HSBC

Transcript

Q2 Results
Fixed Income Investor Call

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Speakers
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FAISAL YOUSAF, GROUP TREASURER: Hello everyone, thank you for joining us. I'm Fas Yousaf, Group Treasurer and I'm joined by Greg Case, Head of Debt Investor Relations, and Neil Sankoff, Global Head of Investor Relations.

I'll keep my opening remarks brief as I'm sure you've had a chance to go through the results already today. There is a comprehensive deck for fixed income investors available on our website and we'll flash up a few selected slides as I talk. Once I've finished, we'll go straight to Q&A.

Today we announced a half-year reported profit before tax of 21.6 billion dollars or 18.1 billion excluding notable items. Stable versus last year. The return on average tangible equity was 17 percent, excluding notable items.

We expect to deliver a mid-teens return on tangible equity, excluding notable items, for 2024 and have today added guidance mirroring this for 2025.

Significant changes have been made to our business over the last few years and during the first half we completed the sale of our Canadian, French retail, and Russian businesses, alongside progressing toward the sale of our businesses in Argentina and Armenia. This has allowed us to increase our focus on the core franchise: our scale activities in Hong Kong and the UK as well as our international wholesale transaction bank and wealth proposition.

The business model continues to be strongly capital generative and in 1H24 we also benefitted from the gain on the sale of our Canadian business. Our CET1 ratio of 15 percent remains above our target operating range of 14 to 14.5 percent, and you should expect us to bring it back down to this level over time. At the mid-point of our target operating range, we will have a comfortable 300 basis point headroom above our MDA hurdle requirement.

We remain conscious of where we are in the interest rate cycle. As such, we will continue to be focused on lowering our earnings sensitivity through hedging, driving growth in non-interest income and cost discipline.

Banking NII of 10.9 billion dollars was down 0.4 billion versus the first quarter, largely due to the disposal of Canada. We have updated our guidance on Banking NII and now expect this to be around 43 billion dollars for 2024.

The sensitivity of Banking NII to interest rates continues to reduce. A 100 basis point parallel shift down in yield curves, would reduce our Banking NII by 2.7 billion dollars based on a static balance sheet and 50% pass-through assumption. This compares to 3.4 billion at year-end, and approximately 7 billion two years ago. The reduction in sensitivity is driven by the deployment of additional hedges, current interest rates and natural changes to the mix and shape of the balance sheet.

Our structural hedge increased by around 25 billion dollars in the first half to 504 billion with an overall average duration of 2.8 years. We have further improved our disclosures, allowing you to analyse the run-off profile of hedge assets during the remainder of 2024 and 2025. Over this period, we will replace around 160 billion of assets, which have an average yield of 2.8 percent.

Turning to credit quality, the ECL charge for the second quarter was 0.3 billion dollars or 15 basis points as a cost of risk. The low charge was driven by recoveries and releases. Excluding these, the Q2 charge was broadly in line with our expected 30 to 40 basis point range.

In the first half, the charge was 1.1 billion dollars or 22 basis points, including balances held for sale. We have updated our 2024 ECL guidance to within 'our medium-term planning range of 30 to 40 basis points.

Stage 3 balances were 2.4 per cent of customer loans, up 1.4 billion dollars compared to the first quarter. This was driven by the refinancing of loans in the Hong Kong Commercial Real Estate book, which had a limited impact on the ECL charge because of the high levels of collateralisation.

Our mainland China CRE book continues to reduce and generated an ECL charge of 126 million dollars in the first half. The level of net loans booked in Hong Kong has more than halved since the end of 2022, standing at 3 billion dollars, driven by repayments and maturities. Balance sheet and issuance.

Now, moving on to balance sheet and issuance.

As I noted earlier, our CET1 position is strong at 15%. Our MREL ratio was 31.8 percent of RWAs, broadly flat on the year-end and 4.6 percentage points above our requirement.

The Group retains strong levels of liquidity with a well-diversified deposit base. We have a total deposit base of 1.6 trillion dollars, and our loan-to-deposit ratio is 59 percent. We hold almost 800 billion dollars in high-quality liquid assets and the Group LCR was broadly flat in the first half. As I've said before, the Group consolidated LCR is calculated using conservative assumptions. We primarily manage liquidity at the subsidiary level and our major subsidiaries all operate with LCRs that are significantly higher than the Group ratio.

Finally, onto issuance. Starting with holdco senior, this year's plan remains lower than our usual run-rate, with negative net issuance anticipated. We see gross issuance of around 10 billion dollars against maturities and calls of around 12 billion dollars. In addition, we tendered for 5 billion dollars of holdco senior in the second quarter, which will further increase the net reduction of senior holdco outstanding. We have largely completed the hold co senior issuance plan with 7.5 billion issued to date, and we aim to be largely finished towards early Autumn.

In Tier 2, we expect to issue 2 to 3 billion dollars gross in 2024, against 2 billion dollars of maturities. This will be broadly half the amount we issued in 2023. So far, we've issued 2.5 billion dollars and we anticipate that any further issuance would likely come in relatively modest size, targeting smaller currency markets.

With respect to AT1, we plan to issue around 3 billion dollars of gross AT1. We've issued just over 1 billion year-to-date in a very successful Singapore Dollar trade, demonstrating the strong support we enjoy from our Asian investor base. You'll also know that we recently announced the call of our USD AT1, removing 2.25 billion dollars of AT1 from the market in September.

So, wrapping up before handing off to Q&A, another strong half building on the 2023 performance.

We maintain prudent capital, liquidity and funding, positions, and we have modest issuance needs in 2024.

On that note, let's open the call up for Q&A – Greg?

GREG CASE, HEAD OF FIXED INCOME INVESTOR RELATIONS: Thanks Fas. So, if you'd like to ask a question over Zoom you can either raise your hand or use the Chat or Q&A functionality that should be in front of you. We have had a few pre-submitted questions so I'll start off with those while we give people an opportunity to signal for a question.

We've got an anonymous question to start. So, the question is: can you give us an idea of how you think about refinancing for the remainder of this year? Is that something that you will use? And if so, could you give us an idea of what kind of products or currencies?

FAISAL YOUSAF, GROUP TREASURER: Okay, thank you. Greg. Well, let me let me start by just recapping some of the things I said in my preliminary statements.

So, in terms of where we are in the issuance plan for the year, as I said earlier circa 10 billion of senior holdco is the plan for 24. That is negative net issuance. We've got 12 billion of calls and we've tendered five so negative seven billion in total. We have probably about two or three trades left to do this year and we've done about 7.5 billion against that 10 billion target.

On Tier 2 we indicated two to three billion in terms of the issuance plan. We've done two and a half at this stage. If we do something it'll probably be in small amounts in some of the non-G3 currencies.

And then from an AT1 perspective we're looking to do about 3 billion in total this year of which we did one, and that was the Singapore Dollar trade earlier in the year.

The real focus for me at this point is to complete that funding plan and my expectation would be, all things being equal, that we could get there by late Autumn - that that's the focus. I'm not going to rule out pre-funding, but at this stage it's not the central outcome.

Just remind everyone that we have a window now to issue senior holdco in January, should we choose to. That relaxes the pressure a bit on the 2025 funding plan.

GREG CASE, HEAD OF FIXED INCOME INVESTOR RELATIONS: thanks Fas. So, we've got a question come in from Dan David at Autonomous. Dan, your line should be open to unmute yourself.

DANIEL DAVID, AUTOMOUS: Great, thanks for the call and congratulations on the results.

I've got three quick ones hopefully. The first one is just building on what you just mentioned, Fas. If I look at your MREL requirements half on half I can see they ticked up a bit. So question: just can you provide some insight on what's driven those changes in MREL, is this a trend that we should continue to see? Noting that you're a net negative issuer on MREL this year, I'm just thinking about where you want to get to longer term on MREL. Is the CET1 target headroom a reasonable expectation for MREL headroom as well?

Then the second one is on Legacy. We noted that you made some pretty strong progress on Legacy, but it has stalled somewhat over the recent quarters. Can we expect you to revisit any of those Legacy positions this year? Also, does the PRA expect you to make progress in a given time frame? I'm thinking of June 25 as the next important date. Can we expect some more progress on Legacy before that date? Thanks.

FAISAL YOUSAF, GROUP TREASURER: Okay, thank you very much Dan. I'll probably go at it in reverse order actually, so perhaps start with the Legacy.

The position as it stands at the moment is that over the past couple of years we've reduced the balance by around 6 billion. It is something I'm very focused on. As I I'm sure I've said in previous calls. We want to reduce that Legacy stack in line with the Bank of England expectations but really any actions we take need to be appropriate and proportionate. So, we really do continue to look out for opportunities for further reduction, we're maintaining active dialogue with the regulators who I'd add have a full and close understanding of the position. The facts we consider in in that space really haven't changed: in no particular order we'll look at the complexity and the options available, the economics, fair treatment to both bondholders and shareholders, and regulatory guidance as well. Where we take action, it's going to be an action that's rational to do. We are willing to take some cost obviously but we will assess the situation at each point and when opportunity arises.
You mentioned as well, I think, we reach the end of the CRR grandfathering period in June 2025. And there are some of our New York issued securities which we undertook a liability management exercise on in 2022 and reduced the stack a little there, pretty much by third. A number of our core investors took part in that. I'm very much looking at that and looking at the options on that as well. At the end of June 25 there's a potential infection risk, which we have no intention of letting happen. So, we will address that issue but it's a year away, though.

There's nothing definitive to communicate to you now and how, but we'll come back when there is.

I'm going to your other questions. Perhaps I'll take question one and two together in terms of the MREL and the MREL requirements and how we think about the issuance on a go-forward basis. We have as you would have no doubt seen from our slides about 460 basis points of capacity. At the moment, we are also running above our CET1 ratio target operating level. The target operating level is 14 to 14.5, the CET1 is 15. It's our intention to get down within that target operating range and if you were to take it down to, let's say the midpoint of that range, like 14.2-14.25 that reduces the overall buffer by about 80 basis points. That's probably where I expect us to end up. We're pretty comfortable with that buffer and that range, it gives us the capacity on a go-forward basis and whilst we've been net negative issuer this year, I would say that is probably a one-off - we have typically issued on the senior side between 15 and 20 over the past four or five years and I think we're going to return to somewhere in that range going forward. Obviously subject to looking at our funding plans, loan demand, and what have you but you can see this probably is an exceptional year.

I'll just check with Greg, whether there's anything you want add to that.

GREG CASE, HEAD OF FIXED INCOME INVESTOR RELATIONS: No, that's clear so thanks for that. I just as a reminder if you do want to ask a question you can raise your hand over Zoom or submit it via the chat or the Q&A feature.

So, we've had some pre-submitted questions. Firstly both Lee Street at Citi and Paul Fenner at SocGen ask a similar question on the development of Stage 3 loans. So, Lee asks can you explain the drivers of the moves in the stage three construction and real estate balances and what are your expectations going forward?

And Paul adds to that, what can we expect for the NPL ratio at the group level and, and do you think that they've peaked here?

FAISAL YOUSAF, GROUP TREASURER: Okay, thank you both. Well, most of the increase that we saw was in domestic Hong Kong commercial real estate, which was up 2.6 billion dollars in 1H24, outside of Hong Kong all the books were broadly stable.

What we've seen is increase in interest rates has created a debt service challenges for some of our clients. However, if we look at Hong Kong collateral levels remain very strong and we have not seen that translate into increased ECL. As always, our main focus is on supporting our customers. My view is that the cash flow pressures will recede as interest rates start to reduce and over the long-term we're very confident in that sector and in the property market, in general in Hong Kong. You may have caught from our disclosures that we have circa 36 billion of Hong Kong commercial real estate loans. About 60% of that portfolio is secured - I think this was mentioned in the equity call earlier in the day. The collateral levels there remain strong, we have LTVs on the impaired portion of around 55% and loans rated substandard have an average LTV of 50%. On the uncollateralized portfolio these are typically loans to strong, listed commercial real estate developers who are generally members of conglomerate groups who have diverse sets of cash flows. We have seen relatively little credit deterioration, in that part of the portfolio - none of it is impaired and around, 90% are rated strong or good, which is our rating which effectively translates to investment grade or above. On NPLs more generally we don't guide towards the NPL ratio. The ratio is an output of both inflows through the defaults and outflows through curing and write off so we're not we're not going to give explicit guidance on that.

GREG CASE, HEAD OF FIXED INCOME INVESTOR RELATIONS: Thanks. So, additionally Lee asks: the U.S has been gradually imposing additional sanctions on Chinese and Hong Kong companies. Have you had to terminate any relationships with any sanctioned companies?

FAISAL YOUSAF, GROUP TREASURER: Okay, so as you know, we apply sanctions as we're required to do so in all of our markets and that includes Hong Kong. So the approach we're taking is no different to other banks that are active in Hong Kong. There's not much more to say on that.

GREG CASE, HEAD OF FIXED INCOME INVESTOR RELATIONS: Okay thanks Fas. Just picking up Paul's additional question as well so on supply… so, you're saying you're now expecting more senior, holdco and AT1 is that correct? If so, why? Is it because of attractive levels? Additionally, on the AT1 - what currency do you think that that could come in?

FAISAL YOUSAF, GROUP TREASURER: Okay, thank you. So, on the senior holdco, the plan was 10 at the beginning of the year and it remains 10 at this stage so we're not increasing that at all. We're at seven and a half so we've still got a bit to do. On AT1 we are looking to do about three billion this year. As I alluded to earlier, we did a Sing trade earlier in the year, which we found of value to us and given the take-up seemed to be really appreciated by the investment community who here we are obviously thankful to. So, this is a space where we think there is good mutual value, given the current levels that we're at and which we're willing to explore further. It works for us, it works for the investors. So we'll we'll look to do a bit more. As you know, over the past four or five years, we have run down the overall quantum of our AT1. If I recall correctly back in 2019, it was about 26 billion and now it's around 19 billion. I think we're now much more in the cycle of replacing as we go and maintaining that stack.

GREG CASE, HEAD OF FIXED INCOME INVESTOR RELATIONS: I could just add to that, just on the senior hold code point, we started the year saying that we want to do less than 10 billion. We have adjusted that guidance ever so slightly to be circa 10 billion. I think that's very much within the context of what you've seen us do in Q2 in particular where you'll recall that we tended for five billion dollars of senior holdco. So, yes, the guidance has changed ever so slightly, but that is in the context of even further, negative supply versus what we'd guided to at the start of the year.

So, just for another flag in case anybody does want to ask questions on the line. Please do raise your hand via the Zoom function but we do have a couple additional submitted questions to get through.

Another anonymous one for you, Fas - on ESG issuance. We've seen quite a bit in the market over the last few weeks, do you have any plans there?

FAISAL YOUSAF, GROUP TREASURER: Okay, thank you. No plans at this stage. As I think the audience will know we published our Net Zero Transition Plan at the start of the year, that's available on our website and I'd direct you to that. It's a comprehensive document in terms of our plans going forward. What we're doing at the moment is currently refreshing our programs and framework to align to emerging best practise. Our main priority is really to continue to improve the Group's overall ESG credentials, and we recognise, we have an important role to play in in that transition, especially given our footprint. All I'd say is, look, we want to continue to be an issue that the ESG conscious and it very much comes into our thinking.

GREG CASE, HEAD OF FIXED INCOME INVESTOR RELATIONS: thanks Fas, and another submitted question anonymously on AT1 calls. So, this question focuses on how you'll think about six-month par calls and when you might think about exercising the call option during that window, can you give us any steer?

FAISAL YOUSAF, GROUP TREASURER: Yes. Okay, so the first thing to say is that there's no security that we have with the six month call window for a little while. I think the first one is around 2028. We recognise at the moment that there's not a consistent set of market practises. My expectation is that it will evolve and that the market will converge or align and from our perspective we would then want to align to that practise as well. Obviously subject to internal governance and what have you. I'm quite happy to engage bilaterally with individuals that want to bring up that topic and talk about it. The six month window is new for AT1s, and we mirrored some of the other market participants that introduced this, the idea was really that the larger window may give sufficient time for uneconomic calls to become more economic versus spot and for organisations to be able to call but I do understand that it causes difficulty for some investors in terms of in terms of their own hedging and planning purposes. So, we'll align to market practise as it converges. The first such instrument we have is a little while away.

GREG CASE, HEAD OF FIXED INCOME INVESTOR RELATIONS: Thanks Fas. So, I think that brings us to the end of the questions submitted and those on the line.

FAISAL YOUSAF, GROUP TREASURER: Thanks everyone for joining, I hope this was useful for you. If you have any further questions, please do pick up with Greg and the IR team.

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