Transcript

Q1 2019 Post results analyst meeting

Meeting with Sell-Side Analysts hosted by Ewen Stevenson, Group Chief Financial Officer

7 May 2019, 9.30am BST

Ewen Stevenson

Well, so I guess not a lot has changed since Friday, other than Mr Trump tweeting, so all of the good work for Q1 was undone over the weekend. We'll see where they get to during the week, but as I said on the call on Friday, we thought if you strip out the noise in the results it was still a pretty decent quarter. Obviously the headline numbers look a lot better. You know, we should talk about NIM, we should talk about buybacks and tax. I think they're, sort of, three areas where I seem to have created a bit of confusion on Friday, but happy to cover any areas you want.

So on NIM, NIM was down four basis points in the quarter. Two of that's explainable by IFRS 16 and Argentinian hyperinflation, the other two is largely Hong Kong related, a couple of things going on in Hong Kong. Firstly, HIBOR is moving up and down. I'm still getting used to HIBOR forecasting. It was about 31 basis points lower, one month HIBOR, in Q1 versus Q4, so around 130 basis points. It bounced back to above 200. It was 198, I think, at some point late last week. I haven't checked where it is today. And the nature of our asset and liability mix, as you know, in Hong Kong is very short dated, typically one or three months, so that translates very, very quickly into the P&L, where literally HIBOR moves and the next quarter your net interest income and NIM will move materially.

And the other thing that's going on in Hong Kong is obviously, depending on where HIBOR is, people on the liability side are choosing to shift money out of on-demand deposits into savings products, and that's a natural consumer reaction. I think that will continue. Other things being equal though, given where HIBOR is now, things should be better in Hong Kong this quarter than Q1.

We've obviously still got some upwards pressure coming through on stuff like MREL issuance. That'll continue during the year. I think the UK, we're – despite the accusations of a number of our peers, we are trying to be prudent in our approach to pricing. We do have substantially lower wholesale funding costs than some of our peers in the UK. That means the sweet spot for us is typically lower LTV lending. You can see that in the average risk weights of our portfolio. You can see that in the stress testing results of the Bank of England. So I hear what they all say, but actually we're not trying to be the most aggressive pricer in the market in the UK.

The other thing that's gone on in the last couple of years in the UK is we didn't really have broker distribution of any substance a few years back. We've rebuilt that now. That's, effectively, two thirds, 70%, of the origination market in the UK. There's a natural market share that we should have because of our liability franchise. We've got low double-digit market share in current accounts. We've got 6.6% share of the mortgage market, so I'm not saying we should have low double-digit of mortgages, because you're always going to have the impact of the building societies in the UK, but we think our share can be comfortably ahead of where it is at the moment. And even in Q1, which was a relatively weak quarter for origination, we still had just over 7.1% share of flow.

But I do think when you look at the full year NIM forecast for consensus that we put out a couple of weeks ago, we're sitting at about 166 for the year. Hard to see, based on what we printed in Q1 and what we currently see existing in Q2 that we're going to be able to get back to 166. Equally, I think consensus average interest earning assets for the full year look wrong. We are growing average interest earning assets faster than the market currently has in the model, so on net interest income that should provide some sort of offset against that. And, to repeat, we do think net interest income will grow modestly this year, through a combination of a lower NIM and average interest earning asset growth.

And as you look forward I think NIM should begin to stabilise from here, I think. You will see more of that average interest earning asset growth, or most of it, just dropping straight through to net interest income.

Tom Rayner, Numis

Can I just ask you a question on that comment about the stabilisation of NIM, because it does seem to be that the repricing of the product and the shift in the mix of the products has been dominating the benefits so far from higher rates. Are you suggesting now that, as this year works through into 2020, that relationship's going to start switching around?

Ewen Stevenson

Well, it's a combination of that switch occurring plus the benefits of what we think will be higher interest rates in Hong Kong for the remainder of the year, offsetting the additional cost that's going to come through from MREL financing over time.

Richard O'Connor

What you saw in the second half of last year was a shift into time deposits in Hong Kong. The system's now over 40%. We're much lower than that, about 15%, but we saw that shift. That shift hasn't happened in Q1 or April, so at the moment, when the HIBOR curve moves up then we get the benefit. Clearly there'll be pricing in the market to reflect that over time, but the big shift in the move into a higher cost deposit, which happened late last year, we haven't seen so far this year.

Ewen Stevenson

Then on buybacks, we haven't invented the special sauce for being able to grow credit assets and not put on RWAs associated with credit assets, so, as credit portfolios grow, RWAs grow. Offsetting that, we continue to think that we've got a substantial opportunity to optimise RWAs on the balance sheet. Some of that is from continuing improvements in our underlying models. Just for the duration of that, there's work on new models. They get submitted to regulators, you have a lengthy discussion with regulators, you either agree or disagree and so on and so forth. So we can model a base case for when we think all of that's going to come through, and the extent to which it's going to come through, but there is obviously subject to some degree of variability, both in terms of the amount and timing.

We haven't changed our guidance, or probably only a subtle change in guidance this year – I'm sort of excluding the IFRS 16 impact from RWA inflation, but we continue to think that, in that previous guidance of 1-2% uplift, that we're targeting to be at the top end of that for the next couple of years, which obviously reflects a much higher gross number, as the underlying business grows, offset by RWA mitigation actions. You can observe, on our balance sheet, we still have a large number of RWAs that, by definition, must be earning less than cost of capital returns, and therefore we can also – we've got, on the wholesale side, relatively short duration books, so there's also an active approach to seeking to reprice or in some case exit customer relationships when they come up for renewal if we're not happy with the current returns that we're making.

Linking that to buybacks, we've got a common equity tier 1 target of being above 14%. We were around 14% at year end. You know, the underlying common equity tier 1 generation in Q1 was about 40 basis points. That was offset entirely by dividends and growth in Q1, and then we benefitted from FX and some other reserve movements by about 30 basis points. Other things being equal, that would make it more likely than less likely therefore, relative to full year, that we'd be able to do buybacks, but we just want another quarter of data, and some of those RWA mitigation actions, we have less confidence in deliverability for the full year. That will colour our judgment.

Brexit still has some pretty broad outcomes actually, but, frankly, we're not expecting a lot of clarity in the next few months, but, fingers crossed, maybe we'll get there. But for us, what we're focused on is making sure that we're not heading for a more severe, harder version of Brexit, because that would impact both the currency and it would have flow on impacts to forward economic guidance and provisioning. But the underlying commitment to neutralise scrip dividends over time remains, so if we didn't end up doing a buyback in '19 or it was a smaller buyback than what you were all anticipating, we're still committed to scrip neutralisation.

The other thing that's floating on the horizon now is Basel III reform. I'm still trying to unpick what's in all your models, if anything. So Basel III reform will have an uplift in RWAs. Part of our reticence in providing clarity is just there are so many national discretions that we're waiting on, and then understanding the interlinkage. I mean, if you think about Basel III reform, none of the banks are taking on any more risk in their portfolios. They're just being asked, typically, to hold – if you're a European bank, higher levels of RWAs for the same level of risk. We've then got to sort of figure out whether that would cause us to adjust our common equity tier 1 target, because if we're not taking on any more risk there should be some offset for that.

But again, it comes back to what happens under a stress test and whether the peak to trough fall under a stress test reduces, and therefore can we work on a lower base common equity tier 1 target? As and when we have better views we'll certainly update you, but, for all of your '21 models, do assume that there'll be some RWA uplift at the end of '21 as a result of Basel III reform. So on buybacks we'll update at Q2, but I certainly wasn't trying to row back, on Friday, from our commitment to neutralise the scrip over time.

And then on tax, just to clarify, when I guided to a lower tax rate on Friday that some of you have picked up, part of that is due to a reclassification of the tax shield on AT1 going into the tax line, which is about 1% of the 2%, but there is a genuine percent of lower tax charges that we see, relative to the current modelling for consensus. And the other thing on bank levy in '21, we think the number's probably fallen to around $400 million, but both pre- and post-tax there's quite a material benefit to us, about $0.5 billion or so of tax benefit coming through the P&L in '21.

Richard O'Connor

So at the moment the consensus is about $1,200 million for AT1 costs. That should be more like $1,400 million, just over, but then you reduce your tax rate by just over $200m to get back to the same answer.

Tom Rayner

So what year are we talking about for that?

Richard O'Connor

This year.

Tom Rayner

2019?

Richard O'Connor

Yes, it's happening this year.

Tom Rayner

Just on the scrip neutralisation, just a philosophical point, because I can understand why you want to wait on share buybacks and have all the information, but shouldn't the scrip neutralisation be regardless of that? Isn't that more about whether the 51 cents of dividend is a genuine cash equivalent or not? I just thought maybe those two should be almost separate.

Ewen Stevenson

It depends what the higher priority is. So for us, another important consideration is where does that leave our common equity tier 1 after you've done it? And if we've communicated that we want to have a common equity tier 1 above 14% and we were going to execute a buyback that pushes us below 14%, I don't think we'd execute the buyback, or we'd reduce the amount of the buyback so that our common equity tier 1 remained above 14%.

Richard O'Connor

Also, Tom, the volatility in the scrip is very material. So last year the scrip dividend was 10%, so therefore hit our common equity tier 1 ratio. In other years, it's been nearer 35% or 40%, so – and obviously, with a buyback, you have to ask for permissions and quite long lead times, in terms of capital planning and regulatory approvals, so I don't think it will be manageable to be able to do it that way. So it's neutralisation over time would be how we would see it.

Raul Sinha, JP Morgan

It's Raul Sinha, JP Morgan. If I can have two slightly broader questions, given that you're a fresh pairs of eyes, looking at the way HSBC is structured. When you think about the way the Group reports the divisions and the Corporate Centre, we can see that the returns that are reported within the divisions are obviously very high, and then you've got a very big negative drag coming from the Group centre. I think the last three years it was more than 5% negative ROTE. I was just wondering what you think about this classification. Do you think that's still appropriate?

And the second question, which is also slightly broader, is I'm still surprised you don't fully hedge the common equity tier 1 for FX, because there is a lot of volatility in FX that drives common equity tier 1. Last year, we had some negative drags on CET1 ratio, and this obviously in Q1 you had 10bps of movement from FX, so just wondering if you -

Ewen Stevenson

On the last point, no one fully hedges for currency, so we –

Raul Sinha

CET1 ratio though?

Ewen Stevenson

No. No one does, so we all hedge. We all have a view on what risk appetite we're prepared to see, and we have risk appetite of around what sort of volatility we're prepared to accept for given FX movements in any given currency, and we manage to that. It would be – I don't think it's in anyone's interests that we seek to fully hedge, because the cost of doing so would outweigh the benefits, so…

Raul Sinha

Do you hedge it to a corridor though, in terms of the –

Ewen Stevenson

Yeah, no, absolutely. So we have defined risk appetite on how much volatility we're prepared to see from any currency, given a certain percentage shift, meaningful shift, in underlying currencies. Yeah, the thing in the UK at the moment is, what may be viewed as a fairly significant move in sterling, actually it was in the range of BAU estimates for most people that you could easily see a plus 10, minus 10 shift in sterling, so we do have some additional hedging on sterling in place because of that, but for the rest of the currencies we just manage within our risk appetite. And for the currencies that are pegged, we assume for the time being that they remain pegged, as part of that policy.

Richard O'Connor

And last year we had Argentina and Turkey as well. Obviously difficult to hedge those, given what happened.

Ewen Stevenson

Yeah, but I'm not aware of any bank that would seek to fully hedge common equity tier 1.

Raul Sinha

Well, some of them might have less challenges than, obviously, you have, given that you've got a very large sterling balance sheet and report in dollars. It might not be so visible for the other banks.

Ewen Stevenson

On Corporate Centre, it is something we're looking at. There are broadly three buckets in our Corporate Centre today. One is the associate interests, heavily dominated by BoCom and our stake in Saudi Arabia. That does distort the numbers, but you should be able to just back that out, I think. And then the other two buckets, I think, are stuff that genuinely should sit in Corporate Centre and the stuff that I think we can take a view on whether or not we should allocate it out.

We're in the middle of that discussion today. We won't do anything until – if we chose to do something – until full-year results, because we understand, if we do it, you're all going to have to go out and adjust your models … but for internal MI we adjusted out… we hold the businesses to a higher cost-of-equity requirement in terms of their internal performance, which effectively normalises for the stuff that sits in Corporate Centre. But we understand, from an external perspective, it's not ideal and I'm not personally a huge fan of large Corporate Centres. And to the extent that we can allocate it out we'll try to allocate some of it out, but we're in the middle of that discussion at the moment.

Andrew Coombs, Citi

Just as a direct follow-on from the previous question, within the Corporate Centre revenue split, if you look at the move, year-on-year it's up a couple of hundred million, but the NII is down meaningfully and it's offset by the trading boost, and you've seen similar trends Q-on-Q, albeit less of a match. I'm just trying to get a feel for what drives the NII versus what drives trading within that division, given there are all the changes around IFRS 9, IFRS 16, hyperinflation, the valuation on the swaps, all these various moving parts – but what impacted on NII versus what impact on trading in that division?

Richard O'Connor

Well, there's no trading in that business.

Andrew Coombs

The non-NII.

Richard O'Connor

Yeah, the non-NII. And clearly there are some significant items – like the fair value moves go through there as well. But, on NII in the Corporate Centre, it has shown a worsening trend mainly because of the MREL issuance. And so what you're seeing is that sort of pick-up, Q-on-Q, in terms of the MREL issuance going through the Corporate Centre. Again, we may well look to allocate that out more over time, as Ewen has just mentioned. There are other movements on insurance and PVIF going through there, so if I were you I would look at our Corporate Centre slide, which is in the appendix, and model it on that basis. And with Balance Sheet Management then obviously the funding costs of interest expense – so I'd look at it that way.

Andrew Coombs

It's more that I just wanted to check that you're not taking a big NII negative on a swap and then taking an offset through the non-NII, but that's not the case. So the minus 935 in NII in that division is a genuine number that will recur.

Richard O'Connor

Yes.

Andrew Coombs

Thank you.

Richard O'Connor

And indeed slightly worse in the absence of a changed Corporate Centre policy.

Gurpreet Singh, Goldman Sachs

I have a question on strategy. China is making more noises on opening up, so can you talk to us maybe about what you see as the big opportunity for HSBC in China? Is it around retail, with the GBA area integration, or in Global Banking and Markets, with the build-out that the Group is doing there? And The second one is on Hong Kong. There's more competition in the payments space now virtual bank licences are being handed out. What do you see as the next area of competition? Will it be on the wealth management side or the personal lending side? What measures are being taken within the Group to kind of secure those very high returns that you are earning on the Hong Kong balance sheet?

Ewen Stevenson

On China, where do we have competitive advantage today compared with the domestic Chinese banks? We certainly feel that in the Greater Bay Area – for those of you not familiar with the Greater Bay Area, it's effectively the aggregation of the Pearl River Delta, Hong Kong and Macau. We certainly feel in that area and some of the larger cities like Beijing and Shanghai, from a sort of geographic basis within China… And then I wouldn't say mass-market retail is somewhere we're going to distinguish ourselves. Where we're going to distinguish ourselves is in affluent, high net worth; it's in commercial customers who want to do business outside of China or foreign businesses who want to do business into China. Clearly, if you look at our investment banking franchise globally, where do we clearly have competitive advantage? It's in Hong Kong and China. Yeah, and then also on the life insurance side, the asset management side, we think we are competitively advantaged and see significant opportunity.

You should also note that you can't just look at mainland China. A lot of that flow is also being booked into Hong Kong as well. So one of the reasons that Hong Kong – you need to view some of the revenue streams we're booking in Hong Kong as associated with the franchise in mainland China and, in some ways, see the two businesses together. Yeah, the formation of the Greater Bay Area could be a competitive advantage for us. It could equally be a competitive threat if it opens up the ability of mainland Chinese banks to compete more effectively in Hong Kong. We've got that competition today.

But, yeah, our main constraints to growth in mainland China – I think overall we've got something like 0.15% of total Chinese banking assets – is our ability to find the growth, which is, can we get enough deposits? Can we hire enough relationship managers? Yeah, so all of the discussions around mainland China are more, how do we support the growth that we're able to put on? What are the natural constraints on growth? So, when people talk about the China-US trade war, it may well have an impact on China, but it doesn't necessarily correspond to weaker numbers from us, given our position. Over time, if that was to become a persistent issue, I think what we're already seeing is Chinese manufacturing shifting to other markets around Asia. And our ability to facilitate that shift in manufacturing capacity to other parts of Asia also puts us in a unique position.

Hong Kong – I think there's a lot of noise at the moment around virtual banking licences. Yeah, we do think today we are the biggest virtual bank by some margin in Hong Kong and can see no real benefit today – I mean, that can change, but we can see no real benefit today in launching a virtual-banking only offering to our customers. We have the biggest mobile bank in Hong Kong; we have the biggest peer-to-peer payments… We have such an entrenched ecosystem and position in Hong Kong across us and Hang Seng. Our ability to monetise that opportunity… I mean, PayMe is a very, very good example. It was launched less than 18 months ago. It is now the biggest peer-to-peer payments vehicle in Hong Kong. We're now taking it into B2C, because we have the best access to merchants in Hong Kong. We are spending globally about $1 billion upgrading mobile platforms for retail banking. We can absolutely trounce the technology spend that some small virtual banking start-up is planning to put on against us.

So we're not complacent about it, but, like most markets where we're an incumbent, the biggest competition today is not from new virtual start-ups; it's from existing competitors. So in Hong Kong our biggest competitor is Bank of China. And that has a far greater impact on us than the impact of some new virtual bank trying to set up and launch. But I do think embedded in that is also… Yeah, we are now trying to do stuff that, if we can demonstrate value, it will be very, very hard for smaller banks to compete over time, given our ability to spend on global technology platforms. So we're doing that in mobile. We're spending about $1 billion to create a unified mobile platform for retail banking across about 20-plus markets, which means if we choose to upgrade the app in some market then it will relatively easy to simultaneously do that upgrade across all of the markets at the same point. If you look at the mobile app and what you can do with it in Hong Kong, as you all will know down there, it's our most advanced mobile app we offer on the planet. You can do currency trading, stock trading etc. We would love to, over time, develop that functionality in other markets.

On trade, we're spending about $600 million to upgrade our trade platform. Again, I think you can see it in the numbers. We are outspending others because of our market position and gaining share as a result. Finally, even if you just take a narrow example of Finance, we're currently working with Google to shift many of our core Finance processes onto the cloud. We started with liquidity reporting. We set that up in Canada less than a year ago and we're now rolling it out to about 20-30 markets. As we test and learn on that, we're then going to take another process and do the same thing. I guess what I've learnt since being here is that our access to the big global technology companies, because of the spread of where we do business around the planet and their eagerness to learn from us… We have extraordinary access to all of the large technology companies, and our ability to test and learn and develop with them does massively distinguish us from smaller domestic banks.

So, yeah, I do think for the time being the people we should be most concerned about on the technology side are the large platform companies globally, both in the US and China, rather than some small fintech start-ups. You can see it in the FX numbers, for example, you can see it in retail banking. Us and all the banks have been seeing an impact from some of the FX flows in retail, but, like all banks, it won't be long before we're able to connect retail customers directly through to our institutional FX business, and then it will just be a question of how we want to price that business, but we will have the capacity in the not-too-distant future to be able to offer institutional FX rates to retail customers when they've anything to do with FX. At that point, it's hard to see how some of these FX-only providers actually compete with the larger banks, because that source of competitive advantage won't be there anymore

Raul Sinha

Is that just in Hong Kong or…?

Ewen Stevenson

No, no, globally.

Yafei Tian, Citi

Yeah, so, one question on the Commercial Banking business, particularly around the GLCM part of the business. You can see that, Q-on-Q, there is a bit of decline in the revenue stream, and it's similar to a trend that we have seen in your peers. So I'm just wondering about strong growth in that revenue stream; is that coming to an end? And along that line, the Commercial Banking business for HSBC has done really well in the region. Along this line, I just wanted to check, how do you see the competition changing for some of the regional players such as DBS started taking up market share? How do you compare HSBC's advantage to some of the regional players?

Richard O'Connor

No, Q1 v. Q4 is seasonal. Two fewer days, seasonally lower deposit balances, versus the end of the year in GLCM, so I would always look at the year-on-year. Clearly, in that business, we've been growing our income by the high teens. That can't carry on forever, but we still continue to take good market share mainly off Western banks in Asia. The regional banks are very good competitors for more regional mandates, but for global mandates there are only a few banks who can do it now, so we continue to see good mandate wins in GLCM. And, on the trend, it is purely a seasonal matter.

Ewen Stevenson

Commercial lending – I don't think there's been any demonstrable, noticeable shift in… Yeah, we do think overall we're picking up market share when we do look at the underlying growth rates and where we're choosing to compete. But there's been no demonstrable shift in competition, as we can see it, in the region.

Manus Costello, Autonomous

Just a small one: were there any assumption changes in the insurance business in the first quarter? Because, when I look at your return on tangible by division, there was quite a big stripping out of PVIF.

Some of that probably was the markets move, but that leaves well over $200 million post tax; is that an assumption change?

Richard O'Connor

It was almost all markets. It was *de minimis* assumption changes. We make more of our assumption changes in Q3.

Manus Costello

Then why is that number so much bigger than the markets number you disclosed?

Gavin Francis, Group Chief Accounting Officer

So, there is a change in the statutory valuation rate for liabilities in Hong Kong, which then drives through into PVIF. But that is a statutory change in Q1.

Manus Costello

Right, but not stripped out of the adjusted numbers.

Gavin Francis

No.

Manus Costello

So, that looks like that's about over $200 million post tax.

Gavin Francis

Broadly that magnitude, maybe a bit more.

Manus Costello

And that would have appeared in your adjusted revenue number.

Gavin Francis

It's included, just like insurance and adjusted.

Manus Costello

Okay, that's quite a big delta on the first quarter, then. Thank you.

Gavin Francis

Yes.

Chris Manners, Barclays

Just a couple of questions, if I may. The first one was on BoCom and the accounting treatment. It's been a debate we've had many times over the years with Iain previously, and obviously we know you sort of tend to be relatively conservative when it comes to these sorts of things. How do you think about the accounting treatment of BoCom? Are you happy with it? When you think about the VIU calculation, is there any chance you might be more conservative?

And the second one is just about the ROTE targets. You're targeting greater than 11% for next year. You know, I see the street and the consensus the team has sent around is looking at high 9s in percentage returns. Could you sort of walk us through what you think the street has got wrong? I think you've been conservative on net interest margin. Is it impairment? Is it capital allocation? I'm just trying to work out what that bridge is between where the analyst community has you and your target. Thanks.

Ewen Stevenson

So, on value in use, I guess the short answer is, yes, I'm comfortable, given that we've now gone through two quarters and it hasn't changed. So, equally, value in use calculations are highly sensitive to the underlying assumptions made in them, so relatively modest changes in assumptions can significantly impact the value in use calculation. When you strip back to the underlying economics, you know, we have about $2 billion of earnings on about $18 billion of tangible equity, so it's making about an 11% return. Over time, that return, depending on the build-up in tangible equity, may adjust, but then our return on common equity tier 1. The way the deductions work, we've only got about $11 billion of common equity tier 1 against it, so, yeah, if, *in extremis*, we were to adjust the market value at some point, yeah, that would have a very negligible impact on common equity tier 1, even if it produces a large accounting loss through the P&L.

We have a very good working relationship with BoCom. We think it does bring strategic advantage to us in China. You know, we're, I think, the only bank that invested in these stakes and kept them, which is noticed. And so, for the time being, there's really no change in relation to the BoCom position. It doesn't constrain us in any way in terms of needing that capital to do anything with, so, yeah, we continue to be comfortable. It doesn't constrain us in terms of the capital we want to put into China from a risk-appetite perspective.

Chris Manners

I was also thinking about recognising the 2 billion a year rather than moving to different accounting. If you end up with, you know, the core value amount being above VIU, that's – you're not close to that at the moment, then.

Ewen Stevenson

No, but, I mean, equally, yeah, things can change and we could be triggered into that.

Chris Manners

Yeah, okay.

Ewen Stevenson

On the return on tangible equity for 2020, again, our target is to be above 11. You're right: the current consensus pre Q1 results was sitting just below 10. Yeah, I think on multiple line items, I guess, is the answer. On revenues, we've been consistently more bullish about our ability to grow the business than is reflected in consensus, and to grow that business while still sticking to our guidance on RWA growth. On costs, yeah, I think we are confident that we can flex cost growth to a lower cost trajectory than is currently sitting on consensus. You know, it's hard to judge Q1 on that basis, but, yeah, I know there has been a greater focus on cost since I've arrived than there was… before I arrived, in part, because of a recognition across the bank that when we set up the plan in June last year, it was based on a more favourable economic and interest-rate environment than exists today. So, almost by definition, to get to an 11% return on tangible, if revenue growth is going to be a bit lower – then, yeah, cost growth is an obvious thing to flex.

Yeah, I think we're marginally more bullish. I mean, if you look at consensus on ECLs, it sort of jumps up this year and jumps up again quite meaningfully the year after. I think we'll see, as the year progresses, how likely or otherwise that's going to be. I think in part the two are linked. Yeah, the more that… You know, we'll see, but, I mean, you can have a debate around that number. Tax I think we've talked about. So, I mean, it's no single one item but a combination of line items. But I would repeat: we do have to go through a process every quarter with our Board in relation to external financial targets. And if we don't think we're able to meet those or don't have a credible plan to meet those financial targets, we would have to update the market and adjust the targets accordingly. We can't just say, 'We aspirationally hope to get to X', without a plan to deliver it.

Martin Leitgeb, Goldman Sachs

Could I also ask two, please? The first one is on the UK and growth. Looking back at the commentary and the growth figures, the UK has been a significant contribution to the growth of the Group. And I was just wondering whether you could comment a little bit on the outlook. Is the future here predominantly on mortgages in terms of what's growing the business or do you see scope to grow the product offering, as an example buy-to-let? This year, HSBC remains very low in comparison to some of the other areas where you could see the Group putting down more focus on growth.

And the second one is the ring-fenced and non-ring-fenced bank. And I think over the last couple of quarters there was a bit of a debate on what capital levels those two entities need to run at. It seems they have stabilised at the current level. Is that kind of your impression so that the ring-fenced bank can pay out from here or would you envisage a further capital build-up?

Ewen Stevenson

Yeah, on UK growth, firstly the macro observation that UK growth looks like it's going to be lower for a sustained period of time, but equally there's quite divergent views on that, depending on the version of Brexit. Having said that, we do think, yeah, we've got a ring-fenced bank that's structurally long liquidity, long deposits, at the moment. You know, we talked earlier about how, just from a business perspective, we really weren't competing in the broker mortgage market, so mortgages are going to continue to be a big theme on growth. We do see, as the UK economy has to structurally adjust to find new trading partners, that should actually help us, because our business can help corporates that are looking globally in a way that not many others can. We're the only bank that offers the combination of a domestic and international network. So we do see significant potential to grow Commercial Banking.

I think the other observation is, you know, if you go to a very severe form of Brexit, we should outperform domestic peers, because, you know, while the UK is important to us it's only small part of our overall Group. Our ability to continue to support the UK given that is high. But, yeah, under that scenario, bad macro will trump good business performance any day of the week. So, yeah, we will outperform in a poor market. We do think in the UK we should be able to continue to see growth rates above market growth rates for a sustained period of time, provided we can attract deposit funding in order to continue that once we've used up the existing deposit surpluses we have. On that, we're paying close attention to what happens with the refinancing of the Term Funding Scheme. We obviously don't have any of that funding, but as at the end of last year it was about £120 billion of funding, which is 3-4 years of natural deposit growth in the market. And all of that funding needs to come from somewhere over time. So that may lead, perversely, to a squeeze on deposit rates but maybe a softening in mortgage spreads correspondingly, so we'll see how that plays out.

On the non-ring-fenced bank, the main operating constraint on the non-ring-fenced bank on capital is leverage currently, because a significant part of the wholesale bank's balance sheet is booked in the non-ring-fenced bank, including the Rates franchise. So, yeah, capital ratios there may appear to be higher than what you would naturally assume, but that's mainly because of the leverage constraints that we have, which we can offset at a Group level. If you look at the overall Group leverage ratio, it's north of 5%, but in the non-ringfenced bank, it's less than 4. So it will lead to higher capital ratios in the non-ringfenced bank but we can offset that at this point at the Group level.

Richard O'Connor

But were you asking about capital in the ring-fenced bank?

Martin Leitgeb

Yes, if you can comment also on the ring-fenced bank.

Richard O'Connor

Yes. We'd expect to very cash- and dividend-generative over time. We've built up capital over the last two or three years. It's well capitalised now and we'd expect it to be a dividend contributor going forward, given how cash-generative it is.

Ewen Stevenson

Does that answer your question?

Martin Leitgeb

Yes.

Richard O'Connor

And no change in risk appetite on mortgages.

Tom Rayner

Ewen, can I just come back to what you were saying on the cost flex? Because the revenue environment was weak in the second half of last year, and HSBC wasn't able to flex the costs enough to deliver the positive jaws, and it looks, even in Q1, on a fully adjusted basis, those jaws might have been slightly negative again. But I think you said on the conference call you saw natural cost growth of 3% plus 1% investment, and the investment, as you've discussed, is pretty important in a number of areas. I'm just wondering: is the ability there to really flex that cost much away from the 4% per annum, if revenue did turn out to be softer throughout the rest of this year, and would you even want to really just to hit a jaws commitment, if that was what happened to be the case?

Ewen Stevenson

So we did exactly what we thought we were going to do on costs last year. If you look at the plans we had last year, we thought we were going to grow costs by somewhere between 5% and 6%, and we grew it at 5.6%. And we did what we thought what we were going to do in Q4 on cost growth. What happened in pretty much the last six weeks of the year was that we suffered a $1 billion revenue shortfall through a combination of the insurance business and the Markets business and a couple of other things, and some valuation adjustments, that was not in the plan and given there were only six weeks to go in the year, we did take a hit to the variable pay but we just didn't have the tools available to flex the cost base. It's just not how it works. So we, at the end of October, thought that we were going to print about a 1% positive jaws for the year and ended up at -1.

So this year, I'm very focused on not having a plan that requires us to be having revenue growth comfortably north of a 5-6% run rate in costs. The comment on inflation was really just that's what the underlying inflation is across the Group: about 3%. So given that half of our cost is direct people cost and about two thirds is people-related, the key is headcount management. Because the technology spend is stuff that we're going to continue to spend on. And as I said on the call, the key target for John and I is return on tangible equity rather than jaws. The problem is what cost target you manage to as a bank because we're not like most banks. Cost-income and jaws isn't perfect because it relies on a revenue line item that you're not totally in control of, so you have what happened last year and everyone says, 'You missed your jaws target', even though some of that wasn't entirely within our control. If we manage to an absolute cost number or absolute cost growth number, we don't think that's right either, because we can choose to flex investment spend or go out and hire people where we want to hire people, so we sit somewhere between those two metrics as the right approach.

The other observation on costs is, typically, given the nature of the costs, it has about a six-month lag period. So if you worked for me today, Tom, and I decided to exit you, the whole point of working through that decision, getting approval and then, typically, three months' notice period means that it does take about six months to begin to take decisions on costs and see the impact flowing through to the P&L. So yes, we started to tighten up cost levers in the organisation in recognition of lower revenue growth. We started to have a debate of: if we were to trade some of the investment spending growth that we're putting on, where would you do that trade? At the moment, we still feel that we've got a combination of things that allow us to invest appropriately while still delivering to the 11% return on tangible target next year. If we get to a point where the underlying macro interest rate conditions make that a lot tougher for us, then I think we get into a much more interesting debate of: do we slash and burn to deliver to something in 2020 versus continuing to invest in long-term franchise development? But we don't feel we need to have that debate today.

But again, on investments, we spent 3.7 billion in ’17 and 4.1 last year. We just spent 15% more than we did a year ago in Q1. We’ve got plans to spend around $5 billion this year, which is probably about 10% lower than what we may have anticipated spending a year ago, but is still substantially up on what we spent in 2018.

Magdalena Stoklosa, Morgan Stanley

Two things. Could you give us a sense of what more strategically is happening in the US to lift that return on tangible number? So that’s one.

And two, if I could come back to China in particular and two revenue stream opportunities, one, the growth in onshore asset management is something that has been quite big post the ownership reform and quite a few of the particularly large institutional players are outlining plans already, since you’re there. That’s where the question comes in.

And two, the investment banking piece overall because, ultimately, I think, at the moment, that business earns the vast majority of your Chinese plus Hong Kong investment-banking pool. And really, how do you compete with the Chinese banks? Because you are, by far, the biggest DCM player from the foreign banks but that is still very small within the scale of the Chinese banks, so what’s the plan? How do you want to position there? Because you could argue that, in terms of how quickly you can earn within the Markets business, it’s sooner than building out a structural onshore retail or commercial capability. Thank you.

Richard O’Connor

I’ll do asset management and China. Look, it’s doing well and it’s got a good share of flows and a good [inaudible] but look, the asset management business is a $1 billion revenue business, so quite frankly, that’s in the roundings. Clearly, when we deep dive into our China strategy, we’ll talk more about it. We talked a little bit about it last year, as you know, in the Asian investor trip and, at some stage, we’ll go back to that in terms of a deep dive. So that business is doing well and performing well within mainland China but it’s tiny within the scheme of the Group so far.

Ewen Stevenson

The comment on investment banking was…?

Ewen Stevenson

Yes.

Magdalena Stoklosa

When you talk about the Chinese opportunity overall, it just seems that, within the investment banking, given your current positioning already, particularly if we take China and Hong Kong as one revenue pool, you’ve been growing share. You are, by far, the largest of the foreign players, particularly within anything debt-related – I suppose a natural position, given your position as a lender. Is that an opportunity shorter-term, given the deepening of the market, given the reforms? Because of course, we can talk about asset management being small. We can talk about the commercial retail banking being a very long-term opportunity. Is that something that is likely to come your way faster and, if that is so, how?

Ewen Stevenson

Well, I think it depends on – at the moment, probably relative to global investment banks, it’s not benefiting us because of the slowdown in investment banking activity in Asia. As I said in the call on Friday, some of the comments that were being made by some of our peers about Q2 having picked up, I think feels more like a US comment than it does an Asian comment. As you’ve seen over the last year or so, by far the biggest revenue opportunity in GB&M is the growing of our transaction businesses and our support for those transaction businesses on the wholesale banking side rather than growing traditional revenues in Equity Capital Markets, Debt Capital Markets and Advisory. I think that’s going to continue to be the case. We do have a natural competitive advantage versus Chinese banks and we come with all of the imprimatur of a foreign investment bank and all the regulatory oversight that comes with that. So people that choose to go to us are actively making a choice not to go with the Chinese banks.

Richard O'Connor

Just two more things. The [HSBC Qianhai] securities JV is doing well – 170 colleagues, the only bank with simultaneous research coverage in both Chinese and English, which is not easy. We've completed transactions in ECM and DCM and, for one quarter, had a very strong M&A market share but it's only one quarter. But I think, if you think about China, the two long-term builds will be things like the credit-card build-up and other retail products, where we're not making money in mainland China. Clearly, that will change over time but it's a very slow build and I think the securities team will also be a relatively slow build – a bit stop-and-start – with licensing. We do think we've got a head start over the other banks. If you just look at mainland China and if you exclude Hong Kong, which you shouldn't, our business in commercial and GB&M in mainland China is very, very profitable and, at the moment the retail business is in build-and-invest mode, so we lost money last year in the retail business. So that will probably improve slightly this year but there'll still be a lot of investment into those two businesses, so I think you should think about it with the established businesses profitable and growing very nicely, and then the two big investments in product capability in retail and the securities joint venture in IB.

Ewen Stevenson

The other area, Richard, is in wealth, as broadly defined: private, life insurance, asset management and Jade.

Richard O'Connor

Those are all big investments for us, along with the credit card business in retail.

Ewen Stevenson

On the US, John has publicly talked a number of times about it being his most challenging target. In 2017, the business had a return on tangible equity of 90 basis points. So in Q1, it was up above 2%, so it's more than doubled its performance. We've got a target next year to get to 6. It remains a challenging target to get to 6. It requires decent revenue growth, it requires us keeping costs significantly under control and it requires us getting approval out of the CCAR process for some fairly meaningful capital release that sits in the business today.

I'm not sure either way whether – I don't think, whatever the answer is, it's going to change our view on the US about the need to get returns up to the mid-single-digit returns. Once we get there, I still think we've then got an open strategic question about: where do we want to take the business from there? Because even mid-single-digit returns, and even if you add on a handful of percent on top of that for business that gets booked elsewhere on the planet – typically, the Middle East and Asia, where the cost of the relationship is booked into the US but the revenue benefits typically accrue elsewhere – that still only gets you to high-single-digit returns. And ideally, you would have a business that's generating more than that.

So yes, we need to work through: what do we want to be in retail banking? I think the commercial banking strategy in the US is very clear and, on the investment bank, we need to decide: how do we want to position ourselves against some quite confident, large US investment-banking franchises? So I don't think our intention is to be an all-singing, all-dancing wholesale bank in the US. And in the retail bank, we can flex between being very narrow and being something more than narrow. But in the very, very near term, we've got a very clear execution plan that we're delivering against, but it's against a backdrop where US interest rates have been less supportive than when we set up that plan about a year ago.

Steven Chan, Haitong International

I think I have a few quick questions. First of all, the HIBOR impact on the Group net interest margin is two basis points. Can we use that to estimate that the whole Hong Kong operation's net interest margin declined by seven to eight basis points QoQ in 1Q '19? That's the first question.

Ewen Stevenson

You can see it in the slides. Somewhere in one of the slides, we break out the net interest margin by legal entity, and you can see that decline.

Stephen Chen

Okay. Are we seeing the same trend for Hang Seng Bank?

Richard O'Connor

No comment. They don't publish Q1 results.

Stephen Chen

Okay. A second question is related to HIBOR again. I think you have mentioned that we have a surge in HIBOR and I'm not sure what has caused the surge in HIBOR in April. Is it more related to capital outflow that is the decline in aggregate balance? Or as some views are saying, some of the China banks in Hong Kong, they are competing aggressively for liquidity in the Hong Kong market, resulting in a short-term boost in HIBOR. If it is the second reason, are we seeing that you're going to see a more softening HIBOR coming forward in May or even in June?

And one related question: under what conditions will HSBC Hong Kong raise the Hong Kong dollar prime rate and savings-deposit rates? Because remember, last year, September, when HIBOR was at 1.5, 2.1, 2.2%, you raised the Hong Kong dollar prime and savings-deposit rate by 12.5 basis points. If liquidity is tightened in Hong Kong and HIBOR moves back to 2.1-2.2%, are you going to further raise the Hong Kong dollar prime rate and savings-deposit rate, or you will still hold it?

Ewen Stevenson

I guess the answer to that last question is: it will depend on how we choose to react competitively to what we see in the market. I'm not going to speculate on what we may or may not do, depending on what our competitors may or may not do.

On the specific question of Chinese liquidity…?

Richard O'Connor

It's a combination of factors. We have seen some local Chinese banks bidding up for liquidity. We've also seen a big move out of Hong Kong into mainland China. So it's a combination. I'm not sure we'd be able to isolate it for you. I haven't seen any economist's notes on it, so it is a combination of those two factors.

Predicting HIBOR is a bit like predicting exchange rates. It's for other people – it's not for us to predict. And it's very volatile and highly uncertain, and I'm not sure we'll say any more than that.

Ian Gordon, Investec

Can I ask two, please? Firstly, on the alleged climate issue, given recent focus, do you see any company-specific challenges a) in relation to the cost side, given your own company carbon footprint, and b) in relation to potential revenue pools, especially given historic company-specific challenges you've faced on certain activities which have upset the environmentalists?

And then, secondly, the old chestnut of location. Are we still meant to think of this as a once-in-a-generation decision to remain domiciled in the UK or are there any circumstances where the newly configured board may want a second vote?

Ewen Stevenson

Well, there's no work going on on reconsidering location. Look, I wasn't here in the circumstances that caused the firm to think about re-domiciling previously, but I don't see it's possible for any company to say that they would never re-domicile. I'm sure you can imagine circumstances where a combination of regulation and politics or whatever would cause you to have to reconsider, if it was in the best interests of shareholders to do so. And shareholders should want us to think about. And I think, last time we thought about it, the fact that we were able to get about a half-a-billion-dollar benefit on bank levy, I assume, was clearly influential in decisions that were finally taken. But if we woke up tomorrow and we were existing in some kind of punitive tax and regulatory environment in the UK that was clearly detrimental to shareholder interests, then you would want us to think about it.

On climate, I guess an overarching comment is it's something that we care deeply about as an organisation. You can read in our ESG document that came out a few weeks ago. I think we recognise, at a macro level, that corporates need to take a bigger, more active role in the impact they're having with customers, colleagues and communities in which they operate in, of which our and all big banks' ability to influence decision based on who we lend to or who we choose not to lend to can have a dramatic impacts in terms of the incentives in relation to climate.

On our own footprint, we've made very, very clear commitments in terms of what we're trying to live up, and I think we intend to deliver against those, and those commitments, I think, are broadly ahead of the industry generally. But by far and away the biggest impact we have on the climate is the decisions we make about who we choose to support or not support. And it's a difficult and complex issue for us, because, for example, there are certain countries in the world that could not afford to generate electricity for their people if we and others didn't help finance coal-fired power production, so the debate we have is: is it up to us to decide how a country can afford to create power for its own people? And in three countries of the world, we've said, 'No, it's not up to us to make that decision.' But in every other country where we can make that decision, we will.

So yes, we're constantly in the middle of a very, very difficult discussion internally, which, frankly, is not driven by environmental-lobby groups. It's driven by what we think is the right thing to do. But we treat that responsibility very seriously. It's something that John cares passionately about, and sometimes we get it right and sometimes we clearly don't get it right.

Richard O'Connor

We'll help our customers transition on the green-climate agenda. As you know, we have a $100 billion commitment. We're already, just over a year in, at $27 billion, so the $100 billion by 2025 looks readily achievable and, indeed, should be upped at some stage, so we think there are opportunities for us in that space where, on any league table, we're number one or number two in terms of green bonds and SDG bonds, so we've got a good presence in that area as well. I'm sure you've read our ESG report, Ian.

Ian Gordon

Of course.

Ewen Stevenson

Look, in context, a couple of months ago we had a three- or four-hour executive meeting with various climate experts just on the topic of climate change and how we, as a bank, need to position ourselves, given that. And if the scientific evidence – you can debate it at the margin but it's an acute problem for the planet and we don't have a lot of time to take action, so we're incredibly sensitive to the impact that we can have – positively and negatively – on that.

Richard O'Connor

Any more in London? Any more in Hong Kong?

Hugh Pye

No more from here, thank you.

Ewen Stevenson

Well, thanks a lot for coming down. Maybe just a few quick comments on Q2, while you're all here. Please don't get ahead of yourself on the back of Q1 – that's why we went out of our way to point out all of the various one-offs that were sitting in the numbers. The only other thing I would observe is I think we do intend to step up investment spend in Q2, so other things being equal, cost growth would be slightly higher than it was Q1. But we would expect that various cost initiatives that we're beginning to put in place will begin to have a more material impact as we progressively work through the year.

And just a general health warning: we've spent a lot of time debating HIBOR today. I'm pleased to see people in Hong Kong have no better ability to estimate it than we do. Brexit is still looming out there. We thought, I guess, until yesterday, that the China-US trade tensions had dampened down a bit, but there's still a lot of geopolitical stuff that's going on in the world. Markets had an unnaturally good Q1 and, at some point, won't continue to be that robust. So we are managing the best that we can manage but, even under a central scenario, there's a degree of volatility around those central scenarios. Thanks.