Transcript

Analyst and Investor Call

Q1 Results Announcement

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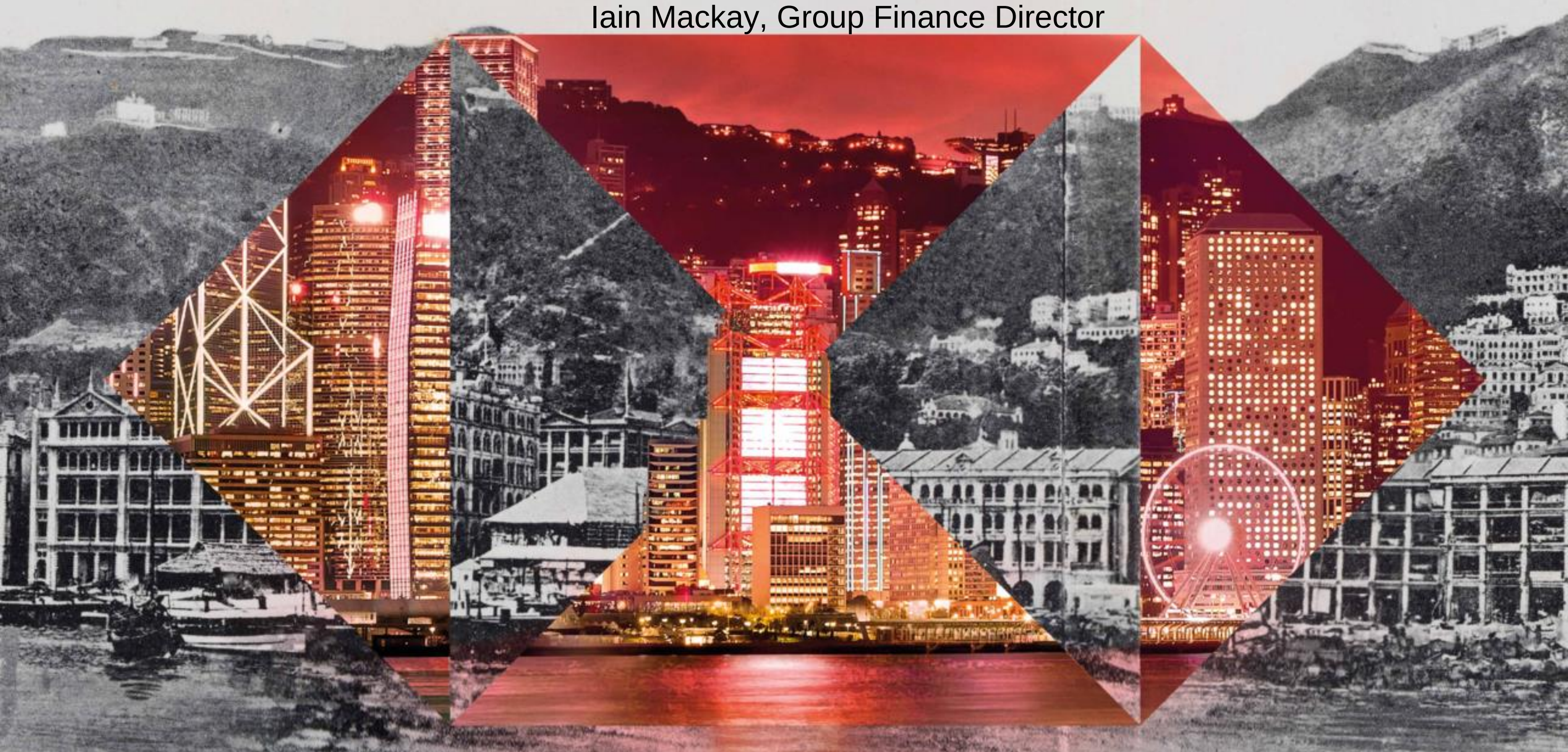
Corporate participants

John Flint, Group Chief Executive

Iain Mackay, Group Finance Director



HSBC

John Flint, Group Chief Executive

Good morning from London, good afternoon to everyone in Hong Kong, and welcome to our first quarter results call. I'll pass over to Iain shortly, but let me begin by saying that we've had a promising start of the year. Our global businesses have maintained their momentum, winning new business and continuing to benefit from interest rate rises and economic growth, particularly in Asia. We see plenty of opportunities to grow the business in the year ahead and we are investing to capture that growth. We continue to manage the business to achieve positive jaws for the full year, and have every intention of achieving that aim.

With that I'll hand over to Iain to take the rest of the call, before we go into Q&A.

Iain Mackay, Group Finance Director

Thanks John. HSBC did reasonably well in the first three months relative to a strong performance in the same period last year. Adjusted revenue of $13.9 billion was up 3% on last year's first quarter.

Retail Banking and Wealth Management and Commercial Banking had very good quarters, with both benefitting from wider deposit spreads and increased balances. Global Banking and Markets adjusted revenue was stable, as growth in transaction banking and Equities balanced the impact of reduced client activity on our fixed income businesses. Global Private Banking revenue was up on last year's first quarter due to increased client activity and the impact of wider spreads. We continued to grow lending in the quarter, particularly in Commercial Banking in Hong Kong and the UK, and in UK mortgages.

Our adjusted costs were 8% higher than last year's first quarter, as we invested to capture and support market share growth in our home markets and across our network, and to improve our technology platforms and digitisation programmes.

As a consequence, adjusted profit before tax of $6 billion was down by 3%. As John said, we remain committed to achieving positive jaws for the full year.

Our Common Equity Tier 1 ratio was unchanged from the year end at 14.5%, and we have this morning announced that we intend to initiate a share buy-back of up to $2 billion, which we expect to commence shortly. In light of the growth opportunities we currently see, we expect this to be the only share buy-back we announce in 2018.

Looking quickly at some key metrics for the first quarter: The reported return on average ordinary shareholders' equity was 7.5%; the reported return on average tangible equity was 8.4%; and we had a tangible net asset value per ordinary share of $7.29, up 21 cents on last year's first quarter.

Slide 3 provides detail on the items that take us from reported to adjusted. The major significant items were legal provisions related to US mortgage securitisation. You'll find more details of these adjustments in the appendix. The remainder of the presentation focuses on adjusted numbers.

Slide 4 breaks down adjusted profit before tax by global business and geography. Profits rose in three out of four global businesses and three out of five regions. Asia PBT continued to grow strongly, driven by excellent performances from Retail Banking and Wealth Management and Commercial Banking. The fall in Europe PBT was caused by a combination of reduced revenue in Global Banking and Markets and higher investment costs in Retail Banking and Wealth Management.

Slide 5 shows the positive revenue trends in our global businesses. First quarter revenue from our four global businesses was $854 million, or 6%, higher than last year's first quarter. I'll go through each business in more detail over the next few slides.

Slide 6 looks at Retail Banking and Wealth Management revenue, which grew by $456 million, or 9%, compared with the same period last year. Higher balances and higher interest rates drove a $347 million increase in deposit revenues, particularly in Hong Kong, the US and Mexico. Income from investment distribution increased by $223 million, reflecting higher sales of retail securities and mutual funds, mainly in

Hong Kong. We continued to grow both loans and deposits quarter-on-quarter and year-on-year. Customer lending rose by 8% and customer accounts increased by 4% compared with the same period last year.

As slide 7 shows, Commercial Banking revenue grew by $347 million, or 10%. Global Liquidity and Cash Management had another outstanding quarter, winning new business mandates and further growing operational balances. This, and the impact of wider spreads in Hong Kong and mainland China, helped GLCM grow revenue by 17%. Credit and lending revenue grew by 4% due to balance sheet growth in the UK and Hong Kong. Commercial Banking grew lending by 3% since the year-end, and by 8% compared with the same period last year, mainly in Hong Kong and the UK.

Global Banking and Markets revenue was stable compared with last year's strong first quarter. We saw positive momentum in the majority of business lines, including double-digit percentage revenue growth in both Global Liquidity and Cash Management and Securities Services. Global Banking revenue also grew by 6%, driven by higher lending and higher recoveries on restructured facilities. Within Global Markets, Foreign Exchange and Equities performed well, capitalising on increased market volatility in the quarter. Rates and Credit were impacted by lower client activity and a difficult trading environment, particularly in Europe. The drop in revenue in these business lines was also relative to a strong first quarter of 2017.

Global Private Banking revenue grew by $45 million, or 10%, compared with last year's first quarter. We grew client assets in Global Private Banking for the fifth consecutive quarter, and attracted positive inflows of $5.3 billion in our target markets.

Corporate Centre revenue fell by $515 million compared with the first quarter of 2017.
This was mainly due to: a $262 million reduction in Balance Sheet Management revenue, reflecting repositioning in anticipation of higher policy rates, lower reinvestment yields and lower portfolio gains; and a $176 million loss arising from mark-to-market movements on bond reclassification.

Slide 11 shows net interest margin. Net interest income of $7.5 billion was $369 million higher than last year's first quarter and broadly unchanged from the fourth quarter. Our net interest margin for Q1 was 1.67%, 4 basis points higher than for 2017. The yield in total interest earning assets rose by 18 basis points, while the cost of interest bearing liabilities rose by 14 basis points. Competition for good quality lending remains strong, balanced by higher yields on surplus liquidity. There are detailed slides on NIM and information on NII sensitivity analysis in the appendix.

Slide 12 looks at the expected credit losses and loan impairment charges. The credit environment remains stable in retail and wholesale sectors across the network. Adjusted expected credit losses of $170 million related mainly to unsecured lending in Retail Banking and Wealth Management. IFRS 9 is obviously a new standard, but the industry is adapting to it, and we expect more volatility between quarters than we have seen in the past. Our expected credit losses in the first quarter were unusually low, so shouldn't be taken as an indicator for the rest of the year.

Slide 13 looks at operating expenses, which were $624 million, or 8%, higher than the same period last year. You'll recall that we spent $3 billion on our costs-to-achieve programme last year, around $900 million of which were in last year's first quarter. That programme ended last December. We are continuing to invest to support growth, which is reflected in progress on revenue. In the first quarter, this meant investing to capture and support market share growth in our home markets and across our network, and to improve our technology platforms and further advance our digitisation programmes. Investment in tech platforms and digital programmes focussed on improving customer experience while also improving business efficiency.

In Retail Banking and Wealth Management, we are investing to grow market share in UK mortgages by expanding our intermediary channel to more than 30 brokers, covering 75 per cent of the market. We are also investing in our Cards businesses in mainland China and the US. In Global Banking and Markets, we made a number of strategic hires in our securities joint-venture in mainland China, and across our businesses in Global Markets. In Commercial Banking we are hiring more relationship managers to win new business in Hong Kong and mainland China, and updating HSBC*net*'s Trade transaction Tracker and our WeChat platform to improve the customer experience.

While our CTA programme has ended, we continue to see the benefit of additional savings, which totalled around $400 million in the quarter. We expect full-year operating expenses, excluding the bank levy, to be broadly in line with our 1Q annualised costs, subject to achieving full-year positive jaws.

Turning to capital, the Group's Common Equity Tier 1 ratio on 31 March was unchanged from year-end at 14.5%. Our Common Equity Tier One capital increased by $3.5 billion in the quarter, which included: $1.9 billion of favourable foreign currency translation differences; and $1.2 billion related to the day one impact of IFRS 9.

Slide 15 shows our Group return metrics. The return on average ordinary shareholders equity was 7.5% and the return on tangible shareholders' equity was 8.4%. Our return on tangible equity excluding significant items and the bank levy was 11.6%.

Our four main global businesses each achieved returns on tangible equity well above the Group's cost of equity.

I'll now hand back to John.

John Flint

Iain, thank you. So, in summary we've had a promising start to the year. Our strong capital and liquidity and robust balance sheet continue to support strong revenue growth from retail and corporate customers across our network. They've also enabled us to announce a further share buy-back of up to $2 billion. We've investing to grow revenue further and improve our digital capabilities while maintaining our cost discipline. We continue to focus on improving the returns of the group, and our commitment to positive jaws for the full year remains unchanged. We will update you on our strategy either at or before our half-year results in August, and we shall now take questions.

Manus Costello, Autonomous Research

I had a couple of questions about IFRS 9 please. Thank you for the disclosure you've given us here both on your fully loaded Core Tier 1 ratio and all the detail on the stages of the assets you've got. Not all your peers have been quite as forthcoming on all of that. But my questions are…

If I look at your coverage ratios on your stage 3 assets, they actually look like they've come down during the course of this quarter. So, I wondered if you could comment on what was going on there, please, because it seems unusual to see such a low provision charge when coverage is coming down like that. What drove that?

And secondly, more strategically, it's going to become very difficult for us to forecast provisions under IFRS 9, it would seem. So, does that impact your thinking about capital buffers for the next couple of years, please?

Iain Mackay

Manus, thanks for those questions. I think as it relates to stage 3, this is going to be an overall comment about how we learn our way through the adoption of IFRS 9. There's really nothing of particular note within the overall coverage ratios as it relates to stage 3. But I think the one thing I would point to is one of the aspects of prudent underwriting within HSBC, which is the overall value of collateral that we hold against those exposures being at fairly elevated levels, but I think –

Manus Costello

The stage 3's actually went up, didn't they?

Iain Mackay

Yeah, beyond, frankly, just the adoption of IFRS 9 and working through what the models do - because, again, this is a largely model-driven approach to generating expected credit loss data – there is really nothing of particular note coming through from an IFRS 9 perspective in the quarter.

On your point about forecasting, I think overall the topic of forecasting under an expected credit loss outlook is going to require a degree of sophistication which perhaps goes beyond that which the industry presently holds, particularly when we start seeing particularly adverse developments in particular sectors of the economy or areas in the network from a credit performance perspective.

In terms of, 'Does it really influence what we think about capital?' that, I think, will be informed by how our regulators respond in terms of their thinking about capital. Now, clearly, one of the things the Prudential Regulation Authority is doing this year within the stress-test is a stress scenario very, very similar to that of last year but incorporating IFRS 9, with the intention to immunise IFRS 9 in the results. So I think that may give us an indication at least as to how the Prudential Regulation Authority is thinking about this.

But, as you know, there is a piece of work afoot with the Basel Committee, not advancing at any particular pace at this point in time, in terms of thinking not just about the transition to IFRS 9 at the point of transition – and you obviously see the effect of those transition mechanisms on our numbers this quarter but also, from a quarter-to-quarter perspective, as we see changes in the credit cycle, how one manages that volatility.

We sit with a very strong Common Equity Tier 1 position. When you look at how we respond to stress-tests as a whole, the business remains very resilient through what are in most instances pretty severe stresses that are set for us by the regulators. But, look, this is an area we're going to remain very focused on. I wish I could, but I don't think we can give you much more other than diligence and attention to this and continuing to work with the regulators as we go through learning about how IFRS 9 impacts the numbers.

Manus Costello

Thank you very much.

Iain Mackay

Thank you.

Jason Napier, UBS

The first is the cost guidance of equal run rates for what remains plus levy looks like around 5% full year growth and positive jaws, whether that's 1% or 2%, may be of some interest. But I'm just interested, perhaps as a question for John, whether you see the cost inflation for this year as including an unusually high level of investment or whether that's a sort of organic cost growth that one ought to expect from the business.

Secondly, the margin – it's good to see it expanding in first quarter, and loan growth looks solid. I just wonder whether you might give us a comment on the extent to which margins in Hong Kong might continue to expand. We're seeing reports of more aggression in the deposit market in particular, if you could give us some colour on that.

And then thirdly GB&M in the fixed space – I appreciate the base was fairly strong and it's up quarter on quarter. I just wondered, is there anything to flag in Q1 which was sort of overtly negative, if you like, which might get better in the second quarter? Is there anything unusually weak that you think you might do better on as the year goes by? I'm just thinking about whether the implication of positive jaws is that you effectively need flat revenues for the next three quarters, whether GB&M can continue to that in a positive sense. Thank you.

Iain Mackay

In terms of net interest margin, obviously we're encouraged by the progress we saw in the first quarter. Interestingly, the characteristics that we saw in the first quarter are broadly informed by how we guided at the end of the year, where we saw a continued improvement in terms of liability revenue-generation off the liability base of the firm, if you like, in terms of how rates are impacting that side of the balance sheet.

We continue to see a pretty competitive environment for our asset pricing across the network. There may be some early signals in Hong Kong that some of that competition is beginning to ease a little bit, and if that proves to be the case over the coming quarters that would certainly be very encouraging to see some expansion both from the asset and liability perspective. And then the third feature, which again I think will be very consistent with the guidance we've provided for the full year, is just some slightly higher costs coming through from issuances of regulatory instruments, namely MREL or TLAC.

So, overall, in terms of NIM, the guidance that we provided at the full year probably holds pretty good. I think it would be very encouraging if in fact we actually did see slightly less robust competition for asset pricing in the Asian market. It would be great if we saw it everywhere, actually, but if there are green shoots in Asia we'll take that.

From a Global Banking and Markets perspective, you'll recall that we did have a very strong first quarter in 2017. But looking at Global Banking and Markets as a whole, it generated return on tangible equity in the first quarter of 11.9%. And underpinning that, notwithstanding some weakness in fixed income, we saw good progress in foreign exchange, where revenues advanced 13% over the same period last year. Equities, we saw good progress. In Global Banking overall we saw good progress, with advances in debt capital markets and equity capital markets, as well as good progress in Global Liquidity and Cash Management and Securities Services.

So, if you look at this business over the longer term, you see a diversified range of revenue streams very much focused on supporting customers' activity and fairly low volatility. I think what you see in fixed income is not unusual in terms of what you see in fixed income in HSBC when you have the sort of trading conditions we experienced in February and March. But overall we're pretty happy with where Global Banking and Markets came out for the first quarter.

John Flint

When we were operating in an environment of low or no revenue growth, we used the CTA programme to generate the capacity to invest in the business. So, last year we spent $3 billion that was in the reported numbers, and $900 million in the first quarter, and those numbers for this year will be zero, because that CTA programme has gone. We're reasonably comfortable this year that we can generate the capacity to grow the business and to make the investments we need to improve, either from a cost or a revenue perspective in the business, within a positive jaws constraint.

Now that we've got a rising rate environment and rates are a tailwind as opposed to a headwind, our outlook suggests that we can generate the capacity from within, which is what we intend to do. So, I think for the rest of this year just keep that construct in mind. Revenue outlook – as long as that remains good, our capacity to sustain this cost of investment, I think, remains really solid. Whether we think about changing our targets – that's something that's part of the strategy review that we'll come to later in the year, but for now positive jaws, because the revenue outlook has changed, I think is the right discipline for us.

Jason Napier

Thanks very much.

Raul Sinha, JP Morgan

If I can follow up on the costs and then just another one on the buy-back. John, if I can just perhaps draw a little bit further in terms of the costs and ask you, how much of the increase in costs is actually directly linked to revenue initiatives across the Bank?

And, related to that, I was just wondering what your thoughts were on operating leverage and the need to delivering operating leverage at HSBC. If I take a look at the shape of the growth in revenues against costs, that implies that even if you do deliver positive operating leverage of, let's say 1% in terms of jaws, you would be exposed to a pick-up in impairment from these very low levels, which would obviously offset a lot of the hard work that you're doing in terms of growth revenues.

So, I guess the question really is, should we think about the investment as sort of linked to the fact that your impairment outlook is quite benign and that is allowing you to invest? And as the impairment outlook turns, you'll actually look to reduce some of the cost investment you're putting in?

Iain Mackay

As we look at jaws, first of all, expected credit losses and impairments just simply don't figure as part of that calculation. Our focus is on making those investments, as John set out, that help us grow revenue or improve overall productivity and efficiency. And the guidance absolutely is to generate positive jaws for the full year 2018.

In terms of where we look at that from a revenue opportunity perspective, notwithstanding the tailwinds we've seen from interest-rate policy adjustment, we're also seeing improving volumes coming through. You can see that in terms of balance sheet growth, which again, looking at it simply from the fourth quarter to the first quarter, was good progress across our businesses, typified really by strength coming through Hong Kong and Asia as well as from the United Kingdom, because those are the big numbers that come through.

But also that's being done with highly consistent underwriting and risk appetite. So, there are not adjustments being made to risk appetite that push us further up the risk curve either as it relates to mortgages or unsecured retail banking credits, for example, or within the wholesale sector. So, this is really very much about looking at the revenue outlook, continuing to build on the investments that we've done over the last couple of years, to improve the interaction with the customer, the efficiency, effectiveness and stability of the technology platforms, improving digitisation capabilities and with a particular focus in that area in Retail Banking and Wealth Management and Commercial Banking, but also in some of the platforms within Global Banking and Markets.

And, to John's point, as the revenue environment supports that, governed absolutely by a commitment to positive jaws for the full year 2018, we'll continue to make the investments necessary to support the growth of the firm for the long term.

Raul Sinha

Okay. And then just secondly, on the buy-back, I was just wondering if you could just share any thoughts on the magnitude and the decision-making. What led you to think that? Is it the take-up of the scrip which was obviously quite low this time around? Did that influence your thinking around the buy-back size?

Iain Mackay

Not really, Raul. The thinking around this goes back to what we've talked about, how we deploy our capital over the course of many quarters. Our focus is on growing the business for the long term and supporting that organic growth through the strength of the capital base and the capital generation quarter over quarter. We generated strong capital again in the first quarter. We equally supported organic growth over the first quarter. And that, informed by also a strong Common Equity Tier 1 ratio as we exited the quarter, informed the buy-back.

The scale of the buy-back is informed by the scale of the opportunity to continue to grow the businesses organically. And, as we've always said, our focus is on the organic growth of the business and deploying our capital to do so and, when the opportunity was either less attractive or unavailable to us, that we would then consider a buy-back.

What we are seeing and the outlook at the moment encouraged our view that, one, we can support the growth through the capital base, but we can also support some degree of buy-back in 2018. And that's really what we're signalling you today as we announce that $2 billion buy-back.

Raul Sinha

Okay, thanks very much.

Joseph Dickerson, Jefferies International

Hi. Good morning. Most of my questions around cost have been answered, but I guess the key question I have is really: to what degree is your cost base flexible? Because it seems to me like, if you're going to deliver an ROE – certainly a reported ROTE that has a 1 in front of it and is double digits, you'll need to do better than 1-2% cost jaws in some year in the next three years. So, what degree of flexibility is there or is the opportunity on the revenue side? Because it seems at the moment that a lot of your investments actually aren't discretionary, because you have to do it to generate the balance sheet growth and the revenue growth. So, if you could elaborate on that, it would be incredibly helpful. Thank you.

Iain Mackay

The way we look broadly at the cost base is we break it down into two or three high-level components. One is we call Run-the-Bank, which is basically showing up, switching on the lights and getting to work in the morning, and the second is Change-the-Bank, which is about investing for the future, whether it's in product development, the overall capabilities of our colleagues that are working in the firm, or the technology platforms that we're all taking on.

And within that cost base for this quarter compared to last quarter, for example, our Run-the-Bank costs are actually marginally lower, so we continue to focus on the cost discipline overall in terms of managing costs within Run-the-Bank and generating productivity within that cost base. Part of that productivity comes from some of the investment we make in people and technology, but it also just comes from that basic discipline around managing the cost base.

Where we've seen increase in cost coming through this quarter has been within the Change-the-Bank environment, which has been orientated around investments in continuing to grow the market presence that we've got in Pearl River Delta and mainland China, with a particular focus on Retail Banking and Wealth Management, and Commercial Banking. We continue to invest in the development of the Qianhai Securities joint venture – a majority-owned securities venture in mainland China. We continue to invest in digital programmes, again largely focused in the Hong Kong, PRD and the UK market to improve the interface and the efficiency of the relationship with the customer, and significant investment around developing and further improving the interface with our Commercial Banking customers through HSBCnet.

You absolutely could view those investments as discretionary. Were we in a revenue environment that was less supportive, the discipline that we would apply to really anything from an investment perspective that we view as discretionary would be different. And frankly, that's really the commitment to positive jaws. If the revenue environment continues to support the level of investment that we see, then we would continue to invest. If the revenue environment were to suggest something different emerging in the future, then we would adjust our cost disciplines accordingly.

Joseph Dickerson

But Iain, sorry, with all due respect, don't you need to make those investments to keep up with a lot of the competitors in the mainland market?

Iain Mackay

Yes, but it's through prioritisation. This is not about opening up the jar and spreading peanut butter everywhere; this is very much about prioritisation of where we see the most attractive competitive opportunity for HSBC.

John Flint

Yes. And Joseph, can I just add, coming back to your question around flexibility and then how we get towards the 10%, I think for us to get to a 10% ROE, we're going to have to grow the business. I think it's very difficult to get there just by shrinking the cost base. And if we were to do that, we're effectively back into a CTA-type environment, where we're going to have to come to investors to say, 'We need to invest again to take more of the cost base out.'

The outlook we've got – what we can see in front of us in terms of the opportunities and, certainly, a slightly different rate environment, we've got the opportunity to get HSBC growing again. And it's worth remembering that the balance sheet is roughly the same size now that it was 10 years ago. The customer base is actually a lot smaller than it was 10 years ago, for all the reasons that everybody understands. We've got an opportunity now – we see an opportunity to try and get parts of the Group certainly growing again, and the revenue environment, as we see it, gives us the capacity to invest in it. But to come back to your original point – the flexibility of the cost base – there are limits to it. There are certainly limits to it, which is why we want to invest in the capacity to grow now, so that we don't miss these opportunities.

Magdalena Stoklosa, Morgan Stanley

I've got two questions. One is on the NIM evolution and another one on the Commercial Banking. So, let me start with the NIM. It's broadly on deposits. Could you run us through your outlook of the deposit evolution from here across the network, I suppose in Asia in particular, and what you expect in terms of growth and pricing, particularly for 2018? I think that what would interest me also a lot is: how do you perceive the balance of the impact of the higher rates versus the competitive pricing or competitive pricing pressures? And I suppose that would be both on deposits and on loans.

And I'm very curious about your commentary on slide 7 of the presentation on the Commercial Banking, because I think that, for the first time in a long time, you're actually commenting on two things: so, wider spreads in the Global Liquidity and Cash Management but also higher fees in Global Trade as well. For years, we talked about pricing pressures in broadly both of those businesses – of course, volume growth, but still pricing pressures – and I was just wondering whether you see some of those trends turning. Thank you.

Iain Mackay

On trade specifically, we've certainly seen stabilisation in those trends in margin over the course of the last two or three quarters. I think it would be a slight overstatement to say that we see significant expansion in margins in global trade. Volumes are improving and, really, overall pricing in Global Trade is very much a function of the pricing of those volumes as opposed to the volumes themselves. But overall, I think we would describe what we see in Global Trade and Receivables Finance, in the round, as stable. For structured products, pricing tends to be more attractive and we are certainly shaping more of the business to be orientated towards structured products with respect to inventory financing, for example, in that particular area. But overall, I think the outlook is certainly more positive now than it has been both in terms of increasing volumes and slightly improve pricing across that space, which is reflected in margin.

From a net-interest-margin perspective overall, I'm not sure there's a great deal more that we could add. One of the things that is very recent news is HSBC in Hong Kong yesterday fpr the first time in probably the better part of eight years increased the savings rate offered to our customers, and we increased it by 10 basis points. That means that the rate that you could get on savings in Hong Kong now has gone from 0.0001% to 0.1%. It probably still isn't a massive change but I think it's a broad signalling of the fact that 1) in terms of doing exactly the right thing for the customer in terms of sharing some of that improvement in the interest-rate environment, then I think we need to lead the way in that regard, but also recognition that it is a competitive environment for deposits that we operate in, not only in Hong Kong but across a number of markets. But overall, we continue to sit with a very strong liquidity position in Hong Kong and across the Asian network and the wider network as a whole.

I think, in terms of asset pricing, it remains a very competitive environment, but there are certainly early signals that perhaps things may be becoming a little bit more interesting for us in that regard in Asia. In terms of overall liquidity balances, I would not expect to see significant change over the course of the year, notwithstanding the fact that we continue to put more of that to work with our customers, as has been evidenced both in the first quarter of last year and the second half of last year.

Ronit Ghose, Citigroup

I just have a few follow-up questions on the cost side, please. First of all, Iain, in previous earnings results, you've given us a quantification of how big you think jaws can be. You're talking about positive jaws now. Are you willing to give any quantification of 1-1.5%, or less or more, for this year and for future years? That's my first question.

My second question is: if I look at the cost evolution in normal years, and this has been alluded to in earlier questions, normally you get a drift in the second quarter up to the fourth quarter in underlying costs, and I'm just wondering: you've run through in great detail what you're spending the extra money on in the deck and on this call. Is there any element of that that is particularly frontloaded that you can call out now to give us comfort that the normal seasonality could be offset as we go through the year?

And the third question is more conceptual on costs, and may be one for John. I understand the discipline and the importance around jaws, but given the growth opportunities you've got in Asia, and given, particularly in retail in the PRD and Hong Kong, both the combination of growth but also competition and transformative competition, is it still relevant, do you think, for your Hong Kong and your PRD business to talk about positive jaws, or should you say, 'We need positive jaws in the developed markets and, in Asia, we've got a couple of years where we just need to invest and go for growth'?

Iain Mackay

In terms of quarterly trend, I think I'd refer to the response I gave earlier around how we view the cost base in terms of running the bank and Change-the-Bank, investing for growth. And there is a very, very strong discipline around managing that Run-the-Bank cost to generate some cost productivity year in, year out, and then focusing on the Change-the-Bank around prioritised investment against the opportunity for each investment to contribute towards improved returns within the Group. So, the guidance that we're giving you today is that, based on what we see and how we've phased investment, we would expect the cost profile for the firm over the remaining three quarters of the year to be broadly consistent with what we see in the first quarter. We're absolutely targeting a delivery of positive jaws. Ideally, we would target that to be around the 1% mark but positive jaws is what we're focused on, and I think that, again, builds very much on John's comments here around taking the opportunity to invest on a prioritised basis against those areas where we see the most attractive growth.

John Flint

Yes. And just to build on the spirit of your question, which I completely agree with, the question around Hong Kong and PRD – would a positive jaws constraint prevent us from taking advantage of the opportunities? Well, we're specifically trying not to allow it to be a constraint. Positive jaws is at the Group level, the aggregate numbers, but within that we are absolutely deploying resources into the opportunities that we see in front of us. The PRD is absolutely negative jaws and has been since we started the investment; Hong Kong, through periods and for certain initiatives and activities, just the same.

Your question comes back to the challenge of: if you're going to pick a metric or you're going to pick a discipline that you're going to convey to the street – positive jaws, a CER target, an absolute cost target – if you pick one, there's always going to be some circumstances in which it doesn't quite fit every circumstance or every environment. The spirit of your question, I completely agree with. We're going to try really hard not to miss opportunities but, at the Group level, given that we've got a favourable revenue environment and a favourable outlook, the discipline, I think, is really important for us to maintain positive jaws, faster revenue growth and cost growth on a full-year basis.

Ronit Ghose

Great. Thanks for that, guys, but can I just go back again to my first question? Iain, I hear you: we don't want to get too tied down to decimal places but, if we're going for around 1%, let's just say plus or minus but around 1%, if I go back six months ago, I think you were more confident about bigger jaws. And some of us on the sell side were even more optimistic and you've guided us down on that. But I'm just wondering, over the last six months, what do you think has particularly changed – or six to nine months – in terms of: why have the jaws become smaller? Because the underlying revenues have been strong, so you're growing your Group almost in line with some of the Asian bank revenue numbers I can see out of Singapore, for example, or even Hong Kong. So, the underlying revenues are actually quite impressive, but I'm just wondering: how much of this incremental cost growth is just something that we're going to have to live with for the next three years, so a kind of 6-7%, maybe 7-8% underlying cost growth is a kind of new normal for you now?

Iain Mackay

No, not at all. I think it goes back to John's comments: we do not want to starve opportunities for growth through not investing in those opportunities for growth. But John set a very clear discipline around generating positive jaws for the firm, and that positive jaws for the firm, progressively over time, will continue to improve the overall cost efficiency of the firm, and that is really the focus that we've got.

To the extent that you observe any narrowing in the guidance around positive jaws, it's informed by exactly what John described: it's the opportunity to invest on a prioritised basis in areas that represent attractive growth for us at the moment, not just in terms of revenue but in terms of what that means for the returns overall against the equity that we deploy into these businesses.

Chris Manners, Barclays

Just a couple of questions, if I may, both of them on the UK. So, the first one was about your mortgage-volume growth. You've been growing about $2 billion a quarter for the last couple of quarters and seemed to slow down in Q1. Could you give us an update on how you think about pricing discipline in that market and about your growth rate? We've had some competitors suggesting to us that you've been pretty aggressive on pricing and I'm wondering how sustainable that is.

A second question was on deposit beta. So, fair enough, it looks like we're not going to get a rate hike in the UK in May but the curve's still pricing something over the next year or two. Given how much liquidity you've got trapped in your ring-fenced bank, how much do you think you would be passing through to customers if we do get a rate hike, and is that going to be a source of NIM expansion for you if that comes through, or are you going to move with the pack?

Iain Mackay

I don't think we'd necessarily want to predict how we're going to respond to any changes that we see in the Bank of England rate over the coming quarters, certainly not until we get much more proximate to that, and what sort of market conditions exist in that environment. I think the competition in the UK, both for assets and deposits, is pretty hot at the moment. I think you can see that in some of the pricing across the market on both sides of the balance sheet.

Going to UK mortgages specifically, Chris, we have grown our market share in terms of looking at the stock of market share. Our share of market at the end of 2016 was 5.9%; our share of market at the end of 2017 was 6.1%; and at the end of 1Q, it's 6.2%. We are growing into this market in a very measured way, I think. Our risk appetite remains very consistent. The underwriting standards reflect absolutely the pricing that is in the marketplace, so, where those very attractively priced products are out there, they tend to be very closely related to fairly robust collateral requirements and booking-fee requirements and affordability requirements of the customers that are able to access those offers.

It is a competitive market. I think the most significant feature in terms of HSBC's position is how we've expanded our access through the intermediaries. If you went back three years, we really were not in that space at all. At the end of last year, we had about 23 brokers that gave us access to about 65% of the intermediary market and, over the first few months of the year, we've added about another seven in the intermediary space that probably now gives us a view to about 75% of the intermediary market. So, we are seeing more of the market, and more of the market that fits our underwriting appetite. So, we have not moved down or up the risk curve, if you like, in terms of how we grow market share, but as you'll also observe from the data that I shared with you, we're growing into this space in a very measured fashion.

John Flint

And if I could just add one thing, just for a reminder, Chris, when it comes to rates going back up and the competitive market and whether or not we choose to respond, one of the advantages we have in many of the balance sheets is because our A/D ratio is so low, we've got pricing power, effectively, and we can choose, if we think it's the right thing, to lag the market. The ring-fenced bank, when it's created, will have a very significant funding surplus. That partly informs the mortgage strategy but it also means that we have a bit of latitude, perhaps more than some others, when it comes to how we respond to rates going up and deposit pricing. Thanks, Chris.

Chris Manners

Thank you – that's very clear.

Alastair Ryan, Bank of America

Three short ones, please. First, given the sequencing you described on the costs and the revenues, can we assume that you've got better than average visibility on revenues into the back end of the year because of balance sheet growth, net interest margin expansion and annuity income streams being the drive?

Second, on the buyback, when does that start and how quickly does it move? So, does it run right to the end of the year or to the full year results next year, or just until it's done?

And third, the Tier 1 redemption: it's quite earnings accretive, given the very high coupons on that. Is there any more of those that you could do? I think people have tended to focus on the cost of the AT1 issuance, which has been substantial; clearly, this is quite a material move back in the right direction. Thank you.

Iain Mackay

Thanks, Alastair. Let me do those in reverse order. So, on the Tier 1 redemption, this is really just part of ongoing improving the overall efficiency around balance sheet optimisation. As you quite rightly point out, these convertibles were issued back in 2008, I think it was, with a pretty healthy coupon on it. Notwithstanding the higher cost of Additional Tier 1s that we put out there, this redemption represents a fairly significant economy for HSBC over the course of the next few quarters. So, really, nothing more than just taking the opportunity to do a bit of sensible refinancing that lowers the overall cost of the capital structure of the firm in that regard. We are continuously looking across both Tier 1s and Tier 2s at, really, the overall capital structure as well as debt structure and, where it makes sense from an economic, net present value perspective, considering also the capital impact of some of those capital instruments, then we will, from time to time, contemplate a liability management exercise. But for the moment, this is it.

In terms of the share buy-back that we announced today, we would expect to start it early next week, as long as nothing particularly interesting happens between now and Tuesday of next week, and we would expect to run it until it is complete. And the sooner we can complete it, the better. Realistically, based on the last three that we've done, we would expect this to probably take us through to probably the end of August/beginning of September, depending on trading volumes. So, that's broadly the timeline but it's basically to get it done as soon as we can, but volumes traded and the criteria that we've set with the bank that's executing this for us, based on experience, would probably take us through August and perhaps into early September.

Cost and revenue visibility: I think that the fact that we've got an investment and cost profile which is broadly consistent with the first quarter I think hints at the fact that we feel that we've got a bit of tailwind not only from rates but also from balance sheet growth, and volumes that we see coming through Retail Banking and Wealth Management across the whole markets but also some of the network markets, and equally what we see in terms of confidence within the wholesale space through Commercial Banking and Global Banking and Markets, and that has been predominantly, not uniquely but predominantly, within Asia, with a particular focus on the strength of the Hong Kong balance sheet and the surpluses that we have in US dollars, Hong Kong dollars and renminbi in particular on that balance sheet.

I think the only comment I would temper that with is, where we see an adverse swing in revenues, then I think we would fairly quickly respond equally from a cost actions perspective, but really that would just be around the reprioritisation of certain investments.

David Lock, Deutsche Bank

I've got one on the Corporate Centre, please. So, I think I appreciate that there's a lot of volatility in here and there's a lot of moving items, but clearly that weighed on the revenue line and, actually, the revenue line would have been significantly better than I was forecasting if we'd adjusted to some of those items. I'm just conscious that the second quarter was particularly strong last year, $650 million. I wonder if you could give any colour on particular lines within the Central Treasury in the Corporate Centre that could maybe help us try to understand what the run-rate expectation is for here, an particularly what you are using as a planning assumption, when you are thinking about your cost jaws and when you're thinking about the firm two or three years out. Thank you.

Iain Mackay

Thanks, David. There were two specific features within Corporate Centre from a revenue perspective in the first quarter. There was a significant item sitting within Corporate Centre within the US from a cost perspective, and that related to the provisions that we made for a civil suit that we're in settlement discussion with the Department of Justice on, and a civil suit that we're in largely completed settlement discussions with a former customer of the US finance company, also related to residential mortgage-backed securities.

So, going back to the revenue line, from a Balance Sheet Management perspective, our Corporate Treasury managing the liquidity surpluses that we've got, in the second half of last year our team did repositioning as a reflection of where we saw rates moving and, as a consequence of that repositioning, within balance sheet management, we see somewhat lower revenues in the first quarter. I think that is really the adjustment effect that we see, so we would expect to see a fairly stable view from Balance Sheet Management over the remainder of the year, and guidance for Balance Sheet Management would remain broadly consistent with that which we provided at the end of the year; so, in the range of $2.3 - 2.5 billion overall for the year in Balance Sheet Management.

The other feature that we reference is we reclassified certain bonds that sit within the holding company capital structure in the first week of the year in response to the requirement to reclassify assets and liabilities in line with IFRS 9 guidance and, on that reclassification, had a mark-to-market on the bonds and the swap associated with those bonds in the first month of the year of US$177 million, which, again, is a one-time feature.

So, I think that, hopefully, gives you a little bit more visibility in terms of what else was sitting within Corporate Centre: slightly higher costs on MREL in terms of issuance that we did in the first quarter and, again, that issuance is in line with meeting regulatory requirements for 2019. And we're largely there from a 2019 perspective but, again, the guidance that we provided around higher MREL costs for 2018 remain absolutely consistent with that which we provided at the end of the year.

Tom Rayner

I just wanted to ask you, Iain, what your guidance today means for consensus for the full year? Because we can annualise the cost number and get to figures around $33.7 billion, which I think, as someone else pointed out, is 5% growth underlying. If I look at the FX-adjusted revenue for last year, I get $53.2 billion, so if I assume zero jaws, which is the worst-case outcome, that gets me pre-provision profit of $22 billion, which is bang in line with current consensus. If my maths is right, every 1% jaws you do on top of that adds 3% to that number, and this is against an impairment in Q1, which is $170 million versus I think consensus for the full year is $2.6 billion. So, again, if you could comment on that and maybe talk about that Q1 impairment number as well, because I know there is seasonality in Q1 and what have you, but it's such a low number I just wonder if there's anything else you can add on that. Thank you.

Iain Mackay

Thanks, Tom. Trying to break that down, I think going back to my comments earlier around impairments in the first quarter, and this has got very little to do with IFRS 9. In terms of what we saw within the portfolios from a credit performance perspective, it was a low charge. It was certainly lower possibly than we expected. In terms of what influence that was, again, to the extent that there's any IFRS 9 influences, it's possibly around how our forward economic guidance, as required by the standard, is applied to overall provisioning for expected credit losses. But I think, as we said a little bit earlier, we'd encourage you not to annualise the first quarter numbers, and I'm not sure whether we would necessarily encourage you to change what you've got from a consensus perspective for expected credit losses at all for the year. I think it would be fair to say that we haven't.

In terms of looking at the top line and the bottom line, by providing the guidance that we've today around what we see as being the quarterly run rate for costs and the fact that we've guided to positive jaws for the year, I think that probably gives you a pretty good roadmap as to how you would read across to how we see revenues developing for the year at this point in time, Tom. I think that's probably the best I can do for you right now.

Tom Rayner

I'll leave the revenue and cost thing. Just on the impairment, though, from $170m in Q1 to consensus 2.6, not changing that, that's a lot of things going on, isn't it, in the rest of the year?

Iain Mackay

Tom, when you look at what we've gone through for the last couple of years on this line, I shan't say we've given up predicting it, because we haven't. What we talked about at the end of the year was if you took out the significant recoveries that we realise principally in the US business on the back of some improving around restructuring and performance of some of our oil and gas credits in North America, last year's normalised cost of credit against average outstanding balances would have been about 25 basis points. And when we think about what logically, against our underwriting appetite and how we have built the book, we would expect to see a credit cost of around 25 to 30, 35 basis points. And that's informed by looking at the long, long time series of how that's developed through a number of cycles. We are in a particularly stable, benign stage of the cycle at the moment. I think we should all reasonably expect to see some turn in that across markets over some period of time. The devil that we're all trying to deal with is: what is that period of time?

Tom Rayner

Yes, sure, sure. Okay. Lovely – thanks a lot.

Iain Mackay

Thanks, Tom.

John Flint

Tom, thank you very much. Ladies and gentlemen, thank you very much for joining us. That concludes today's call. Thank you.

Iain Mackay

Thank you.

HSBC