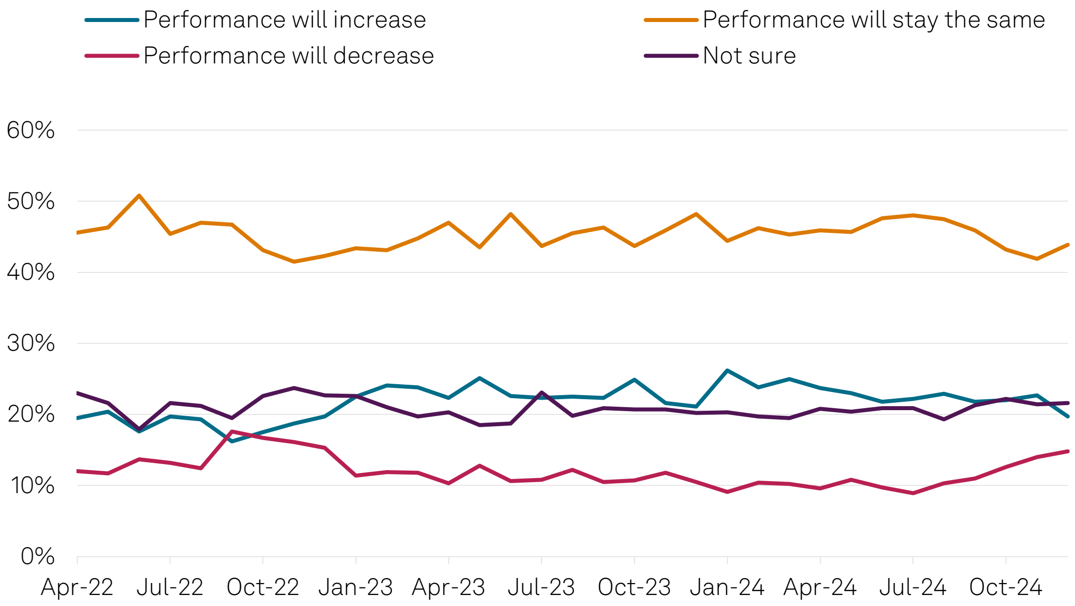
Reaction to the U.K. government's autumn budget (October 2024) remains mixed, as the fiscal effect of raising net government borrowing over the medium term has been offset by a dampening of business confidence from a hike in employer national insurance contributions.

Household confidence has recovered since 2022



Measure of U.K. consumer confidence.
Sources: Office Of National Statistics; S&P Global Ratings.

Business confidence took a knock following the budget

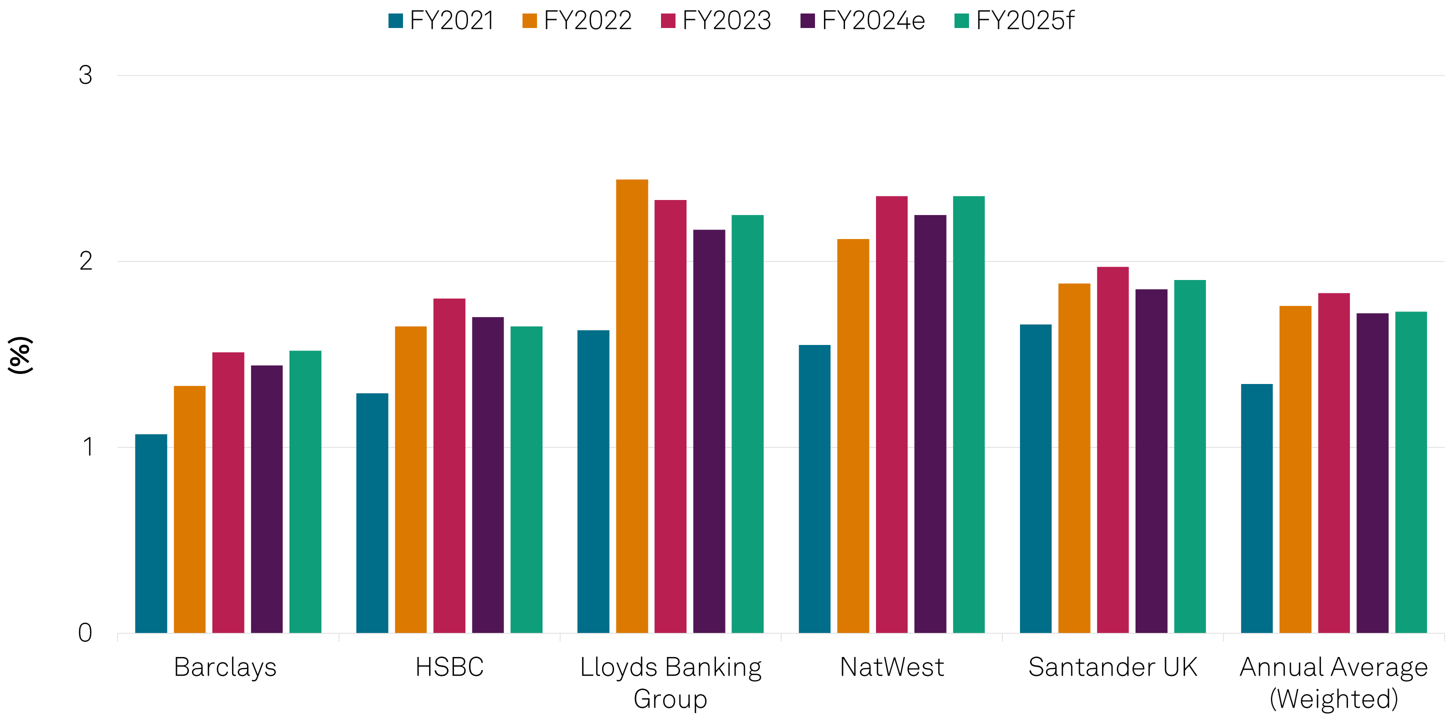


Survey Responses To Business Performance Expectations Over The Next 12 Months.
Sources: Office Of National Statistics; S&P Global Ratings.

S&P Global Ratings

Elevated Net Interest Margins Will Bolster Earnings

Major U.K. banks' net interest margins should hold up well



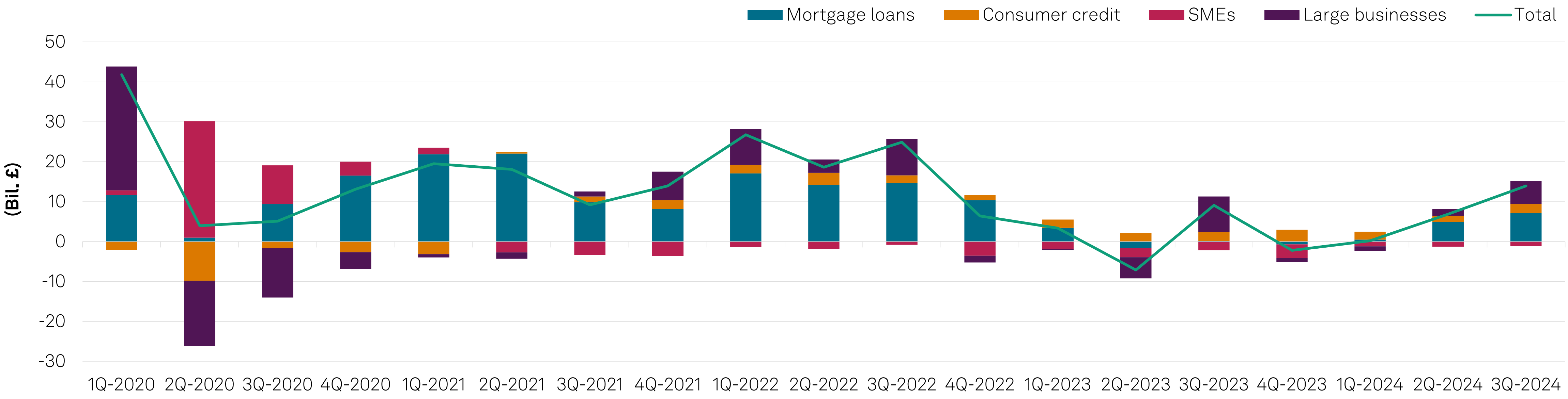
e--Estimate. f--Forecast. FY--Financial year. Annual average figures includes weighted average of the five banks. Source: S&P Global Ratings-adjusted figures.

- Large incumbents make up the majority of our rated U.K. banks.
- We project that rated U.K. banks will deliver strong pretax earnings in 2025 driven by elevated net interest margins, as rising structural hedge yields continue to deliver a powerful tailwind despite expected falls in the base rate. Our 2024 forecast for earnings includes sizeable provisions for motor finance investigations for affected banks (see slide 12).
- In a downside scenario where impairment charges increase more significantly than our base-case projections, we think resilient preprovision earnings should still enable banks to remain moderately profitable.
- Banks that have provided 2025 earnings guidance anticipate stable or improved performance, which is also our base case.

Loan Growth Is Picking Up...

We expect 2025 to be a better year for lending for U.K. banks, as interest rate cuts ease pressure on household finances and business potentially look to ramp up investment. That said, household and business confidence remains subdued following the autumn budget.

U.K. financial institutions' quarterly net lending to U.K. households and businesses



Q--Quarter. SME--Small and midsize enterprise. Source: Bank of England.

...Combined With Good Cost Discipline To Drive Solid Returns

- We expect low to mid-single-digit cost growth as wage pressures and ongoing technology investments offset cost savings from past initiatives.
- Overall, we expect healthy revenues from improving loan growth and rising structural hedge yields to offset increased operational costs, impairment charges, and motor finance investigation provisions, leading to solid profitability.

Operating cost-to-income ratios for selected banks

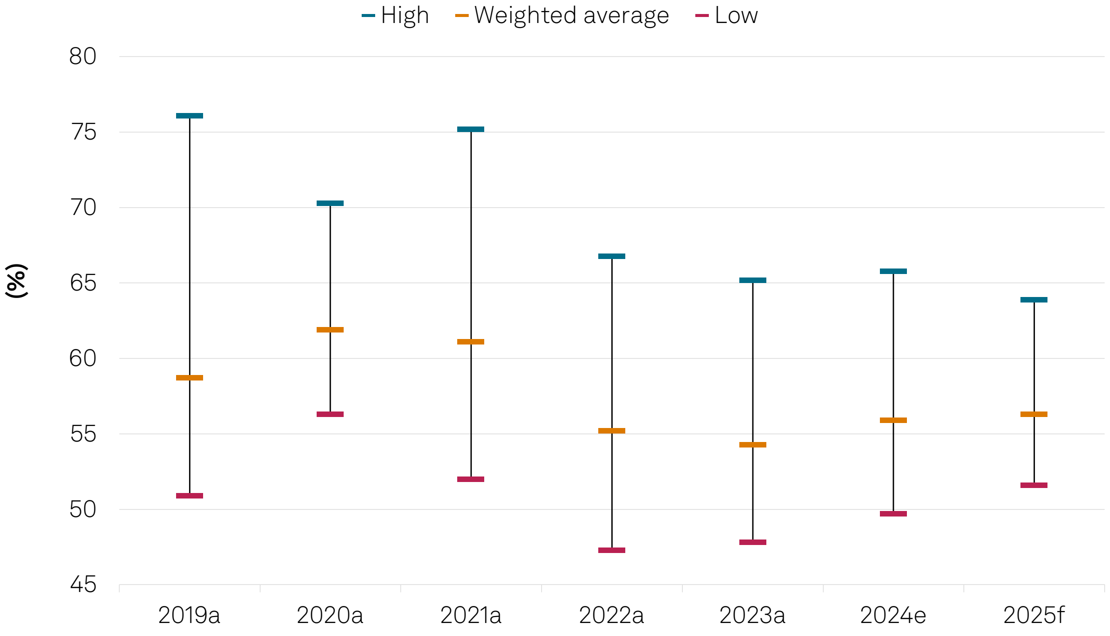


Chart covers Barclays, HSBC, Lloyds, Nationwide, NatWest, Santander UK, Standard Chartered, and Virgin Money. a--Actual. e—estimate. f--Forecast. Sources: Banks' reports, S&P Global Ratings.

Return on tangible common equity for selected banks

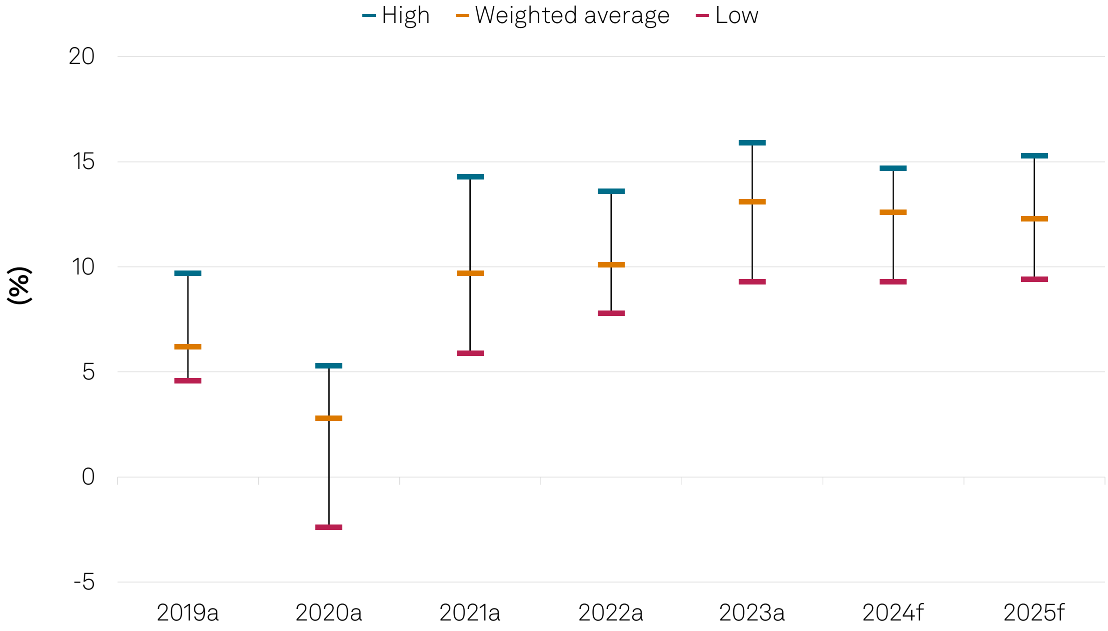


Chart covers Barclays, HSBC, Lloyds, NatWest, Santander UK and Standard Chartered. Our calculation method differs from those used by the banks. a--Actual. f--Forecast. Source: S&P Global Ratings-adjusted data.

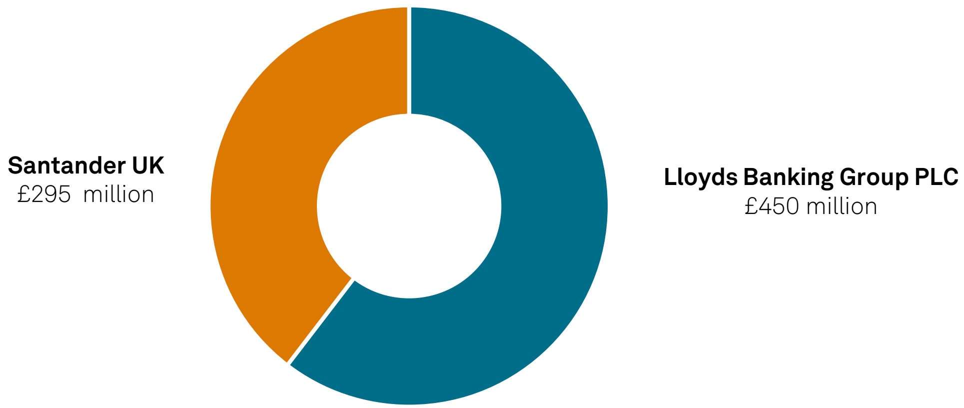
Motor Finance Investigation Could Dampen Earnings For Some

...but we do not expect a material impact on rated banks' capital ratios

- We expect rated banks with material exposure to motor finance--FCE Bank PLC, Lloyds Banking Group PLC, Santander UK Group Holdings PLC, and to a lesser extent Barclays PLC--to maintain solid capital positions despite the potential impact on earnings.
- The Court of Appeal ruling on motor finance commissions in October 2024, and the separate FCA investigation around fairness of historical discretionary commission arrangements (DCAs) in the sector, is an earnings risk for impacted banks in both 2024 and 2025.
- The Court of Appeal ruling on motor finance commissions may ultimately be overturned given the Supreme Court's acceptance of an appeal.
- Lloyds and Santander UK have booked provisions for potential customer remediation, and our 2024 earnings forecasts for the sector include assumed provisions for a redress scheme in respect of DCAs.

- The ultimate cost to affected banks is highly uncertain given the FCA's pending decision on the parameters of any customer redress scheme for DCAs, which will occur after the conclusion of the legal process.

Provisions taken for motor finance investigation by rated U.K. banks



Source: Banks' disclosures.

Asset Quality Should Be Contained...

We expect loan arrears and credit loss charges to increase modestly in 2025 due to high debt-servicing costs relative to pre-pandemic levels, despite the easing cost of borrowing. Solid underwriting and cautious risk appetites should overall limit asset quality deterioration for rated U.K. banks.

Credit loss charges as a share of average customer loans

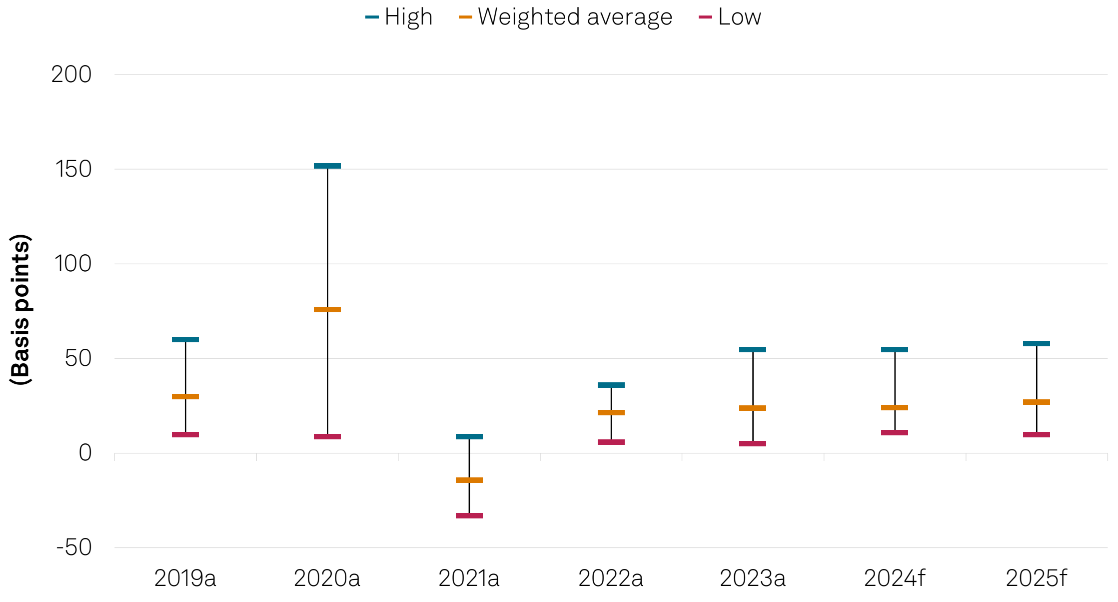
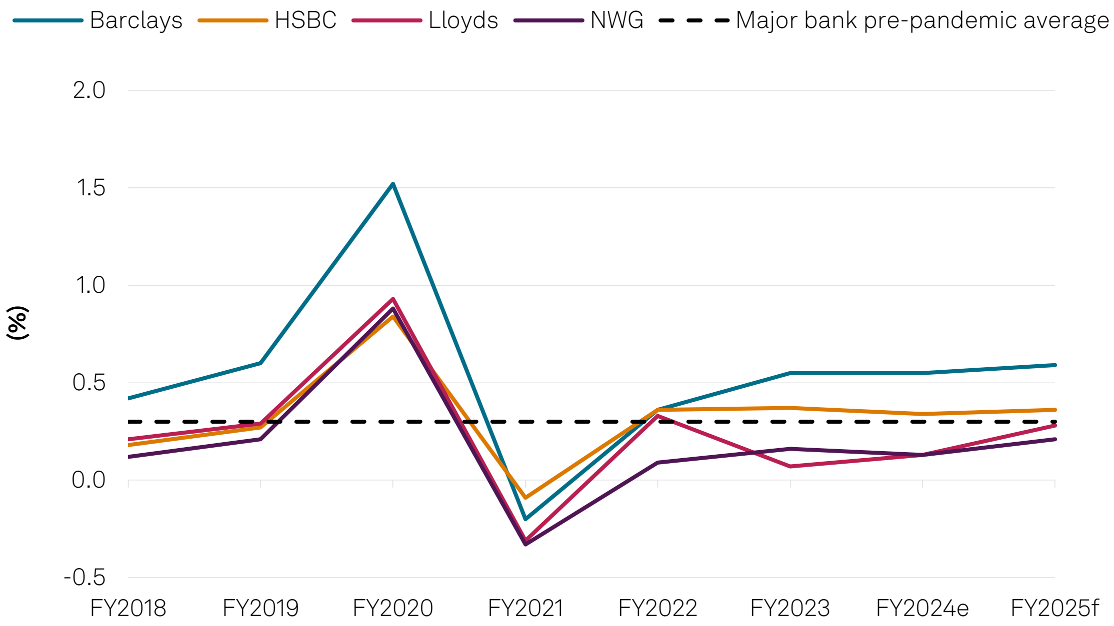


Chart covers Barclays, HSBC, Lloyds, Nationwide, NatWest, Santander UK, Standard Chartered, and Virgin Money. a--Actual. f--Forecast. Sources: Banks' reports, S&P Global Ratings.

Impairment rates as a share of average customer loans

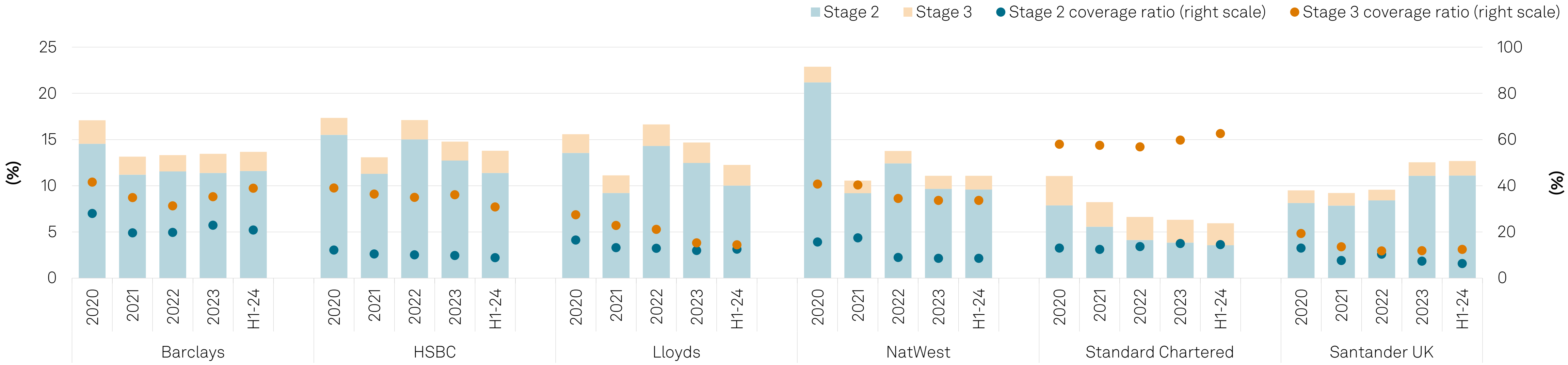


e--Estimate. f--Forecast. FY--Financial year. Source: S&P Global Ratings-adjusted figures.

...As Proportionate Provisioning Abates Credit Quality Pressures

- U.K. banks appear to be sufficiently provisioned, driven by low triggers for exposures to move to stage 2 (which require lifetime credit loss provisions) from stage 1 (requiring only 12-month provisions), and legacy post-model adjustments (PMAs) in place due to uncertain economic conditions in recent years.
- Banks began to release these management provisions in 2024, as concerns around credit losses arising from a lag in cost-of-living pressures did not crystallize. We expect PMA releases to continue in 2025, though at a slower rate.

Loan staging and stage 2/3 coverage ratios

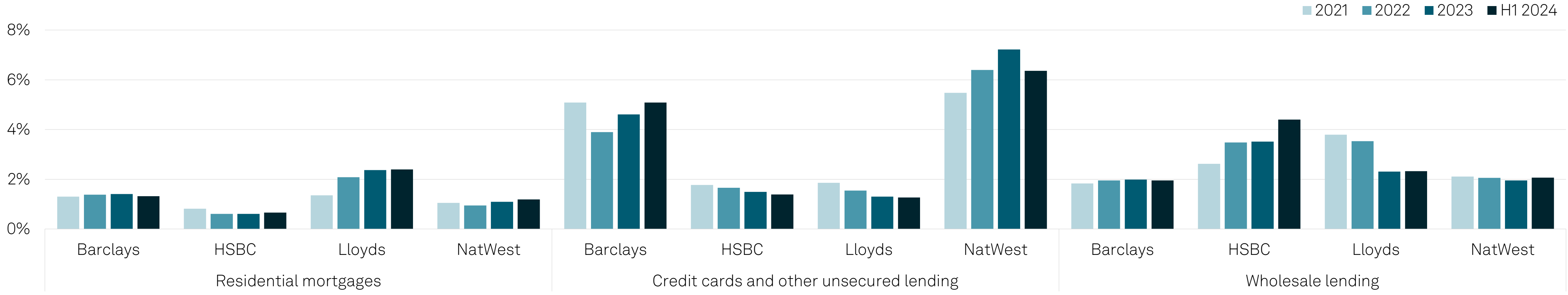


Source: S&P Global Ratings-adjusted data.

Banks Will Look To Manage Pockets Of Risk In Corporate And Unsecured Lending

- In a severe downside scenario, credit losses could increase particularly in higher-risk segments of corporate lending and unsecured consumer credit portfolios. Banks have been undertaking significant risk-transfer securitizations to partly mitigate single-name and portfolio credit risks in the corporate sector, and we expect this activity to continue in 2025.
- Low unemployment, solid real wage growth, and falling mortgage interest rates should overall limit downside. Rated banks' limited exposure to high LTV mortgages should contain the potential effects of house price falls.
- HSBC and Standard Chartered have a significant presence in Hong Kong, where higher interest rates triggered cash flow pressures among commercial real estate borrowers. These exposures are well-collateralized and we expect realized losses will remain low.

Big four banks' gross stage 3 loans ratios by portfolio type



Source: S&P Global Ratings-adjusted figures. Material differences in banks' stage 3 ratios are primarily driven by legacy loans and varying write-off policies, rather than significant differences in risk appetites.

S&P Global Ratings

Capitalization Should Remain Stable On The Back Of Strong Earnings

U.K. banks have solid capital and leverage profiles

	CET1 ratio as of Sept. 30, 2024 (%)	CET1 maximum distributable amount threshold as of Sept. 30, 2024 (%)	U.K. leverage ratio as of Sept. 30, 2024 (%)	Risk-adjusted capital ratio projection reflected in our ratings (%)
Barclays	13.8	12	4.9	11.75-12.25
HSBC	15.2	11.3	5.7	9.25-9.75
Lloyds	14.3	10.3	5.5	9.25-9.75
Nationwide	28.4	12.8	6.7	11.25-11.75
NatWest	13.9	10.5	5	8.75-9.25
Santander UK	15.4	11.2	4.9	9.75-10.25
Standard Chartered	14.2	10.6	4.7	9.0-9.5
Virgin Money	13.6	11.1	5.14	9.5-10.0

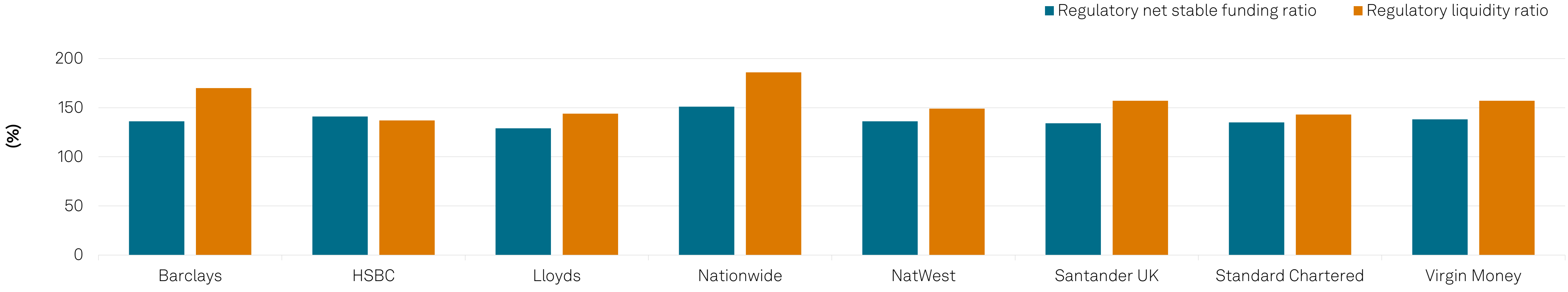
CET1--Common equity tier 1. Sources: Banks' disclosures, S&P Global Ratings data.

- We expect rated banks' capital, leverage, and additional loss-absorbing capacity metrics to remain relatively stable in 2025, with strong earnings comfortably covering banks' incremental capital needs from asset growth and internal rating migration.
- We assume banks will continue to distribute these excess earnings to shareholders through ordinary dividends, supplemented by share buybacks and special dividends, with potential for lower distributions by lenders facing more material motor finance redress costs.

Rated U.K. Banks' Funding And Liquidity Metrics Are Sound

- Banks have solid funding profiles entering 2025, with robust deposit balances and loan-to-deposit ratios. Total outstanding Term Funding Scheme for SMEs (TFSME) has reduced to £103 billion as of Jan. 1, 2025, and will mature over the next several years, and we expect banks will repay this using existing excess liquidity and some increased wholesale funding issuance.
- Banks hold manageable amounts of bonds valued at amortized cost as their structural hedges in sterling primarily use swaps and their liquid assets in sterling are mostly central bank reserves, with gilt holdings largely hedged.
- We think rated banks are well equipped to manage the challenges arising from the continued, albeit alleviating, effects of deposit migration, quantitative tightening, and the refinancing of TFSME in 2025.

U.K. banks' regulatory NSFR and LCR metrics

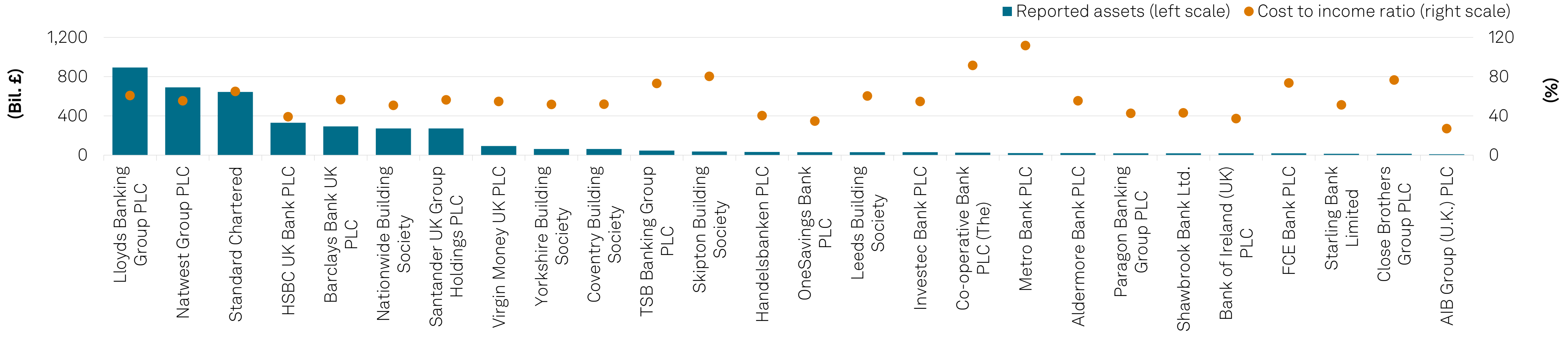


Data as of Sept. 30, 2024 for all banks. Sources: Banks' disclosures, S&P Global Ratings.

Further Consolidation Could Be On The Cards In 2025

- Higher net interest income and contained credit losses have boosted the sector's profitability over the last few years, allowing banks to deliver elevated shareholder distributions and pursue both bolt-on and transformative acquisitions, such as Nationwide's acquisition of Virgin Money, Barclays' acquisition of Tesco's retail banking business, and NatWest's purchases of Sainsbury's Bank's retail banking business and a Metro Bank mortgage portfolio.
- Small and midsize banks continue to face structural challenges as they look to deliver scale and profitability. This, along with rapidly advancing digitalization trends, could lead to further consolidation in the domestic banking sector in 2025, as banks look to put their spare capital to use.

Scale and agility of sector



Half-year is June 30, 2024, unless stated otherwise. Virgin Money UK PLC and Paragon Banking Group PLC's half-year is March 31. 2024. Aldermore's data is year-end June 30, 2024. Close Brothers Group PLC's data is year-end July 31, 2024. Nationwide's data is year-end April 4, 2024. Investec Bank PLC's and Starling Bank's data is year-end March 31, 2024. AIB Group (U.K.) PLC's, Bank of Ireland (UK) PLC's, FCE Bank PLC's, Handelsbanken PLC's, and TSB Banking Group PLC's data is all year-end Dec. 31, 2023. Source: S&P Global Ratings.

Global Banks Outlook 2025

Discover our latest content through the linked resources

Country-By-Country Outlook 2025: Cautiously Confident

Our overarching view and one-page summaries for 86 banking jurisdictions

Global Banks Outlook 2025: Cautiously Confident

A slide deck presenting key messages and summarizing our outlooks

Global Banks Outlook 2025 Video

A video capturing key points from our reports

Global Banks Outlook 2025 Dashboard

An interactive dashboard with key data from our reports

Related Research

- U.K. Economic Outlook 2025: Monetary Policy And Trade To Offset Fiscal Impetus, Nov. 26, 2024
- Santander UK's Motor Finance Provision Indicates The Size Of U.K. Lenders' Potential Redress Payments, Nov. 20, 2024
- Banking Industry Country Risk Assessment: United Kingdom, Oct. 23, 2024
- United Kingdom 'AA/A-1+' Ratings Affirmed; Outlook Stable, Oct. 18, 2024

Analytical Contacts

Rohan Gupta

London

+44 20 7176 6752

rohan.gupta3@spglobal.com

Richard Barnes

London

+ 44 20 7176 7227

richard.barnes@spglobal.com

William Edwards

London

+ 44 20 7176 3359

william.edwards@spglobal.com

Joe Hudson

London

+44 20 7176 6743

joe.hudson@spglobal.com

Emelyne Uchiyama

London

+ 44 20 7176 8414

emelyne.uchiyama@spglobal.com

Ankit Jalan

Mumbai

Research Contributor, CRISIL Global Analytical Center, an S&P affiliate

Financial Institutions EMEA

Financial_Institutions_EMEA_Mailbox@spglobal.com

spglobal.com/ratings

S&P Global
Ratings