HSBC

Transcript

Post-Results Equity Analyst Call
Q2 2023 Results

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RICHARD O'CONNOR, GLOBAL HEAD OF INVESTOR RELATIONS: Good afternoon, everybody. Good evening. Welcome to the HSBC Q2 '23 post-results equity meeting. We've switched to a virtual Zoom-only format because of travel issues in the UK and Europe. Georges is unable to be in the room, but he is on Zoom.

Before I open up to Q&A, I'll just hand over to Georges to make introductions and then formally open the meeting. Georges, over to you.

GEORGES ELHEDERY, GROUP CHIEF FINANCIAL OFFICER: Thank you, Richard. Morning and afternoon, everyone. Again, apologies. I was one of the victims of the air traffic control glitch in the UK, which has me stranded probably for another day. I'm very glad to speak to you all. I know it has been a month since we announced our results, and we hope all of you have managed to take some downtime and some rest time, albeit the economy kept surprising us.

I'm looking forward to the session today. Again, Richard can moderate. That will make the best use of your time in the Q&A session. I am joined also by the team in Hong Kong, led by Ming, our CFO for Asia, who can address some of the more specific questions around Asia that you may have.

RICHARD O'CONNOR: Thanks, Georges. So over to the Q&A session – for those of us in our London office – there are three or four analysts in person – please raise your hand and we'll hand a microphone over to you. For those on Zoom, as per normal, use the 'Raise Hand' function at the bottom right of your screen and, as ever, for everyone, when asking your question give your name and institution, and please generally stick to no more than two questions at a time.

With that, we'll take one from the floor in London, Alastair, whilst the others are settling down. Over to Alastair for the first question, please.

ALASTAIR RYAN, BANK OF AMERICA: Thank you. I'll ask the blindingly obvious one so we can address it to start with. So there's been a relentless drip of bad news from China since your results. The problem with having a Q2 review this long after Q2 is that stuff has happened, and various developers' bond prices have collapsed and there's been some visible strains at some of the trust companies.

Now, the Q2 disclosure was quite helpful on the size of your positions, but really just to invite whether, from your perspective, there's been a meaningful change in the credit environment, whether that changes your credit cost guidance for the year, which was quite clear at Q2, but that's three weeks ago now. Every day has been bad for the China news flow. Thank you.

GEORGES ELHEDERY: Thanks, Alastair. So, look, as we looked at our exposure in China, the one that has been a cause for concern was the offshore-booked exposure on China real estate. It remains the one that is mostly driving concern. That exposure has dropped now from $9.4 billion to $8 billion. Within that exposure, just north of $5 billion has been classified as sub-standard or credit impaired, and if you take out the $1 billion of which has a security, we're left with about $4.1 billion that is unsecured and against which we've taken substantial provision.

We also did indicate earlier at the year-end that we're looking for a plausible downside scenario where we may take an additional $1 billion on that portfolio. We have taken about $300 million at Q2, at the half year. Clearly, as we've seen things develop over the last three weeks, that plausible downside scenario is probably becoming more plausible. We still look at it at this stage as the plausible downside; it's just that the probability of it is definitely looking like it has increased.

We're aiming to give more details at the end of October Q3 results, but at this stage we can continue sticking with that plausible downside scenario, and at this stage we remain comfortable with our indication of our overall ECL of 40 basis points for our loan books, which was cautious and we believe is cautiously there to capture some of the downside we see in China.

RICHARD O'CONNOR: Thanks, Alastair. Over to Alvaro. Just a reminder to everybody on Zoom, use the 'Raise Hand' function. Thanks for the question.

ALVARO SERRANO, MORGAN STANLEY: Just a couple of questions on revenues. Obviously, HIBOR has come down quite a bit as well. I don't know if you can give us some views on how impactful that might be, obviously, from Q4 onwards. And in your planning how do you see HIBOR going forward? Remind us of that.

And relatedly, on revenues, obviously the China slowdown, China Wealth – all the ramifications of the China Wealth creation was part of your growth in insurance and Wealth more broadly. Are you seeing major impacts or are you worried about any major impacts of those revenue lines as we think about next year? Thank you.

GEORGES ELHEDERY: Thanks, Alvaro. So HIBOR has come off in August. Look, firstly, July HIBOR was substantially higher than the average for Q2, so that remains an important factor for the Q3 averaging. There is seasonality in HIBOR as well, so it is not fully unsurprising that over the summer we see it more subdued and towards year end we tend to see it a little bit tighter. Whether we continue seeing this seasonality this year is to be seen, but that's the general seasonality. But, all in all, we remain at this stage at relatively higher levels than in Q2.

Now, I can't comment much more on where this is going in Q4. The only thing I can point you to is the historical seasonality. Obviously, that's absent any additional parameters we may observe, and then the best indicator, really, for our NII is average HIBOR, because we do have fixings that do happen across the quarter. So the average across the quarter as well as the HK Exchange Fund Bills average yield – this is the essential instrument we use to put our excess liquidity in. So that's as much as I can say on HIBOR.

About China Wealth, I think there are two elements I would call out. The first one is all the efforts we're doing to develop domestic mainland China Wealth, including Pinnacle, which is our insurance initiative. Those are essentially now investments. We're not really expecting any material revenue contribution for the foreseeable future. These are long-term investments. We will continue using these times to continue that investment and, as you recall, during Covid we continued investing knowing that this is more of a long-term play. So it is unlikely to have an impact on our earnings just because the contribution to our earnings remains minimal.

With regards to Hong Kong, we did call out at half-year results that some of the outperformance we've seen from insurance in Hong Kong was benefiting from the opening of the border between mainland China and Hong Kong and seeing more mainland Chinese contracting insurance in Hong Kong. Now, again, that dynamic at this stage continues, but if you do see more restriction on travel, that's unlikely, but, also, if you do see restrictions on funds flowing from mainland China into Hong Kong, then it could impact some of that outperformance.

Now, remember, this is Hong Kong insurance. We are a top-three player in Hong Kong insurance. We have a very substantial market share in Hong Kong among the Hong Kong domestic population. So essentially it remains a Hong Kong business. It's benefiting from the additional inflow of mainland Chinese travelling to Hong Kong. That inflow may be a portion that could be at risk. Only that portion, I would say, would be uncertain as we look over the next six months in terms of capital flows for mainland China to Hong Kong. Thank you, Alvaro.

RICHARD O'CONNOR: Let's hand over to Tom Rayner. Tom, over to you.

TOM RAYNER, NUMIS: Thanks, Richard. Hello, Georges. Can I just go back to your RoTE guidance for 2023 and 2024, mid-teens excluding notable items? I was just looking at the consensus that you published yesterday, which shows RoTE just a bit above 17% this year and next year, then dropping back about three percent to just over 14% in 2025.

And I'm just trying to get a sense – I think maybe a 2% of that drop is notable items coming out, and possibly 1% might be to do with interest rate expectations. I obviously don't know all the individual forecasts, but I'm just trying to get a sense, is that profile consistent with that mid-teen underlying guidance you've given? That 2025 figure, maybe just around 14% to 15%? Is that consistent with what you were trying to – the message you were trying to put out there? Thank you.

GEORGES ELHEDERY: Thanks, Tom. So what is the definition of 'mid-teens'? It's definitely two-sided, the way we look at it as mid-teens. So you can argue it's 14% to 16% or 13.5% to 16.5%. It's certainly not one-sided that we're trying to call it out as mid-teens. So that is one assessment I would make. The other assessment I would make is there is going to be a likely notable item next year with the sale of Canada, hopefully a very likely notable item with the sale of Canada, which will obviously contribute to the divergence of the overall RoTE from the ex-notable item guidance.

And I would also probably want to highlight that it is likely we will reinstate the impairment related to the sale of the French retail business sometime this year, and the reason why it is likely is we have been working towards or aiming towards a closure early next year for the sale.

RICHARD O'CONNOR: Let me add to that. Consensus for next year has in revenue just over $4 billion, $4.1 billion that is de facto the analyst forecast for the gain on Canada. Just to remind you, it's tax free. So if you wanted to strip that out of the 17% consensus, Tom, that would get you much nearer to the mid-teens, which, just to remind you, we're guiding mid-teens for 2023 and 2024. We're not guiding for 2025 at the moment.

At some stage there will be a debate on 2025 RoTE, but that's not one we'll have now. But, clearly, the debate is, 'Can you maintain that mid-teens for 2025 or will it drop back?' and that is something which we obviously will debate internally over the coming months, and we'll have that debate with the market probably during 2024.

RICHARD O'CONNOR: Manus, I think you raised your hand there. If we can unmute Manus, please.

MANUS COSTELLO, AUTONOMOUS: Thanks, Richard. Thanks, Georges. I just wanted to follow up on the commentary around the China macro piece. There's obviously been quite a lot of commentary around FX weakness in China. I wondered if you could comment on how you think yuan weakness impacts HSBC.

Just to link it to a comment you made previously, you talked about the insurance business and the Wealth business obviously being impacted if there were any restriction on flow of funds, and I wondered if that was gesturing towards a concern that there could be some kind of restrictions put in place because of currency weakness?

GEORGES ELHEDERY: Thanks, Manus. So I'll give some of the perspective. I'll ask Ming also to comment after me. He can probably give you a little bit more detail.

So the first thing is, when you look at our China PBT, there are two components of it. There's, obviously, the component we manage, which is our own business, for which we reported about $1 billion PBT last year, probably on track for that ballpark this year. That's commensurate, say, to the PBT we generate in countries or territories such as India or Singapore. This is what we generate in our mainland China jurisdiction. Then there's obviously the component which we don't manage which relates to the earnings from BoCom, and that one is their earnings times our share of it, and then we earn a divided on our share of it.

So if I more specifically talk about China macro, I think our house view is that we're faced with a cyclical challenge in the China economy, a post-Covid challenge. It's essentially driven by lower sentiment or weaker sentiment by consumers specifically for high-cost investments or

high-cost spend, such as real estate, and that's certainly driving some of the challenges we're facing on the credit spectrum of late. We continue believing this is cyclical. We continue believing that the fundamentals of China, mainland China in particular, and mainland China growth for the medium to long term remain strong.

We continue believing also some of the policy measures being taken structurally are the right ones. We continue seeing strong investments in areas such as EVs, where China is becoming one of the biggest producers and the biggest exporters of EVs, likewise for renewable energy. So there are definitely areas of investments in the future that are defining how we structure this – why we structurally believe that China is still strong in the medium to long term. We have seen some flooring of some of the weaknesses in trade that we've observed since the peak in Q2 '22, and that's essentially now intra-Asia trade that's compensating some of the weakness we're seeing in the East-West trade. So that also provides a floor.

Now, you could argue some of the policy measures may be slower than what some of the Western economies have been doing in dealing with similar types of economic challenges, but these are through-the-cycle policy measures trying to adjust the cycle. I think we just need to be patient and see how they will work themselves out in the short-term cyclically, but it's not changing our medium to long-term outlook on the resilience and the growth potential that China offers.

In terms of specifically on Wealth, I'll probably hand over to Ming.

MING LAU, CHIEF FINANCIAL OFFICER, ASIA-PACIFIC: Thanks, Georges. I guess, Manus, are your points specifically on the comment related to controls and so forth on outflows? China today for individuals has a control which limits the annual amount individuals can remit offshore, $50,000. I don't believe there's any concerns on that changing at this point.

From an underlying basis, I was actually up in Shanghai last week, and I think the dynamic we're actually seeing is the fact that when you look at investment returns, when you look at interest rates - Hong Kong dollar, US dollar interest rates are clearly stronger than onshore RMB interest rates, so there's an increasing demand in terms of investments coming into Hong Kong. So that's what we're seeing.

I think as long as some of these differences in rates and particularly stronger performance in terms of equities ex-Hong Kong ex-China continuing, you'll continue to see that demand and flow coming into Hong Kong, which I think from our perspective, just given naturally our market share and our position in Hong Kong, positions us well. I think we've communicated and indicated in the past, since the China border re-openings, we've seen a pretty sizable pick-up in terms of demand for new account openings. We've seen a pick-up in terms of insurance sales, and through the third quarter so far that trend is continuing.

RICHARD O'CONNOR: Thanks, Ming. Thanks, Manus. Over to Katherine at JP Morgan. Katherine, thanks for the question.

KATHERINE LEI, JP MORGAN: Hi, sorry I dialled in late. I'm not so sure if somebody has asked this question. So post second quarter results, I think one event is the Country Garden potential default event. I understand the management won't be able to comment on a single name, but can you give us some colour? Say, for example, during the briefing in 2Q, management guided that potentially there could be another $700 million of provisions on the China CRE portfolio and with the risk event with Country Garden – does that change your guidance of potentially an additional $700 million?

RICHARD O'CONNOR: We have had that question, Katherine, but let's just briefly summarise again what was asked before and if there's any other colour which Georges or Ming want to give.

GEORGES ELHEDERY: Thanks, Katherine. Look, at this stage we're holding with our guidance. I think as you said, we called a plausible downside scenario of $1 billion. We had taken $300 million in Q2. I think the way we should look at the events now, as they're unfolding in China, is that the probability of such a plausible downside has increased from maybe the outlook that it was in Q2, so we're not revising the quantum at this stage. We would want to

continue giving you updates, and at Q3 we'll give you additional updates, but at this stage it's more of a matter of probabilities of such a downside scenario manifesting.

RICHARD O'CONNOR: Thanks, Katherine. Any questions here in London? Thanks, Aman.

AMAN RAKKAR, BARCLAYS: Two questions, if I may. One is on loan growth. Tim, you were helping me with part of this answer earlier on today. Around loan growth, I understand the point that Chinese corporates are finding borrowing in mainland China more attractive right now, given the level of interest rates. Could you help us just scope the size of that book? So how big is that corporate book of Chinese corporates that have an optionality in terms of whether they're going to do the lending in Hong Kong versus China?

And I guess the reason I'm asking is, a key question, a key debate, is the impact of a slower China on your loan growth ambitions because they in turn have an implication for your net interest income run rate in 2024 and beyond. So I guess the broad question is how sensitive is your loan growth to China? And I think that corporate wholesale book for Chinese corporates in Hong Kong and mainland China – if you could give us any detail there, that would be great.

The second one was just to come back on distributions. I asked the question on the Q2 results call around – at face value, if I just take consensus, your 50% pay-out ratio implies something like a 60 cents ordinary dividend this year. I think you gave quite a confident response to my question around the earnings outlook and the impact of buy-backs on share count as to why actually you're quite confident in that, but I guess we did just address the point a minute ago that sustaining this level of return on tangible equity is a live debate; it's a live question.

And there's two-way risk around your earnings outlook, and, if rates were to come off, say, your return on tangible equity could fall quite meaningfully. I know you've done a lot to reduce your rate sensitivity, so I'm just going to ask again, basically, around that 60 cents dividend and how comfortable are you that in the future it might not be 60 cents? In a couple of years' time you might have to announce 50 or 40 or some number that's some way below that.

GEORGES ELHEDERY: Thank you, Aman. I'll answer your second question and then I'll give some perspective on your first question and ask Ming to elaborate on your first question.

So on your second question, the sheer fact that we announced a 50% dividend pay-out ratio for 2023 and 2024 effectively means the dividend would be volatile. So there's no indication whatsoever that we will try to maintain a fixed dividend or any progressive dividend, whatever. It's effectively a direct link between our earnings, ex-notable items and our dividend, therefore the dividend can go up and down based on returns. So that's an accepted outcome of a fixed dividend pay-out ratio.

Now, this being said, some parameters I just want to give you that you can embed in your analysis as you look forward. The first one is obviously the dividend pay-out ratio is subject to the share count. The dividend per share or earnings per share is subject to share count.

Now, it remains our intention to use the next few quarters, where we do seem to be highly capital-generative, it remains our intention that we use these quarters to pursue a rolling series of share buy-backs, obviously subject to approvals and subject to earnings and capital adequacy ratios being able to support it, but it remains our intention to use this as a means to address somewhat the share count, which will allow us to sustain for the same dollar amount of earnings a better dividend per share. So that's the first thing to call out.

The second thing to call out, Aman, is the efforts we have been conducting and that we continue conducting towards creating additional stabilisation and structural hedging in our earnings by effectively locking in medium-term rates more so than we have done in the past, and therefore reduce our exposure to short-term rates and, by doing so, reduce therefore our NII sensitivity and our earnings sensitivity for a potential reversal of the rates cycle. As and when it happens, next year or the year after, I don't know, but kind of putting some protection there.

So those two parameters I would urge you to consider. The third parameter to consider is all the investments we are doing in non-rate-sensitive businesses such as Wealth – an assessment of how much compensation we will see from these investments in Wealth over the coming years will support, if you want, the potential loss of earnings from rate-sensitive income,

but, clearly, our intention is to continue investing in this space and expecting higher returns and higher growth rates from these fee-earning businesses than from the rest of the portfolio.

Now, if I move on to your first question about loans, so maybe I can give you first two numbers. Loans in Hong Kong have dropped by around 4% to 5% Hong Kong-wide. Loans contracted in Hong Kong by borrowers for utilisation outside Hong Kong have contracted by more than 10%. So clearly offshore borrowing from Hong Kong has contracted much more, and the reason is obviously these offshore borrowers, specifically mainland Chinese, will borrow at a cheaper cost in mainland China at mainland Chinese rates rather than borrowing at dollar-equivalent rates.

The other parameter I want to give you is our market share in the loan business in China. Our balance sheet market share in China is 0.2% – our organic business, which means we are much less impacted by volumes in the market because we are such a small market share, and therefore we can effectively much more proactively drive our own exposure because we're so small, in the context that we can effectively define what balance sheet growth do we want to achieve based on our risk appetite, somewhat irrespective of the overall market share – overall market, just because we are a very small player in the market.

And then the last thing I'll say before handing over to Ming is that we are not changing our risk appetite. I think you guys have been used to HSBC's risk appetite – probably more cautious risk appetite, and we will maintain the risk appetite. So if, with this risk appetite, it means that we will see lower loan growth, so be it, but we are not going to chase loans by changing the way we look at risk. That's a fact. Probably, Ming, if you want to take specifically our corporate book in China and whether we want to add more colour on this?

MING LAU: Sure. Thanks Georges, and thanks Aman for the questions. So just to give you a sense, overall for the market in Hong Kong, roughly about a fifth of the lending is for offshore use outside of Hong Kong. On a broader basis, just thinking through your question on loan growth and so forth, the factors I would say I would also draw your attention to is, when you look at the market and what's happening on trade, particularly imports exports, the Hong Kong number is probably down north of 20% year on year in terms of volume. So that specifically has impacted the trade finance portfolio across the board.

However, having said that, our market share from an overall trade finance perspective remains to be broadly at about 22% for the market in Hong Kong. There clearly is also the impact of higher interest rates across the wholesale portfolio. We are seeing very cautious sentiment in terms of investments and investments in things like capex and also, as a result of higher interest rates, we are also seeing more and more clients deleverage from an overall investment and balance sheet perspective. So I think it's a combination of those few factors which is leading to the contraction on the wholesale lending side of the business.

RICHARD O'CONNOR: And just to remind everybody, you'll have these facts and stats anyway but our Hong Kong loan book is $289 billion out of $1 trillion, including held for sale, and about half is in retail, which is obviously onshore, and half is in wholesale, so we have more of a retail skew than the market as a whole in Hong Kong in terms of that Hong Kong loan book. And on your second question, we are obviously aware of the issue and we will work through it. Okay, next question from Zoom. Matt Clark, please. Thanks Matt.

MATT CLARK, MEDIOBANCA: So two questions from me. Firstly, on capital allocation, in this slower environment, where can you or do you hope to allocate capital in the next six to twelve months? So where is there potential appetite to grow with a new portfolio? Then secondly, on the structural hedge, with the adjustments you've made, is the snapshot at the half-year stage it for now? Have you repositioned it the way you really want to be for the next phase of the rate cycle or is there more repositioning still to come? Thanks.

GEORGES ELHEDERY: Thank you, Matt. In terms of capital allocation, as we're seeing at this stage slow loan growth, particularly in Hong Kong, mainland China and the UK, we are seeing increased demand in loans in places such as the Middle East and south and southeast Asia, but not enough to compensate some of the slowness we see in the UK and Hong Kong. We've been returning capital back to you guys, so the share buyback is a means to make good use of any capital surplus. Now obviously, we continue being on the lookout for bolt-on acquisitions that could be very much in line with our strategy and accretive but outside that, I think we will

– at least my intention would remain to return capital where we can, and as long as we're generating those capital accretion earnings that we've been seeing.

On the structural hedge, no, I would say we are not fully there. We are clearly now sharing NII sensitivities, and you have probably seen from the NII sensitivity between year end and now the impact of our structural hedge, so about $1 billion of our initially $6 billion NII sensitivity exposure has been reduced due to structural hedge. The rest of it was rate level changes. It reduced to $2.6 billion, so the rest of it is rate level changes as well as some modelling adjustments, etc.

But there are two things I just want to highlight, Matt, for your assessment. The first one is we did talk about banking NII and we included the trading book funding component, which is a rate-sensitive earning that has therefore interest rate sensitivity that we have not been including in our NII sensitivity previously, but is certainly driving part of our trading book funding, so driving sensitivity in our overall earnings – sensitivity to rates. We are enhancing our disclosures to encompass Banking NII sensitivity and Banking NIM, and our structural hedging strategy is therefore meant to cover for the overall interest rate sensitivity, not just in accounting NII sensitivity.

And then the second thing I would point to your attention, Matt, is that we today give you a five-year NII sensitivity as a metric to give you a sense of the duration of our hedge. We are looking at ways to enhance this disclosure so that you also have a sense of not how much has been stabilised but for how long, and therefore you can have a better visibility on your forecast for a year, two years, three years in advance – how much of those earnings have been structurally hedged against other ones. So therefore it's very much a continuing exercise. I do need to caution you though that these are mostly dependent on availability of hedges in places such as Hong Kong, where long-term Hong Kong dollar instruments are in very much short supply. We will remain somewhat sensitive because there is just absence of instruments we can use to hedge for that sensitivity.

MATT CLARK: And sorry, if I could maybe just have a follow-on, obviously you got caught out on the AFS portfolio last year when rates unexpectedly moved upwards. In the way that you have implemented the structural hedge now, is that basically not a risk in the future? As in you've done it outside of the AFS portfolio, so your CET1 is not so much at risk, or if we were to see unexpected volatility at the long end, should we expect to see material CET1 impact again in a good direction?

GEORGES ELHEDERY: It's a fair question. Previously one of our policies was to – for historical structural hedging – utilisation of our excess liquidity for purchasing treasury instruments, as you can figure out. Historically, it has been all utilising AFS portfolio, which means when you have rate movement, all of the impact has gone in to capital, whereas many of our peers have utilised held to collect or equivalent held-to-maturity type portfolios, for which the impact does not go into CET1.

So first thing to call out is that we have now – we are approaching this with a dual kind of utilisation – dual business models, using AFS and HTM, or under IFRS HTC&S and HTC, partly to mitigate implications on CET1 ratio from big rate moves. That's the first thing to call out, and the second thing to call out is we're clearly putting much more disclosure to you guys in terms of what's also in our HTC portfolio or held-to-maturity portfolio, so you have visibility even for the amount that doesn't impact CET1 ratio, what would be the impact of such a move. For instance, we called out at half-year that our HTC unrealised losses that have not fed into capital stand at about $2.8 or $2.9 billion, which contribute around 30 basis points of our CET1 ratio, so you have full visibility even for the amount that didn't hit our CET1 ratio. Again, if you compare us to many of our peers, we remain at the very low end of that impact, and therefore we think we have good room to manoeuvre here.

RICHARD O'CONNOR: I'll add a couple of things – slide 35 of the H1 results shows what Georges has just been talking about in terms of the movement in AFS reserves, which are currently $6.5 billion. Clearly you're talking about an unexpected shock upwards, the disclosures are there in the Pillar 3 if you want to look at that, and you'll see that that present value loss has come down.

On the hedging strategy, we made good progress in H1. Part of that progress as we report for that 100 basis points downward shift was due to assumption changes and rate changes, but there was about a third of it was underlying organic progress. That's the sort of run rate I think you should think about for the second half. We'll update you at the full year. And just on capital allocation, just to remind you in the last couple of years we've made four acquisitions in wealth-related areas of about $1.7 billion, and there's organic investment in the wealth business of hundreds of millions of dollars a year. It's not going to eat up the capital surplus, but just to add to Georges' comments on the loan growth side as well there. Ok, over to Jason at UBS please.

JASON NAPIER, UBS: Good afternoon. Thank you for taking my questions. Thank you for the new disclosure on Banking NII. I'm on a quest to use it usefully, and the first thing that strikes me is that the Banking NII looks more volatile than the stated statutory number, so I've got two questions on that, if I could. The first is if the second quarter underlying funding cost of the trading book was about $2.2 billion, how from the outside would we think about the big moving parts of how that might be in the second half? Above $7 billion seems too low a number. You might have said above $8 billion quite plausibly, so just what might outside observers look at in order to think about that?

And then secondly, looking at Banking NII, if you could help me understand why Banking NII would have been flat in Q1 quarter-on-quarter but then up 13% in the second quarter – what are the bigger moving parts are? Some of that 13% is obviously the accounting change on the funding costs, but even then, it's 1% growth becomes 10%. I just wonder whether you could talk about how that interrelates with guidance which basically says it is flat in Q3.

GEORGES ELHEDERY: Thank you, Jason. So maybe just worth clarifying the first thing. What we mean by Banking NII is the sum of NII and the trading book funding, but the trading book funding on a standalone basis, which is the $2.2 billion you quoted, is effectively the sum of the NII of $9.3 billion and the $2.4 billion.

JASON NAPIER: Agreed.

GEORGES ELHEDERY: So that's what we're talking about. Now, if you look at the total amount, it should be more stable. The situation has been that some of the NII forecasting versus trading book funding effectively are communicating, which means if one increases, the other one decreases by the exact same opposite amount and vice versa, whereas when you look at the sum, you have a more stable outlook for our earnings because you capture both together, irrespective of how the cursor is shifting between one and the other – between NII proper and then the trading book funding. That's the first thing to call out.

The second thing to call out – if you look at the trading book funding for Q2, essentially – and I just want to be cautious, not go into too much detail. It's something we can take offline, but essentially you can look at it as how much of our deposit base bank-wide do we provide our trading activities for generating non-NII income. The trading books – the GBM, the Global Banking and Markets trading books, pay interest on that funding to the central pool when they take the funding. The funding they were taking or they were using at the start of the year was about $100 billion, so about 6% of our total deposits have been lent to GBM and on which we earn the interest of it for that quarter.

Due to the slow loan growth in Q2 and the availability of additional funding, essentially, our Asian teams have allocated more of the deposit base to the trading teams, and that funding moved from about $108 billion to about $130 billion, so that $20 billion will automatically generate $20 billion times, say, 5%. It's essentially dollar short-term rates, $20 billion times 5% times a quarter, divide by four, of additional earnings in the trading book funding component. Equally, an opposite amount has been deducted from the accounting NII, but when you look at the Banking NII, the two net out. That differentiation gets washed out if you look at it in total.

JASON NAPIER: I guess building on that framework, rates are unchanged on Q2. They're high. Loan growth will remain tepid, so $2.2 billion underlying for Q2 would be the kind of number I would expect for Q3 and Q4, would be the first question.

GEORGES ELHEDERY: Your forecasting can assume flat balances – call it $130 billion, times whatever rate forecast you have – call it 5% – times two quarters, and that would be a fair forecast for this trading book funding. If the balances change – let's say, for any reason, we

reduce the balances – the commensurate drop in the trading book funding will be – the exact opposite will be added to our NII forecast and vice versa.

JASON NAPIER: Thank you. And then the first question was if you look at your slide 13, that Banking NII in Q4, $10.2 billion, Q1 $10.3 billion, Q2 $11.6 billion. What are the dynamics that create such a step change in that underlying more stable number in the quarters that are absent in the second half?

GEORGES ELHEDERY: So the main dynamic has been first an improvement in our underlying NII in the UK, which you can translate when you look at the UK NIM. The second one is an improvement in NII in the non-ringfenced bank – an improvement in rate-sensitive earnings, but most of that earning appeared in trading book funding, and that's due to higher dollar rates with the couple of rate increases we have seen during the quarter, and then the same dynamic in Asia. You've seen an improvement of HIBOR. Average HIBOR for Q2 was about 100 basis points higher than average HIBOR in Q1, which has generated some $300, $400 million additional earnings, except that most of those earnings didn't appear in NII. It appeared in trading book funding because Asia has used more of our deposits to fund the trading activities, but the sum of the two has benefited from improved HIBOR.

JASON NAPIER: That's helpful, thank you.

MING LAU: Jason, what I was going to point you to, to try to answer your question on why Q1 2023 to Q4 2022 banking NII is broadly flat and the second quarter is higher is if you look at slide 25, you will see that the average one-month HIBOR between the fourth quarter and the first quarter of 2023 actually fell by about 65 basis points, so we actually saw a reduction in NII on the Hong Kong dollar book, which is then offset by increases in the other currencies from an overall bank perspective, but if you look at the second quarter, then HIBOR, as Georges indicates, moves up then by 100 basis points while the other currencies also move up. So I think that's the dynamic you need to consider, and then as you look forward for the second half, I would say look at where third quarter-to-date average Hong Kong dollar rates and other currency interest rates are now relative to the second quarter, and that should give you a better indication as to how to model the second half banking NII.

JASON NAPIER: Thank you.

RICHARD O'CONNOR: Just to add, for that trading book funding or trading book NII it's primarily US dollar short-term, US dollar rate-related – not overnight, by the way, but it's primarily at the shorter end of the curve, for obvious reasons.

OK, Gurpreet at Goldmans. Gurpreet, thanks for the question.

GURPREET SINGH SAHI, GOLDMAN SACHS: Thanks for taking my question. Hello, Georges and hello, Ming. With respect to the funding costs in Hong Kong, it seems like switching to time deposits continues to happen, and then we're getting around 2.5% for the system as weighted average funding cost, as published by HKMA. So maybe we have a lower cost, but then my question really is mortgages are being originated at 3.6% – the new ones, and the back book is at 3.3% or 3.4%. So the spread is razor thin, so what's the risk? How do we view this market? How do we compare to the UK mortgage margins and is there a risk that, even if Fed holds rates here, then we might have to raise the prime rates somewhere down the line? Thank you.

MING LAU: Thanks, Gurpreet. Look, on time deposit migration first itself, I think in terms of what we're seeing broadly over through the third quarter now, is we continue to see a pace of migration broadly in line with what we saw in the second quarter, so roughly about 1% per month. Expectation is it's probably a bit early to call the peak on that. We're still seeing competition in that space, and generally, because we're significantly lower than the market in terms of time deposit mix, I think that through the rest of the year we'll expect to continue to see some of that migration dynamic continuing to happen.

Your question overall on pricing, on mortgages and so forth, and potential impact on the prime rates in Hong Kong – look, I think there clearly are quite a few different dynamics we need to consider, including competition itself overall. So the raising of – or the US dollar rates itself is one thing we consider in terms of making that decision, but clearly we also monitor the dynamics around competition itself on deposit pricing and market share on deposits when we

look at whether or not to move that, but I think if you look at in general over history, it's typically when the Fed rate decisions are happening that we look at the decisions around the best lending rate and the Hong Kong dollar savings rates.

GURPREET SINGH SAHI: Understood. Thank you.

RICHARD O'CONNOR: Okay, very good. Georges, over to you to conclude the meeting. Thanks very much.

GEORGES ELHEDERY: Perfect. First, thank you very much everyone and, again, thanks for the questions, and again, as usual, if there is any follow-up requirements or any additional level of detail, please do reach out and the IR team will very gladly, with myself and Ming, support what you need.

The second one is at the end of October we will be announcing our Q3 results. We will provide additional detail on what we think has happened in China and whether we see any changes to what we guided towards at the half year, but we do recognise that there's a lot of moving parts coming from China.

And then the last thing I wanted to share is thank you for not asking questions on areas that we haven't guided towards yet. I know some of you would be keen to hear that, but as Richard earlier said, we will be in internal debates around some of these areas and in due course we will give you better clarity on some of these unasked questions, but with that, thank you, all. Thank you for those who came. Apologies I couldn't be there in person. Thank you for all those who joined by Zoom, and I look forward to speaking again in a couple of months.