HSBC

Transcript

Post-Results Equity Analyst Call
Q2 2024 Results

2 August 2024, 9.15am BST

NEIL SANKOFF, GLOBAL HEAD OF INVESTOR RELATIONS: Good morning, everyone here in London. Good afternoon to everyone in Hong Kong. Welcome to everyone joining us on Zoom for HSBC's second quarter post-results analysts' meeting.

There are a few people in the room with me here today: Georges Elhedery, the Group CFO and CEO-designate, Jon Bingham, our Global Financial Controller and Interim Group CFO, Claire Baird, the CFO of HSBC UK, Fas Yousaf, our Group Treasurer. Joining us from Hong Kong we have Ming Lau, who is our Asia CFO.

ANDREW COOMBS, CITI: I'll just kick us off with one and then I'll hand over, but we talked a lot about your hedge and your interest rate sensitivity on the day of results and, given the market reaction yesterday, it seems a good time to come back to it. In particular, I did discuss this with the Investor Relations team – we're keen for a bit more detail – your overall sensitivity continues to decline, so you're down to $2.7 billion, so slide 25, but within that, the US dollar amount has gone up, and I think it's because you've reallocated out of 'other' to USD. So perhaps you could just elaborate a bit more on the US dollar sensitivity specifically, how you've changed that disclosure and any more detail you can provide.

GEORGES ELHEDERY, GROUP CHIEF FINANCIAL OFFICER: Thanks, Andy. I am going to hand that question to Fas, who is responsible for the structural hedge, but, basically, the overarching comment is you're right. There have been some cross-currency swaps that have been utilised and that have increased the sensitivity in US dollars and reduced it under the category 'other', which is now down to $0.9 billion. Fas, do you want to say a few more words?

FAS YOUSAF, GROUP TREASURER: That's exactly right, Georges. Andrew, the overall sensitivity to US dollars now is about $0.9 billion of the $2.7 billion, and that comes from, as Georges says, the movement from other currencies into US dollars, so what we've done is, in some of our local markets, we've put on hedges that swap into US dollars, therefore increasing the US dollar exposure.

ANDREW COOMBS: What's the logic for that?

FAS YOUSEF: It's easier to hedge in US dollars, so the cross-currency market is quite active. We can swap it into US dollars and then easier to hedge.

ANDREW COOMBS: Thank you for that comment. You're saying you've swapped it into US dollars so it's easier to hedge. Does that mean that it then gives you more potential to then increase the structural hedge notional and that's the logic or you're talking about the broader picture?

FAS YOUSEF: I'm not going to comment on exactly where we think that overall hedge notional might go to. What we've said is that we're always looking for opportunities to reduce the overall structural hedge sensitivity. We've taken it down from $4.3 billion about a year ago down to $2.7 billion now, and it was, if you look back, above $7 billion 18 months, two years ago, so we've brought it down quite a lot. We will look at opportunities.

Going forward, we've done about $25 billion of extra hedging in the first half of this year, and it's probably reasonable to assume a similar kind of run rate for the second half of the year in terms of the amount of hedging we do.

GEORGES ELHEDERY: Subject to market conditions.

ALVARO SERRANO, MORGAN STANLEY: On the NII discussions around next year, we've discussed the rate sensitivity, but, obviously, loan growth is going to become increasingly important, and it's difficult to get optimistic on loan growth on my side, looking at the dynamics in China, Hong Kong, ISM data in the US and the sell-off. So maybe you can talk through how you can influence that loan growth. Now that you're going to be taking over, I don't know if you've already thought on things you could do differently on that side, on risk appetite or markets or segments that you haven't addressed, that could lead us to be a bit more optimistic around loan growth.

GEORGES ELHEDERY: I'm going to take the first part of the question, and I'll ask Claire and Ming to come in briefly as well. So first maybe take a step back. Our NII is driven by loan growth and by our deposit growth as well because, when you look at our average interest-earning assets, they're actually driven by deposit growth. Our deposit franchise has been very strong. There will always be some seasonality in the deposits, but we've seen it by and large very steady, and we remain a very attractive balance sheet for our customers to deposit money, plus the whole deposit offering we have around it. So that is one driver, which is expectation of probably less deposit competition or pressure with lower rates, which will make it also important for us to continue raising deposits through GPS, which are wholesale deposits, as well as retail.

Specifically on the loans side, we've seen strong loan growth in South and Southeast Asia, and that carries on. We've seen strong loan growth in mortgages in the UK and Hong Kong. They're lower margin so they're not going to be material NII movers, but it's an area where we keep maintaining or growing market share. We've seen some growth in some of our unsecured, again in particular in Hong Kong and the UK and a few other geographies, but that's starting from a low base.

So, if you want, the two areas that have not been growing as fast as we would have liked in previous quarters have been the wholesale business in the UK and the wholesale business in Hong Kong, so really, it's about the outlook for these two activities, which will be a major turning point in the overall loan growth.

A couple of things to say: one, we're not going to change our risk appetite so you shouldn't expect us to chase loan growth down the credit curve. It's basically awaiting customer needs when the right economic conditions and the right interest rate level is right for them, and if we have to wait it out, we will wait it out, but we're not going to jeopardise our risk profile for that. Second, we have ample capital at the firm level and in our legal entities to support loan growth, so we're not going to be constrained by liquidity, 60% loan to deposit ratio, nor by capital, 15% CET1 ratio. So it's really waiting for these economic conditions to come and, broadly, interest rates coming down are, we believe, one of the important levers to get the conditions right.

But I'll ask Claire first to comment on wholesale UK, specifically the outlook, and then Ming can comment on wholesale Hong Kong. Those two engines are the ones that are yet to grow, but they've been stable.

CLAIRE BAIRD, CFO AND EXECUTIVE DIRECTOR, HSBC UK BANK: In the UK, from speaking with our large corporate clients, they have been cautious year to date. I think they were waiting on more certainty from the outcome of the election, any new policies that may come as a result of that and, as Georges said, just that easing over all of the economic conditions. So, I think, with rates coming down, with a new government in situ, hopefully they'll start to feel more confident to go out and invest again, which would then drive their borrowing from us. As Georges said, we have plenty of room to grow within our existing risk appetite, so this isn't about changing risk appetite or going above it. It's more about just being ready to go.

The other thing from a UK perspective is that, obviously, this corporate lending is Basel 3.1 friendly, and that's another thing where we're really focused on going into next year about where should we be deploying the bank's capital, so I think we're pretty optimistic. The loan growth has been muted, but clients are being sensible, but we do expect there to be some growth to come now.

MING LAU, ASIA-PACIFIC CFO: For Hong Kong, if you look at the overall position at this point, quarter on quarter, Hong Kong was broadly flat on lending, so we've seen a stabilisation of the portfolio thus far.

I think there are green shoots and positive signs when I look at Hong Kong, particularly if you look at trade. The second quarter trade export data indicates exports grew 12.5% year on year, which I think is a positive sign, and we continue to grow our trade finance market share at this point in Hong Kong. Our trade finance market share is now 26%.

Beyond that, I would say, when you look at the rest of the portfolio on the wholesale side, we're not seeing the same levels of deleveraging and pay-downs at this point. So, look, there are some positive signs at this point from a Hong Kong perspective, and then I think the last thing I would say on lending is we are also looking at pushing Wealth lending – it's a small book at this point, but it is an opportunity that we feel, in terms of a proposition and product perspective, really caters well towards our Wealth franchise.

GEORGES ELHEDERY: Thank you, Ming. And, Alvaro, as we already shared, we continue to target mid-single-digit loan growth in the medium term.

AMAN RAKKAR, BARCLAYS: I have two questions. Maybe one for Ming on wealth management, please – if you could talk about the dynamics of that business in Hong Kong, in particular the growth rates that you're experiencing there, and could you just talk about your take on competition? Are you taking market share? If so, where from?

And the second question is around the outlook for RWAs - just interested in what would be driving RWAs from here. Is it simply lending or lending growth or should we be thinking about any regulatory inflation and any efficiency that you can do to offset that from here? Thank you.

GEORGES ELHEDERY: Thank you, Aman. Ming, do you want to take the first one?

MING LAU: Sure. So, on Asia Wealth, second quarter, we had Asia Wealth revenue growth roughly about 25%. We generated $19 billion of net new investable assets in Asia overall, predominantly in Hong Kong and Singapore. The dynamic there in terms of how I would articulate it is, if you look at what's happening onshore in China, interest rates are depressed, equity returns are depressed, and property is not doing too well, but that's driving a demand from mainland Chinese to invest offshore, and naturally, Hong Kong is one of the first steps for them when they do go offshore. We opened 345,000 new-to-bank accounts in Hong Kong through the first half of this year. Two-thirds of that, roughly, is from mainland Chinese, but that's built the franchise, and that's helping to build net new investable assets and deposits from an overall Hong Kong franchise perspective.

So I guess, Aman, to your question, there is this structural shift in terms of onshore versus offshore dynamics between China, Hong Kong and the rest of Asia that's equating to this opportunity on Wealth, and I think, if you look at our competition, the competition is also doing well, but we're capturing a decent share of the market here in Hong Kong just given our sheer size and scale between Hang Seng and HSBC.

In terms of momentum, I would say thus far – typically the first quarter is the strongest quarter we see from a seasonality perspective on Wealth, but this year the second quarter has just been as strong, if not stronger, than the first quarter. I think the fact that we added 345,000 new accounts in the first half and that pace continues into the third quarter, I think, bodes well from a future growth perspective as we head into the second half of 2024 and into 2025.

GEORGES ELHEDERY: Thank you, Ming. And, Jon, do you want to take the RWA question?

JON BINGHAM, GLOBAL FINANCIAL CONTROLLER AND INTERIM GROUP CHIEF FINANCIAL OFFICER DESIGNATE: On RWAs, the general factor is around how we grow loans on the balance sheet. There are a few things we're obviously looking at in a small picture. We've got the disposal of Argentina coming up, which is about an $8 billion reduction. We are waiting for the final PRA rules on Basel 3.1. We've indicated so far immaterial, but obviously we'll update you when we see the final rules.

I suppose from a broader strategic perspective you would expect us to say we're very focused on RWA efficiency in general, but I think we will be particularly focused as we go forward on what we're calling the balance sheet velocity, which is recycling of RWAs. That will also be a key factor in driving our efficiency. So nothing specific that we'd want you to particularly highlight or model in.

AMAN RAKKAR: Can I just ask one follow-up on the Asia wealth piece? So that circa 25% growth rate in revenues – what should we be doing with that in terms of what's a more sustainable revenue CAGR for Asia wealth management from here? I guess you've got some of the catch-up from post-lockdowns that's probably flattering that number.

And I think I remember at your trip to Hong Kong and Singapore last year, you set out an aspiration for high-single-digit revenue growth in the wealth business, in a higher-for-longer interest rate environment, but you're clearly running well ahead of that. So is this just a temporary phenomenon that will normalise from here?

MING LAU: The high-single-digit target we set last year is a medium-term target. I wouldn't take the 25%, which we saw in the second quarter, and run-rate that or assume we can maintain that. It's been positive this year thus far. I think some of the 25% growth, you've got to keep in mind, has also been driven by what's happened in the market. The Hang Seng Index and the turnover volumes on the Hang Seng Index were quite favourable in the second quarter. We have seen some of that come off now, early part of the third quarter, but I would say from a medium term we're still sticking to the high single-digit growth, which we guided to last year.

KUNPENG MA, CHINA SECURITIES: Good morning, Georges, in London. I've got two questions. The first one is about any preliminary thoughts or views on the long-term ROTE framework. I think maybe it's too early to make the final version to us, but any thoughts or any preliminary ideas about the framework of ROTE in a three- or five-year framework will be very helpful, under the background of rate drops, and maybe other positive factors like a recovery in demand and a good recovery in trade and the continued trend in the wealth management business.

The second question is regarding Hong Kong CRE. I think, in my view, the timing is a little bit weird because the Hong Kong CRE problem is a long-term problem, but there was a sudden jump in stage 3 in the second quarter. I'm just curious about the timing because you downgraded most of your secured CRE exposures to stage 3, but secured loans are secured, and the Fed is maybe going to cut rates very soon so maybe those stage 3 parts will recover in the future. So I'm a little bit curious about the timing of this downgrade in stage 3 Hong Kong CRE or – maybe I'll put it more frankly – it's a little bit like a kitchen sink before the transition of the CEO. Sorry to use this word. Thank you.

GEORGES ELHEDERY: Thank you. On the first question, we're not guiding yet for a three-to-five-year ROTE. I understand this is a question that comes quite often, so nothing to share at this stage apart from we're all ambitious here, but we'll get to it at the right time.

On your Hong Kong CRE question, I'm going to share with you also some of my thoughts and I'll ask Ming to complement with additional colour. The first one to share is that this is absolutely not related to kitchen-sinking. I can be absolutely adamant and clear. There is a very rigorous process of ECL assessment with the risk function. There is a very clear process in how we do the judgments, where judgments need to be taken, with the Finance function. All of this is reviewed by our external auditors, PwC, as well as by our Audit Committee. So there is absolutely zero input in terms of overt discretion, if you want, apart from the natural accounting judgment discretion, but that's highly controlled in the way we conduct it. I want to be very clear about that.

The second thing I want to share is the way we apply our rules - we move to a stage 3 or an NPL for a loan even if it is performing if certain triggers in the way ourselves and the borrower have reached, for instance if we roll a certain facility or if there are any conditions we put to the facility. So in our case the borrowers are all performing, but the triggers in our probably prudent approach have been triggered and therefore there is an automatic reclassification to stage 3. But you're right: there could be easily circumstances where stage 3 moves back to performing. That's not a concern.

And then the third one is just also to highlight it's about 9% of the Hong Kong CRE book that's gone to stage 3. So I may have misheard you, but it's not the majority at all. It's 9%. It's a large number, but it's 9%, it's $3.2 billion of a $34 billion exposure.

And I'll finish by saying we are comfortable and confident in the medium-to-long-term outlook of Hong Kong CRE, the actual underlying real estate situation. It will benefit from rate cuts, and it will benefit from the economic outlook and the economic activity in Hong Kong, and then we are therefore also comfortable with our borrowers and with the level of collateralisation we have but recognise some of these borrowers have short-term cash flow pressure because of the high rates among other factors and the current economic conditions.

That's the overarching comments I want to make. Ming, you want to give more colour?

MING LAU: Sure, Georges. Look, I would say it's not a sudden progression to stage 3. There has been progressive deterioration in the portfolio and, just reiterating Georges' points on what's happened, these clients are still current and paying interest. We've experienced credit deterioration in the portfolio given the dynamics of higher interest rates and the current weakness in the property sector across office space and retail space.

I think for those of us living in Hong Kong you can see vacancy rates are higher at this point, but, when you combine the combination of high interest rates, high vacancy rates from a rental perspective – that's putting pressure on rents, which are falling. That is putting pressure on these borrowers from a debt-servicing perspective and, as we assess the deterioration on debt servicing, together with refinancing risk on these clients, we've taken a prudent approach to put them into stage 3, but we're still continuing to support the clients. Many of these clients have been clients with us for decades. We've got strong collateral, low LTVs. The average LTV in the portfolio is 55% so, from an overall collateral and security perspective, it's pretty healthy and it can absorb a further drop in property prices.

The last thing I would point out on the structure of these loans – the loans are structured with recourse, which means if the valuation of the asset falls below the value of the loan, recourse allows us to access other assets from the borrowers, which is why, in some of these instances, even if there are high LTVs, the recourse allows you access to other assets and cash of the borrower, which then reduces the overall provisioning on these particular borrowers.

NEIL SANKOFF: Just to clarify, when we said there was credit deterioration in the portfolio – we saw some credit deterioration in the 60% of the Hong Kong CRE portfolio that's secured. We haven't seen any credit deterioration in the 40% of the portfolio that is unsecured.

MING LAU: Yes. I'm talking specifically about the $3.2 billion which is in stage 3. We've got 40% which is unsecured in our overall aggregate Hong Kong CRE exposure, but about 90% of that is in 'Strong' and 'Good', and those, as you can imagine, are to the largest conglomerates and developers in Hong Kong, which have very strong balance sheets, lowly geared, and they've got diversified cashflows, so there's no concerns on that part of the portfolio.

JON BINGHAM: Maybe just one add on the process – we apply a globally standard definition of default which is broadly based on the EBA definition of default, and it was non-financial indicators which triggered the move into stage 3, which, as Ming and Georges have indicated, these are still performing.

GURPREET SINGH SAHI, GOLDMAN SACHS: Thank you. Good morning, Georges and Jon. Good afternoon, Ming. Just to follow up on CRE, two related points: the first is the situation on the ground and how we model it in. Is it that the values we are relying on are the values that these third parties - JLLs and CBREs - are giving us, or we are forward-looking and taking a haircut on the current values and then having those metrics, and then you saw the deterioration $3.2 billion – first point is that.

Second question is regarding capital. Maybe I am guessing because the HBAP position is not yet out. So is it the capital position for HBAP got hit just like Hang Seng from this IRB and then regulatory reserve, and how does that tie up with the HSBC Group reporting, which is under the PRA capital rules here?

MING LAU: Let me take the question on the LTV first. The LTV values are refreshed, minimum, on an annual basis. There are seven external valuation firms that we use that provide the valuations. On the stage 3 and Sub-standard portfolio particularly, these are managed by our special credit unit, which is carefully managing every single loan and client that is in that bucket, so the LTV and the valuation of those assets are refreshed much more frequently relative to the rest of the portfolio. So I guess if you're asking whether the valuation is out of date, and so on those buckets of loans that are in 'Sub-standard' and 'Credit impaired', we are very frequently reviewing the asset values on that part of the portfolio.

From a capital perspective – question on the impact of RWA deterioration or increase in expected loss – that's the same for HBAP as it is for Hang Seng. The impact at a Group level as a result of the deterioration in credit on the Hong Kong CRE is about 10 basis points on CET1.

GEORGES ELHEDERY: Gurpreet, also the LTV on these $3.2 billion NPLs is 55%, so even if there is some flux on the actual valuation, we are still at 55% LTVs, and that gives you a sense of the level of collateralisation.

GUY STEBBINGS, BNP PARIBAS EXANE: A couple of questions – the first one is building on Andrew's earlier question on the hedge. I think you implied that you're fully hedged or nearly fully hedged in the UK on the results call, and you've talked to some of the challenges of hedging in Hong Kong, so I just wondered if you could give any more colour specifically on other currencies you're likely to build the hedge – I guess asking in part to understand if these are currencies where the curve is more inverted and there's a cost in the near term. I recognise you talked about 'subject to market conditions' and things can change, but just if you can give any more colour around that, that would be helpful.

Then the second question on impairments – in terms of the actual impairment rate that you reported, very encouraging in Q2. H1 sits quite a bit below the full-year guidance still. Clearly, there is some uncertainty in some markets that we've talked to, but your remarks sound like you're quite confident in terms of how those shake through. So I'm just wondering if there's anything you're seeing that would imply the second-half run rate is towards the top of that medium-term range to get you back into your full-year guidance, as it were, or whether there's just an element of conservatism, which is understandable. Thank you.

FAS YOUSAF: As you rightly say, from a sterling perspective we are well positioned. We've hedged probably to where we want to be at this point in time. The way we generally think about this is we will split the currency mix into broadly two categories: the categories of major currencies, so US dollar, euro, sterling, Hong Kong dollar, and any other currencies where the rate trajectory is similar to those currencies. There are obviously other currencies that fall into a different bucket where the rate environment is quite different, and that we may have a different view on in terms of our hedging appetite for those other currencies. That's broadly the split.

In terms of that bucket one that I talked about, I think there is still scope to go in terms of our US dollar hedging. We talked earlier, when I was answering Andrew's question, that what we've done is we've swapped some of the currencies into US dollars, and what's happened is the US dollar structural hedge sensitivity has ticked up. You'll see that in our disclosures. I think it's gone, from memory, from about $0.5 billion to around $0.8 billion, so that gives us a bit more scope to do hedging in the US dollar space. We continue to look for opportunities to manage our exposure in Hong Kong dollar. As we've said repeatedly, the Hong Kong dollar market is such that there aren't necessarily the long-term assets out there to go and put on as much long-dated hedging as we would like, but we're looking at opportunities constantly to manage that exposure down, and that's another area of focus. Euros is broadly where we want to be, I'd say.

JON BINGHAM: On ECLs, a somewhat simple answer. ECLs is a volatile number. We got positive volatility in the second quarter from releases, and some of the overlays that we had been holding on to with higher interest rates, we released. There is nothing at a portfolio level that we're pointing people to when we think of the guidance. We just have the confidence to move back within our normal planning range. Obviously, the macro and election season – we'll have to see how that plays out, but there's nothing specific we're trying to guide you to look out for.

RAUL SINHA, JP MORGAN: I've got a few detailed follow-ups and one broader question. Just on banking NII, coming back to the moving parts, did I hear right, Georges, that you're assuming $1 billion within the $43 billion for Argentina? I am struggling with that because I think it printed $0.9 billion in the first half of the year, so depending on the timing of that, I don't know if Argentina prints $1.5 billion or – I don't know – almost $2 billion. Does that mean the $43 billion is then going to be adjusted higher by the delta to the $1 billion you've assumed?

Second detailed follow-up – the Hong Kong stage 3 is up to 6.6%. I couldn't find the ECL coverage anywhere, and you very helpfully give us the ECL coverage on the mainland China series, so I was wondering if we could get that disclosure for Hong Kong as well. I don't know if you have that now, but perhaps going forward?

The third one on detail – Commercial Banking topline. If you look at the detailed product revenue performance, although main lines, Global Payments, Trade, Cash and Credit & Lending are down, but the 'Markets Products, Insurance and Other' line was up quite strongly. It was up 20%, so all of the Commercial Banking growth seems to be coming from markets and other, and I was just wondering if you could comment on that. Was there something exceptional in the quarter that you would call out?

JON BINGHAM: Banking NII in Argentina – I think you've heard us say we've got a planning assumption of $1 billion, which was based on last year's numbers for Argentina. If you dig around, these are in the public domain, but if you look pre-adjustment for hyperinflation, the Argentina results are a little bit up but broadly stable, so it really is around the volatility that could be created by hyperinflation and Argentina. So when we looked at this for the full year 2023, that was effectively a $0.5 billion negative that could be created by hyperinflation. Hopefully we don't see quite the same economic moves, but that's why we've gone for the, 'we'll just keep it at a billion,' and what happens with hyperinflation will happen, so to speak.

RAHUL SINHA: Is that right to assume then, if it's more than $1 billion on Argentina, then the $43 billion automatically moves higher?

JON BINGHAM: Yes. We very much see it as '$42 billion plus Argentina'.

On the ECL coverage, on page 90 of the interim report, it doesn't quite get to exactly your question, but you can see, consistent with what we say about the security and coverage, the ECLs are pretty minimal against there, but you can see some of the allowance – the $258 million that we've got against the Hong Kong CRE in that table.

GEORGES ELHEDERY: On your third question, Raul, we give a little bit of the detail on the slide. Markets Treasury allocations, lower interest on debt held by Group holding company, Argentina volatility – which is inflating the earnings because of the inflation taking hold but no devaluation taking place in Q2 – as well as GBM collaboration, which basically reflects foreign exchange or interest rate hedging, et cetera. So it's a combination of all of the above that has created the additional 20% or $100 million in CMB.

RAUL SINHA. Thank you. I've got a general question. I think you've had these recurrences of buybacks now for a number of quarters. I think the market has got used to you doing buybacks at $2.5 billion – plus or minus – every quarter. You've still got a large amount of capital surplus, and to me it looks like you could continue doing this for a very significant amount of time, but is it really the best use of capital when the market may be penalising your valuation for the NII gearing with rates? Would you be now willing to consider, perhaps, alternative uses of that surplus capital to supplement strategically your revenue profile?

GEORGES ELHEDERY: Raul, the reality is we have enough capital to do all of the above. That's the reality. If I take it in order of priority, the first thing we do is we provision for a 50% dividend payout ratio. That's immediate use of that capital, which is based on our earnings, because that's what we've given for dividend guidance. That's the first use.

Second use of capital for our organic growth, and this is essentially driven by loan growth. A you probably know, the mortgage growth, which is 40% of our loan books, doesn't consume a lot of RWAs, so that growth is not highly RWA-intensive, therefore not highly capital-intensive, but other commercial growth or unsecured growth will drive more of that capital. The growth has been good in certain areas, subdued in the wholesale space in Hong Kong and the UK. We think, as we discussed earlier, the trend is turning, but to date we have the capital available to support that growth, it's just that it hasn't happened to the tune of what we have capacity for.

Third usage is we continue to look at inorganic bolt-on opportunities. The inorganic opportunities need to be dead-on strategy and accretive. We are not looking at 'shopping around', we are looking for something that will accelerate our strategy, provide us capabilities needed for our strategy. We've done a few. Most recently, we just closed the acquisition of the Citi wealth business in China. We will continue to look at similar opportunities for uses of capital.

Then the last priority in that order is utilisation for share buybacks. I look at share buybacks in a number of ways. First, it is a way of addressing our excess capital when it is not used by any of the above. The second is it is also a form of distribution that has been appreciated by a number of our shareholders. Third – and this is a very important one – is that it is allowing us to consolidate our share count. After this $3 billion we announced, once concluded, we will have bought back around 10% of our shares. That gives us, everything else being equal, 10% progressivity on our earnings and 10% progressivity on our dividends, which in particular matter for our retail shareholders – 30% of our shareholding is retail Hong Kong, about 10% is retail UK and other, and we have a number of our institutional shareholders in income funds, so we think it's giving us a runway for future progressivity, everything else being equal, by continuing to consolidate the share count.

EMMA XU, BANK OF AMERICA: In terms of the Hong Kong CRE downgrade, I just want to ask your assumptions in assessing the portfolio's future payment capability. What's your assumption of the red cards when you have the discount rate, and what's your assumption in the numerator, like the continued declining property price or rental yield? What's the assumption when you do this assessment? Could you give us a little more detail of the profiles of this portfolio? You mentioned that many of them could be with the bank for decades, but is there more detail? Like they are smaller second or third-tier developers, investment property, office, landlords, et cetera – are there more details about the profile? Lastly, I see there is still $1.9 billion or something in the 'Sub-standard' category. Will we see more migration from this bucket to the 'Credit impaired' one?

MING LAU: Let me answer the last question first. We've got $2 billion in 'Sub-standard'. Just given the current conditions, I think it is fair to assume there will likely be further migration from 'Sub-standard' to 'Credit impaired', but again, that portfolio has about 50% LTV. These loans have recourse, so even if that happens, we're not expecting any material impact on ECLs, and any downside risk on ECLs is covered within the 30 to 40 basis point ECL guidance that we've put out at a Group level.

In terms of assumptions, we're working on the basis of the forward yield curves. At this point, I think the market is expecting a Fed rate cut coming in September, so hopefully that helps to relieve some of the cashflow pressures on these developers. From an overall perspective in the market on office space and retail, at this point I think near term there will continue to be challenges, just given increasing supply that's coming on to the market, particularly in the office space. That's the base case we're working on when we have assessed the credit, but again, just to reiterate, the portfolio has strong LTVs. There is recourse, which is why, when you look at the provisioned coverage, it's only 8%.

EMMA XU: But when the Fed starts to cut rates, say in the fourth quarter or from September, will we see some recovery?

MING LAU: I would not expect a recovery to happen that quickly, because if you just think about a 25-basis-point rate cut, it's not going to materially change the debt servicing position.

EMMA XU: Then how much rate cut do you think could move the needle?

MING LAU: It would have to be, I think, in excess of 200 basis points, if you just have a look at where rental yields are at relative to where base rates are at this point.

In terms of the profile of the developers, we've been pretty conservative in terms of who we're lending to, but predominantly these are long-term relationships which we have had, and the credit deterioration that we are seeing is an effect of the macro rather than individual stress.

JEREMY HOU, CICC: Maybe two more specific questions on Hong Kong CRE. The first is: could you add some colour on property development and property investment separately? Because I assume you included both in the $36 billion CRE exposure, but I think that the clients' portrait and operating landscape can be quite different between these two.

The second one is a medium-term concern, like the cap rate in Hong Kong for retail properties is 3.2%, and offices can be even lower. If that continues to be at this level, I suppose there will probably be a price correction and may hit you with the ECL charges. How much does that concern you with your CRE exposure in the medium term? Thank you.

MING LAU: On development versus other types of lending, I'd just say we don't disclose that. What I would point you to is we're typically about 25% in terms of market share of the market in Hong Kong, so if you have a look broad based across Hong Kong – what that mix is in terms of types of lending across development, office space, et cetera – we'd broadly be in line with the market, and that's how I would guide you.

In terms of the question then on cap rates, yes, near term, as I mentioned, there likely will be continued stress unless rates fall quite quickly, but what I would point you to is, again, we've got strong LTVs. The low LTVs in the portfolio – these loans are structured with recourse, which gives us additional access to assets on the borrowers, and that's why, when you assess the risk on this portfolio, it is materially different than China CRE, which is offshore, unsecured and subordinated.

GEORGES ELHEDERY: Jeremy, I just want to reemphasise the last point that Ming shared. There may be some short-term pressure. There are short-term pressures, which may extend in the medium term, but on the whole, medium to long term, we remain confident, both in the underlying sector as well as on our portfolio in terms of borrowers' exposure. Again, we attribute some of these short-term pressures to high rates as well as the economic conditions, and as we see those adjust, we bring comfort from how it will turn. Again, it's a very different dynamic to the situation we faced with some of the China CRE exposure.

KATHERINE LEI, JP MORGAN: My question is still on the Hong Kong CRE side, because I looked at the track records. I've got data from back in 2006 to now. I've never seen such a big jump on impairment ratio regarding Hong Kong CRE, not only on HSBC, but broadly in other Hong Kong banks as well. So I would want to ask, is there any change in the recognition mechanism? I think somebody was explaining you recognise that according to certain criteria. Is there any change in the recognition criteria that trigger that this time the pattern could be different from the previous cycle? This is number one.

Number two, I would say, I just want to confirm - just now I think you said about the Hong Kong CRE, even if it's in stage three, does not necessarily mean delinquency. So some of the loans, clients are still serving the interest payments, the principal payments, but you are just pre-emptively looking at the numbers and think that there's risk. That's why you downgraded the loan. I want to make sure that my understanding is correct on that front.

And then, also on capital treatment on the Hong Kong CRE, just now you said it's about 10 basis points of impact on CET1, but if we look at Hang Seng, the impact is much bigger. We calculated that it's roughly about 140 basis points. I understand HSBC and Hang Seng are under two different jurisdictions when it comes to capital treatment, but my concern is we'll assume there's no further deterioration, i.e. no further downgrade, just with the existing portfolio. Would there be any scenario that triggers a bigger drag on capital than you currently have recognised? Thank you.

JON BINGHAM: Essentially, this is all consistent. So it's IFRS 9 definitions of default, and they all remain consistent during the period, so there's nothing from that perspective.

MING LAU: On your second question, the clients are still current, so they're still covering and paying interest. The reason why they've been put into stage three and impaired, again, is largely on the basis of stress on debt servicing, which I had explained earlier, and, secondly, refinancing risk. Just based on where the sector is and where the clients are from a debt servicing perspective, when these facilities mature, the clients are struggling to get refinancing in the market as a result. We are still supporting these clients. That's the reason why they're in stage three, but that's just to confirm these clients are still current and paying interest.

Your last question on capital in terms of treatment itself between Hong Kong rules and the PRA rules, it's broadly the same, the net impact at the end of the day on capital, both for HBAP and the Group, is broadly the same between the two sets of regulations.

JON BINGHAM: Sorry, coming back, maybe I didn't answer all your question. If you're comparing back to 2006, then with IFRS 9 and definitions of default, yes, the environment has changed. In 2006, it was very much an incurred loss model and very much based on performance criteria. So you're right. In that space, it would be different to 2006.

KATHERINE LEI: More forward-looking now, right, if I remember correctly?

JON BINGHAM: Yes, more forward-looking and more consideration of non-financial and economic indicators.

GUY STEBBINGS: Thanks. On UK NIM outlook, I think there was a comment I recall talking about sort of stability going forward. I'm not sure over what sort of timeframe specifically you're referring to around that. In terms of the dynamics at play, I presume mortgage book churn isn't really an issue - back and front book must be pretty aligned. Deposit mix has broadly abated. So we're just talking about structural hedge roll broadly offsetting expectations for rate cuts and the impact on hedge deposits there. Thank you.

CLAIRE BAIRD: Yes, so NIM outlook, when we say 'stable' that's looking out several quarters at least. The dynamics that we're seeing within that are largely the ones you've said. We'll get a pickup from the structural hedge re-pricing. Deposit mix is broadly stabilising now, which is good. We are expecting more rate cuts to come, albeit we've massively reduced our net interest income sensitivity since December 2021. I think it was $1.1 billion per 100 bps parallel shift now down to about $400 million or so. I think on that, the structural hedge will give us protection around those things.

On mortgages, similar dynamics to what our peers have said this week in terms of new business margins. They're definitely better than they were. We're paying cost of capital, which is good, but they are lower than the back book rolling off, so we'll still see that continued downward pressure on the overall NIM from mortgage margins for the time being. I wouldn't want to call when that will abate.

MANYI LU, DBS: Thank you. I have a follow-up question on Asia Wealth, because you have mentioned in the mid-term, the growth target would be a high single digit on the revenue side. I was wondering whether any colour, like what are the resources to support the revenue growth target, for example? Also, any target on how much capital we are going to allocate in this space or what is the cost guidance, for example, to increase the staff number or the branches to support this growth? And within the Asia Wealth, as you mentioned, there is a trend of increasing Chinese people coming to Hong Kong for the Wealth Management services. So any colour on whether to shift some resources between China and Hong Kong, for example? Some capital or some resources from China wealth management to shift to other areas of Asia. Thank you.

MING LAU: On capital and investments itself, the way I would articulate it is, first on capital, I think it's back to what Georges mentioned. We are selectively looking at bolt-on inorganic transactions. You would have seen the purchase of the Citi portfolio onshore in China. We've bought the AXA insurance portfolio in Singapore. Typically, the wealth business beyond wealth lending is not as capital intensive, so any use of capital would typically, more predominantly come from inorganic-type activities. That's how I would say to think about it.

We are exploring opportunities, but again they will largely be bolt-on acquisitions that supplement our either distribution or product manufacturing capabilities. I think the markets we predominantly would look at would be China, India, Singapore, from an Asia perspective.

On costs and headcounts, I would guide you to our China investment across Private Banking and Pinnacle. Pinnacle is one of the big investments we've put in over the last few years. We have just over 1,700 Personal Wealth Planners onshore in China. Beyond that, we are selectively investing in Private Banking, for example, in Singapore. Those are the cost and FTE investment.

Having said that, anything that we're guiding to in terms of the investment is embedded in the 5% cost guidance that Georges has put out at a group level overall.

GEORGES ELHEDERY: Thank you very much. I will be handing over for Q3 to Jon. You'll see me in a different format, but you'll carry on seeing me. Thank you for the engagement today and wish you all some rest over the summer.