UK banks brace for profit impact amid Labour's proposed tax adjustments

According to Bloomberg Intelligence, if the Labour government decides to raise taxes on banks in October's Budget, Lloyds, Barclays and Natwest could see their 2024 profits fall by "low single digits".

Bloomberg analysts believe that Lloyds Banking Group and Natwest would likely offset the hit to their profits by repricing their loans. They do not anticipate these potential measures derailing the lenders' targets for return on tangible equity (ROTE), as reported by City AM.

This research indicates that UK banks, which saw significant profits due to higher interest rates last year, could be an easy target for a tax raid to fill what Labour claims is a £22bn "black hole" in the public finances left by the Conservative government.

On Tuesday, Bloomberg stated that a windfall tax on the banking sector is a "real risk", but its "impact looks manageable".

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City AM has learned that executives from some high street banks have been called to meet Chancellor Rachel Reeves at Downing Street on Thursday, where they are expected to bring up this issue.

While the government has not committed to raising taxes on banks, Prime Minister Keir Starmer recently said in his first major speech that the Budget would be “painful” and that those with “the broadest shoulders” would bear the heaviest burden.

(Image: (Image: GETTY))

Treasury officials have several options to consider, but senior industry figures believe the most likely outcome is an increase in the corporation tax surcharge on bank profits, introduced in 2016.

Bloomberg has suggested a three per cent increase in the surcharge as “a possible option as policymakers consider the impact on monetary transmission and credit supply”. Lloyds Banking Group and Natwest are expected to be ‘most directly affected’.

Analysts have also proposed the idea of doubling the UK bank levy, introduced in 2011, by reducing interest paid on the £760bn that commercial lenders hold in reserves at the Bank of England. The levy applies to lenders’ balance sheet liabilities and equity and is projected to raise approximately £1.4bn in the 2024 fiscal year, according to the Office for Budget Responsibility.

Bloomberg has indicated that increasing the levy to £3bn through a European Central Bank-style “deposit tiering” system would result in less than a five per cent hit to Lloyds’ and Natwest’s 2024 profits.

Lloyds Bank

“Lloyds Banking Group and Natwest with 90 per cent-plus of UK-based business would be the most directly affected by any additional levies or changes in remuneration of central bank reserves,” stated Tomasz Noetzel, an analyst at Bloomberg.

Together with Barclays UK, these banks earned nearly £40bn in total revenue last year. This includes £7.4bn from central bank reserves, which constituted between 14 and 20 per cent of Lloyds and Natwest’s revenue and roughly seven per cent for the wider Barclays group.

“The huge uplift to bank profitability that rising rates brought in the UK is exemplified by Natwest Group, which raised its 2024 ROTE guidance at least 200 basis points to more than 14 per cent,” Noetzel remarked.

“Though capital return and buyback have boosted ROTE expectations, much of the uplift comes from expectations for slower monetary easing in the UK and better margin performance.”

He further observed: “The chart for Lloyds Banking Group, the other heavily UK-focused domestic bank, is similar.”

A Treasury spokesperson did not dismiss the possibility of tax hikes, stating: “The Chancellor has been clear that difficult decisions lie ahead on spending, welfare and tax to fix the foundations of our economy.”