Asia Strategy

Investor and Analyst Webcast

Presentation

21 November 2011

Peter Wong, Chief Executive, Asia-Pacific

Good morning, afternoon or evening wherever you are in the world. My name is Peter Wong, I'm HSBC's chief executive for Asia-Pacific, and I'd like to welcome you to this analyst and investor webcast on our strategy in the Asia-Pacific region.

We're going to split this webcast into two sections. We'll start with a presentation from me, based on slides which you'll be able to see on your screens, and then we'll break for questions and answers.

Before we begin, please note this cautionary information about forward-looking statements.

My plan for today's presentation is to explore four main topics.

First, I'll cover a subject dominating the headlines – the macro-economic outlook – and explain how that's shaping the management team's thinking.

Second, I'll update you on our progress so far this year.

Third, I'll talk about our strategy and how we aim to meet the goals we set out in May.

And fourth, I'll highlight the key markets in Asia that will drive our growth over the next four to five years.

Once we've been through all that, I'll be joined by some Asia-Pacific colleagues for the open mike session.

So, starting with the economic backdrop, it's clear that these are challenging times in the developed world. We believe weaker Western demand will diminish trade and will probably lead to a global slowdown next year.

There's still a lot of anxiety about the strength and unity of the eurozone, and recent US data indicate the government will have to work hard to prevent unemployment from rising.

Political and economic uncertainty is deepening a sense of social dissatisfaction and powerlessness; a feeling that's triggered unrest ranging from the 'Occupy' movement to full-scale rioting.

Unsurprisingly, the uncertainty is having a direct impact on financial markets, making it harder to increase revenue and making regulators extremely cautious about capital and liquidity.

Fortunately, Asia is providing some relief with respectable levels of GDP growth. Though these numbers could drop quickly if conditions in the US and Europe worsen, the current outlook gives us confidence that intra-regional trade will provide a buffer against the global slowdown.

In contrast to the West, most Asian countries have the fiscal strength to implement stimulus policies if the slowdown does turn out to be sharper than we expect.

We forecast China will achieve a soft landing as inflationary pressures ease and as domestic demand supports economic activity.

Nevertheless, high inflation rates do mean we must be vigilant on costs. Staying alert to the risk of a sudden deterioration in our Asian markets, we must manage our business with caution.

Looking just at the Asia-Pacific region, our profits for the first nine months of the year rose 17% to 10.1 billion US dollars.

We achieved healthy loan growth during the first half, and began managing down the pace of growth in the second half in response to global market volatility.

Strong sales of wealth management products in Hong Kong boosted fee income, as did higher trade volumes. Our associates continued to play a very positive role, and our interest income benefited from balance sheet growth in both loans and deposits. I'd highlight China and Singapore as significant contributors in this area.

Taking the third quarter in isolation though, we did start to feel some effects of the global slowdown. Loan demand decelerated in several of our markets, and loan impairment charges crept up from their very low base in Hong Kong.

These charges, combined with higher costs attributable to wage inflation and investment in front-line staff, pushed Hong Kong's pre-tax profit lower than in the third quarter of 2010.

Overall, I believe our regional results show we're on the right track to achieve the goals we set out at our Strategy Day in May.

We said then that we'd defend our leadership position in Hong Kong while building scale in the key markets of China, India, Singapore, Indonesia, Malaysia and Australia.

We're doing exactly that, and we're investing in Taiwan and Vietnam to benefit from their growth and their synergies with mainland China.

In the next slides I'll show you how we're progressing in our strategic objectives to build quality assets in our key markets and to grow non-interest income with cross-sales initiatives.

We'll look at how we're attracting liabilities - especially in Hong Kong - to fund loan growth, to cross-sell within wealth management and to capture interest rate rises.

We'll explore the direction we're taking to cement our role as the leading international bank for cross-border connectivity and for expertise in the RMB.

Then I'll highlight our efforts to increase efficiencies within our far-flung organisation so that we meet our target of a 3.4% to 4.2% return on risk weighted assets.

This slide shows how HSBC is working to increase customer loans and funding across the world, and you can see that Asia set the pace for growth in loans and advances during the first half of 2011.

In case you're wondering why I'm using first half numbers, it's because I can only give you third quarter or nine month data where they've been disclosed in our recent results announcement.

As I mentioned earlier, while we did see a slowing of loan growth in the third quarter, we continue to seek opportunities to expand our balance sheet.

To illustrate how we're taking a cautious approach to loan growth, I'd like you to look at the middle left hand side of this slide.

Here we can see that gross customer loans rose by 12.4% on a reported basis in the first half. Just above that you can see that risk weighted assets increased at a lesser rate of 8.5%.

The contrast is even more visible in the Hong Kong figures, where lending climbed 13.2% and risk weighted assets rose 3.6%.

What this shows is that we're keeping a very close eye on credit quality, and that we're being rigorous in our approvals processes. Commercial lending rose 18.3%, or three times the increase in loans to the property sector, and much of this additional commercial lending was in the form of short-term, self-liquidating trade finance.

On the right hand side of the slide you can see that our loan impairment charges and impaired loans remained low in absolute terms during the first half.

Looking at the third quarter loan impairment charges in a little more detail, you can see they fell year-on-year in the rest of Asia-Pacific.

In Hong Kong there was an increase compared with the third quarter of 2010. This does not indicate any systemic issues though as it was due to provisions we took for an individual credit in the commercial bank, lower recoveries than in the previous period and higher collective provisions due to increased loan balances.

While we'll continue to work to keep impaired loans at low levels, I think it's important to take the Hong Kong numbers in context. Even with that rise, Hong Kong LICs were 0.28% of average customer loans on an annualised basis.

The total for Asia-Pacific was less than a third of a percent, and declined versus the third quarter of 2010 as we managed down our unsecured loan book in India and reduced risk in our Global Banking and Markets business.

While we had a good first half in terms of net interest income, driven by 2010 loan growth and interest rate hikes in some territories, we remain focused on fee income and other sources of non-interest revenue.

A concerted effort to cross-sell across businesses and across borders helped us boost net fee income by 17.2% in the first six months. We were particularly successful in cross-sales within our corporate relationships, notably in trade, forex, payments and insurance.

The right hand side of the slide lists the major products and services from which we derived higher fee income, and which we'll continue to promote as we enter what will probably be a period of slowing loan demand.

Loans and fee income contributed to a 10% increase in total Asia income for the third quarter, which translates into a 13% rise for the nine month period.

Before we move on to look at some of the priority markets, I'd like summarise the three building blocks of our growth strategy over the coming years.

First, we're going to expand our balance sheet with liability cross-sales in deposits and wealth management, and with asset growth from high quality borrowers. A tighter credit environment, and rising interest rates designed to combat inflation, are already enabling us to re-price some assets to improve margins.

Second, we believe any slowdown in inter-continental trade

-related fee earnings will be offset by our efforts to develop other sources of non-interest income, such as growing intra-Asian trade. For this reason we can sustain the momentum built up this year into 2012.

Third, we'll focus on increasing revenue from priority Asian markets that are either sustained through downturns by domestic consumption, as in the case of China and India, or by their positions as regional hubs, as in the case of Hong Kong and Singapore.

Many of you will have heard our Group CEO, Stuart Gulliver, speaking at our Strategy Day in May. He said then that Hong Kong is absolutely core to our business and is a market in which we'll defend our leadership status with energy.

For this reason, it's encouraging to see in the nine month results that higher costs due to wage inflation and increased headcount were more than offset by income generated from loan growth, wealth product sales and trade-related fees.

While we think trade will dip, we anticipate that consumer spending will help sustain growth in Hong Kong's economy. This will be domestic spending, supported by higher wages and inflation, and imported spending by tourists from mainland China.

That said, wage inflation - and investment to support higher business volumes - did have a detrimental impact on our cost efficiency ratio. I'll come back to our global programme to improve cost efficiency in a minute.

In the rest of Asia-Pacific we had a good nine months, with profit rising by 31% on growth in all our major markets. In particular, I draw your attention to the bar chart showing a 171% increase in organic profit before tax from mainland China during the first half.

Going forward, we'll continue to leverage our global network to attract commercial banking business, and we'll seek to expand in wealth management – a business that showed good growth potential in the nine-month results. Success in these areas will yield greater benefits from widening interest spreads and faster loan growth.

As in Hong Kong, we had to deal with inflationary pressures. Even so, I'm delighted to say that we managed to lower our cost efficiency ratio despite the challenging environment in many Asia-Pacific countries.

Though we're performing particularly well in China, as you saw in the last slide, we cannot be complacent in a market that's becoming increasingly competitive.

To capture the opportunities that China offers, we're investing heavily to sustain our position as the leading foreign bank. We now have 126 outlets in 29 cities and we're cooperating closely with our local strategic partners. We're using our network to help Chinese companies reach out to the world and to help foreign companies reach into China.

Our strength in Hong Kong is proving invaluable as we build a proposition based on connectivity; because it's clear the economies of Hong Kong and the mainland are becoming increasingly intertwined. We see, for example, that most IPOs in Hong Kong are by Chinese companies. Many of our customers in Hong Kong are from the mainland, and vice-versa.

Put together, our footprint on the mainland and our capacity to deliver products and services across a global network is a strong platform for growth.

Corporate connectivity is similarly at the heart of our proposition for India, where we've set ourselves the goal of building a 1 billion US dollar business within four years.

We'll diversify from our strong franchises in Global Banking and Markets and Commercial Banking by expanding our retail network and wealth management distribution capabilities.

Our network of 152 offices in 60 cities gives us the capacity to reach customers inside India, and we'll be increasing our efforts to connect the Indian diaspora to opportunities in their homeland.

Here you'll see I've pulled together the strategies for our other target markets.

In Singapore we're working to build a 1 billion US dollar business within five years. Of Asia's three major financial centres - Hong Kong, Shanghai and Singapore – we see Singapore as the hub for private banking and wealth management. It's also a leading centre for foreign exchange and trade, so we're enlarging our dealing capacity on the ground.

We're the largest foreign bank in Malaysia and in Indonesia where – if you factor in Bank Ekonomi – we have 185 outlets across the country. Both are major markets for our Amanah Islamic finance business, and we're aiming for a 1 billion US dollar business in the two countries combined within four years.

Taiwan and Vietnam have different economic profiles, but in both these countries we see scope to win business from affluent, internationally-minded individuals and the top tier of commercial enterprises. We're aiming for significant profit growth from Taiwan and Vietnam combined over the medium term.

In Vietnam our Global Banking and Markets business will be at the forefront of our efforts, while Taiwan is a key part of our Greater China strategy. Taiwan's Economic Cooperation Framework Agreement with China is a positive development for cross-border trade, and we expect capital flows will increase as policies governing the RMB are relaxed.

This is a sample of our Asian bond league table rankings to give you a sense of our Global Banking and Markets leadership and our ability to connect global customers with Asian investors.

Clearly this is a business of vital importance to our non-interest income, and we'll continue to ensure that our Commercial Banking and Global Banking and Markets teams work closely together.

Although I picked Hong Kong's RMB bond market for the first table on the last slide, I think it's worth clarifying our objectives when it comes to the Chinese currency.

To start with, there's no doubt that the offshore RMB markets in Hong Kong present us with tremendous opportunities in our heartland.

We've built a leadership position in offshore RMB bonds, with a 22.6% market share at the end of the third quarter. I could also highlight our role in the first offshore RMB equity IPO, the strength of our RMB deposits, and that we were the first foreign bank to offer an RMB card to corporate customers.

But while Hong Kong remains the pre-eminent offshore centre for the RMB, the currency is being 'internationalised' at a faster pace than many expected.

We believe we're at the beginning of what will be a transformation of the RMB into a currency for global trade, investment and reserves, so we're positioning HSBC to be at the forefront of this change.

We've made RMB retail services available in 11 Asian markets, and trade services available in more than 50 countries across the globe. As a result of this investment in connectivity, we've been able to settle RMB trades for customers as far from Hong Kong as Canada, Turkey and Ireland.

What I find particularly exciting about the RMB is its potential to open up trade, particularly with Asia, in the same way that wide acceptance of the dollar has helped businesses connect across markets and lower transaction costs.

I think the best proof that we have the right strategy for connectivity and the RMB comes in our cross-border referrals. Between Hong Kong and China, our corporate and Premier referrals rose by about 50 percent in the first half of the year.

Only with a footprint as extensive as ours can we bridge continents, whether its helping a mainland Chinese company issue shares in Hong Kong, a German company invest in India, or a Middle Eastern investor sell Australian assets.

Only with a universal model like ours can we meet the totality of our customers' financial needs, whether its helping a mid-cap company issue bonds for the first time, or a high net worth investor hedge his positions with derivatives.

Before I wrap up I'd like to say a few words about our cost efficiency goals, and the challenging steps we're taking to get HSBC into shape for the next phase of growth.

Earlier in the year Stuart set out our goal for the HSBC Group to achieve 2.5 to 3.5 billion US dollars of sustainable cost savings in three years. He said this would involve a gross reduction of about 30,000 positions across the Group; cuts that would focus on back-office support and management de-layering in head offices.

He also said these reductions would be partially offset by front-office hiring to support growth markets.

Asia contains many such growth markets, so we'll need more revenue-generating positions, but we still see potential to improve our customer service by reducing bureaucracy and by implementing consistent business models.

The Asia-Pacific region already has a cost efficiency ratio in our target range of 48-52 percent, but this doesn't mean we can be complacent. In Hong Kong the ratio has been rising, and it's higher than the target range in the rest of Asia-Pacific.

We have inefficiencies to eliminate, we have inflationary pressures to manage, and we have to achieve positive jaws across all our global businesses and countries. These goals are high on the regional management team's list of priorities.

In conclusion, we believe Asia's emerging markets will grow at a reduced but encouraging rate through 2012. We expect a soft landing for China, the region's economic engine.

Despite considerable political, economic and regulatory uncertainty, HSBC is well positioned to grow lending and generate higher fee income in Asia.

We had a solid first nine months of the year, and we've set out challenging but achievable plans to increase revenue and control costs going forward.

Thanks for your attention. I'll now stop so those of you with us in 'real time' can ask the top team some questions.

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Questions & Answers

21 November 2011

Peter Wong, Chief Executive, Asia-Pacific

I am joined for this question and answer session by my colleagues Sarah Legg, CFO for the region and by Robin Phillips and Gordon French from Global Banking and Markets, Louisa Cheang from Retail Banking and Wealth Management, and Noel Quinn from Commercial Banking. Thank you Operator, we are now ready to take questions.

Alastair Ryan, UBS

It's Alastair. I'm just dialling in on Anton's line. Maybe just trying to square off this characterization of your appetite versus the third quarter call a couple of weeks ago, I think we may have come away from the Q3 call with a sense that Stuart and the Board were quite concerned about pull back of other banks in Asia, the dislocation that that was going to create. And it certainly sounds that you're much more focused on continuing to grow the business. And therefore, presumably, you've got an appetite to pick up opportunities that are left for you by people pulling back.

So I'm just trying to circle between the two things and get a sense of, do you have market share ambitions? Do you have funds that you're looking to put to work with existing clients or new clients to the degree that other people leave? Or are you concerned that the dislocation that may be brought on by the crisis elsewhere is something that might in itself be the dominant issue for you?

Thanks.

Peter Wong, Chief Executive, Asia-Pacific

Right. Well, what I would like to say first of all is about the macroeconomic situation. First of all, Asia is not dislocated from the rest of the world. What's happening in Europe and what's happening in the US will impact Asia.

About a few weeks ago, I had the round of calls with my CEOs in Asia-Pacific and together with them, their economists. And without exception, most of the economists in Asia-Pacific have reduced their GDP growth forecast. So it is going to be a challenging situation, especially if you look at the electronics industries in Singapore, it's already having negative growth.

But all that said, the growth opportunities are still in Asia-Pacific, and we're going to try to go after that. But we're going to go after it in a way that is going to be -- we're going to try to grow quality assets. Then as we have identified in our strategy, we grew quality assets in 2010 by 40% in loans and debentures. And also in the first half of this year, we grew by about 11% to 12%.

So what we're going to do is that utilizing these opportunities, we've grown the fee income by 17.2%. This is according to our strategy. And we will continue with that strategy, because we have a huge customer base and we will work the customer base a lot harder.

So as far as opportunities in Asia are concerned, first of all, there are offsetting dynamics. On one hand, you may say that there's some banks are pulling out of Asia-Pacific, but I think that the American banks will continue to grow in Asia-Pacific. And at the same time, because of what's going on in Europe and the United States, it has impacted Asia, and therefore, the loan demand will be tempered a bit.

So I think that there're offsetting factors, but to a certain extent, we are still looking for opportunities to grow.

Let me give the stage to Noel Quinn, the Head of Commercial Banking in the region, and he can share some light on the Commercial world. Noel?

Noel Quinn, Head of Commercial Banking, Asia-Pacific

Okay. Thank you, Peter. We are seeing some early evidence of European institutions maybe tempering their appetite for certain types of lending, syndicated deals that may be rolling over, and some appetite in trade finance. We see that as an opportunity for ourselves to increase our penetration of our important client base. We are still planning for growth in our trade related assets throughout Asia-Pacific.

And I would also say, and echo Peter's comments, that there is still good liquidity supply in Asia from certainly Asia financial institutions and the US. So I don't see any evidence at this stage of a liquidity crunch such as you may have seen in 2008/2009 impacting trade finance.

What I see in terms of trade activity at the moment is there is some adjustment of orders taking place, some early signs of that from buyers in particularly Europe more so than the US. But it is adjustment rather than a sudden halt to activity, as we may have seen, or as we did see in 2008/2009, as people take on board the tightening economy in Europe and other parts of the world.

Peter Wong, Chief Executive, Asia-Pacific

Thank you. And may we have the next question, please?

Rohith Chandra-Rajan, Barclays Capital

Thanks very much and just following up actually along similar lines. Just really thinking about your risk appetite again and what we've seen in loan growth so far this year and also in the third quarter. The third quarter we obviously saw Hong Kong had declined a little bit, and a very specific issue I guess around trade finance there which I guess has a little bit further to run. But interested in your comments about risk appetite in different countries around the region, and also interesting to see your property-related lending only grew 6% year on year. So how you're thinking about property markets also around the region, that would be great.

Thank you.

Peter Wong, Chief Executive, Asia-Pacific

As far as risk appetite is concerned, we will continue to capitalize on opportunities, but we're going to do it in a more cautious way. We're going to make sure we grow quality assets. And especially in view of the fact there will be new regulations coming out, including Basel 3, the treatment of capital for risk-weighted assets will be different. And so what we're going to be doing is that we will continue to go after opportunities, but we're going to do it in a little bit more cautious way.

As far as the trade finance is concerned, the trade finance is a very important product for us, and we'll continue to look for opportunities in that area. And I'll get Noel to say a little more about that on the trade finance.

And as far as property is concerned, we do see a little bit of slowdown in terms of property in Hong Kong. I think the property prices have gone down anywhere between 5% to 10%. And we also see a bit of a slowdown in the property sector in China. So I think that it is important for us to note a couple of things in Asia-Pacific.

First of all, when we look at risk in the property sector, we should differentiate between end-users' risk and also developers' risk, okay? As far as Asia is concerned, the Asian mentality is that after they have acquired a property, it's very seldom that they would just throw away the property, or default or whatever. It is not in the culture.

If you look back in the early 2001, '02 and '03, you can see that although Hong Kong property prices have dropped by 70%, the default rate is actually very, very small. So I think that it's important to understand Asian culture in terms of owning properties.

As far as developers' risks are concerned, that will depend on whether developer has the financial strength to hold on to some of the properties that they have.

So I would probably say that as far as properties are concerned, I think people are taking a more cautious outlook in terms of what's happening, because we have gone through quite a property boom, so I think that it's only natural that we have certain amount of adjustment. And I think that at this point in time, the adjustment is really not that big. So I am still very optimistic about the property sector.

And I think that all the governments in Asia-Pacific, they're well aware of the importance of the property sector, and especially Hong Kong, China, and so forth. I think the regulators are taking steps against any potential downfall of the property sector. Noel?

Noel Quinn, Head of Commercial Banking, Asia-Pacific

I think on trade, I think one big feature that we're seeing develop in Asia is intra-Asia trade. It isn't just trade between Asia, the US and Europe. So for example, we're seeing significant growth in activity between China and Bangladesh, Sri Lanka, Vietnam, and India as well. So although we're not decoupled totally from what's happening elsewhere in the world, we are seeing a lot of activity in that direction.

And in terms of property financing for commercial real estate in Hong Kong, we have very good, safe loan-to-value ratios that give us a lot of protection in terms of that lending. There is no doubt that the appetite for new lending in commercial real estate in Hong Kong and China has slowed, but we had already anticipated some of that early in the year. And most of our balance sheet growth has come from trade related assets over the last year rather than commercial real estate lending.

Peter Wong, Chief Executive, Asia-Pacific

Can we have the next question, please?

Sally NG, CICC

Two quick questions. If I look at your geographical PBT update for the first half, if I annualize that and look at your aspiration of PBT in the next five years, it seems like you're factoring pretty modest growth in India and Singapore. But for Malaysia and Indonesia, you seem to factoring in pretty strong CAGR of about 20% per annum in PBT. So I'm just wondering, is there any implicit messages behind the relative conservatism in India and Singapore versus the relative optimism in Malaysia and Indonesia?

And the second quick question is we've heard from one of your major peers that the RMB LDRs in Hong Kong have been rising quite sharply in the last couple of months. I was just wondering whether you're seeing the same thing, and if so, what will be the reason behind it. And is that going to help your margins as well, because it is supposedly a higher price loan product?

Thank you.

Peter Wong, Chief Executive, Asia-Pacific

On the geographical piece, I think that as far as India is concerned, we're saying that the $1 billion is going to be in the next three to four years definitely, and it's not going to be in the five-year range.

And also as far as Singapore is concerned, it is Singapore we identify as one of the financial centers, one of the three financial center initiatives. There's Shanghai, Hong Kong and Singapore. Singapore is a trade hub, and also it's the largest foreign exchange center in Asia-Pacific, slightly ahead of Hong Kong. And at the same time, it's a Wealth Management hub. So our PBT aspirations for Singapore should be high.

As far as Malaysia and Indonesia are concerned, we are putting in place all the infrastructure. As far as Indonesia is concerned, as you remember, we acquired Bank Ekonomi, and it has taken some time for us to come up with a strategy for Bank Ekonomi, and as well as our own branch over there.

So going forward, we're envisioning that the two entities will work well together, and also there will be a strong aspiration in terms of the CMB in a Commercial Banking area.

As far as Malaysia, it's the same story. I think that right now, we're putting in place everything that we need, and also I think there will be opportunities in the Commercial Banking area.

As far as RMB in Hong Kong, actually, the RMB deposit growth has slowed a bit, the reason being that in the first half of this year, the RMB has grown quite a bit up to about [RMB600 billion], or something, and then slowed down ever since. I think what's happening is because of the continual accumulation of RMB in Hong Kong, and there is no investment outlet, therefore, everybody's just sitting on RMB.

So what China has done is basically allow more issuance of bonds in Hong Kong in order to take some of the RMB liquidity back into China so that not all the RMB would sit in Hong Kong.

And also at the same time, China has also allowed the borrowing of RMB in Hong Kong and directly remitting it back into China. In the past, as you know, you probably have to do a syndicated loan in Hong Kong and then remit it into China and then turn it into RMB and then for investment. With the new rules coming out, they will allow more direct remittance of RMB from Hong Kong into China. This is very significant, because it actually means that there's opening of the capital account.

I'll get Gordon French from Global Markets to comment on and discuss it further.

Gordon French, Head of Global Markets, Asia-Pacific

Yes, so what we've seen is great growth in the debt capital markets side of the business, as Peter said, and we've been able to take advantage of this quite substantially.

So as was mentioned earlier in the numbers, we're number one in market share in the debt capital market space for dim sum, with more than a 22% market share; and number two is about 11% or just under 12%. So we have a leadership position there.

We have a leadership position in the foreign exchange business in CNH. And obviously, what we're seeing is increased turnover in the trade business, which means that we expect to see further activity there, which is driving some of the P&L increases that we've seen, both in Hong Kong and China around the CNH business and the CNH space.

We do expect more product growth. So we expect more activity again in FX forwards and the hedging instruments, given that there has been an increase in the uptake of both CNH used for trade finance, but also for those investors coming to town, as Peter said, who are going to raise money here, look to take it onshore for use in their activities for operating capital, or for the Chinese customers coming to Hong Kong to raise money in Hong Kong and bring back onshore to China.

Peter Wong, Chief Executive, Asia-Pacific

Thank you, Sally. Next question, please.

Ian Gordon, Evolution Securities

Can I have two questions, both on Hong Kong, please?

Peter, in your opening remarks, you recognized the fact that margins had modestly declined in the first half, whereas you are aspiring to see some asset spread expansion going forward. Can you just add a little bit of colour in terms of the product drivers for that?

Peter Wong, Chief Executive, Asia-Pacific

Ian, can you repeat your question? It did not -- your question -- your voice line did not come over clearly.

Ian Gordon, Evolution Securities

Sorry, apologies for that. I hope this is a bit clearer. Just in terms of the Hong Kong margin evolution, you referenced the fall in margin in the first half. Looking forward, you are hoping to see some asset spread expansion. Can you just provide a little colour on the drivers of that, either by product, or whether it's a mix effect?

And then secondly in terms of loan growth, obviously the pace of loan growth across Hong Kong and the rest of Asia slowed materially in the first half relative to the accelerated pace we had seen. Given that you have cited reduced loan demands, plus your own quarter's risk appetite, is it conceivable that in Hong Kong we could see loan growth reducing to low single digits as a percentage of growth? Or would you be confident enough to rule out a reversion to the flat loan book, which we saw at the bottom of the crisis?

Thanks.

Peter Wong, Chief Executive, Asia-Pacific

Thanks, Ian. As far as the margin is concerned, what we are witnessing in Hong Kong is the following. And there is -- to a certain extent, there's a bit of a liquidity squeeze in the market, because first of all, there's a curtailment of loan growth in China, and therefore there's a lot of borrowing from China. So loans are going into China and, therefore, lowering the deposit base in Hong Kong.

And secondly, also because of the -- US has already declared that it's going to be a weak US dollar policy, the interest rate continuing to be low. And therefore, there's also a certain amount of conversion of Hong Kong dollar deposits into foreign currency, such as RMB or maybe Australian dollar from time to time, and also Singapore dollars.

And you can see also in Hong Kong that some of the banks on a retail basis, they're quoting about a 2% interest rate to attract deposits, and so that's way, way higher than the interbank market. And therefore, that means that going into the future, there has to be a widening of -- there's a price increase in terms of loans. And I'll get Gordon to comment on that a little bit more.

Then as far as the risk appetite in Hong Kong is concerned, our appetite basically, first of all, depends on the demand, and secondly, it also depends on the quality. If there is quality loan growth, we'll go after it. But at this point in time, I think it's because in the last couple of months, not even couple, just last month and a half or so, the situation in Europe has deteriorated quite a bit, and therefore it has dampened the appetite of a lot of the corporates. The Companies are suddenly holding on to their plans and taking a wait and see attitude. I think you can probably witness that around Asia-Pacific.

But at this point in time, as you can see that we still have a pretty good loan growth in the first half of the year, and then on a total year basis, we'll still be very healthy. And we will maintain, we will continue to maintain good quality loan growth, as you can see from our loan impairment charges, and also the growth of risk-weighted assets.

But as far as our appetite is concerned, if there's demand out there, then we do have the appetite. I'll get Gordon to comment a little bit more.

Gordon French, Head of Global Markets, Asia-Pacific

On RMB, we actually are still seeing some growth, even though we've seen some volatility obviously in the exchange rates with a small reversion in recent weeks to US dollars and greater demand for US dollars. But at the end of September, the depot market was up to $620 billion in Hong Kong, which was up 97% year to date.

So we actually believe that there will continue to be growth there, but there's going to be short-term volatility based on the risk in Euro sovereign debt and Euro sovereign markets. But in the medium term, we see further growth in that market. That provides us with more opportunities, as I said earlier, for wealth products and both hedging products as well.

Peter Wong, Chief Executive, Asia-Pacific

I'll get Sarah to comment on the margins.

Sarah Legg, Chief Financial Officer, Asia-Pacific

Okay. Your question was about half and half, so the half-year 2011. In Hong Kong, there was a small reduction in the net interest margin of 3 basis points in the Bank, and 2 basis points in our subsidiary in Hang Seng. That was generally the headwind that we're seeing in the high volume in mortgages year on year, in the trade-related lending, which continued to be constrained in terms of the strikes. That was offset by a mix change as well as we grew the loan book, so moving from lower yielding financial investments into customer advances.

Peter Wong, Chief Executive, Asia-Pacific

Thank you very much. May we have the next question?

Jason Napier, Deutsche Bank

Two quick questions, if I might, please the first on credit quality evolution in the third quarter. I appreciate that the loan loss charge in Hong Kong and other Asia-Pacific remain extremely low, but in both cases, they're up very markedly in percentage terms sequentially. So I wonder whether you wouldn't mind just giving us additional colour on the drivers of that and whether we should interpret that as the beginning of a trend, given some of the comments you've made around knock-on impacts of European weakness and the like.

And then the second question comes around reports that emerged last week that HSBC were looking to exit some of the smaller markets in Asia, perhaps countries like Bangladesh. And whether or not you'd like to comment specifically on that is not the focus of the question.

Really what I'm interested in is what the upside is to the business of existing countries that in the medium term absolutely do have growth that are viewed as attractive by some of your international peers, and I just wonder why on the EM side, especially for smaller businesses like those, it makes sense to exit where some medium-term optionality has got to be attractive. It's not going to be doing anything on the capital or liquidity side that's meaningful at the Group level.

So I wonder whether you wouldn't mind just talking about country plans in Asia, and whether we are likely to see a number of countries shed.

Thank you.

Peter Wong, Chief Executive, Asia-Pacific

Jason, okay, on the credit quality, let's put it this way. There are no systemic issues that we have seen in the credit. There are some credit hits here and there, for example in Australia and so forth. There's some credit hits because of the linkages to the Middle East and so forth. But we don't see any systemic issues coming up from the portfolio.

As far as HSBC exiting from various countries and so forth, I think that on Strategy Day, we've already talked about we're going to evaluate countries on using a five-filter analysis. And that is the -- especially on return on equity by business, by country, and in return on the cost income ratio, and also strategic importance and so forth.

There are some businesses we may elect to exit or sell in Asia-Pacific at this point in time, but these are businesses that we will consider as not strategic and don't have the potential to give us huge profits going forward. Because your question alluded to the fact that there are some -- it may be short-term -- there may be no short-term profits but longer-term opportunities. But our evaluation would be based on the fact that the short-term profit is not there. Even on a longer-term basis, we do not see a lot of opportunities. So it's based on a five-filter analysis.

And then what that will do is that we do exit some of the businesses, then what that will do is that it will reduce our cost base. It does not have a lot of impact on the revenue side, but it will reduce our cost base. And also, because of the fact that Hong Kong is supporting a lot of these countries, so reducing the businesses in certain countries will also reduce the cost base in Hong Kong.

Jason Napier, Deutsche Bank

So just to be clear, one of the key elements of the five-filters has got to be whether the business has any prospect of being material in HSBC centers. It's not just about the ROE in and of itself being good, it's about whether the dollar millions is likely to show up on a [inaudible] when you look at it from a Group standpoint. Is that right?

Peter Wong, Chief Executive, Asia-Pacific

That's correct. [inaudible] is also one of the key factors, so therefore it is not going to be -- this is also a factor that we have a lot of interest in. So that's one of the factors that we do pay a lot of attention to.

Jason Napier, Deutsche Bank

Thank you.

Steven Hayne, Morgan Stanley

My question comes back to some of your outlook comments in relation to your objectives. We've already discussed Singapore and Malaysia, etc. To be clear, when I was writing it down, like India, I wrote down that your medium term was within four years; in Singapore I think you said within five years; Malaysia and Singapore I think you said within four years. I'm just wondering -- and also, you haven't given any guidance on where you see Hong Kong more medium term. And I was wondering if you were able to give some further term outlook on Hong Kong.

In particular, we've talked about slightly lower volume growth and we've talked about the margin in the second half. But I'm wondering if you can piece that together in terms of with the lower volume and lower margin potentially going into next year what that might mean.

And should I just take, to be simple, all these targets to be 2014 or 2015?

Thank you.

Peter Wong, Chief Executive, Asia-Pacific

As far the rest of Asia is concerned, it's about three years to four years, and Singapore is within five years. And then Malaysia, Indonesia taken together is also between four years to five years, so just to set it straight.

As far as Hong Kong is concerned, I don't think we have given out anything in the past. But what I can continue to say is that the Hong Kong will definitely -- Hong Kong, the way we should look at Hong Kong is not in isolation because we need to look at Hong Kong in terms of how we can group together with China. Because a lot of the syndication facilities raised in Hong Kong are basically for investment in China, and we are at this point in time having a number of initiatives growing the referrals from China into Hong Kong.

For both Hong Kong -- and we have also stated that the Hong Kong is going to be our key market and it's one of our leading markets and we will use our energy to defend that leadership. And also as far as Hang Seng is concerned, it will continue to grow.

So our strategy is actually quite simple. Hong Kong will continue, we'll put a lot of focus to maintain our leadership in Hong Kong in most of the product areas. And as far as the rest of Asia-Pacific is concerned, we'll continue to focus on the six key markets, that's Malaysia, Indonesia, Singapore, China, India and Australia, and the two strategic markets, which is Vietnam and Taiwan.

So if you look at the rest of Asia-Pacific, the growth in these countries in terms of PBT in the first half is also quite -- I would say I am encouraged by the growth.

As far as Hong Kong is concerned, the base is big, and I think the importance of Hong Kong, whether Hong Kong can continue to grow is also based on how China is going to move forward.

As long as China is going to have GDP in excess of 8%, then Hong Kong will be in a pretty good position. But as China continues to curtail growth to battle inflation, then I think the Hong Kong growth would also be impacted.

Raul Sinha, JP Morgan

Can I just ask about your appetite for lending and risks around unsecured lending, and particularly SMEs as well? Do you see any contagion impact on asset quality for these two particular product categories due to the global slowdown that we've talked about today?

Peter Wong, Chief Executive, Asia-Pacific

I'll get Noel to answer this question. Noel?

Noel Quinn, Head of Commercial Banking, Asia-Pacific

Firstly, we don't adopt a uniform universal approach in every market in Asia. We serve eight markets, and we really focus on three primary customer segments; corporate banking and then business banking upper and business banking mass. And the way our term business banking mass, it's the S of SME, and business banking upper is the M of SME, with corporate banking then above it.

So I think it would be unwise to take an absolutely uniform approach in all markets, because market opportunity is very different. And again, that comes back to Peter's comment on five-filters. You address the market opportunity that you think you can best serve, both strategically and from a return point of view. Our focus in most markets is more on the corporate end and the business banking upper.

Clearly, in Hong Kong, we have a very dominant position in SME banking. And I think if you look at market statistics, we have somewhere between a 30% and 35% market share of the SME market here in Hong Kong. So we see more of our opportunity in corporate and upper end of SME banking outside of Hong Kong.

Are we a big unsecured lender in the SME marketplace? No, we're not. We tend to be more of a secured lender, hence our strong returns and relatively low LICs. And I wouldn't see that particularly changing going forward.

Raul Sinha, JP Morgan

Any comments you would make on unsecured personal lending across your market? I noticed that you're lagging behind; you have reduced lending in India for example on the unsecured side.

Peter Wong, Chief Executive, Asia-Pacific

Louisa, can you answer that?

Louisa Cheang, Head of Retail Banking and Wealth Management, Asia-Pacific

Sure. Similar to Noel, we don't have across the board strategies for unsecured lending. If you look at market by market, India and Indonesia, we have been coming out from the unwinding of our consumer finance book.

So for both of the markets, we are now gradually going back into the market and book some new unsecured lending, but at a very cautious pace. Other places like Singapore and Malaysia, Hong Kong and Australia, we have been observing pretty healthy growth in terms of the unsecured lending.

Raul Sinha, JP Morgan

Thank you.

Peter Wong, Chief Executive, Asia-Pacific

Thank you. Can we have just two more questions?

Alistair Scarff, BofA Merrill Lynch

Just a very quick question, if I can. Looking at your Wealth Management business, looking at how transferable is your products that you develop in Singapore and Hong Kong across the rest of the business, particularly in your China and your focus market in Asia.

Thank you.

Peter Wong, Chief Executive, Asia-Pacific

Thank you, Alistair. I'll get Louisa to answer the question.

Louisa Cheang, Head of Retail Banking and Wealth Management, Asia-Pacific

Sure. In terms of the manufacturing capability, I think we are highly transferable. We have our in-house insurance manufacturing, so majority part of our insurance product we have been doing it in-house and manage it from our regional hub in Hong Kong.

For other products like FX and structured products, we have been working really closely with Gordon's area in Global Banking and Market. So again, I think that capability is highly transferable across the region.

In the asset management area, we have been launching in fact quite a number of global products, like World Selection, which not only demonstrate the regional transferability, but also the global ability for us to actually roll out things across the world. So I think that is one of the key strings that we have in HSBC in terms of growing our Wealth Management revenue in the low interest rate environment.

Alistair Scarff, BofA Merrill Lynch

And if I could just have one quick follow-up question. In terms of your recent momentum of your sales, could you comment firstly on the pace on, say, a third quarter versus second and third quarter? Is it a slowing pace, an accelerating pace or steady? And what other products that are typically getting the highest demand at this stage?

Thank you.

Louisa Cheng, Head of Retail Banking and Wealth Management, Asia-Pacific

I think if you specifically look at Hong Kong which is our biggest market, the third quarter obviously has been also affected by the macroeconomic sentiment. So we are seeing, comparing to first and second quarter, a slowing down in terms of the Wealth Management sales. But we are seeing consumer behaviour actually shifting between different products so that they can still try to earn some return from their deposit.

We have been seeing a growth in the FX income, so showing that customer is shipping the portfolio to foreign currency. And other areas like insurance, we also have quite good sales in third quarter.

So general momentum is slowing down as compared to first and second, but we are seeing some shifting in customer portfolio.

Alistair Scarff, BofA Merrill Lynch

Great. Thank you very much.

Peter Wong, Chief Executive, Asia-Pacific

Can I have the last question, please?

Tom Rayner, Exane BNP Paribas

Just have three quick ones, please, the first on the Renminbi business. We hear a lot about your ambitions to be, or remain the leading international bank for Renminbi. I just wonder if you could try and put some sense of materiality around that in terms of profits, both today and what you expect over the next five to 10 years as that market continues to develop.

Second question just on your confidence over the soft landing in China. If things were to be a little bit worse, could you give us a sense of how that might affect your businesses, both in Hong Kong and across the rest of Asia region?

And then finally, just on deposits, just wondering why you're really looking to grow deposit balances, given the surplus deposits you have in the region. Would you not be better off just trying to recycle those deposits into wealth management products or into customer loan opportunities rather than actually competing with other banks to grow the deposit base?

That's it from me. Thanks.

Peter Wong, Chief Executive, Asia-Pacific

Let me answer the third part first. Regarding deposits, it depends on what types of deposits, because you have the currency. For example, Hong Kong dollar is tight, and to a certain extent US dollar's also tight in the region.

So growing the deposit has basically three uses. One is to fund the loan growth. Second, you can only sell, cross sell investment products into your deposit base when you have more deposits. And third, if the US raises the interest rates, and we have our biggest deposit base in Hong Kong, and that will benefit us. And as you can see, in the rest of Asia-Pacific, some of the countries have already raised interest rate and therefore we have benefited. So getting the deposits has basically three objectives.

As far as RMB business is concerned, I would probably say this is still in an early stage, because RMB, to a certain extent does not have a lot of investment outlook. And what we are able to do at this point in time is that we have trade settlement in RMB in more than 50 countries.

So as RMB continues to be internationalized, and also in RMB -- one day within five years or so, RMB becomes a convertible currency, I'd say convertible sovereign-managed currency, then we also already have all these countries, all trade settlement in RMB, set up in all these countries.

Now versus that of the Chinese banks, as far as the Chinese banks are concerned, they are to a certain extent, they have a huge balance sheet and lots of branches and so forth. We're not going to -- we won't be able to compete with them in that area. But as far as international connectivity is concerned, that will be our strength. We're able to take companies out of China, go into the other markets, and as they do trade and so forth, then we are set up to capture that opportunity.

I probably would not take put a lot of emphasis on profit at this point in time, because the revenue from RMB is not going to huge. It's all about at this point in time setting up the infrastructure and being the leading bank in this area.

And as a matter of fact, what we're seeing right now is that in China, many companies, because of the 12th five-year plan, these companies are based on the Chinese policy of trying to move overseas. And we are capturing quite a bit of market share in that area because of our international connectivity. And I'll get Gordon to comment a little bit more

And also, as far as the soft landing in China, - I have visited China about no less than four times in the last 1.5 months. And each time, I've gone to see the regulators, some of the senior officials in China and so forth. They are absolutely confident in terms of having a soft landing in China, and you can actually see what they are doing in terms of curtailing loan growth and so forth, and the inflation is coming down. They're already talking a little bit about relaxing lending again, and we have seen some evidence of that.

And also, in terms of the NPLs, it's actually most of the banks and also the partners, Bank of Communications and so forth, the bad debt situation is less than 1% of the average loans.

And I think that there's a lot of noise up there about the provincial lending and also the shadow banking lending. As far as I can -- as far as I understand, the provincial lending is about RMB10.7 trillion. Within that RMB10.7 trillion, probably about probably about 70% of those can be serviced by the infrastructure, the cash flow from the infrastructure projects.

Another 25% of those have a little bit of issue that is to a certain extent -- let's say if the monthly repayment is about 100, they can probably service about 70 to 80. And then the rest of the 5% have a little bit of a problem.

So it's not the RMB10.7 trillion. If you take all of that into account, it's actually a pretty small number.

As far as shadow banking is concerned, the information that we have gathered is that it would be between RMB3 trillion to RMB4 trillion to begin with, and now it's actually lower. Out there, certain investigation and so forth, it's actually anywhere around RMB1 trillion to RMB1.5 trillion. So it's not RMB3 trillion to RMB4 trillion, it's actually RMB1 trillion to RMB1.5 trillion.

So the issues; we see a lot of press, we see a lot of media on this. And I think that as far as the media is concerned, we should dampen this sensationalism a bit.

So as far as RMB business, I'll get Gordon to talk a little bit more.

Gordon French, Head of Global Markets, Asia-Pacific

Yes. As Peter said, we're spending a lot of time and effort on building the kit, working on the plumbing and the infrastructure. We talked about our positioning in dim sum, but it's also the leading market maker in CNH FX, which is obviously very important to us, given that our plan is to be the leading international bank for trade and connecting customers worldwide.

So the markets are active at the moment. We expect them to be a lot more active. Peter mentioned the potential internationalization of the RMB and it becoming a reserve currency at some point. So a lot of time and effort going into these areas, both including products, hedging products, FX, wealth management, dim sum obviously across the piece, whereby we expect not only to be making meaningful sums in the near term, but obviously in the medium to longer term very material amounts of money from these activities as a whole.

Tom Rayner, Exane BNP Paribas

Okay, thanks very much.

Peter Wong, Chief Executive, Asia-Pacific

All right. Thank you very much for joining and I just want to say something in conclusion.

We believe that Asia's emerging markets will grow at a reduced but encouraging rate through 2012. We expect a soft landing for China, the region's economic engine. And despite considerable political, economic and regulatory uncertainty, HSBC is well positioned to grow lending and generate higher fee income in Asia.

We had a solid first nine months of the year, and we have set out challenging but achievable plans to increase revenue and control costs going forward.

So ladies and gentlemen, thank you very much.

Operator

That will conclude today's conference call. Thank you for your participation, ladies and gentlemen. You may now disconnect.