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Transcript

Investor and Analyst Call
Q1 2020 Results

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NOEL QUINN, GROUP CHIEF EXECUTIVE OFFICER: Good morning in London and good afternoon in Hong Kong. Thank you for joining us. I've got Ewen with me today and he will present the numbers in detail before we go to Q&A.

Let me start by saying that these are clearly unprecedented and challenging times for society, for our customers and for our people all over the world. The COVID-19 pandemic is testing us all in ways we could never have anticipated and is causing huge disruption, stress and uncertainty. HSBC has a massive role to play in supporting our communities, providing stability and helping to rebuild economic growth. That purpose has been true throughout our history and remains true today. We are determined to play our part to the very best of our ability.

I'd like to pay tribute to the extraordinary work that our people have done and are doing for our customers and for each other each and every day. I have been humbled by their dedication and commitment. Our operations have been highly resilient, with around 80% of our branches open for business, more than 90% of our staff working from home and a high degree of business continuity. Since the start of the year we have issued more than 28,000 additional laptops to enable our colleagues to work from home. We have increased our VPN capacity from 118,000 to 250,000 and enabled more than 80% of our contact centre staff to work remotely. This has enabled us to react quickly and effectively in support of our customers.

We have introduced a broad range of customer support measures and have worked very closely with governments and regulators to channel state support to the real economy quickly and efficiently. In Hong Kong we have approved more than HK$30 billion of immediate liquidity relief to businesses facing market uncertainty and supply chain pressures. We have granted more than 80% of our eligible Hong Kong Commercial Banking clients a pre-approved extension to their import trade loan facilities, and we have put in place a dedicated 100-strong team to proactively identify eligible businesses and process applications for the Hong Kong Government's 100% loan guarantee scheme, with thousands of applications under way after the first week of operation.

In the UK we have granted more than 118,000 applications for retail payment holidays and approved more than £1.9 billion of COVID-19-related financial support for small and medium-sized businesses. We have been heavily involved in the UK CBILS scheme, approving more than 4,200 applications worth over £600 million. That's around 17% of all CBILS lending by accredited lenders, which is nearly double our market share for SME lending in the UK. In total we have grown Group lending by $41 billion and seen $47 billion of deposit growth in the quarter.

As far as the plans we announced in February are concerned, our intention is to continue to improve the long-term capital and operational efficiency of the bank. In the short term we have decided to pause the vast majority of redundancies associated with this programme where notices have not already been issued. Continuing with our job reduction programmes in the current environment would simply not be appropriate at a time of significant stress for our people and communities.

We are proceeding in other areas as planned, including the combination of our wholesale back office operations and the combination of Retail Banking and Wealth Management with Global Private Banking. We have invested a further $1.2 billion in business growth and digital in the quarter and accelerated our digital plans to improve customer access during the current crisis.

We are also applying the lessons of the last few weeks, particularly from parts of the business that have responded to a fast-moving situation with exceptional pace and agility. We will press ahead with our transformation thoughtfully and purposefully while doing everything necessary to safeguard the wellbeing of our customers and our people. There will be no let-up and we'll move at pace wherever we can.

As you know, in response to a direct request from the Bank of England, the Board cancelled the payment of our fourth quarter dividends of 2019. The Board also decided that, until the end of 2020, we will make no quarterly or dividend interim payments or accruals in respect of ordinary shares. We will review our dividend policy at or ahead of our 2020 year-end results.

Turning to our performance, we had a good start to the year with a solid January and February, but in March the spread of the COVID-19 pandemic and the fall in oil prices had a sizeable impact on our first quarter numbers. The resulting increase in expected credit loss provisions contributed to a 47% drop in reported pre-tax profit and a 51% fall in adjusted profits compared with the same period last year. The impact of falling markets on volatile income streams in insurance manufacturing and Global Banking and Markets led to a 5% fall in reported revenue.

Generally, though, our businesses showed good resilience, particularly in Asia, while Retail Banking, Global Markets and Global Private Banking all grew revenue compared with last year's first quarter. We maintained good cost control with a drop in adjusted operating expenses of 3%, and our balance sheet remains robust with a CET1 ratio of 14.6% and strong liquidity and funding at the end of the first quarter.

Turning to some of our performance highlights in the quarter, we added more than 100,000 Retail Banking customers and grew retail deposits by more than $13 billion worldwide. We also enhanced our digital capabilities to serve more customers remotely, to accelerate verification and to improve our ability to get our customers the products they need during the current crisis. Commercial Banking lending balances saw good growth, largely due to client drawdowns on existing facilities. Our trade finance business showed great resilience, particularly in Asia, and our recently upgraded HSBCnet treasury management platform for businesses saw a substantial increase in activity, with downloads of the mobile app up 32% and a 97% rise in the volume of mobile payments, both of which stand us in good stead for the future.

Global Private Banking added a further $5.3 billion of net new money in the quarter, bringing the total over the last 12 months to $17.7 billion. And Global Banking and Markets did an excellent job keeping capital flowing into our customers, leading on more than $685 billion of financing for clients in the capital markets globally.

With respect to social and COVID response bonds, we helped our clients raise $19.9 billion to support the COVID-19 relief effort. We were at the forefront in reopening the global debt capital market, achieving a top two bookrunner position for international bonds in Europe, the Middle East and Asia ex-Japan, and we provided sustained access to equity capital markets for our customers, achieving a leadership position in Asia ex-Japan and ex-A-Share, and raising more equity capital for UK listed corporates than any other bank since the start of the year.

I'm pleased with the way the business has responded in support of our customers and we continue to work extremely hard to meet the significantly increased funding demands we are seeing across many parts of the bank. We know that the rest of 2020 will be immensely challenging, but we face it with a resilient business and strong capital and liquidity. With that, I'll pass over to Ewen to go through the numbers.

EWEN STEVENSON, GROUP CHIEF FINANCIAL OFFICER: Thanks, Noel, and good morning or afternoon all. Compared with last year's first quarter it was clearly a much tougher quarter: a 48% fall in reported pre-tax profits and a 51% drop in adjusted pre-tax profits. We had a decent January and February, but March was heavily impacted by

COVID-19 and the fall in oil prices, and the outlook has significantly deteriorated since our 18 February business update.

Certain parts of our business continue to perform well in the quarter, including a resilient performance in our Hong Kong and broader Asian franchises, the continuing turnaround of Global Private Banking and a strong quarter for Fixed Income and Currencies trading revenues in Global Markets. But our results were heavily impacted by the sharp fall in equity markets, the widening of credit spreads and much higher expected credit losses. Net volatile items were $1.6 billion adverse to the first quarter of last year, the Prudent Valuation Adjustment against CET1 was $0.5 billion higher than the previous quarter and expected credit losses were $3 billion or 118 basis points of gross loans.

Overall, adjusted revenues were down 6% against last year's first quarter, but up if you exclude volatile items. Net interest income grew by 3% overall while non-interest income reduced by 16%. We started to take action on costs to adjust for the weakened revenue environment. Our adjusted costs fell by 3% against the first quarter of last year, reflecting a reduced accrual for variable pay and various lower discretionary cost items. Our tangible net asset value per share of $7.44 includes 17 cents of our own credit adjustments or reserves. That's a 29-cent move quarter on quarter from a negative 12 cents at year-end.

Turning to revenue on slide 5, total adjusted revenues in the first quarter were $13.3 billion. That's down 6% on the first quarter in 2019, but up 6% excluding volatile items. Looking across the four global businesses, in Retail Banking and Wealth Management revenues were down 17% but stable before negative market impacts in insurance manufacturing. Retail Banking revenues grew by 1%, driven by higher customer deposits, but Wealth Management revenues were down 52%, heavily impacted by an $872 million negative movement in market impacts and insurance manufacturing. However, investment distribution revenues grew 4% as a result of strong Hong Kong trading activity.

Global Private Banking revenues were up 13%, underpinned by another strong net new money performance and higher customer activity levels in the quarter. Commercial Banking revenues were down 5% with Global Liquidity and Cash Management down 10% due to lower interest rates, Credit & Lending up 3%, reflecting growth in lending balances, and Trade Finance up 2%. A resilient performance, particularly in Asia.

Within Global Banking and Markets, while revenues were down 8% overall, Global Markets grew 25% with a strong performance in Fixed Income and Currencies trading, up 38%. Against this were adverse movements of $392 million in credit and funding valuation adjustments and $313 million in bid offer adjustments, while our Principal Investments business made a loss of $235 million in the quarter.

In Corporate Centre revenues were up $634 million, Balance Sheet Management was up $221 million due to gains on disposals, and we had a $209 million increase in favourable fair value movements on our own long-term debt and associated swaps.

On slide 6, net interest income was $7.6 billion. That's stable against the fourth quarter of 2019. Our net interest margin was 154 basis points. That's down 2 basis points on the fourth quarter. This included a combined 2-basis-point adverse impact from margin compression, reflecting lower rates and hyper-inflation in Argentina, and a 1-basis-point favourable impact from lower customer redress costs in the UK ring-fenced bank.

Given the drop in interest rates since the start of the year – around 100 basis points globally – we expect an impact on net interest income of more than $3 billion in 2020, which is greater than our February guidance at our full-year 2019 results.

Turning to slide 7, adjusted costs were 3% lower than the first quarter in 2019, and that's despite a further $1.2 billion of investment in business growth and digital. Where we can, we've begun to take action on costs, including a $359 million lower accrual for variable pay, the start of a material reduction in the approximately $400 million we spent last year on travel and entertainment, and discipline across various other discretionary cost line items. We now expect full-year 2020 costs to be below 2019's run rate, with the degree of reduction in some line items dependent on various factors, including group profitability, which could drive further cuts to the variable pay accrual in the coming quarters, and the impact on activity levels in our operations as a result of COVID-19. And due to the current pause in parts of our transformation plan, we also expect to spend less on cost to achieve in 2020 than previously guided.

On the next slide, we saw substantially higher credit cost provisions in the first quarter, some $3 billion or 118 basis points of gross loans. This reflected extra charges across all global businesses and regions, largely reflecting the changed forward economic outlook as a consequence of COVID-19 and the falling oil price.

Around half of first quarter expected credit losses were for stage three exposures, with all of the stage three increase coming in wholesale, including a significant charge in Commercial Banking related to a corporate exposure in Singapore, as well as charges in Global Banking and Markets relating to a small number of clients.

As you can see, we have provided a range for group expected credit losses of $7-11 billion for 2020. The mid-point of that range is based on the $3 billion charge for first quarter 2020, plus $2 billion for the rest of 2020 based on the historic average run rate, plus a further $4 billion representing the incremental expected credit losses from our 100% weighting of our severe scenario, which is disclosed in the earnings release.

The bottom end of the range represents a milder economic scenario than our severe scenario, with an economic recovery commencing in the second half of 2020, and the top end of the range represents an economic scenario worse than our current severe scenario, extending into 2021.

We will no doubt update our thinking here as we go through the year. There's a wide range of potential outcomes, including the risk that the upper end of the range may increase, and I would encourage you, in that regard, to read our COVID-19 risk factor and earnings release.

Turning to slide 9, both customer loans and advances, and customer deposits, saw good headline growth on a constant currency basis since the end of last year. Customer loans and advances grew by $41 billion, or 4%, and customer deposits grew by $47 billion or 3%. Part of this growth came from customers in Commercial Banking and Global Banking and Markets as a result of both drawing down on committed credit loan facilities and then partially redeploying these funds into their deposit accounts to increase their cash reserves. This continues the trends of the past several quarters where we've seen consistently good volume growth across the customer franchises and resilient performances in key areas such as trade financing cash management. Our finding and liquidity ratios remain robust. We continue to have a low and stable loan to deposit ratio and significant excess high-quality liquid assets.

On slide 10, our CET1 ratio at the end of first quarter was 14.6%. That's down 10 basis points from the end of 2019. The cancellation of the fourth-quarter dividend in 2019 added 40 basis points to our CET1 ratio. This and the decision to not pay an interim dividend in this quarter offset the negative impacts of lower profitability, FX movements and an increased prudent valuation adjustment. Risk-weighted assets rose by $13.7 billion in the quarter. This was primarily due to loan growth, partially offset by FX movements due to the strong US dollar.

We've seen limited impact from pro-cyclicality so far, less than $5 billion of movements from changes in credit quality in the first quarter. However, we currently expect pro-cyclicality impacts to increase materially during 2020, hence our guidance on expecting mid- to high-single-digit RWA growth for the year as a whole.

As a result, we expect our CET1 ratio to decline in the coming quarters and we're comfortable, if necessary, falling below our 14% target over 2020 and 2021 as we progress through the pro-cyclical impacts of COVID-19 while retaining capital capacity to continue to support our customers.

So, in summary, a good January and February and a difficult March. The combined impact of COVID-19 and lower oil prices has significantly impacted some of our businesses while others have proved fairly resilient. Changes to forward economic guidance coupled with certain stage three exposures caused a significant spike in expected credit loss provisions and we expect expected credit losses to remain elevated over the remainder of the year, with a broad range of outcomes foreseeable depending on the economic impact of COVID-19.

We were there for our customers in the quarter with good volume growth in both lending and deposits. We've begun to take necessary action on costs and retained some capacity to partially offset a further drop in revenue across the coming quarters. Our liquidity and funding ratios remain robust, providing our customers with stability during the current disruption, but the economic outlook for the remainder of the year is expected to now be much weaker than previously guided at our full-year 2019 results.

We'll continue to monitor the impact of the COVID-19 crisis and review our financial performance and business plan accordingly. At the same time, we'll continue to assess the appropriateness of our 2022 financial targets and we'll review dividend policy at or ahead of our full-year 2020 results. We're not expecting the next few quarters to be easy, but we enter this difficult period with strong capital and liquidity, a strong and resilient franchise, particularly in Asia, an ability to invest in the business while also managing costs down, and a commitment to continue to build for the future while responding to the needs of our customers in the present.

With that, Sharon, if we could please open it up for questions.

JOSEPH DICKERSON, JEFFERIES: Hi, good morning. I guess a couple of questions, firstly on the Hong Kong ECL charge of $133 million. It didn't have some of the same movement as you thought elsewhere and is kind of in line with the 2019 run rates. Just any comment as to what's driving that: is that business mix? And I guess what your outlook is for that market, firstly.

And then secondly, on the line drawdown, so right now that's translating through to deposit growth, but are there going to be any earnings associated with these drawdowns and, if so, are these baked into your guidance around things like net interest income, etc? Thanks much.

NOEL QUINN: Joseph, thank you. I'll take the second question first, if I can, and then pass on to Ewen for the second question. With respect to the drawdowns, yes, we do anticipate there being earnings associated with those drawdowns, and that will therefore help mitigate some of the impacts of the rate effect on the deposit book. And just a quick comment on your first question: I think what we've seen in the first quarter is the resilience of Hong Kong as a business and as a customer base. Clearly there are uncertainties on the horizon with respect to coronavirus and COVID-19, and how it will develop, but we've been very pleased with the resilience of the Hong Kong customer base.

EWEN STEVENSON: But in terms of the ECL charge in the quarter, it did benefit from the release of around $70 million of overlays. As you'll recall, during the second half of last year we did build up fairly reasonable overlays in relation to the Hong Kong book, given what we could see at the time.

JOSEPH DICKERSON: Yeah, okay. That makes sense. Thanks.

FAHED KUNWAR, REDBURN: I have a couple of questions. One was on NIM. I think in your sensitivity guidance you talk about year 2 and year 3, the loss on revenue is higher. So for the 3 billion, or greater than 3 billion, hit to NII that you flag in 2020, in terms of 2021 and 2022, assuming rates stay where they are, does that hit to NII continue to build or have you baked in all of this hit into 2020 in that 15-basis-point margin hit?

That was the first question, and the second question was on credit RWA inflation. Could you just give a bit more colour on this? I guess the PRA was talking about looking at the shock as temporary. If I look at some of your peers, the credit migration hasn't been as strong. I think the US credit migration wasn't as strong either. What's really driven the size of increase in RWA inflation that you're guiding to now for the full year?

And, if you don't mind, just a third question on credit card spending as well. Has a lot of this credit card activity been people maxing out their maximum credit allowance or – and do you think that will continue throughout the course of the year on the credit card book? Thank you.

NOEL QUINN: I'll pick up the credit cards. We've seen a significant reduction in credit card activity over the last two or three months. I think we're seeing a reduction in spending of around about 40%.

EWEN STEVENSON: It's actually the reverse of what you've just said. People are not maxing out their credit cards. What they're actually doing is not spending and the balances are actually coming down at the moment.

On net interest income, I think you should expect, as per the tables that we previously provided, that there will continue to be impacts from the lower-rate environment if this were to persist into '21 and '22 as you continue to get the progressive and cumulative impact of those lower interest rates. What I would say is, though, that the interest rate sensitivity of the bank, we do have quite a short-dated book, particularly in Hong Kong, both on the asset side and liability side. The trade book is relatively short-dated, so you do see a very meaningful impact in year one, which we're signalling with the 3 billion, and then the impact is progressively substantially less in the subsequent years.

On credit rating migration I'm not sure about the peer comparisons. If you look at Q1 the impact of ratings migration was less than $5 billion in terms of the uplift in RWAs. I think what we're signalling for the full year though, that the bulk of that uplift that we're now talking about mid- to high-single digits, will be as a result of expected credit rating migrations. We provided you, I think, some disclosure in the past on the book that you can run numbers on, but you should assume that the bulk of that uplift is because of anticipated ratings migration over the final three quarters.

NOEL QUINN: And you normally have a lag effect of six to 12 months. It starts to feed in as companies update their financial reporting, so there is normally a lag effect on credit rating migration, and we're just giving you a guidance on that's still to come.

EWEN STEVENSON: But consistent with the guidance around expected credit losses, there is a broad range around that estimate in the same way there is around our expected credit loss estimate for the full year.

FAHED KUNWAR: No, of course. That's fair enough. Thank you very much. Cheers.

TOM RAYNER, NUMIS: Good morning, Ewen. Good morning, Noel. Can I just have a few on RWAs, please, and then maybe a quick one on costs as well? Could you just confirm the base figure for the mid to high-single-digit growth guidance? Because there was quite a big FX move in Q1, I just wanted to check that we've got the starting point right for the guidance.

I wonder if you could then comment, following on perhaps from what the last question, what the direction of the RWA movements if we look beyond 2020, whether you'd expect further positive credit rating migration to come in 2021 or whether you might actually start to see that reverse again. And also maybe comment on the timing of the $100 billion reduction that was part of the restructuring programme, whether – how far back has that now been pushed?

And then, finally, on RWAs, just loan drawdowns. Again, how much of that is translating into RWA as well? Thank you.

EWEN STEVENSON: So if you use around $850 billion, I think, as a base for the RWA inflation for the remainder of the year, in terms of ratings migration I think if – as Noel just said, in terms of a lag effect you should expect, I think, some continued ratings migration into the early part of next year. Assuming we're into a stronger recovery at that point post the trough in COVID-19 impacts then you're right: over time you should see that ratings migration begin to reverse over the remainder of '21 into '22.

The impact of drawdowns, I think we have provided some analysis of where – in the earnings release on where you saw significant uplifts in RWAs which principally were in Global Banking and Markets and Commercial Banking. A decent part of that was in relation to drawdowns.

On the drawdowns themselves we did see substantive levels of drawdowns in mid-March, towards the backend of March. That has eased off substantially in April and, in fact, in some cases, some of the money being drawn down is actually reversed out now. So I think you should view that very much as a significant impact on Q1 that we won't see repeatable during the remainder of the year at this point.

TOM RAYNER: Okay. Thank you for that. And the cost question. Just the redundancy programme, the 35,000 which obviously has been put on hold for now, I'm just wondering how much you've therefore had to absorb in terms of cost reductions which have been pushed further out to in your 2020 guidance, and then what – how that might phase in as we look further forward, in terms of the benefit of those redundancies coming out of the staff costs going forward. Thanks.

NOEL QUINN: Yeah, Tom, I'll take that. We thought it was the right thing to do, for the benefit of our customers and our people, to actually pause that redundancy programme at this point in time in 2020. We wanted our people to be 100% focused on serving customers and not to be fearful of a redundancy programme, hence the pause. The cost of that pause in terms of lost savings in 2020 is in the order of around about $380 million of forgone savings in 2020.

Now, as Ewen said earlier on, we believe we can mitigate that impact by cost savings elsewhere in the elements of costs that are variable and under our own control that are not people-related. If you go back to our February presentation, we guided that our total cost base for 2020 would be flat on 2019. Now we're guiding that our cost base for 2020 will be lower than 2019, but we can mitigate that loss of savings, plus some, by reduction in other elements of the cost base, such as hiring activities, travel and VP, and other discretionary line items. The issue for us will then be at what point do we reactivate that programme in order to make sure that 2021 and 2022 cost base is appropriately positioned, but it's too early to make that call at this point in time.

EWEN STEVENSON: Yeah and, Tom, just to give you some numbers around that, last year we paid out $3.3 billion in variable pay, travel and entertainment was just over $400 million, marketing was just over $1 billion. So there was about $4.7 billion of spend across those three line items. We accrued – spent about 35% less in the first quarter across those three line items than we had in the previous year, which would get you to fairly meaningful cost reductions.

When Noel was talking about the pause in the restructuring programme and certain elements of that, I think what the means is that, at the full year, we also talked about $6 billion of costs-to-achieve, of which about 40% of that would be incurred in 2020. I think you should assume that that number will come down, but it will be a timing difference. So I think the right way to think about the programme is we intend to do the programme, but the front end of it will have slipped.

I'd make the same observation about the RWA rundown programme. We still think that we can do the bulk of what we expected to do this year. I think some of the stickier, more complex stuff may be harder to shift and it really comes down to an economic case of whether we want to crystallise valuations at that level or we want to pause. But again, I think, realistically, we'll get the bulk of what we wanted to do done this year, but with some pause of part of that into next year.

TOM RAYNER: Okay. And should I assume – you haven't flagged it specifically – that the actual investment, strategic investment spend, is not going to get chopped significantly?

NOEL QUINN: We're targeting our strategic investment spend obviously much more cautiously today than we would have done three, four months ago, but we're still spending on programmes that we believe are strategically important for the future, particularly in anything to do with digital. We've seen the evidence of that in the first quarter. We spent well, over the past two years, on upgrading many of our digital platforms. I mentioned the treasury management platform for corporate and the mobile version of that. We've seen a massive take-up in activity levels on that platform and I think we see this, the COVID-19 situation, increasing the demand for digital support, and therefore we will continue to invest in it.

TOM RAYNER: Okay. Thanks very much.

MARTIN LEITGEB, GOLDMAN SACHS: Good morning. I just wanted to ask, to start with, on your view on how severe this credit cycle is going to get. Just looking at some of the economic forecasts out there, it seems to indicate that the base of economic contraction is worse than what we have experienced in prior credit cycles. On the other hand, there's equally a number of government support schemes in place, which are obviously softening the impact. I was just wondering if you could help us, in a sense, how you think about the credit cycle.

And tied to that, just in terms of the $7-11 billion ECL guidance for this year, is it possible to point to some form of real GDP assumption for this year which this is tied to? I think one of the European peers tied their guidance to a specific contraction number in GDP, and I was just wondering if there was any more colour you can give us, either for the $7-11 billion or for the severe case in terms of cumulative real GDP contraction.

And lastly, I was just wondering, in terms of looking at your loan book geographically, if there's any elements within geographies that you are most concerned about. It seems like Asia, in particular Hong Kong, is holding up better and already part of the cycle is already starting to recover there. Is it other parts of the book outside of Asia you're most worried at this point? Thank you.

NOEL QUINN: I'll take a couple of comments first and then pass to Ewen specifically on the $7-11 billion. Our job at the moment is to position the bank to manage a variety of different outcomes that could emerge from COVID-19. None of us know for certain what the severity of the crisis will be. We're modelling different scenarios and we're making sure, as a bank, we're prepared for each of those scenarios that could emerge. That's why we're confident we can handle this, because of the strong capital, strong liquidity that we have, but none of us know for sure. We're not – I'm not a medical professional; I'm not an economist. Our job is to be prepared for all of the scenarios.

With respect to the government support schemes, we've been particularly impressed with the pace and the determination that the governments around the world, in Hong Kong, in China, in the UK, in the US, have put in place support schemes that are very material. But, again, none of us know fully; we've not seen that level of support come in, and we haven't yet seen how that will change customer behaviour. We're very positive on them. We factor them into our scenarios to provide mitigation to some of the risks that we see, but only time will tell as to how effective they are at supporting the economy, but they are very beneficial to have in place and we'll see how they work over time. With respect to $7-11 billion, I'll hand over to Ewen.

EWEN STEVENSON: The $7-11 billion, Martin, is part science, part art. I wouldn't try and say, 'Here's a GDP forecast, a GDP recovery profile and that gets you to X'. I think that's too simplistic. We're having to overlay, as Noel just talked about, fairly unprecedented levels of government support, which we think will significantly mitigate some of the more extreme scenarios you may have seen, in terms of expected credit losses. Also, COVID-19, personally, I think is going to be quite disruptive to the profile of how some industries recover. How the airline industry recovers will be different to another sector, for example, but, equally, within a sector like the airline sector, how governments respond and who gets recapped may be very different too. It's not a straightforward piece of maths that we can give you to say, 'This gets you to the low end and that gets you to the high end.'

The thing I would probably pay most attention to is the recovery profile that we begin to see as we progress through the second and third quarters of this year. We're already seeing the start of a decent recovery, particularly in mainland China and, to a lesser extent, Hong Kong. We expect the second quarter to be tough in western Europe, UK, US and other places, therefore understanding the path of that recovery into the second half of this year, I think. Therefore, when we stand up at Q2 results I think we'll know a lot more. We'll be able to provide you with a lot more colour at that point on what we're seeing.

In terms of the question on geography, I think if you look at the spread of ECLs in Q1, a couple of observations. We took $1 billion of the $3 billion in Asia. If you back out Hong Kong and mainland China, there was about $800 million across the region. A decent chunk of that related to one single name exposure we had that's been commented on in the press in Singapore, so Asia definitely out-performed but it was pretty broad-based across the rest of the world. On the retail side, some emerging signs of deterioration in the consumer credit portfolios across a number of markets. On the wholesale side it was pretty diverse, and not just COVID but also oil price related.

MARTIN LEITGEB: Just to follow up in terms of your comment, if we were to think about 2021, 2022, and the comments on the recovery, should we then expect a comparatively sharp drop in risk costs again from today's perspective, or would this in any case take longer to level off from here?

EWEN STEVENSON: If you were being conservative you would assume, I think, that there's going to continue to be elevated credit costs in '21, but the pro-cyclical impact of IFRS 9 should mean that 2020 is materially ahead of 2021, and then you should begin to see, I would have thought, a relatively sharp drop-off as you get into 2022.

MARTIN LEITGEB: Perfect. That is very helpful. Thank you very much.

GUY STEBBINGS, EXANE BNP PARIBAS: Morning, Noel and Ewen. Thanks for taking the questions. I just wanted to come back firstly on capital and RWAs, and the commentary around CET1 going below 14% this year. If we take the RWA guidance and assume circa 5% growth for the rest of the year, that would knock off about 70 basis points, I think. If we assume cash generation pre-RWA moves comparable with the first quarter of 20 basis points, you end up back in the middle of the 14-15% range. I'm trying to understand if going below 14% is reflective of the dividend taking you there, with Q4 perhaps being more than just the normal 21-cent final, or if the 20 basis points underlying run rate cash generation pre-RWA moves that we saw in Q1 could be lower for the rest of the year. That was the first question.

Then I had a quick question on BoCom. In the Earnings Release you referenced that should the current environment persist, it might have implications for certain assets like your stake in BoCom. I don't think you published the value in use in Q1; I'm not sure if you calculate it internally and what you're seeing there, or whether we have to wait for H1 for an update. Thanks.

EWEN STEVENSON: Yeah, just quickly on BoCom, no change in approach. The value in use continues to be higher than where we hold the asset and we'll update more fully as part of Q2 results.

I haven't got your maths on capital, but I think we can imagine scenarios, as we progress through 2020 and 2021, that our CET1 ratio will fall below 14%. I think as we progress through the pro-cyclicality impacts of IFRS 9, both in terms of ECLs and the impact on RWA inflation because of ratings migration, I think we are comfortable operating the Bank in a sort of 13-14% range, if necessary, over 2020 and 2021. I don't think we're going to be under any regulatory pressure at that level.

Our MDA, as you will have seen, has actually fallen because of the reduction in countercyclical buffers. The MDA for the group now is at 10.9%, so we would be several hundred basis points above MDA at that level. As I say, actually, the regulators at the moment I think would be comfortable probably operating at levels below that, because they're very keen for us to continue to be able to support domestic lending, both in Hong Kong and here in the UK, so it will be very much, I think, driven by our view as to what the appropriate level of capital is. I also would not read into that any implications about future dividend policy and where we may set it.

MANUS COSTELLO, AUTONOMOUS: I just wanted to follow up on that question around the dividend, please. You said with the strategy update, Ewen, that the group would need a sustainable return on tangible equity of 11-12% in order to keep the dividend sustainable, but you've outlined for us today pressure on NII of an extra $2 billion and rising, potentially further pressures on ECL. My question is what goes into the mix in terms of working out the future dividend payout? Would you constrain RWA growth in the future in order to sustain the dividend, or have you got further cost cuts which can help drive you back up to the 11-12% return?

EWEN STEVENSON: What you've repeated back to me in terms of what I said is what I said. I think we're going to need to sit down later in the year and really understand where we are in a sort of post-COVID-19 environment, where the long-term trajectory on interest rates are, where long-term trajectory on business growth is. Does that environment have implications for parts of the strategy that we set out in February? When you throw all of that together in the mix, where do you get to a combination of sustainable returns and sustainable growth? Out of that you can then say, 'What is a sustainable distribution policy?' but it's too early to sit here today and give you guidance on that. Realistically, I think we won't be having that discussion well into the second half of the year, and we're obviously committed to give you an update ahead of full-year results in 2020.

MANUS COSTELLO: But there isn't $2 billion or $3 billion of costs that you can easily strip out of the business, presumably, to make up the NII deficit.

EWEN STEVENSON: That would be part of the mix, too, that we're going to have to consider. As I talked about earlier, I went through three line items that got to $4.7 billion of costs that we think that we can materially reduce, but obviously flexing down the cost structure and ability to flex down the cost structure… As Noel referred to earlier, we're already beginning to see the emergence of a meaningful shift in some markets towards greater use of digital channels than what we would have seen, and the acceleration in parts of our business plan towards digital that we couldn't have imagined a few months ago. Again, that's part of the mix of things that we're going to have to think about post understanding of where COVID-19 takes us.

MANUS COSTELLO: I just have one very quick follow up on the credit costs, which people have asked about. I'm just trying to juxtapose your $7-11 billion with the much higher charge you take in the UK stress test. You're over £55 billion over five years, but a lot of that is in years 1 and 2. Is the delta between your severe scenario and the Bank of England stress test the government support which you mentioned, or is it the pace of recovery, in that you're assuming things get better quite quickly next year? Which of those two is dominant in producing a lower ECL?

EWEN STEVENSON: I think there's three things. I think the extent of government support I think has a material mitigating impact relative to what you saw in the ACS results. I think, again, the pace of recovery and the shape of that recovery I think looks very different to what you saw in the ACS. The third thing I'd point to is just parts of Asia are already in recovery, so the – I do think when we've done that comparison for ourselves we're comfortable, for the time being, that the $7-11 billion range, we've sat down and thought about how that sits alongside an ACS scenarios.

NOEL QUINN: ACS was much more penal on our Asian franchise than the current scenarios we're modelling for COVID-19.

MANUS COSTELLO: Understood. That's very clear. Thanks very much, guys.

EDWARD FIRTH, KBW: Just some very quick points of clarification. Just to be clear, in terms of your $7-11 billion impairment guidance, it's too simplistic to say that relates to the GDP range that you've given. It's not a straight $11 billion is at the top end, and $7 billion is at the bottom, in line with those sort of GDP ranges? Is that too simplistic a sensitivity?

EWEN STEVENSON: Yes.

EDWARD FIRTH: Okay. Secondly, the rating migration that you've highlighted in terms of risk-weighted assets – I think you said that that does incorporate something for government schemes or regulatory comments about trying to mitigate the extent of that. Can you give us some – have you got any idea of roughly how much – what it would have been without that, because it seems to be a huge number even on its own and I'm just trying to get a sense of what the sensitivity around that might be?

EWEN STEVENSON: We provide you, I think in the full-year results, disclosure on the spread of – profile of our loan book, and you could run proxy estimates across that of what the impact of one or greater notch downgrade would be. I think we see the impact of the government support is it will limit the degree of downward notching of the corporate book that we would otherwise expect, but you can run approximate maths in some of the disclosures that we've already got out there to come up with your own views on that. That mid- to high-single-digit growth in RWAs is consistent with a fairly significant credit deterioration across the book over the remainder of the year.

NOEL QUINN: I think what you're seeing is a change in the modelled relationship between a credit migration on the balance sheet and the ECLs that may emerge in the P&L account, in that the government schemes are mitigating some of the emergence of the ECL, but you're still going to get the credit migration, you're still going to get a movement in your balance sheet, but that movement will not straight-line or model in the usual way into a P&L impact. That's why I think you may get a breakage in the normal relationship.

EDWARD FIRTH: Yeah, it does make sense. In the context of your strategy, which is taking out $100 billion, I assume that this year there's very little of that included. Is that correct?

EWEN STEVENSON: No. We do have a programme, a fairly mapped-out programme to reduce RWAs by $100 billion over the next three years. Where we can execute parts of that programme in this environment we will execute it, and we do think the bulk of what we thought we could do this year we will end up doing by the end of the year, but not all of it.

EDWARD FIRTH: Great. Thanks so much.

RAUL SINHA, JP MORGAN: Just a couple of questions from me then. Coming back to the $100 billion, obviously there was the $100 billion gross RWA reduction that we talked about, but there was also the $100 billion of growth in initiatives that obviously you plan to do over your three-year plan, and I was just wondering how the changed environment impacts your thinking around where you wanted to position the business in terms of growth, and where you actually are seeing capital consumption going up. Just some thoughts on how that $100 billion of reinvestment would look like, or are you just parking that to the side for the moment?

The second one may be a bit more specific on ECLs. I have had a look at the page 18 disclosures, which are really helpful so thank you for that, but the questions I have still remaining are around oil price. For example, how are you factoring in oil price risk within your scenarios? Also, we've seen a significant increase in fraud losses. Obviously you mentioned the one in Singapore, but there's also been one in the Middle East. I was just wondering what risk management lessons are you drawing from that, and you looked at the rest of your book for potential losses within that? Thank you.

NOEL QUINN: Let me take the RWA growth comment. You could argue we've just done 40 billion of RWA growth in the first quarter out of 100 billion because it didn't come in the way that was originally intended through new-to-bank and new-new business, but we saw an expansion in the balance sheet as customers drew down on credit lines. Will we see that repeated in Q2, Q3, Q4? No. Ewen's right to guide that that level of balance sheet expansion is unlikely to repeat in future quarters, but we've already put $40 billion of earning assets on the book in three months. We'll see how that moves over time.

In terms of the $100 billion programme, I gave a statement in my opening comments. We're still committed to capital efficiency, the capital efficiency programme we launched in February. We have to adjust in light of COVID-19, but the long-term goal of taking capital from under-performing businesses and re-investing in performing businesses is still our intent. I'm pleased to say that RWA growth in the first quarter is happening with good clients, long-term strategic clients and in good areas of the business.

With respect to fraud, and then I'll hand off to Ewen on how oil has been factored into the scenarios, clearly at a time of stress the emergence of fraud becomes more prevalent. A time of economic stress normally identifies fraudulent situations that are taking place, and therefore we are alert to that risk. We are doing a number of deep dives by sector on our portfolios that would be more susceptible to that. That's part and parcel of normal credit management. We're taking learning from any situations that emerge to try and read across to other parts of the portfolio and adjust accordingly. We're taking those proactive steps. I'd hand off to Ewen on oil price and scenarios.

EWEN STEVENSON: Yeah, we've included a slide on what our oil and gas exposures are at the back end of the appendix. There's $25.7 billion of exposure at the end of Q1. Yeah, the higher end of the $7-11 billion range clearly includes specific sectoral stresses in some places, including the oil and gas sector, so we have thought about it, we have tried to build in appropriate stresses into that range.

RAUL SINHA: Got it. Thank you.

AMAN RAKKAR, BARCLAYS: Just to follow on your disclosure on the at-risk sector stuff, thanks very much for that. Can you give us a sense of any existing provisions that you've got against those books, in terms of what kind of coverage you have after what you're stating today, and particularly it would be useful – I'm just kind of thinking about what the residual risk is for those exposures from here. Any colour you can give would be really good.

Then another on government guaranteed lending. I was just really interested in whether, when you look forward, do you envisage that being a material driver of the group balance sheet going forward? I know take up, up until now, has been fairly slow, but obviously you've seen an acceleration in the terms of that scheme not least a 100% guarantee. I guess as part of that as well it'd be interesting also if you could give us some indication of the commercial terms of lending under that scheme as well? What's the fee you have to pay to the UK government for the guarantee, if it's, say, 80% versus the now 100% on the smallest lending? Particularly on that last tranche of lending, is there any reason why that's not potentially a fairly profitable form of lending? I saw the PRA basically confirm yesterday that you should benefit from credit risk mitigation benefits on expected credit lost and risk density. I think there'd be a provision charge in the capital that that lending consumes. That potentially implies that's pretty profitable lending. Is there anything I've misunderstood there? Thank you.

NOEL QUINN: On the new scheme, we're still working through the details of that. That will launch next week. As you say, it's 100% guarantee. The fees and the pricing structure are still under debate, so I can't give you any details on that at this stage. We support the programme. We think it's a good initiative, and we're doing it because we think it's right to the customers not because we view this as a profit opportunity. We think it will be the right thing to do. In the grand scheme of things on our balance sheet, the size of our balance sheet, it's not something that I would guide you, from an investor point of view, that it will be material in the grand scheme of our balance sheet, but it is material to the customers that are drawing down those funds, and it's important to the UK economy, but it wouldn't change your modelling in any way with respect to the materiality of that scheme or the other government schemes that are being launched.

EWEN STEVENSON: In terms of the sector specific disclosures, I just refer you back to the full-year disclosures we had that we'll update at the interim results. We're not planning to give you further details at this point.

NOEL QUINN: Okay. Thank you all for joining us. All the best.

EWEN STEVENSON: Thank you.