Transcript

Investor and Analyst Call

Q2 Results

5 August 2019, 07.30am BST

Corporate participants:
Mark Tucker, Group Chairman
Ewen Stevenson, Group Chief Financial Officer

Mark Tucker

Good morning to everybody in London and good afternoon in Hong Kong, and welcome to the 2019 HSBC interim results call. With me today is Ewen Stevenson, Group Chief Financial Officer. You will have all seen by now our announcement regarding John Flint, who is by mutual agreement with the Board stepping down as Group Chief Executive. I will say a few words about that, and then hand over to Ewen, and Ewen will talk about our good interim results, which are a credit to John, the management team, and the 238,000 HSBC people.

The Bank is very grateful to John for his personal commitment, dedication, and the significant contribution he has made over his long career at HSBC. HSBC is clearly, as you have seen by today's results, in a strong position to deliver on its strategy. However, in the increasingly complex and challenging global environment in which the Bank operates, the Board believes that a change is needed to make the most of the significant opportunities ahead of us. For this reason we've initiated a process to find a new Group Chief Executive, and will be considering both internal and external candidates.

Noel Quinn has agreed to serve as Interim Group Chief Executive until a successor is appointed. Noel has been the Chief Executive of Global Commercial Banking since 2015. He is a proven leader, with a strong track record of achieving business success, excellent client relationships, and deep global experience. I'm sure we'll come back to this later, and I'm happy to answer any questions, but I think more importantly to go to Ewen now and the interim results.

Ewen Stevenson

Thanks, Mark. Morning or afternoon, all. I'm now going to quickly step through the slide pack, which you can find on our Investor Relations website. Turning to slide one, on the key messages, we continued to make good progress in the first half. Reported profits before tax were $12.4 billion. That's up 16% on the first half of last year, and adjusted profits before tax were up 7%.

We're pleased with the progress we're making on improved cost control, which has helped drive a much stronger jaws performance. Our return on tangible equity in the first half was 11.2%. Results were flattered by $828 million dilution gain from the merger of Saudi British Bank and Alawwal Bank, but this largely offset a large, non-recurring PPI charge and some severance costs. Our Core Tier 1 ratio remained stable at the first quarter at 14.3%. We're announcing today a billion dollar buyback, and that's part of our ongoing commitment to neutralise scrip dividends over time.

On outlook, we continue to progress towards our 2020 return on tangible equity target, but the interest rate outlook has softened relative to the first quarter, and geopolitical risks have heightened across many of our major markets. In response to this we're actively managing costs and investment growth in order to respond to a more challenged revenue outlook.

Looking at slide two and progress against our eight strategic priorities, we're making good progress against most of these. To call out a few, Asia continues to grow well for us, with revenue growth in the first half of 9%. We're continuing to build leadership in sustainable finance, an area where we see considerable growth opportunity over the coming years, and our UK ring-fenced bank is growing in both volumes and revenues. We continue to take market share in both mortgages and commercial banking. However, one priority where we're not on track is the turnaround of our US business. While good underlying progress has been made on costs and capital – costs were down 7% in the second quarter relative to the second quarter in 2018 and we got CCAR approval to dividend a further $1.8 billion of capital back to the Group – the US revenue outlook has become more challenged in recent months. There's been a sizeable shift in US dollar interest rate expectations, so we're now not expecting to achieve a 6% return on tangible equity in 2020. But we recognise that current returns in the US are not acceptable, and it remains a firm priority of ours to improve these.

Turning to outlook more generally on slide three, consistent with what I've just said about our US franchise, the interest rate outlook for the dollar bloc has shifted in recent months. In addition, geopolitical risks have risen across many of our major markets, which creates additional volatility around our central base case. In the very near term Brexit remains unresolved, which skewed risk to the downside, and trade tensions between US and China are progressively impacting the growth outlook for both markets. We're responding to this change revenue outlook with a tightened focus on costs. We've slowed investment growth, and some of which you can see reflected in today's results.

Going into the detail now on our results on slide four, in the first half we had adjusted revenue growth of 8%, and this excludes the dilution gain from the Saudi merger. Cost control has improved; first half cost growth was 3.5%; that's down from 5.6% for the full year in 2018. And returns were up in the first half; a return on tangible equity of 11.2%, driving earnings per share up 6 cents to 42 cents.

On slide five we continue to see robust top-line growth, up 7% in the second quarter and up 8% in the first half. Looking across the four global businesses, in Retail Banking and Wealth Management overall revenues were up 14% in the second quarter. In Retail Banking revenues were up 10%, driven by a good lending growth and higher deposit margins. Our Insurance franchise had a strong quarter, with the value of new business up 19%. Commercial Banking continued to grow strongly in the second quarter, with 8% revenue growth, but given the impact of interest rates and lower global trade flows we do expect second half growth to moderate. In Global Banking and Markets revenues were down 8% in the second quarter and down 3% in the first half. Most of our transaction franchises continue to perform strongly; Securities Services, GLCM and GTRF had combined revenue growth in the second quarter of 10%, but this was offset by Global Markets, down 11%, and Global Banking, down 8%. Global Private Banking had another good quarter; revenues up 8%. Total net new money inflows in the first half were $14 billion; that is more than double the run rate we saw in the first half of 2018. In Corporate Centre revenues were up $185 million on the second quarter in 2018. Favourable valuation differences on long term debt and associated swaps, together with reduced losses on legacy portfolios, more than offset the expected lower revenues from Balance Sheet Management.

Turning to the next slide, net interest margin was up 3 basis points, to 162 basis points in the second quarter. Average interest earning assets grew by 1%, and net interest income by 5%. Underlying this, in Asia net interest margin improved by 6 basis points. One month HIBOR in the second quarter was much more supportive, up 70 basis points to an average of 2% across the quarter. In the UK ring-fenced bank NIM declined by 8 basis points in the quarter, driven by a combination of a changed asset mix towards mortgages, the continued issuance of MREL, and the start of wholesale funding programmes.

On slide seven we are now showing progress on better cost control. Cost growth in the first half was 3.5%, down from 5.6% in the full-year 2018. Significant work sits behind that. We've taken the decision to materially shift the 2020 cost run rate, and so we've been working hard across the Bank on various cost plans, some of which you see reflected in today's results. Severance costs were $199 million in the second quarter and $248 million in the first half. For the full year we expect total severance costs in the order of $650-700 million. The payback on this is good, with around one-for-one pre-tax annual savings, so we expect $650-700 million of pre-tax run rate benefits in full year 2020. Also note this quarter in significant items is a $559 million PPI charge. This includes a provision for the Official Receiver for its bankrupt customers' claims, and for the remainder it's a combination of modelling much higher information requests for July and August relative to the first half run rate, and the required 'auto conversion' of these requests into complaints.

Turning to slide eight, we invested a further $1.2 billion in the second quarter and we're on track to spend around $5 billion this year. That's up over 20% on 2018, and over a third on 2017. Given the changed outlook, we're now planning to spend around $14.5 to $15 billion over 2018-2020. On a currency adjusted basis that's towards the bottom end of the $15-17 billion range we announced last year. This should be put in perspective, though; we're spending around $100 million a week on investments, so we're talking about deferring less than one quarter's worth of investment spend across 2019 and 2020 combined. On what we're investing in, around half is focused on growth and enhancing digital capabilities, and the other half on productivity improvement and regulatory and mandatory investments.

On the next slide on credit, ECLs continued to perform in line with expectations, with credit charges of $555 million or 22 basis points in the second quarter. With $1.1 billion of credit charges in the first half, and from what we can see at this point, we remain comfortable with full-year 2019 consensus of $2.7 billion. I would however continue to caution on the UK in particular. It remains the market we're most focused on. UK provisioning will remain sensitive to forward economic guidance, which, given the uncertainty around Brexit, has considerable potential to diverge in the second half. Also note that we've changed the probability of an adverse trade scenario; it's now at 10%, resulting in a modestly higher trade economic uncertainty charge.

Turning to the next slide, our common equity tier 1 ratio remained stable at 14.3% during the second quarter. RWAs were up $6.5 billion in the second quarter, and up $20.7 billion in the first half. We expect full year RWAs to be broadly in line with the second quarter, resulting in an overall annual growth just above our 1-2% guidance range. As we've previously signalled, more of our RWA mitigation actions this year will fall into the second half. We're also announcing today a billion dollar buyback. This represents just over 10 basis points of common equity tier 1 to be deducted in the third quarter. We think this creates the right capital management balance between continuing to execute against our commitment to neutralise scrip issuance over the medium term while being appropriately conservative given Brexit uncertainties. Also note that our TNAV per share for the first half benefited by 10 cents per share. Our first quarter dividend will be accounted for when it is paid in the third quarter, so this is purely a timing difference on recognition.

To conclude, we've delivered a good set of numbers for the second quarter and the first half. We continue to show good top line volume and revenue growth. We've made real progress in moderating cost growth. Credit conditions remain below long-term trends, and both profits and returns are growing. The billion dollar buyback announcement is a clear signal of our continued commitment to active capital management, but given the changed dollar bloc US interest rate outlook we're now facing a weaker revenue outlook for most of our businesses, and we're operating with higher geopolitical uncertainty across various markets. So while we're pleased with these results, we recognise the outlook has softened, and we need to and are taking action to adjust for this.

Mark and I will now take your questions.

Martin Leitgeb, Goldman Sachs

Good morning. The first question is on Asia, just trying to understand what the announcements today might mean in terms of the broader strategy of the Group. I'm not sure whether this is the right timing or to what extent this can be answered at this stage, but just looking at the Group profitability coming from Hong Kong and UK retail, and obviously given the incremental disclosure on ring-fenced and non-ring-fenced it remains to be, what we can see, a meaningful driver in terms of profitability from the non-ring-fenced bank. So I was just wondering if you could comment where this – where we might be heading in terms of strategic direction, and what measures you might undertake, in particular in the non-ring-fenced bank in terms to improve profitability.

The second question is more with regard to capital management. Just looking at your disclosure for the ring-fenced bank it seems to be that there is a payout ratio of close to 100% in terms of payments to Holdings. How should we think about that capital contribution going forward for the UK ring-fenced bank being profitable, upstreaming the bulk of its profits? Is this essentially going to be the source to help the Group utilise scrip going forward? Thank you.

Ewen Stevenson

I think Mark will start on the first question, Martin, and then I'll add and I'll carry on after that.

Mark Tucker

Let me set context, and I think Ewen can give you more detail, Martin. I think the way we think about this is we've agreed the high level strategic priorities that shape of our business, and again, there is total alignment in the organisation and agreement on the strategic direction. These high level strategic priorities remain very firmly in place. Having said that, I think where we're looking to do more is realising and how we go about realising those priorities. I'll let Ewen give you a sense of how we're thinking about that.

Ewen Stevenson

Martin, in terms of the non-ring-fenced bank I would bucket it along with the US as well, geographically clearly our most challenged return businesses. We have about 30% of our capital invested across the non-ring-fenced bank and in the US. The two businesses combined are achieving extremely low returns at the moment. In terms of commonality across the two, we've got loss-making or break-even retail businesses in the US and France. We've got multi-year plans to turn them around, which we're continuing to invest in. Wholesale banking obviously faced quite challenged market conditions, both in the US and particularly in Europe in the first half, and I think the Commercial Bank across both markets is actually performing okay. Both markets have a cost problem; cost income ratios in the mid 80's, so a focus on cost is a priority in the US.

We also have an issue with excess capital sitting in the US business. I think the CCAR results from about a month or so ago is another important step in that, getting about $1.8 billion out of our US business in the coming months, and I would say with some of the customer selection too we are looking hard at that, because we've still got a lot of the corporate customers where we're not earning a sufficient return, and we are trying to recycle capital away from those relationships, either reprice them or recycle them into better returning customers. Overall I think we would ask that people be patient. These turnarounds across these two markets are going to take time, but we recognise that the type of returns that we're achieving at the moment are not acceptable and need to be driven higher.

On the ring-fenced bank I wouldn't read in or try and overly be too complex about dividend flows across the Group. We think we've got adequate dividend serviceability and it would have no impact on our ability to continue to commit to neutralising the scrip dividend over time. I think the overall challenge at the Group level is a more complex issue. We've committed to keeping our common equity tier 1 above 14%, which we think remains appropriate. You'll see in our Pillar 3 document some additional disclosures today around MREL and where it sits across the Group, and double leverage. That's another thing that we're managing too, and we're also cognisant of the fact that we've got some potential capital challenges on the horizon, Basel III reform being one, and the other is we're waiting to see where we end up on G-SIB buffers at the end of the year. If we were to bump up a buffer – which is not clear at the moment – that would come into effect on 1 January 2021, but in terms of the ring-fenced bank cash flow, really no impact in terms of our dividend serviceability in the Group.

Joseph Dickerson, Jefferies

Hi, good morning. I guess just a couple of quick questions. Mark, you know the region very well, and alluding to some of the outlook comments on geopolitical risk would you consider the role of Chief Executive of HSBC? It seems like somebody with your experience in the region would be welcome at this point.

Secondly on the US, just given the lack of progress on returns, I appreciated your point, Ewen; you can look to take out cost or put in further cost efficiencies, but is there a broader strategic issue with the scale of the business and the mix of business in the US? Would some sort of M&A or divestiture be more appropriate in the medium term? Thanks.

Mark Tucker

Thanks for the question. The answer is under no circumstances. I spent 32 years as a CEO, and that is a decent enough innings. I have made a very conscious decision to be a non-executive Chairman, and that's what I intend to be. I think we have people with much greater capability and much youth on their side that can do a materially better job, so I hope that's fairly clear.

Joseph Dickerson

Very clear.

Ewen Stevenson

On the US, Joseph, I don't think it's a scale issue. There are plenty of businesses in the US with a similar scale to us earning much better returns. That's a combination of needing to drive higher revenues, reduce costs, and be more efficient on capital. I don't think it's a scale issue. We don't think we need M&A to solve our returns problems in the US, and nor do we think the market would be particularly supportive of M&A.

Equally we think it's critical that we do have a meaningful presence in the US. It's critical to our global business, and therefore I don't think you should expect us to be reducing our presence in the US.

Chris Manners, Barclays

Hey, good morning. So two questions, if I might. The first one was just to follow up on the G-SIB comments that you were making. I saw that page 99 on your derivative disclosure showed your derivative notional was up about $5 trillion half on half, and I guess that was one of the bits that looked like it could push your G-SIB score north of the magic 430. If you do trip into the next G-SIB bucket, either this time or in the future, should we be adding 50 bps to that 14% capital target or should we assume that that's encapsulated within there?

And then the second question was just a net interest margin question. Obviously good improvement in the quarter, up 3 basis points, a lot of that coming from the move in HIBOR, and as you flagged the UK was a bit weaker. How should we think about that dynamic? Obviously HIBOR's come down about 100 basis points from the peak but it's still running around the level that it was for the average of Q2. Maybe you could walk us through the net interest margin drivers, and whether we should be expecting slippage over the next several quarters from the 162, and that's the revenue headwind – one of the revenue headwinds you're talking about, or whether we would actually sit around a sustained level.

Ewen Stevenson

On G-SIB we're comfortable with our 14% target for the time being. I don't think if we went up a bucket, from what we can see today, that it would change our view on what the appropriate common equity tier 1 ratio is for us. Remember, it's adding 50 basis points to our regulatory number, and not our target, so I think for the time being we're very comfortable that the 14% target is appropriate. The G-SIB indicators are a bit of blunt instrument, as you know. It's a set of basic indicators. We have much more sophisticated modelling on how we manage our capital base. There was a technical reason in relation to the increase in derivatives, but we've got some systems improvements going through, so you should expect that number to come down.

On NIM, you know this is my favourite debate with you all every quarter, and how much I love not forecasting NIM, but given the recent rate cut in the US and given the likely direction of further – at least another rate cut this year, I think you should all expect NIM to come down. HIBOR, for the time being at least, has been relatively uncorrelated with US dollar interest rates, but at some point if it connects would be expected to come down as well. Overall I think I would be unsurprised if NIM was lower at the end of the year.

Tom Rayner, Numis

Hi, good morning. Because you love it so much, Ewen, I thought I'll ask you another question on NIM, if that's okay. I see as one of the negative offsets to the positive HIBOR was deposit mix shifting towards interest-bearing. I think after Q1 you said that this had largely stopped in Hong Kong, so I'm just wondering are we now seeing deposit mix issues elsewhere, such as in the UK?

I have a second question just more on strategy, which may be for Mark as well. I don't know how you want to deal with that.

Ewen Stevenson

Do you want to ask that question now?

Tom Rayner

Yeah, it's just when I look at what changed today it doesn't feel like that dramatic in that the revenue environment's worse, you're probably going to be doing a couple of percent per annum less revenue growth, and therefore you've got to find a bit more cost to take out, yet we're changing the Chief Executive, and I'm just wondering if there's something else; a broader, strategic – and I know you mentioned a few things, but a more strategic view which maybe John did not agree with, and therefore this is – we are going to see some change in direction, whether it's Wealth Management growth or – I just wonder if there's something more to it that you can add or Mark maybe could add some more colour to. Thanks.

Ewen Stevenson

Yeah, so on NIM – look, it would be unsurprising if as HIBOR goes up that you would see some shift out of on-demand current accounts and savings products, so I think the nature of how that migrates through the remainder of the year will depend very much on the direction of interest rates. I think in the UK there were a few things going on. There was a deposit campaign at some point. We had also the – as I said earlier, we're continuing to issue MREL and the UK ring-fenced back had very non-diversified funding because it was only set up recently, so we started a few wholesale funding programmes as well.

Just a word on costs, and then I'll hand over to Mark on the strategic point. You alluded to the fact of lower cost growth. I think previously we've guided to "low-to-mid single digit" cost growth. I think if you were to read that today I would change "low" to "very low", and "mid" to "low", so "very low to low" cost growth from here is what we're targeting.

Mark Tucker

Let me give you a sense, and starting with the clear point, there has been no disagreement on strategy. I think everybody in the company is clearly aligned on these high level strategic priorities. The element of where we have work to do is how we go about realising those priorities. I think across a number of elements – of which Ewen has covered some off already – amongst growth and how we make the most of our opportunities, be it regionally or locally, looking at the trade side, particularly how we extract value where we're strong. On resource allocation; again, how we best allocate people and capital, which again, Ewen has clearly spelt out. And against execution; again, in simplifying and speeding up execution. Those are the elements where I think going into an environment which we feel will become increasingly complex and challenging, we feel Noel will bring the right perspective and experience to this. We will give him full accountability and responsibility for taking the Group forward.

Edward Firth, KBW

Good morning, everybody. I guess this is a question for Mark, and it's partly an area that's been covered, but you've talked a lot in the past about how the US business, and I guess the European business as well, is – we shouldn't look at it as stand-alone, because actually there's a lot of interlinking businesses elsewhere, particularly in Asia, which actually make it a far more acceptable return than we might think. I suppose my first question is: do you still believe that, and do you agree with that as a sort of broad concept?

I guess as a second point then, if that is the case, what can you point to which can make us assume that these businesses can get any better? It must be now 10 years since either of those businesses have made anywhere near their cost of equity returns, but there must have been four or five management teams in each of them. It's not obvious to me in this environment what we can see that – or what you can point to us which makes you believe that these will get to a cost of equity return.

Mark Tucker

That is a joint question, Ed. I think in terms of belief in the network, belief in the exporting of opportunities across that network, the US is a massive exporter of business across the network, and I think is the most significant element of the Group in terms of exporting value. I think the power of the Group and the network, and the interlinkages, the understanding of the trade corridors is absolutely fundamental and I think gives us an advantage that no other bank on the planet has, and therefore it's something that we do view as a material strength, and we can get better at it in terms of how we think about some of the different elements of the region, how we think about trade, how we think about extracting value where we're strong.

But fundamentally I think the point you make in terms of Europe and the US in terms of extraction of value are two areas of immense focus for us. I think Ewen has taken you through the US and I think can take you through Europe. I think there are many elements that we can do better on in terms of both resource allocation and execution, which I think we're on the path to do. I think we need to speed some of this stuff up. Ewen, do you just want to talk about Europe a little bit as opposed to the US?

Ewen Stevenson

Europe – the non-ring-fenced bank – is a combination of UK/European wholesale and retail commercial banking in France, and commercial banking elsewhere – largely France and Germany – in continental Europe. The first thing I'd say about Europe is we're not alone. You all know that returns for European banking are weak, not helped by the interest rate outlook. We do think that there is significant upside from where we're currently sitting in terms of returns. There is a significant cost issue in the non-ring-fenced bank that we are looking hard at. It's got a cost income ratio in the mid 80's; we think we can reduce that materially. There is a customer selection issue that I think we have in Europe, where many of the customer relationships are earning well below cost of capital returns, and we need to be harder with those relationships, and either reprice them or exit those relationships.

I think we need to stay very, very focused on where we have a right to win and a right to be great, which is customers in Europe who want to do business elsewhere in the world, particularly in the Middle East and Asia, and vice versa. When we look at the travails of a number of our European peers we're confident that we can drive the business to higher returns where we have some unique competitive advantages. But as I said, it's not going to be quick, but I think we recognise that current returns are unacceptable and we need to improve them.

Edward Firth

Thanks. I mean is there any way at some point you can give us greater clarity on some numbers around what the US franchise creates in the Group as a whole, or customers in the US create in the Group as a whole? It's very difficult externally to really have any…

Ewen Stevenson

Yeah, I'm sure we can – I'll talk to Richard O'Connor and the team. I'm sure there's stuff that we can do to help explain that better.

Guy Stebbings, Exane BNP Paribas

Good morning, gentlemen. My first question, if I could just come back to the CEO and the changes there, because if I'm honest I'm struggling a little bit to really understand what has specifically changed, and if it's just execution and resource allocation why John couldn't have delivered against that and why the interim change in role for Noel sort of changes what he can contribute from his current position, if you like. Can we read anything into the fact that Global Banking and Markets was probably the weaker performing division in the period and most others were perhaps better than expected? Is that a focus or is it more around a focus on costs?

And then just a second question was on buyback. The one billion won't neutralise the scrip on an annualised basis, and I think you mentioned uncertainties around Brexit as a factor. If we were to see a more positive outlook regarding Brexit, should we take your comments to mean your view on capital is such that you should be able to do further buybacks at that stage, and underlying capital generation is still sufficient to neutralise the scrip? Thanks.

Mark Tucker

Thanks, Guy. Let me take the first part and hand the second to Ewen. I think we go back to what we've said. We're in a strong position to deliver on strategy but the environment is changing, in our view materially. It's becoming more complex, becoming more challenging, and we feel that a change – both we and John feel a change is needed to really make the most of the opportunities ahead of us, and this is a decision about the future and how we see the future. The realisation of those high level strategic priorities we feel needs a different approach, and I think the elements that Noel can bring to that we view are significant and different enough to warrant the action we've taken.

Ewen Stevenson

On the buyback we openly acknowledge that a billion-dollar buyback will be insufficient to neutralise the scrip for this year. I guess what we said is we remain committed to the medium-term target to neutralise it. I don't think you should expect that we wake up at the end of Q3 results with a more favourable Brexit outcome, that we'll be back doing more buybacks this year. I think we'll take another view at the beginning of 2020 as part of the full year results.

Manus Costello, Autonomous

Good morning. I had a couple of questions, please. Firstly, given the focus on growth which you talked about, Mark, do you think your payout ratio of over 70% is still appropriate? We've seen a number of banks with payout ratios in that area look to cut it. I wonder if that's part of a strategic rethink that you might have with a new CEO if the focus is going to be on growth, and RWA efficiencies start to fade.

My second question is around the complex environment that you're talking about. There's been some press reports that HSBC could be placed on a list of unreliable entities by the Chinese government. I wondered if you think there's any risk of that for HSBC and if that plays into your thinking about a complex environment which you're concerned about.

Mark Tucker

I think Ewen is probably best to talk about the payout ratio and growth.

Ewen Stevenson

On the payout ratio, 51 cents per share is a high payout ratio. It was over 100 percent in 2017, and we've been migrating down from that. That's why we've been very deliberate in our language of saying we expect to keep the dividend stable, and as returns improve we expect that payout ratio to fall materially, and to fall to a level where we think we can both fund the dividend, neutralise the scrip, and continue to grow in the way that we want to grow.

I think the balancing item at the moment is the fact that we still see significant opportunity to both improve models and optimise RWAs with some customer relationships. We do expect in the second half of the year to keep RWAs neutral while still growing credit assets, and we still think that we've got potential over 2020 and 2021 to see further material RWA mitigation actions. At that point we'll have returns higher and that will allow us to both fund the 51 cent dividend and grow in the way that we want to grow.

Mark Tucker

Let me take the second part. I think, as you know, we've been in China for over 153 years and we have a clear and long-term commitment to China, and if you look at what we're doing in terms of China's growth priorities, we're actively participating in the opening of China's financial markets, we're actively participating in the Belt and Road Initiative, we're actively participating in the development of the Greater Bay Area, we're actively participating in the internationalisation of the renminbi, and we're actively participating in the growth of green finance, and we look forward to continuing to support China's growth and economic prosperity.

Our business operations in China continue as normal and we are confident about our China business, and we don't comment on speculation.

Alastair Ryan, Bank of America

Morning. Thank you. A question for the Chairman, really. What's the risk of, while you're trying to move things forward in the longer term, that there's an extended period of something of a hiatus between a new CEO coming in now, getting his feet under the table, and then possibly somebody different a few months from now, which takes some time to get their feet under the table? How does one avoid that risk? Thank you.

Mark Tucker

In our view, that's not a risk. Noel has been given full authority to take things forward in the way that allow him the flexibility to make the decisions that he and executive team view as the best for the business. So, on that basis, there should be no risk that there's going to be any hiatus period. I think we're going to get straight in and Noel understands that we need to move with pace, ambition and decisiveness.

Raul Sinha, JP Morgan

Hi. Thanks for taking my questions. I hope you don't mind if I ask three. The first one, I was wondering if you could comment a little bit on Hong Kong in terms of the outlook for the second half and also your July performance, if there's anything there. It doesn't seem like there's anything in the numbers itself that prompted concern, but it would be useful to get a comment along those lines.

The second one is on the RoTE and the decision to continue to target above 11% in 2020. Obviously, as you know, consensus is around 10%. In the first half of the year, if you take the gains out, you're obviously well below the 11 on my numbers, and obviously you're flagging a difficult second half. So I was just wondering again what I might be missing on the 11%.

The third one, maybe more for Ewen, actually, on the Basel III reform, I mean, you are now quite different from your peers in the sense that we don't actually get any indication about the potential RWA inflation for HSBC and I was wondering if you might be able to put a range, at least, in terms of how much we can expect. Thank you.

Ewen Stevenson

Yeah. So look, on Hong Kong, as you've observed, you don't really see it at all on the first half numbers. Numbers were good. Second quarter was good. Revenues were up significantly, profits were up significantly. Do we expect some impact in the second half? Yeah, inevitably there will be. If the current situation continues for a prolonged period of time it will impact confidence. It probably will have some impact on the retail sector. Yeah, a big driver of profitability, though, in the second half, will be where does HIBOR go, and at the moment it's remaining comfortably higher than where it was in first quarter, which flowed through into good second quarter results. So it's difficult to put all that together and say what does that mean for Hong Kong profitability in the second half, but for the time being we're continuing to see decent growth and decent profit growth.

On the RoTE, a few things. I think it's slightly unfair just to back out the Saudi dilution gain in the first half. If you do that you should probably add back the PPI charge and add back the severance costs, which broadly get you back to the same point. However, that wasn't the bank levy, as you know, that hits in Q4. Yes, we look at consensus. You're right, consensus is currently sitting below 10%. If you think about the mix there's a slightly different – we're more bullish, I think, on revenue growth than the street currently, particularly in non-interest income and volumes. On costs, I think, as you can see today, we're setting a much more rigorous approach on cost management. I'm pretty pleased with the progress we've made in the first half. We took cost growth down by 2 percentage points from the run rate last year and, as I said earlier, I think we're managing for very low to low cost growth from here over the next 18 months.

There's a technical thing on the tax rate. I think we're continuing to generate more of our earnings in lower tax jurisdictions, so the effective tax rate being modelled by the street is probably 1-2 percentage points too high. And I think there's a partial offset in the interest rate environment, we think, where probably 2020 consensus on credit cost currently is potentially sitting marginally too high as well, which is an offset of the lower interest rate environment and the impact on NIM. But I think you can do the maths and figure out that we're obviously substantially more bullish across a number of those lines to get to the gap between 10 and 11%.

On Basel III reform, I sort of openly acknowledge we've been a bit shy on this. It really is quite a complex story for us. We operate in 65 markets. We're dependent on an enormous amount of national discretions. We don't know whether in we're solving in the UK for UK national discretion or European national discretion until we understand the course of Brexit. As we look at large parts of Global Banking and Markets that are impacted by Basel reform, I think as time goes by we get increasingly more confident about being able to offset some of the more negative impacts of Basel reform. So, look, as soon as we feel sort of confident within a range, we'll tell you. We would continue to say we do expect some impact of Basel reform, so please don't take from my comments that this is going to be an answer of zero. We don't think it will be. But, relative to even when I joined six months ago, I think we've become more confident about our ability to offset some of the more negative impacts of Basel. But, as soon as we feel confident about a range, we'll tell you. My concern at the moment is we would just be misleading you.

Fahed Kunwar, Redburn

Hi. Morning. Thanks for taking my questions. I just had a question on the RWA reforms and the payout ratio, and I think you've given a number before of around – I think it was like $12 or $13 billion of model optimisation that was sitting with the PRA ready for approval. Is it these optimisations that are coming through in the second half of the year to give you confidence that your risk rates will be flat and whilst you're growing the credit book?

And just a second question on that, kind of more high level, how many more as optimisations are coming through? It feels like as margins are coming down, or at least under pressure, growing your balance sheet is going to be a key way of hitting that revenue target, which you say you're more bullish on than consensus, but obviously you're stuck on quite a high payout ratio as well. I think the previous CEO was very much wedded to the dividend. If it came to a point of thinking about a high payout ratio dividend versus loan growth, how do you think about which one you would prioritise if margins stay as difficult as they are at the moment? Thanks.

Ewen Stevenson

On the last point I don't think we feel we need to have that discussion for the moment, so we're not having it. On RWA growth, I think modelling improvements is part of the answer. There's also a significant part which is to do with recycling RWAs out of customer relationships where we're not achieving acceptable returns. We're continuing to run off a considerably smaller Legacy Credit portfolio. So it's not just all model improvements and those model improvements are not just with the PRA. They sit across a number of regulators globally. But overall it's something that we track religiously. I run a meeting every month where we go through all of the RWA mitigation actions and have a pretty confident view about our ability to deliver within – accepting that some of that is obviously beyond our control, such as timing of regulatory approval.

Fahed Kunwar

On the second one, could I just ask – I know you won't give the answer to this – on the payout ratio, how… Obviously you want to grow into a lower payout ratio; I understand that. How long would you accept the payout ratio as high as it is right now before you would ask that question and have that discussion?

Ewen Stevenson

Well I think, as you can see this year, we've continued to maintain the payout ratio that we're maintaining and we've grown our common equity tier 1 ratio by 30 basis points, so we think for the time being we can continue to commit to the 51 cent dividend and it's not a topic that we spend any time debating internally.

Magdalena Stoklosa, Morgan Stanley

Three quick questions from me. The first one is about the details of your efficiency programme. We have seen the announcement, 650-700 million. Could you give us a sense where it's coming from and how much of it would you consider business as usual and how much of it would you consider as more ambitious restructuring, and to a degree whether you see that programme potentially being bigger as the revenue pressures come through? So that's question number one.

Question number two: your investment spend that you have shown us still has a lot of digitalisation business investment, but it also has a lot of regulatory investment there too. If you were to guess your next investment cycle, would you see that amount of regulatory spend too, or do you think you're at the end of that tremendous regulatory inflation you've seen over the last couple of years and continuously investing in?

And my last one is really a little bit coming back to Hong Kong. Of course, we have seen the results given where the HIBOR was, but when you actually look at your underlying client activity over the last quarter and now, what do you see transactionally from the perspective of the pipelines? Can you already see the declines of confidence, the less of the activity, given what the GDP has done and of course what is happening politically? Thanks very much.

Ewen Stevenson

On the last one if you look at underlying growth trends, loan growth was 7% in the first half, so that doesn't feel like customer activity has been particularly impacted at this point. If you look at our new peer-to-peer app, PayMe, we think we're now getting over 50% of peer-to-peer wallet share. We've just launched the B2C version of that. We've got over 3,000 merchants signed up, so it doesn't feel like in Hong Kong that the underlying volume growth is being unduly affected. Look, in context, in terms of the operational impacts on the business, there's been a few localised branch closures for very short periods of time, so fundamentally I think Hong Kong remains robust.

On investment spend, firstly just to note investment spend in the first six months was up 17% on the first six months of last year. Regulatory spend, I would love to sit here and say we're now at peak regulatory spend. I do genuinely think that's probably the case, but I've been proven wrong on that in the past. But if we look at the big reform programmes we have ahead of us at the moment, I guess things like FRTB, Basel III reform, a new IFRS 17 accounting policy coming, we've got LIBOR transition, and there is still ongoing work on recovery and resolution planning. There doesn't seem to be anything new getting added to the pipe, but certainly for the next two to three years I think we're going to continue to be in peak regulatory spend until we're through the bulk of some of those programmes.

Then on the efficiency programme, I think the bulk of it I would describe as non-BAU. That's why we're taking 650-700 million dollars of severance costs. Remember, across most parts of our business we have a 5-10% natural attrition rate, so we can manage headcount down normally through just being much more selective on rehiring. This programme is about 4% of our overall wage cost for less than 2% of headcount, so you can read into that that it is at the more senior levels of the organisation and therefore more strategic in terms of its focus, and I wouldn't pick out any particular area of the Bank. It's been a pretty broad programme impacting most parts of the Bank. Most of the people who are subject to this programme have been notified, but not all, and hence our reluctance to go into specific details on specific areas at this point.

Magdalena Stoklosa

But, Ewen, is it fair to say that it is – that there's a disproportionate level which is impacting the business headcount or more of the central functions headcount?

Ewen Stevenson

I think it's been across the piece. My own area, we've done some. Most areas of the Bank have been involved in cutting headcount. I mean, overall, I think we recognised, you know, several months ago that the revenue outlook that we had anticipated in June last year when we set up the strategy was going to be different, and therefore we needed to get to the 11% in a very different way. We needed to assume that revenue growth was going to be lower and therefore we needed to materially shift down the cost growth. So, you know, we grew costs in 2018 at 5.6% and we're now signalling the fact that, for the next 18 months, we expect cost growth to be in the very low single digits. So we do think we have taken pretty decisive action to shift that cost run rate.

Mark Tucker

Let me just say a few words to end the call. Thank you everybody for being on the call. I think this is a great organisation. As you've heard today, we have a strong business, we have committed people and we have incredible opportunities. The board believes a change is needed to make the most of those opportunities ahead and it's the role of the board to make those decisions, and I think we have acted in a way clearly and decisively, from a position of strength, with agreement, with good results behind us, with a clear strategy, with very good bench strength. But this is a decision, as I said early on, about the future, and we believe that with Noel coming in he the brings pace, ambition, and decisiveness which are absolutely essential to capitalise on the opportunities ahead.

So thank you again for your time this morning. Thank you for your questions and I'm sure there'll be follow ups.

Ewen Stevenson

Thanks a lot.

Forward-looking statements

This presentation and subsequent discussion may contain certain forward-looking statements with respect to the financial condition, results of operations, capital position and business of the Group. These forward-looking statements represent the Group's expectations or beliefs concerning future events and involve known and unknown risks and uncertainty that could cause actual results, performance or events to differ materially from those expressed or implied in such statements. Additional detailed information concerning important factors that could cause actual results to differ materially is available in our Interim Report. Past performance cannot be relied on as a guide to future performance. This presentation contains non-GAAP financial information. Reconciliation of non-GAAP financial measurements to the most directly comparable measures under GAAP are provided in the 'reconciliations of non-GAAP financial measures' supplement available at www.hsbc.com.