Transcript

Q1 2019 Earnings Release

Conference call with analysts and investors hosted by Ewen Stevenson, Group Chief Financial Officer

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Corporate participants:
Ewen Stevenson

HSBC

Ewen Stevenson

Good morning, afternoon, whatever time zone you're in, and thanks a lot for taking the time to join the call. I was going to plan to speak for just over 10 minutes and then there'll be plenty of time for your questions at the end. You'll be able to find a full set of slides on the Investor Relations section of our website. Rather than running through that deck slide by slide, I'm just going to provide some overall comments on Q1, and then the slides are there to provide some additional detail for you.

On today's results, on the basis of the headline numbers, a very good quarter – bottom-line profit of $4.9 billion – and even if you ignore certain favourable items included in Adjusted Earnings, still a good quarter overall. On a reported basis, Q1 on Q1, revenues up 5%, post-tax profits up 31 cents, EPS up six cents to 21 cents, and return on tangible equity up 220 basis points to 10.6%. On an adjusted basis, revenues were up 9.2%, and cost growth moderated to 3.2% this quarter, meaning that we had a very healthy adjusted jaws of a positive 6% in the quarter. On the balance sheet, we grew lending by 7% from Q1 2018, and we grew deposits by 2%. And despite a 1.6% increase in RWAs this quarter, around a third of which came from the day-one impacts of IFRS 16, common equity tier 1 improved by 30 basis points to 14.3%. Fully diluted TNAV was $7.02. That's up four cents in the quarter.

Looking at the adjusted revenue in more detail, firstly by business line, in Retail Banking and Wealth Management, revenues were up 10% on Q1. This was underpinned by loan growth of 9%, notably in mortgages in the UK and Hong Kong. Wealth Management revenues were up against a strong Q1 last year. Much of that growth came from insurance manufacturing, with revenues up 66%, in part benefiting from particularly strong equity markets this quarter.

In Commercial Banking, revenues were up 11% on Q1. That was underpinned by loan growth of 8%. We grew revenues across all major products and all regions, with a particularly strong performance by Global Liquidity and Cash Management. We're also continuing to see decent revenue growth in Global Trade and Receivables Finance on the back of higher margins in Asia and higher balances in the UK.

In Global Banking and Markets, overall revenue growth was up a very credible 3%. Global Banking and Global Markets revenue were softer, down 9% and 5% respectively, but were more than offset by other business lines, particularly the strong performance of our transaction banking businesses, notably Global Liquidity and Cash Management, and we did see some positive valuation gains on CVA and FVA.

In Global Private Banking, while revenues were down 4% on Q1 last year, this was mainly due to a repositioning of our US Private Banking franchise. We did attract $10 billion in net new money in the quarter, with strong growth in Asia, particularly in Hong Kong.

Also a word on Corporate Centre, where revenues were up almost $200 million on Q1 last year, largely due to the non-recurrence of a loss from a bond reclassification under IFRS 9 and favourable valuation differences on long-term debt and associated swaps.

On a geographic basis, we continue to see particularly good growth in Asia. Hong Kong revenues were up 8%, thanks in part to good loan growth. Ex-Hong Kong, revenues in Asia were up 14%, albeit flattered by some favourable items but with robust underlying growth in mainland China and in the ASEAN region, notably in Vietnam and Singapore. Volumes were good in most Asian markets and we continue to see strong new business trends in insurance and private banking.

In the UK, growth slowed but was still up 5% Q1 on Q1. Retail Banking and Wealth Management and Commercial Banking performed particularly well, delivering year-on-year loan growth of 10% and 7% respectively.

And in Latin America, headline revenues were up 42%, in part due to $157 million in combined gains from the stake sales in two small card and payment businesses.

You can find details on significant items and other items in the appendix of the presentation. If you adjust for those other items we highlight in our adjusted revenues, you would have seen underlying revenue growth in the quarter of around 3-4%.

As you all know, we do have natural sensitivity in some of our revenue streams. In Global Banking and Markets, around 30% of its revenues are more volatile quarter on quarter. And in other parts of the Group, like our wealth and insurance-manufacturing franchises, we have natural revenue volatility linked to the strength or weaknesses of markets. Just as a reminder, a 10% uplift in equity markets equates to around $200 million of positive revenues in insurance manufacturing, and a 10% decline around a $200 million loss in revenues.

Turning to net interest income and net interest margin, net interest income was up 5% year on year, and down versus Q4 due to a two-day-lower day count in Q1, the impact of Argentinian hyperinflation, and the impact of IFRS 16. NIM was down four basis points in Q1 versus Q4, but down two basis points once you exclude the impact of Argentinian hyperinflation and the impact of IFRS 16. The other two-basis-point decline was largely driven by Hong Kong, which saw lower one-month HIBOR – a Q1 average of around 130 basis points, which was an average of 30 basis points lower than Q4. I'd also note that one-month HIBOR is currently sitting at over 2%.

As a reminder on HIBOR sensitivity, a 100-basis-point uplift in interest rates benefits net interest income by over $700 million, as disclosed in the relevant table in the full-year 2018 results. As we look forward, given underlying loan growth, we continue to expect modest net interest income growth in 2019.

On operating costs, we're focused on slowing down the growth rate. As we said at the full-year, the revenue outlook has become more uncertain since our strategy update last June, and we recognise the need to show more cost discipline because of that. We started this in Q4 last year, but please be patient – it won't happen overnight. Decisions on costs take time to be reflected into the P&L. Growth in adjusted operating costs was 3.2% over the quarter. This included around a $100 million or 15% increase in investment spend through the P&L versus Q1 last year, the bulk of which was spent on enhancing digital capabilities across our global businesses.

Key investments to call out in the first quarter: in RBWM, we're investing in a new global mobile platform, providing customers with a central hub for products and services. And in Commercial Banking, we're making a substantive ongoing investment into our Global Trade and Cash Management platforms, and developing online platforms that will automate aspects of business banking both in Hong Kong and the UK.

We remain committed to investing sensibly and sustainably and, as we guided at our strategy update last year, we expect to increase investment this year to around $5 billion, with $1 billion spent in Q1. We will, however, continue to proactively manage investment in line with the more uncertain outlook. The majority of investment will continue to be on growth in technology, aligned to our strategic plans.

On credit, I would repeat what John and I said at the full-year results in late February. Credit conditions remain relatively benign in most markets but we remain vigilant on the UK, where we expect prevailing uncertainty particularly around Brexit to continue impacting business and consumer confidence. Overall credit costs were $585 million in Q1, some 24 basis points on an annualised basis, with similar credit conditions to those seen in the latter half of last year, if you exclude the additional UK overlays we took in Q4. We saw a few specific cases in Commercial Banking this quarter, mainly in the UK, versus some recoveries in the prior quarter last year.

On the outlook for credit, our views remain unchanged. We expect credit costs to pick up this year and into 2020, and are comfortable with current consensus for this year. Just to remind you, the range of potential economic outcomes in the UK remain broad due to Brexit uncertainty, and could either positively or negatively affect future provisioning trends.

Turning to common equity tier 1 and buybacks, our common equity tier 1 ratio improved by 30 basis points in the quarter to 14.3%, with stronger profits and other favourable FX and reserve movements more than offsetting the impact of a $14.2 billion uplift in RWAs, of which $4.5 billion was from the day-one impact of IFRS 16. Continued strong loan growth will put pressure on gross RWA uplift, but the actions we are targeting to mitigate RWAs should help lower net growth to around 2% for full-year 2019, if you were to exclude the IFRS 16 impacts I just talked about. We expect these mitigation actions to be heavily weighted towards the second half of the year. We will take a decision on any full-year 2019 buyback at the interim results in August. We remain committed to the discipline of scrip neutralisation, subject to regulatory approval, and it remains a core plank of our capital management approach.

So in summary, we had a good quarter, particularly set against a more challenging Q4 last year. We recognise the headline results are significantly flattered by some favourable items, but even ignoring those items, top-line revenue growth continues to be solid and strongest in the areas we've targeted for growth, particularly Asia. We've moderated our cost growth relative to last year's run rate. Credit conditions continue to be relatively benign and we've just recorded a strong bottom-line profit of $4.9 billion. Return on tangible equity was up to 10.6%, EPS was up 40% to 21 cents, and we've improved our common equity tier 1 ratio by 30 basis points. We're not planning on Q1 being fully repeatable for the full year, but we remain cautiously optimistic for 2019 and committed to meeting our return on tangible equity target in 2020.

On outlook, we recognise that a combination of geopolitical outcomes, volatile interest rates and the direction of markets could impact our results this year and into 2020. We remain alive to those risks and will continue to proactively manage costs and investment accordingly. So we're happy with the quarter and the start we've made to the year. We've got a lot of work to do in order to be happy with the full year but it does give us a very good base to build on. Our focus remains on executing the strategy we announced in June last year and meeting our financial targets that underpin that.

With that, I'll now open up to take questions, if I could now hand over to Sharon, please.

Chris Manners, Barclays

Good morning, Ewen. Thanks for your opening remarks. Just two questions, if I may. The first one was about the buyback and the fact you're going to take a decision at the half-year. Does that mean that you might not do the buyback and we should think about this as a phasing – that you're going to neutralise scrip over a course of years and that you want to manage the capital ratio more dynamically – or is it just a formality, rubber-stamp approval?

And then the second question was on the NII and the net interest margin. I guess that the net interest margin has missed what people were looking for a little bit there. Maybe just to zoom in one part of it: in the UK, you've managed to hold your net interest margin flat but you've slowed your mortgage volume growth. Could I ask just a little bit about how you think about pricing there? You've only got 5% risk weight density on that UK mortgage book. Risk weightings are going to be increasing but you've still got a lot of surplus liquidity, so maybe if you could just talk us through a little bit on your thoughts on that dynamic of margin versus volume in the UK business. Thank you.

Ewen Stevenson

Thanks. Look, on the buyback, it's more the former than the latter. It's definitely not a signal of rubber-stamping a buyback as part of the Q2 results announcement. To give you some things to think about around our common equity tier 1, we have a target of having our common equity tier 1 ratio above 14%. It was at 14% at year-end. It benefited from favourable FX and reserve movements to 14.3% at the end of Q1. Underlying that was about a 40 basis point common equity tier 1 underlying capital generation in the quarter. We're continuing to see very good top-line loan growth, which is putting upward pressure on gross RWA increases. We've got a whole bunch of RWA mitigation actions that we're planning, some of which are things like model improvements. Those model improvements are sitting with regulators, some of which could be delayed in terms of timing, and there's uncertainty around quantum and execution of some of those actions, and we've also got Brexit uncertainty. So John and I would just like to get to another quarter of data and then take a view, with the benefit of sitting towards the end of July, on what the full-year outlook is for our capital base, and take a decision then on buybacks. If that were ultimately to mean there'd be no buyback in 2019, if that was the decision at that point, then we're still committed to the underlying neutralisation of the scrip over time, but we take it as positive the fact that our common equity tier 1 went up 30 basis points in the quarter.

Chris Manners

So if you could save 20 or 30 basis points by not neutralising the scrip this year, but that puts you in a more comfortable capital position, you might do it. But then, if we look forward to ’20 and ’21, you would eventually neutralise it and get the share count back to where it was?

Ewen Stevenson

Fundamentally, if we see the opportunities to continue to put on good loan growth, I think we’re always going to take an opportunity to put on good loan growth if we think that’s achieving returns above the cost of capital. And in many parts of the world, we are seeing good loan growth that meets that criteria at the moment.

On the second question on NIM, I’m sure yours will be the first of a number of questions on the topic of NIM. But on the UK, we did take some pricing decisions in Q4 to test pricing elasticity. As a result of that, we did see a slightly slower flow share in mortgages in Q1. It was about 7.1% flow share, still ahead of our stock share of 6.6%. That meant that NIM stayed stable at about 221 basis points. But yes, we remain committed to continuing to grow our UK mortgage book ahead of our stock share. Again, just to repeat, we’ve got a natural share on the liability side of low double digits and, therefore, with the stock share sitting below 7%, we do see ample opportunity to grow that mortgage portfolio over the coming years.

Chris Manners

Got you. And on the point about only having a 5% risk weight on the UK mortgage book and potential that you have that risk weight going up, would that change your return profile and some of your decision making, or are you already pricing for that?

Ewen Stevenson

Yes, it’s a bit of both. Look, we’re going to price to the – depending on the product and the duration of that product, we’re going to price with one eye in mind to Basel III reform coming down the track. But even today, if you were to fully load that into pricing, we still think that we’re earning very attractive returns on our UK mortgage book – and today, highly attractive returns.

Chris Manners

Understood. Thanks very much for the questions.

Ewen Stevenson

Chris, the other dynamic that I think everyone should be alive to, which is nothing to do with mortgage pricing is just, at some point, we need to refinance the Term Funding Scheme. There was about £120 billion of TFS funding out in the market at the end of last year. We didn’t take any of that but we’re alive to the impact on deposit pricing that it may have, which, again, may have an influence on where people choose to price mortgages in the coming periods.

Chris Manners

Okay. So we could see a bit more firming in mortgage spreads, do you think?

Ewen Stevenson

Depending on what’s happening on the deposit side, I think.

Tom Rayner, Numis

Good morning, Ewen. A couple, please. Just one on the margin: just looking at where consensus is currently expecting it to go, it looks like it’s trending to about 1.7% by 2021 versus 1.59%. I hear what you say about HIBOR having gone back up; also the gap against dollar LIBOR has closed, so I guess they’re both helpful. Is that enough, do you think, to offset some of the competitive pressures you’re seeing from the deposit switching in Hong Kong and elsewhere? Are you comfortable with the consensus margin trajectory at the moment?

I have a second one on costs, if you want me to do it now or…

Ewen Stevenson

Just on NIM, you know I don't like forecasting NIM but we just printed 1.59 in the quarter, and consensus for the full year is sitting at 1.66. Even if you factor in a more positive – if you were to just assume that the HIBOR curve stays where it is for the full year, I don't think that gets you back to 1.66 for the full year. So yes, we do expect some of that gap, if HIBOR was to stay where it was, to narrow. I don't think that gets you back to where current consensus is but, equally, we continue to see, growth in average interest-earning assets that's been consistently higher than where consensus has been. So if you look at it on an aggregate net interest income basis, there's probably some gap to consensus today but it's not as big as purely implied by the NIM gap that we saw in Q1.

Tom Rayner

I get that '19 consensus looks pretty tough but I just think, in 2021, it's not a lot of margin expansion over that period.

Ewen Stevenson

Interest rates are bubbling around so much. We would have expected, going into the start of this year, to have seen a rate rise in the US and a positive environment going into 2020. That doesn't look to be the case anymore.

Tom Rayner

Okay. Thank you. And just on costs, you took $1 billion of investment, I think, in Q1, and I think your target for the full year is $5 billion. Can you say anything about the phasing of the remaining four quarter as we go through the year? Is this going to be fairly evenly spread or is that going to depend on the revenue?

Ewen Stevenson

So just to unpick costs, there was 3.2% adjusted cost growth in the quarter. I think that was slightly flattered because there was a bank levy charge in Q1 of last year, and there was also a very small impact of hyperinflation benefiting the numbers in Q1 of this year. If you were to back those two things out, that cost growth would have been about 3.8%. Within that, there was about 15% growth in the P&L impact of investments towards $1 billion – or just under a billion. For the remaining period of the year, therefore, you should expect investment spend and the impact of that investment spread on the cost structure to increase, which will put a bit of upward pressure on cost growth. And I think, therefore, the onus on us is to manage more actively the other part of the cost base – the Run the Bank cost base – more proactively over the remainder of the year, but there will be a ramp-up starting in Q2.

Fahed Kunwar, Redburn

I just had two quick follow-ups on Tom's questions. On margins, I just want to understand something you said on 2020, when you expected a rate rise. That looks unlikely now. If there are no rate rises going forward, should we still expect loan growth of 4% and NII growth of 5% as consensus, in the sense that people still expect margin expansion? It feels like it's unlikely we're going to get margin expansion now going ahead without rising rates. And I completely appreciate volume growth could still meet your NII expectations but, on the margin side of things, without rate rises is it too much to expect NII to be tracking ahead of loan growth? That's the first question.

And the second question was just on capital – the movement in the fair value through comprehensive income. I think it was about a 10-basis-point to capital, which explains probably a third of your beat. Is that a permanent change or is there anything that means that that would reverse over the course of the year?

Ewen Stevenson

Yes. Look, on the latter, no. AFS gains and cash-flow-hedging reserve movements, I don't think you should assume that that is – that swings around a bit, and hence it's linked to the commentary on buybacks too. It's good that we got those benefits in Q1 but – they could swing around.

On NIM, mathematically what you say has to be right. I'm not going to build your models for you, and I'd just observe that we're far more sensitive to HIBOR than we are to US-dollar rate impacts, so yes, that will be a bigger driver, but the biggest single driver of net interest income growth in the coming years is underlying volume growth.

Guy Stebbings, Exane BNP Paribas

Morning, Ewen. Thanks for taking the question. Can I just come back to costs briefly? And then I had a follow-up on RWAs. Thanks for the colour so far. If we take the 3.8% underlying growth, should we be thinking of the phasing of the investment spend this year and the salary years to come through as putting incremental pressure on that figure or whether the actions you're outlining should mean we should see a significant offset to that? And are you able to give any colour around some of those actions you're hoping to take? So that was the first question.

And then, on RWAs, thanks for the guidance for this year. As we look into next year, would you be able to give any guidance in terms of some of the regulatory drivers of the RWA movements likely to come through over 2020, 2021 etc? And does that have any bearing in terms of size, timing of buybacks or can be absorbed through the normal course of business? Thanks.

Ewen Stevenson

Yes. So look, on costs, we have natural inflation in our cost base of around 3%. So if we were to do nothing and keep the headcount flat and not change our approach to investment year on year, you would expect natural cost growth in the business of around 3%. The fact that we're spending more on investment at about a percent or so on top of that in terms of additional cost growth, which gets you, say, to around about the 4% level that you saw in Q1 of this year, so yes, depending on the flex on that investment spend. However, the main priority is broadly to keep headcount relatively flat while we're continuing to put on volume growth and, therefore, the investments we're making should, drive productivity improvement, which allows us to continue to achieve that objective.

So I don't think we're talking about any significant cost programme across the Bank; what we're talking about is just sensible cost discipline. What I looked at last year in the 5.6% increase in costs that we had, which was very much what we planned to do, we just had about a billion-dollar revenue shortfall in November and December because the market impacts meant that we went from what was anticipated to be a positive jaws to negative. I just feel more comfortable trying to plan on the basis that we can manage costs to below that sort of run rate that I just talked about.

On RWAs, putting Basel III reform to one side, I still think we're trying to manage towards about a 2% RWA growth in 2020. I know we've talked about 1-2%. I'm comfortable at the higher end of the range, not the lower end of the range. I did talk about, as part of full-year results, that we are anticipating some RWA impacts as a result of an expected decision on French mortgages, which is going to impact the whole sector, which will be about $3-4 billion, I suspect, uplift in RWAs at some point.

And then, on Basel III reform, I think we continue to be cautious on providing guidance until we've got a bit more data and clarity about the implementation of the rules. We've got an acute degree of complexity; given that we're waiting on about 60 national regulators in terms of discretions. So when we are comfortable, we will talk, but I would just encourage everyone not to assume that the answer is zero. There clearly will be some impact because of Basel III reform. And then we have to then work through what that would imply or otherwise for our CET1 targets as well, and whether, if RWAs are going to go up in the absence of a change in the risk profile of the Bank, whether we should also be rethinking what our core tier 1 target is as well.

Magdalena Stoklosa, Morgan Stanley

Good morning. Two questions on your balance sheet, really, but more on the underlying business. On slides 12 and 13, when you showed us the details of Retail and Commercial segments, the loans, of course, have outgrown deposits quite significantly year over year, and I'm just wondering if you could give us a sense of how that relative growth – how much of it was literally just underlying business conditions versus your deliberate pricing strategy to drive one versus another. And two, how do you think his is likely to move forwar019-2020?

Ewen Stevenson

Yes. Look, on the lending side, I don't think it's driven by any particular pricing strategy. In the ringfenced bank in the UK, clearly, we, as a result of ringfencing, as we've talked about at full-year results, ended up with an excess of deposits sitting in the ringfenced bank, and equally a liquidity shortfall sitting in the non-ringfenced bank. So we also didn't have, going back a couple of years, a well-developed distribution channel through intermediary mortgages. We've now set that up. So we used to have a very, very low market share in intermediary mortgages, which is about 70% of mortgage distribution in the UK. So we just think, as I talked about earlier, if we're got a low-double-digit natural share of liabilities, we should have an asset-side share that's substantially higher than where we sit today.

In Asia, Asia's growing and we're just taking advantage of Asian growth. In context, if you were to look at our overall mainland Chinese market share, it's less than 0.2% or something, so our ability to grow in the Greater Bay Area at sustainably high growth rates really comes back to your question on deposit growth, which is: how could we fund that growth? Because we've got ample opportunity in Hong Kong and the surrounding region to grow loans.

On the deposit growth, some of that was deliberate. We do have some very large liquidity surpluses in some parts of the world, particularly Hong Kong and the UK, and we've been taking advantage of those liquidity surpluses – deposit surpluses to grow loans rather than the need to grow deposits. That's clearly not a sustainable proposition over the long, long term, so you would expect, over time, to see deposit growth, I think, to begin to increase, and that gap would narrow.

And in Q1, there were just some one-offs in the commercial side that impacted the headline deposit growth in some of the places, particularly Hong Kong.

Magdalena Stoklosa

But Ewen, just to follow up on this one, when you look at your underlying activity per segment, per country, where do you see the loan-growth delta to the upside, or where do you expect potential surprises? I suppose where do you see the relative strengths?

Ewen Stevenson

Well, if you break down our business by where we have 10-plus percent, say, market share in lending and deposits: UK, Mexico and Hong Kong. Hong Kong, you should expect our lending to broadly grow in line with the market. I think, between us and Hang Seng, we are already around 40% of mortgage origination, so is that going to change significantly on the upside? I don't think so.

In the UK, we do think we're underweight on the asset side and we do have the ability to grow. We do think, on the commercial side, for example, in the UK, with Brexit, that plays to our competitive strengths as corporates develop new international relationships.

In Mexico, again, we should, plus or minus, grow in line with the market. Every other place that we do business is different. Every other place that we do business, we have the ability to grow substantially higher than market-growth rates, if we choose to, and we can fund that growth through deposit growth. So for example, in the US, the business plan is premised on us taking share from a base of very low share. In mainland China and the ASEAN region, our premise is the same. In some of the other markets we do business, like Canada and Australia, where we're not one of the big incumbent banks there, we've been growing both businesses very nicely.

So I think the answer is a very nuanced answer, depending on which market we're in. In the established markets away from the UK, where we are one of the larger banks in those markets, our growth rate should be more in line with the market. In the UK and many other markets where we have got significant upside to grow loan growth ahead of market growth rates.

Jason Napier, UBS

Good morning. Just one question and I wonder whether it links to your answer to the previous one. That's around the emphasis that we've heard in the past around positive jaws. In today's release, you cite that you've had 6% jaws in Q1 but a big chunk of that comes down to market movements and so on.

Jason Napier

I think John's emphasised that, at an organisational level, weaning yourself off restructuring budgets and so on, you've liked the discipline of positive jaws. I just wonder whether you could give us colour on how do you deal with things like market moves when you think about these things? Isn't, on the cost side, emphasising the longer-term growth of the organisation more important? And then, just for clarity's sake, are you still committed to delivering positive jaws for the full year, excluding things like market moves? Thank you.

Ewen Stevenson

Yes. So, I think we've always committed to positive jaws and we haven't tried to get to an adjusted, adjusted positive jaws within that, so we certainly took the hit last year in Q4, when, because of adverse market movements, we recorded a negative jaws rather than a positive jaws. But in terms of how we take that, for us the difficulty is there is no perfect – there are imperfections with whatever we would communicate around cost targets to the markets. Cost-income jaws are imperfect because, while we can control costs, we're not fully in control, as you point out, of some of the revenue line items. So there is market and interest rate sensitivity in our top line that does mean that, while we can have a base planning assumption on what our revenues are going to be for the year, things that sit entirely beyond management control, such as what happened in November and December last year, mean that we need to manage to a gap to ensure that we get to positive jaws.

Equally, setting hard cost targets we don't think is right either, because we can flex our cost base according to what the growth opportunity is. And if we see growth opportunities, then we want to invest for that, so managing to an absolute cost number, to us, doesn't make sense either.

So John's right: jaws is a good discipline internally. It's not a perfect metric because we're not in total control of some of the revenue-line items, but it's a decent metric to manage to. But fundamentally, I'm managing both to jaws and to absolute cost growth, personally.

Jason Napier

And just to follow up on that, at your level and at John's level, the jaws thing makes sense. How does that work at a global business level, or does it devolve to them in exactly the same way?

Ewen Stevenson

Well, it depends on the business. It depends where they are in terms of their own respective investment programmes. So for example, we're investing very heavily this year in an investment programme in Commercial Banking, so it may be, within Commercial Banking, you have negative jaws. We're comfortable with that because we know that, elsewhere in the business, we're going to have positive jaws to offset that. So at the individual business level, they are not held – each individual business is not held to positive jaws, because we don't think that's the right thing to do. Where we've got an individual business that needs to invest for longer-term value creation, we're not going to hold them to positive jaws.

Alastair Ryan, Bank of America

Good morning – afternoon. Some helpful new disclosure you've given us the last couple of quarters, and you've been around long enough now for us to start picking on you about it. The non-ringfenced bank and Europe Other: I know you never really set the bank up for those but they don't look like they're doing that well. They've got a lot of cost. And I know the Corporate Centre's in there, but also the Corporate

Centre's partly been revealed by the carving out of the UK ringfenced bank. Is that where you're looking at costs, really, in the levers that you're going to pull? These are areas that were set up almost for a different HSBC that was more European, less Asian, I guess. And if you're seeing the revenue opportunities in Asia, one assumes you're not going to be pulling too hard on the costs there. Is that the right way of thinking about where the cost flex comes?

Ewen Stevenson

So if you look at how our capital is invested around the globe, some of the numbers are not perfect because, in places like Europe and the US, we absorb cost of relationship banking where revenues are booked elsewhere on the planet. But even if you adjust for that, the US and continental Europe are where we have our biggest strategic challenges at the moment in terms of returns. So yes, those are two areas that

Ewen Stevenson

Yes.
we're more focused on: how do we turn around those businesses? It's a mix of revenues, costs and capital, frankly, for both those two businesses. So the current performance of our non-ringfenced bank is not good enough. We recognise that. We need to improve it. Not dissimilar to a situation, although the underlying business drivers are different, to what we have in the US as well.

Manus Costello, Autonomous

Hi. Thanks for taking the question. I wanted to come back to HIBOR, please. I wanted to ask why it's so volatile. Maybe a naïve question but if you could shed any light on that, it would be useful. But perhaps more relevant, given the volatility over the last 12 to 18 months, is it changing the way that you're approaching ALM in Hong Kong at all or should we still expect that same kind of sensitivity to flow through? Because it has a somewhat different impact if it's swinging around.

Ewen Stevenson

Yes. Look, I'm probably not the world's expert on HIBOR at this point but my learning curve is rapidly improving. But look, basically there are huge money flows, is my understanding, in and out of China, which just means that HIBOR swings around substantially, even though it is linked somewhat to US-dollar interest rates.

Another feature, Manus, of the Hong Kong market is, on the assets side and the liabilities side, all have repricing mechanisms typically around one and three months. So what you see within any given quarter is a very rapid translation that you wouldn't see in other markets between a change in the underlying interest-rate curve into the underlying P&L. And you can see that, I think, if you look in our full-year disclosure, you look at the amount of sensitivity we show for 25 and 100 basis points shifts in interest rates. We have a far higher year-one impact as a percentage of a five-year rolling impact than we would for other banks that I've seen.

Manus Costello

Even if that's going to be much more volatile in future, you're happy taking that incremental volatility into your NII.

Ewen Stevenson

Well, yes, you're talking about having to fundamentally change customer behaviour in terms of the product offering and, at the moment, can you do that? Possibly, but it's very unusual to change customer behaviour and customer preferences, particularly on the assets side, for a product. So depending on which market we are in the world, we tend to be a taker of the product preferences of customers in those markets.

Manus Costello

So we should expect more volatile NII.

Ewen Stevenson

Yes. So I don't think you should – look, on non-interest income, clearly we are growing that substantially and we do see – one of the features for us, we think, in Hong Kong is a substantial opportunity on the wealth side, both in terms of private banking, affluent banking, asset management on the insurance side, which should provide some offset to that. But do I think, over the next couple of years, we're going to see a fundamental shift in our interest rate sensitivity to Hong Kong? No.

Joseph Dickerson, Jefferies

Hi, Ewen. So much of this call has been focused on net interest income, but looking at the other half of your revenue base, there's a very interesting ongoing story in terms of your Global Liquidity and Cash Management revenues, which were particularly strong. And I thought it was nice to see the chart looking at the funded assets that support those, and those were only up 4%. So I guess that seems like it's been a fairly sustainable business for you, so are these the type of growth rates that we can expect? I know you don't want to anybody to annualise anything from Q1 but these have been consistently strong. What's driving that strength and can it continue, firstly?

And also, on the non interest income, I think you said in February you were above budget in the early stages of Q1. If your peers are any read-across, you've probably had some ongoing momentum in the Markets business in Q2. If you could comment on that, that would be great.

And then the 4% increase in FTEs: what's that, like 9,000-plus new people year on year, I guess? Where are these FTEs going in terms of your business units and lines? That would be quite helpful. Thank you.

Ewen Stevenson

Yes. So on GLCM, it's a mix of two things, I think, that goes on. One is we think we are taking share particularly against western banks in Asia, and we've seen, in some cases, some fairly significant market-share gains. It is a business we've been investing in and it is a business we're very good at, but there is some benefit from higher interest rates coming through there. That interest rate benefit should begin to moderate over time and whether we can continue to achieve the strong share gains, we'll see. But we do think that is a business where we are competitively advantaged.

On markets, I think I would just note that our business is not the same as some of the peers that have been reporting. Our bias is much more Asia, a bit of Europe, rather than the US, so I think some of the commentary has been a recovery in US markets. You can see that, for example, in the US IPO markets, Hong Kong was the biggest IPO market in the world last year and is still relatively slow at this point. So I don't think we've seen the recovery into April that some of our peers have seen or seem to be talking about in recent results announcements.

Joseph Dickerson

Your local markets are up quite a bit though – are up not quite a bit but they're up. They've performed well and volumes have been a little better in Q2.

Ewen Stevenson

Yes. And look, the other thing I would say about Global Banking and Markets for us is it's a very different business mix. So Q1 on Q1, revenues were up 3%. FICC was down about 4%, which we viewed as a pretty good performance relative to peers. Equities headline was down 8%, but there's a one-off in there and, if you strip that out, it was a weaker performance. And then the transaction businesses are doing very, very well. For us, the performance of GB&M, the nuance around our business is very, very different to others.

Look, on headcount, where are we investing in headcount today? We've got more frontline staff. We're investing in the Hong Kong wealth and private banking businesses. We're putting people into China. I think the other dynamic that you should expect to see with us and probably all the banks is a shift out of contracted resource in the UK into full-time staff. So we do publish, I think, contractor numbers and you would expect that number to come down as the year progresses, which is really just, in some cases, a shift from contractor headcount to FTE headcount, and this is very much driven by – I think it's IR35 – a new tax position of HMRC in relation to contractors.

Joseph Dickerson

I can't wait to analyse that one. Thanks, Ewen.

Raul Sinha, JP Morgan

Morning. Thanks for taking my questions. Maybe just a follow-up on the costs and then a broader question on the RoTE target. Firstly on the cost growth, you talked about, on a clean, adjusted basis, if we take out the levy comparator from last year, the cost growth was about 3.8% year on year. And then investment spend is likely to intensify through the year. So I was wondering, on a net basis, should we be expecting cost saves to be ramping up from the Q1 level, so that you hold the cost-growth number around the same level, or does that 3.8 number effectively represent something that is a start and you will invest from here?

Ewen Stevenson

Well, look, I think, for Q2, you could see that drift up, because investment spend will go up. I would hope, by the time we get to Q4, we'll have better discipline around Run the Bank cost base and, therefore, Q2 costs may well go up as a growth rate but, over the full year, I would hope, by the time we get into Q4, what you'll begin to see is Run the Bank costs helping offset that growth rate.

Raul Sinha

Okay. And then, just linked to that, I was wondering: what do you think about the challenge that is represented by the 11% RoTE target that you've come into? You've done 10.6% on your numbers but that excludes the levy in Q1. And maybe growth picks up from here but credit is still very benign. You're doing $5 billion of investment but there are plenty of big banks around the world that are probably doing even more. So I was just wondering how you think about the building blocks to that RoTE target, given where we are today.

Ewen Stevenson

Yes. So I guess we've been persistently more bullish on our ability to grow top line. I hear what you say on other big banks in the world. Other big banks in the world don't have our advantaged position in parts of the world that are growing, so you can be a big bank and investing a lot in a market that's not growing and you're still not going to grow a lot. Your costs may go down but your top line's not going to go up. But yes, we think that there is more top-line upside than we're currently getting credit for. All of the discussion on NIM, if NIM, instead of coming down, begins to stabilise and go up a bit because of improved Hong Kong interest rates, then all of that volume growth at that point drops through to revenues.

I think, on costs, I think we can control costs a bit better than what we're getting credit for in consensus at the moment. I don't think we have a big difference of view on credit costs. I think, on tax charges, we do think that our effective tax rate is probably going to trend towards a couple of percentage points below where we're currently getting credit for. And I think, when you put all of those drivers together – and it does require a supportive underlying macro-environment – we're still confident that we can get to the 11% in that context, but we would note that that leads to several different outcomes relative to where consensus is for 2020.

The other thing I'd say, going into 2021, is obviously that the bank levy moves to a very different place in 2021. You know, we think it trends to around $400 million in 2021, which, relative to today, is about a $500 million pre- and post-tax benefit to our numbers.

Raul Sinha

Got it, thank you very much.

Jon Peace, Credit Suisse

Hi, morning. So, firstly, could you talk about the very strong net new money in Global Private Banking in the first quarter? How sustainable do you think that is? And are you seeing any improvement in risk appetite from Asian private clients?

And the second question is one of your European peers today saw a capital surprise from RWA mitigation in global markets. I just wondered if you saw any opportunities there as part of your overall RWA mitigation or if your different mix means that's less relevant. Thank you.

Ewen Stevenson

Yeah, so, look, on the second question I don't know. I've been tied up since about 5 o'clock this morning on calls so I don't know what the RWA mitigation action was, but certainly embedded in our forecasts of RWA guidance are quite significant RWA mitigation actions across the businesses. We do have significant RWA mitigation, because it's not like we've developed a special sauce where we can grow top line at the rate that we're growing top line and still commit to underlying RWA growth of 2%. So there is a significant amount of RWA mitigation actions built into our plans already, but I'm not sure what the specific thing is that you're talking about.

On Global Private Banking, it was a very strong quarter for net new money. In context, Q1 was more than the entire net new money than full year 2018. So is that going to be sustainable? Maybe, maybe not. But we've got a new management team in place in Global Private Banking, with António Simões. It's a business, I think, with huge potential. If you look at the current returns we're getting out of that business, there should be significant potential to improve returns and improve profitability in the coming years. In Asia we think we have been punching significantly under our weight in the region. When we look at our product offering, we think we are uniquely competitively advantaged, because no other bank – a lot of the banks we are competing with can't offer that mix of ultra high-net-worth private banking, commercial banking and investment banking together as one complete package for customers. Many of them are either fighting on one leg or two legs, so we do see significant potential in that business.

Jon Peace

Great, thank you.

Martin Leitgeb, Goldman Sachs

One follow-up question, just building on some of the earlier comments and questions made. I mean, if I take either the return guidance or the return consensus at this stage and square that up with your comments made on RWA growth – I think, if I heard correctly, that was around 2% from here. And even taking into consideration scrip neutralisation, that means either the common equity tier 1 ratio is going to edge higher over the coming years, or there's a meaningful amount of capital available for the growth from here for the franchise. And I just wanted to ask you a bit in terms of what areas of growth you're most excited about. I think you flagged before both opportunities for growth within the lending business, where you are below 10% market share you could gain share. But, equally, in the non-lending business – and I think you flagged asset management, wealth, private banking and so forth. And I was just wondering if you could give us a bit more on where you would be most excited about growth and whether this would be predominantly organic or whether there could be scope for small inorganic steps. Thank you.

Ewen Stevenson

Yeah, so, look, just on that very last point, none of our plans are currently premised on any inorganic activity. We think we can deliver our plan without any of that. Your point on capital – as returns improve, we have progressively better and better capital generation in excess of funding the current distribution policy. I'd just caution that we're less than three years away now from Basel III implementation. So, yeah, we are going to have to build up some capital in anticipation of likely higher RWAs under Basel, although, as I said earlier, we still haven't worked through whether there is an offset and, if so, how much, or whether that would drive you to a different common equity tier 1 target over time.

In terms of where we're excited about growth: Asia, Asia wealth, the Greater Bay Area, which is Macau, Hong Kong and the Pearl River Delta, we think, should offer exceptional growth opportunities. We see significant opportunities to build and take share in the ASEAN region. The UK, as we've talked about – we think we can continue to grow better than the market. We're in other markets like Mexico where the growth upside is material. And then in some of the other areas where we've got a lot of capital, it's mainly on a returns-uplift focus, particularly US and the non-ringfenced bank that we talked about earlier. But, overall, given the markets we're in, particularly in Asia and other places like the Middle East and Mexico, we have natural growth opportunities that are substantive.

Martin Leitgeb

Very clear, thank you.

Ewen Stevenson

Okay, look, thanks everyone for joining the call today. Thanks for your questions and thanks for the relatively few questions on NIM. But, Sharon, with that, if we could please end the call. And, just before I finish, obviously Richard O'Connor and his team are happy to take any follow-up questions you've got during the day, but thanks all for joining.

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