

Group Chairman's Statement

Amid a turbulent period, nothing cast doubt on the strategic direction and priorities we laid out just over a year ago.



The first half of 2016 was characterised by spikes of uncertainty which greatly impacted business and market confidence. This was reflected in lower volumes of customer activity and higher levels of market volatility. Concern over the sustainable level of economic growth in China was the most significant feature of the first quarter and, as this moderated, uncertainty over the upcoming UK referendum on membership of the European Union intensified. Demand for credit for investment slowed as a consequence. Equity market activity was also markedly lower, particularly in Hong Kong, reflecting both economic uncertainty and weaker market pricing, which was exacerbated by net selling from sovereign funds impacted by lower oil prices. The period ended with exceptional volatility as financial markets reacted to the UK referendum decision to leave the EU, a result that had not been anticipated.

HSBC came through this period securely as our diversified business model and geographic profile again demonstrated resilience in difficult market conditions.

Pre-tax profits of \$9.7bn on a reported basis were \$3.9bn, 29% lower than in the first half of 2015.

On the adjusted basis used to assess management performance, pre-tax profits were \$10.8bn, some 14% lower than in the comparable period. Most of the decline in respect of our global business revenues reflected weaker market-facing activity, where lower transaction volumes evidenced customer restraint in uncertain times. Credit-related income remained solid although impairment charges rose against historically low levels. We made progress against our cost challenges, in reducing legacy assets and taking actions to release capital from secondary activities.

As a consequence, our common equity tier 1 capital position, which is critical to our capacity to sustain our dividend, strengthened to 12.1% from 11.9% at the beginning of the year. The sale of our Brazilian operations which closed on 1 July is expected to add a further 0.7 of a percentage point in the third quarter. Earnings per share were \$0.32 (1H15: \$0.48). Our first two dividends in respect of the year, of \$0.20 in aggregate, were in line with our plans and the prior year.

Reflecting this strengthened capital position, the Board has determined to return to shareholders \$2.5bn, approximately half of the capital released through the sale of Brazil, by way of a share buy-back to be executed during the second half of the year.

The Board has also determined that in light of the current uncertain economic and geo-political environment, together with our projections for an extended period of low interest rates, it would be appropriate to remove a timetable for reaching our target return on equity in excess of 10%. While the target remains intact and appropriate, the current guidance which points to the end of next year is no longer considered achievable. In addition, the Board is planning in this environment on the basis of sustaining the annual dividend in respect of the year at its current level for the foreseeable future.

Strategic direction remains clear

Nothing that has happened in this turbulent period casts doubt on the strategic direction and priorities we laid out just over a year ago. Our focus on the Pearl River Delta remains a key priority. We see growing movement in public policy decisions towards needed infrastructure investment on a massive scale, notably through the Belt and Road

initiative in China, to underpin increased urbanisation across Asia, the Middle East and Africa, and in support of the transition to a lower carbon economy. Capital markets development in both Europe and Asia remains essential to diversify funding sources, to address demographic ageing and to expand the role of 'green' bond finance. Outward investment from China is growing fast and is expected to accelerate. Internationalisation of the renminbi is also expected to accelerate as a consequence of all of the above. HSBC is well positioned for all of these mega trends, with clear evidence of this contained within the Group Chief Executive's Review.

Regulatory policy must be aligned with public policy support for growth

At the end of June we, along with the rest of the banking industry, submitted analysis to the Basel Committee on Banking Supervision in response to their request for a quantitative impact assessment around new proposals, inter alia, aimed at reducing the complexity of the regulatory framework and improving comparability. How the regulatory community responds to this consultation, due by the end of this year, is of huge importance to our customers and our shareholders. Any substantial further increase in capital requirements, which is quite possible within the range of outcomes implied by industry-wide impact studies, could have a major impact on the availability and cost of credit, as well as on the return on capital our industry is able to generate. Such constraints would also lean against the increased public policy emphasis on stimulating economic growth at a time of elevated uncertainties.

We therefore welcome statements from within the regulatory community and, most recently, in the communiqué from the G20 Finance Ministers and Central Bank Governors meeting in Chengdu, China, that these proposals should not lead to a significant broad-based increase in overall capital requirements. This is consistent with our view that satisfactory levels of capital have been achieved in most banks through the already extensive revisions to the regulatory capital framework. These, together with improvements in risk management and stress testing, have contributed to financial stability, with significantly increased levels of regulatory capital now in place. Near finalisation of the principal resolution regimes have also significantly extended the range of capacity available to absorb losses in the event of failure. A revised calibration that failed to take this progress into account would, in our view, risk undermining that progress.

UK referendum on EU membership

As a consequence of the UK referendum decision to leave the European Union, we are entering a new era for the UK and UK business. The work to establish fresh terms of trade with our European and global partners will be complex and time-consuming. Our first priorities have been to offer support to our colleagues working outside their home country who may feel unsettled, as well as proactively reaching out to and working with our customers as they prepare for the new environment.

Now is a time for calm consideration of all the issues at hand and careful assessment of how prosperity, growth and a dynamic economy for both the UK and the rest of Europe can be ensured following an orderly transition period. Critical elements include securing the best possible outcome on continuing terms of trade and market access, and ensuring the UK remains attractive for inward investment and has access to all the skills necessary to be fully competitive.

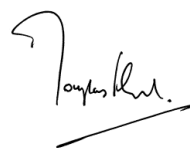
HSBC's experience in facilitating and financing trade for over 150 years has shown the value and importance of open trading relationships – for individuals, businesses, communities and nations. We believe that such an open trading relationship must be at the centre of the new relationship between the UK and the EU, and indeed the rest of the world. We aim to do our part in making the transition for our customers to the new arrangements as smooth as possible.

Board changes

Since we last reported to shareholders we have welcomed David Nish to the Board. David most recently served as Chief Executive Officer of Standard Life plc between 2010 and 2015, having originally joined as its Group Finance Director in 2006. He brings to HSBC considerable relevant experience in financial services, in financial accounting and reporting, as well as a wide-ranging understanding of all aspects of corporate governance. David has also joined the Group Audit Committee.

Outlook

It is evident that we are entering a period of heightened uncertainty where economics risks being overshadowed by political and geo-political events. We are entering this environment strongly capitalised and highly liquid. More importantly, given our history we have considerable experience within the senior management ranks of responding to severe stress events, experience that was deployed most recently in successfully dealing with the market volatility which followed the UK referendum decision on EU membership. Re-positioning our own European business once the future of the UK's current 'passporting' arrangements for financial services is clarified in the upcoming negotiations will add to the very heavy workload already in place to address the regulatory and technological changes that are reshaping our industry. On behalf of the Board let me therefore close my statement by once again recognising the dedicated commitment and effort by all of our 239,000 colleagues to implement these changes and so position HSBC for future success.



Douglas Flint
Group Chairman
3 August 2016