HSBC

Transcript

Post Results Equity Analyst Call
Q3 2022 Results

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RICHARD O'CONNOR, GLOBAL HEAD OF INVESTOR RELATIONS: Good morning. Good afternoon, everyone. Thank you for joining us today. I'll hand over to Ewen for a few introductory comments. We'll do Q&A first of all in the room in London, then, Mark and team, you direct it in Hong Kong; and then we've got a number of guests on Zoom. If you can do the 'raise hand' function, and we'll rotate that around two or three times to make sure all your questions are answered. With that, I'll hand over to Ewen.

EWEN STEVENSON, GROUP CHIEF FINANCIAL OFFICER: Thanks, Richard. Good morning to everyone here in London and good afternoon for those of you in Hong Kong. Thanks a lot for coming in and joining today. In addition to me here in London, I've got Carlo Pellerani– Carlo's our Group Treasurer – Jon Bingham, who is our Global Financial Controller; and Richard and his IR team, who you all know. And, in Hong Kong, even though you can't see them on the screen, we've got Georges Elhedery – Georges is going to be our new Group CFO from 1 January – Ming Lau, Asia CFO; Kathleen Gan, Global Head of Finance; and Martin Haythorne, our Asia Chief Risk Officer.

I took away from last week that there were three areas that we should particularly focus on today: firstly, our net interest income and flip guidance for 2023; secondly, our China real estate exposure, particularly the offshore book in Hong Kong; and, thirdly, our operating cost guidance, the 2% growth for 2023 – but obviously happy to take questions on whatever other topics you want during Q&A.

Before we kick off on Q&A, a few points from me on our NII guidance for 2023. To reiterate what I said last week, we upgraded our like-for-like 2023 net interest income guidance by $1.5 billion after taking into account two factors. Firstly, FX: relative to when we spoke to you at second quarter results, there's a net interest income headwind of about $1.2 billion if you were to use September average rates. Obviously, this will also have a beneficial impact in lowering our dollar operating costs. As I said last week, at the same September average rates, 2021 operating costs would have been around $29 billion.

Secondly, the impact of funding our trading book assets with banking book liabilities – this is expected to be at least $1.3 billion of additional net interest income drag in 2023. This is because, as rates rise, the cost of funding net trading assets increases, which depresses net interest income, with an equal and offsetting amount reported as trading income. This is a pure offset between net interest income and non-interest income, and the corresponding part of the trading book income has all the characteristics of net interest income.

Are we still interest rate sensitive in 2023? Yes, but we do think it's right to be conservative at this point in the cycle. We are seeing, as you know, unprecedented speed and magnitude of rate increases and high volatility in market expectations. The market now expects interest rates in the UK, US and Hong Kong to peak in the next six to 12 months at levels not seen since at least the global financial crisis.

Our published NII sensitivity assumes a 50% deposit beta. We've been lower than that so far, but we do expect that to move substantially higher from here during this rates cycle. It also assumes a static balance sheet, which is particularly important in the context of our Hong Kong deposit book. Given the yield pickup available on the market, we assume a further material shift from NIBCAs into time deposits. Just as an example, we currently offer a 3.7% rate for new money at HSBC Premier for a one-year term deposit.

If you look at the market as the whole in Hong Kong, the proportion of time deposits was around 36% going into 2022. That's risen to over 45% by September, and we expect it to increase to above the 2018-19 cycle, which peaked at around 50%. Do note that our time deposit percentage is currently around half the market level, but we do expect it to continue to increase from here, and we think we've been fairly conservative in our assumptions on peak migration, which we expect to occur during 2023.

As we said last week, we'll revisit and refine 2023 assumptions during the fourth quarter, and Georges looks forward to updating you at our full-year results in February. So, to repeat the 2023 guidance, at least $36 billion of net interest income, which includes the $1.2 billion impact from FX and second-quarter reporting and an extra $1.3 billion of non-interest income from net interest income flipping into non-interest income to fund the trading book. So, relative to our second quarter guidance for net interest income of $37 billion, we've upgraded our revenues by $1.5 billion.

And finally, before I open up for questions, a few words on our 2023 operating costs. I know there was some concern last Tuesday that my departure will see a lessening in our commitment to cost delivery. Georges and I have been through our 2023 cost plans in some detail over the last few weeks. He and I are totally aligned on what is required to deliver to that 2% cost target this coming year, and we've got clear bottom-up plans that are being executed that are consistent with the guidance that we've given.

With that, I'll open up for questions. Just as a reminder, we've got Martin Haythorne, Asia CRO, here to answer any questions you've got on the China commercial real estate book. And we've got mics here in London, and I think in Hong Kong, if you could please speak into the mics so that everyone can hear. Thank you.

RICHARD O'CONNOR: If you give your name and institution as well, just for the transcript. Thank you very much. So we'll start with a few from London.

RAUL SINHA, JP MORGAN: Just maybe starting off on China CRE, one of your competitors gives a breakdown of the secured/unsecured bit within the Hong Kong offshore exposures, and I was wondering if you could give us a little bit more colour around those exposures and how you think about the stress or the risk in terms of credit loss on that.

And then, secondly, just to follow up on your comments on costs, Ewen, I think previously you have hinted about the fact that you needed to do some additional cost saves to hit your target. Can you talk to us a little bit about where those cost saves might be coming in and a little bit more colour in terms of which areas within the bank there's still scope to take cost out? Thank you.

MARTIN HAYTHORNE, ASIA CHIEF RISK OFFICER: Thank you. Thanks very much, and good afternoon, everyone. Thanks for the question, Raul. Perhaps just to start on the China CRE positions secured/unsecured question, the China CRE exposure that we set out in our disclosures is obviously a portfolio of assets for us. I should start with the nature of that lending. That lending is just over 60% relating to residential. The remainder is a mix of commercial and industrial assets. The commercial, it's important just to note, is a mix of our support for clients who are in development stage, but also includes a mature portfolio of income-yielding assets, so all of those constituent parts are in the numbers in our disclosure.

I think, secondly, it's worth pointing out that, of the exposure – and, again, the credit quality is set out in the disclosure – the split is roughly 70% to privately owned enterprises in the mainland and 30% to state-owned enterprises. And then, as you would imagine for a portfolio of assets of that kind of order, it's a real mix of both secured and unsecured, the secured pieces being project and asset-specific security as well as an unsecured book. The largest element of the unsecured book is typically in the format of multi-bank syndicated lending done from offshore in the Hong Kong book, and that is the piece that is overall exhibiting the most challenged conditions for our clients.

Specifically, what we say is that we have $9.8 billion of loans and advances in the Hong Kong offshore book, and roughly around $8 billion of that is in the higher-risk format that I've just described.

RICHARD O'CONNOR: Just to add to that the disclosures show that the exposure as at June less than satisfactory, good or strong is about $4 billion out of – call it the $10 billion offshore book. And, as at the end of September, we had about a $1.3 billion provision on that exposure. And that's that offshore, Martin, syndicated loan book which you described earlier.

MARTIN HAYTHORNE: Correct.

RAUL SINHA: That's as of first half – has it changed?

MARTIN HAYTHORNE: I didn't hear the question. I wonder if you could repeat it.

RICHARD O'CONNOR: What's been the change in Q3 since that disclosure we made at the end of June in terms of the substantive and credit-impaired part of that exposure?

MARTIN HAYTHORNE: Well, the operating conditions for the client-set continues to remain challenging. I think that the main developments for the client-set in Q3 have been the ones that you will all be aware of. Clearly, we've seen a continuation in the fall of home sales year-on-year in China, which is the top line for that client-set. You'll also know that there's very limited new offshore funding being made available to the clients through the bond markets as well as the banks, and, of course, that client-set continues to be challenged by the higher US dollar borrowing costs that are that are filtering through for them. So there continues to be a challenging set of circumstances for that client-set.

EWEN STEVENSON: On costs, we've been doing a substantial amount of additional work over the last few weeks, including this week. I would say confidence in delivery against that 2% target continues to grow based on that work. We are down to a gap of less than 1% in terms of delivery against that number. Obviously, remember it is a bit of a super-tanker. It is a $30 billion cost base, so we are prone to both positive and negative surprises month in, month out. I would say it is pretty broad.

If you think about the underlying inflationary trends in the market at the moment, they are comfortably above that 2%, so I would say very few parts of the Bank are immune from having to think about tight cost control next year, but we have been looking hard into areas like consultancy spend. We have got a new Head of Procurement who is going through everything on the supply side, tightening up on third-party contractors, looking at the efficiency of how we deliver change, slowing down the pace of some change that we are delivering, looking hard at the efficiency of all of the regulatory spend, which is quite substantial at the moment, and how we improve the efficiency of that spend. Overall, I think we continue to commit to that number, so you should take confidence on that that we have got the underlying support to continue to make those statements.

ALASTAIR RYAN, BANK OF AMERICA: Sorry, I am going to follow up on the question before, please. That was a really non-specific answer on the China commercial real estate. It's a talking point, as you rightly highlighted, Ewen, so can we work back then? You have given us a Group loan loss expectation, so although this portfolio is material and it's very hard for us to judge credit losses, which could in theory be high because these developers are going to cease to exist, but that is embedded within your Group guidance for next year, so the ongoing deterioration is somehow captured at a Group level, even if it feels like the loss content of that book could be higher.

EWEN STEVENSON: Again, to repeat the numbers, offshore book is about $12 billion. We have got just over a billion dollars of provisions against that book today. We have been running at a few hundred million of loan loss provisions each quarter for the first three quarters of this year. I think it's going to take more than 2023 before you're going to begin to see a recovery in the China commercial real estate markets, so the guidance we've given at the top end of our 30 to 40 basis point range would imply $4 billion plus or minus of loan loss charges next year. I think it's comfortably within that.

Having said that, I think where we've seen sensitivity is particularly the sensitivities around the larger names, and if we see idiosyncratic default risk around those names. The China government is clearly introducing a broad set of policy measures to try to help mitigate some of the adverse impacts that we're seeing in the real estate markets, and those policy impacts

are continuing to be rolled out. But I take the point, and I'll leave it with Richard, on us providing you more disclosure, I guess, at full year on the nature of that portfolio and some of the security that sits behind it.

RICHARD O'CONNOR: Martin, correct me if I'm wrong. It's $12 billion, of which $2 billion are guarantees, so it's $10 billion drawn, and, at the end of June, about $4 billion of that was below satisfactory, and that's the bar which we are providing for at the moment. There have been a couple of names – one in September and one post-September – which have gone into – let's call it restructuring, and we've taken provisions on those particular names, so it is on a name-by-name, bottom-up basis.

EWEN STEVENSON: In addition, of that four billion that's sitting in sub-standard or impaired, it's only a percentage of that that's currently sitting in the work-out unit. The provisioning level against that is decent, but the question is what else rolls into that work-out unit.

MAGDALENA STOKLOSA, MORGAN STANLEY: Just a couple of follow-ups on the potential for provisioning in the corporate book. Of course, we have talked about the Chinese portfolio, but where else, particularly on a six to nine-month view, are you seeing a potential for deterioration across your global book – because, effectively, you are one of the largest corporate lenders globally. Where do you see early signs of, one, what are you watching? And, two, remember during Covid, right at the beginning, we did have a conversation about risk-weighted assets migration. It never materialised. How do you look at it today in different circumstances, different behaviour of the credit market?

EWEN STEVENSON: In capital forecasts, there is an element of credit rating migration. It's relatively modest at the current time, but, if you look at the statements we have made around returning to the low end of a 14% to 14.5% range by mid-year, in that is an element of offset for migration. The market that we are spending most time on at the moment is the UK, which is both corporate and non-corporate. Frankly, around the world at the moment, outside of the China commercial real estate book, we are seeing very few signs of emerging credit impairment. We are all anticipating that it will come, but we are not seeing it at the moment. And I would say we don't have a big book in Europe, but, if we did, I guess we'd be paying attention to that, but it's really the UK.

YAFEI TIAN, CITIGROUP: Thank you. I have a follow-up question on the interest margin here in Hong Kong. I think Ewen mentioned on the call that you're expecting Hong Kong margin to peak around fourth quarter, but can you give us some colour around the current deposit beta you're seeing in Hong Kong? And what is the assumption you baked into that peak margin guidance in Hong Kong? I'm just wondering, with the additional potential higher Fed rates to 5% as the terminal rate, does that guidance of peak NIM in Hong Kong stand?

MING LAU, CHIEF FINANCIAL OFFICER, HSBC APAC: So you would have seen, I guess, Yafei, through the third quarter, net interest margin for HBAP overall actually increased quite significantly. So we saw about a 33 basis point increase in NIM for the third quarter. The exit rate, actually, for the third quarter was quite a bit higher than the 179, but not yet to the peak which we saw between 2018 and 2019 of roughly about 205 basis points. So, just looking at the fourth quarter alone, I would expect the fourth quarter net interest margin to continue to rise.

The thing we need to keep in mind, and I think is one of the biggest factors in terms of why we're calling potential for peak net interest margin, is essentially the point around time deposit migration. Ewen has spoken to the fact that, if you look at the market in Hong Kong, we've already seen roughly about a 9 percentage point increase in time deposit migration in the market overall. Our assumption in terms of why we believe margins are going to start to peak is, essentially, we are seeing a pickup in terms of time deposit migration in the portfolio.

If you work through the impact of that, we roughly have about a $540 billion deposit book in Hong Kong. 60% of that is in the retail space. Roughly a 10% migration in time deposits in the retail portfolio - if you take a simple, roughly 300 basis point difference between your savings accounts and your time deposits, in terms of the price which you pay the client - that would give you a sensitivity of roughly $1 billion for every 10% shift in time deposit mixed in the retail book.

If you just look at what we're thinking through in terms of assumptions, you could argue the assumptions are conservative, but, just looking back on history through when interest rates were last roughly around 450 to 500 basis points, it was between 2004 and 2006, and, at that point in the market in Hong Kong, time deposit mix was in excess of 60%.

YAFEI TIAN: The second one is page 17 of the slide around the wealth balances. I just want to understand about the wealth deposit decline in particular. I understand the investment assets are very much impacted by market activities, so I just want to understand the current deposit dynamics in the geographies that you are operating in, particularly in Hong Kong. Are we seeing very slow deposit growth, and how does that impact your wealth?

MING LAU: If you look at what's happened recently on deposits, we did notice through September migration in terms of a bit of outflow on deposits to wealth, and that was particularly evident in Hong Kong with the government issuing the silver bond. But the other thing I would say on wealth balances overall – it's pretty evident it's been impacted by the drop in equity prices across the globe, but, when you actually look at net new money inflows, we still saw a pretty significant inflow of net new money into our Asia Wealth business.

RICHARD O'CONNOR: If you look in just WPB, it was impacted by the move of France deposits to held-for-sale, so in the quarter, deposits were down $6 billion due to that outflow, but net new money was year on year over $90 billion and over $30 billion in the quarter. So you can see that we are picking up balances, but there is some shift from deposits to the Wealth business happening in Hong Kong.

GURPREET SAHI, GOLDMAN SACHS: Just a small follow-up, again on Hong Kong, on the mortgage book, this time around we know LTVs – and maybe related to UK also – LTVs at around 50 per cent and very conservative, but property prices might already have peaked in both these geographies and are starting to come down. At what point do the risk managers really get concerned: at 10%, 20% or 30% price fall from the peak? Then, on the ground, are you seeing the level of competitiveness from the banks already withdrawing from the market – because we are seeing mortgage originations at a very low level.

MARTIN HAYTHORNE: As you rightly say, the book is pretty conservatively positioned at an LTV of 50%, and, as you'll know here, that's partially because of the regulatory caps that are in place with any mortgage over 60% being insured by the HK Mortgage Corp. There is a regulatory environment which actually pervades across the whole of Hong Kong, not just in the numbers we've talked about.

The portfolio remains strong and delinquencies are both low and stable today. We've seen, I think, by some measures, from peak to today, we're down about 11%. I think HSBC's analysis is down 8% for the year to date for 2022, so we have seen that kind of move. If you look in historic terms, what we have seen since – really you have to go back to the Asian financial crisis for this to be multi-year downs of significant order. Even the 2008 period was one year down Hong Kong.

The numbers that I've talked about – and you've talked about of the 50% LTV gives us obviously a significant space around valuation. The other element that is important for mortgage is, of course, affordability. We, and I'm sure other organisations, have been stressing the income ability to repay for some time now, assuming 200, 300 basis point rises in rates from where we are today for new business. We're confident in terms of the new business that we continue to write, and, of course, Hong Kong benefits from a quality legal system and a good credit bureau which helps in the quality of the book.

MARK PHIN, HEAD OF INVESTOR RELATIONS, ASIA-PACIFIC: The other thing I would add, Gurpreet, is to look at our downside two scenario, which includes Hong Kong house prices down, as I recall, 22%, 23%.

TOM RAYNER, NUMIS SECURITIES: Could I just come back on costs, Ewen? You've talked through your plans for next year with Georges. I think Georges is going to be helped by the flowthrough from some of the cost savings put in place this year. I think you indicated $1 billion, so, if we were to look at the underlying cost rate in 2023 excluding the benefits of those cost savings, you'd be closer to 5%, or maybe above 5%.

I just want to get a sense. Have you talked to them about 2024? Obviously, it becomes a bit more philosophical, then, whether or not you're going to be looking for the same sort of incremental cost savings to bring that cost growth back down to closer to 2% in 2024. I just wondered if you could give us some colour around that, please.

EWEN STEVENSON: Underlying cost growth at the moment is materially higher than 5% for 2023, which is consistent with underlying inflationary trends we're seeing across the world, which would imply that the cost savings we need to deliver are materially higher than the $1 billion that we've talked about so far. It's that incremental set of cost actions that we're continuing to work through.

On 2024, I would say there's been less focus, but, philosophically, as you move into 2024, revenue growth is going to be much more consistent with underlying volume growth because you've probably got the peak benefit of interest rates through the numbers at that point. Therefore, we have to think about underlying operational improvement of 2% to 3% per annum. Given how 2024 inflation numbers land at the moment, it's very, very hard to say, 'Here's a realistic view,' but I guess the underlying philosophy that Georges and I and Noel have talked about is, 'How do we drive continuous – even though I hate the term – operating jaws, between core top line growth and underlying cost growth?'

Half of our cost base, just as a reminder, is fixed pay, so that will be very, very much driven by underlying inflationary trends. Last year, the cost growth in our fixed pay was at 1.6%. This year, it was 3.6%. Next year, it's expected to be a couple of percentage points higher than that, but, again, when you get into 2024, with inflation coming down, that should fall materially. But the numbers are moving around, thinking about 2024.

RICHARD O'CONNOR: We all hope, Tom, that inflation comes down to, say, 3%, 4% in 2023-24, but let's see how we get on, and then there's productivity improvements on top of that, which Ewen mentioned.

MANUS COSTELLO, AUTONOMOUS: I wanted to follow up on that, but I actually really wanted to ask Georges his opinion since he's here. Georges, I wondered if you agreed with your largest shareholder who's out saying today that they think that HSBC should be much more aggressive in radically reducing the cost base. If I look at the time that you were running GBM, there was an improvement in the cost income ratio during that time, but there was also quite a significant improvement, more marked, in the return on risk-weighted assets. I wonder if you could share if there's any insights to what you've learned over your time in improving the efficiencies of GBM that could be applied across the rest of the Group.

GEORGES ELHEDERY, INCOMING GROUP CHIEF FINANCIAL OFFICER: If you allow me, I will skip the first question and move straight to your second question, if you don't mind, because that's tangible at this stage, and then, obviously, we can discuss your first question as we're sitting together in February 2024. I will probably let Ewen comment on your first question.

On your second question for GBM, that is part of what we've been disclosing for the last two years. We've gone on a transformation, which we made public in February 2020 during the results, to take down RWAs from the business and to take down costs from the business. The result in what we announced more recently has showed that more than most of the RWA journey announced has been delivered upon, i.e. we delivered slightly higher. We guided for slightly more than what we initially guided, and delivered towards the new target and the cost, obviously. You've followed the numbers. There's been a multi-pronged approach. Maybe here I'm just reminding information, but just to confirm that that's exactly what we've done.

First, we've reviewed our business footprint in terms of optimising which balance sheets we operate on and from, in terms of which businesses we would do, especially the businesses that were highly dense in RWA, and therefore not attractive any more compared to the past. We cited long-term derivatives. We've equally reviewed customer relationships; we focused on high-returning customers specifically interested in our global international proposition and exited the relationships where the demand was only for domestic in areas that are not highly strategic for HSBC, such as the Americas or continental Europe.

From the cost point of view, the programme went into driving efficiencies across all sorts of areas, just, at a high level, starting all the way from the management structure, all the way to how we execute programmes at the detailed end of the programme. There was a consistent look through from how we operated on the leadership organisation, all the way to how we get simple projects executed and what is required.

EWEN STEVENSON: On Ping An's comments, we broadly agree with them. If you go back in time, the organisation hasn't been particularly cost efficient. We fundamentally disagree with them on the extent of productivity improvement that can be driven from here and some of the numbers that were quoted today in terms of the cost income gap. If you look back in time, in 2018 – the year I joined at the back end – we grew our operating costs at 5.5% that year.

With an organisation that rightly could be accused in 2018 of having very limited cost discipline, we've done a lot of work over the last four years in Finance, in HR and in Digital Business Services to basically build a pretty robust cost management set of capabilities across the organisation. If we deliver to flat costs this year, we'll have kept costs flat over the last four years. Very few organisations of our size have come anything close to that. We're committing to 2% growth next year. Again, that is several percentage points of cost efficiency ahead of where most of our peers are.

Some of the criticism from Ping An is quite dated relative to actually what's been going on in the organisation over the last few years. It's that cost discipline in part which has been a big driver of why we've got confidence in getting back to 12-plus percent returns next year. If you go back to 2019, the last time we had a positive interest rate environment, we earned a return on tangible equity of 8.4%. We do fundamentally think that both the work on costs and capital discipline that we've done over the last few years, part of which Georges just touched on, has driven about a 400 basis point core improvement in the underlying returns of the business.

RICHARD O'CONNOR: Just to build on that, obviously, the *FT* article had some data cost income ratios in. For the nine months in 2021 to September, our adjusted cost efficiency ratio was 62.5%, so very much in line with that number, and this year it's 56.7%, and Q3 was 51%. Now, obviously, Q3 was an exceptional period in terms of income growth – 28% income growth – but you get a drift we're in the right direction. I think some of that criticism is now quite dated, but we accept we need to improve our cost performance and our return performance, and we're on track to do that.

CORINNE CUNNINGHAM, AUTONOMOUS: A couple of debt questions, please. In this year, you've had the ability to be able to redeem some of your AT1s on an outright basis. Do you see further scope for net redemptions in 2023, and how would you measure that? Do you measure it on a consolidated basis, or do you take into account what you need to downstream to the subsidiaries – in other words, take into account double leverage? I've just got a follow-up question on that as well, thank you.

CARLO PELLERANI, GROUP TREASURER: In terms of AT1 scoring, when we're looking at a particular redemption, we take into account bunch of factors. The decisions are mainly economical. We look at what is the PV cost of the call, and then we look at whether we need additional funding, i.e. whether we need to replace it or not, and then we also look at what are the conditions in the market and the sentiment. We put all those things together and we make the decision.

I'm not going to give guidance as to whether we are at this stage going to call the February transaction, which is a decision we haven't made. All I would say is that the reset on that transaction is 345 over, and, if we were to replace that trade today, that would cost us about 200 basis points more than that. It seems to me that the market pricing on that instrument hasn't taken into account that higher spread today.

CORINNE CUNNINGHAM: When you do weigh up the economics, etc, do you also take into account who the buyer base is for a particular bond, or are you agnostic as to who owns the bonds?

CARLO PELLERANI: Overall, our bonds are well distributed, and all very real money investors and longstanding institutions. For us, it's very important, of course, the long-term relationship with those institutions. I call it a 'repetitive game' because we are in the market all the time.

Yes, of course that is part of the of the assessment, together with the other factors that I mentioned.

OMAR KEENAN, CREDIT SUISSE: I've got two questions, please. The first one is on the hold-to-collect-and-sell portfolio and structural hedges, and the second one is on capital efficiency measures. So, on the HTCS portfolio, this reduced from $347 billion to $271 billion, and we knew that the duration, I think, was around four years before. Could you give us an indication of where the duration sits now, and, when you think about the bond portfolio for interest rate hedging, could you talk about the size of that today versus what the potential size of that could be? And how would you think about the timing around deploying that potentially in the future? And, if you could help us with the UK structural hedge, that would be great as well.

And my second question on capital efficiency – you've previously talked about some tactical measures to get the CET1 ratio up and handle the temporary headwind that was coming from the HTCS portfolio. Can you talk about what those measures are, how much of that has been delivered, and how much remains to be delivered in the fourth quarter, and what the sources of them are? Thank you.

CARLO PELLERANI: Let me start on the bond portfolio. The bond portfolio has a well-spread set of maturities between one and, let's say, 15 years. The average, about four years, that you mentioned is still valid. The way we have been looking at it is we have made a policy decision over the last few months to indeed increase our NII stabilisation hedges, so we have been increasing the size of that portfolio in line with the increases in rates. We have reduced the sensitivity to a downside of interest rates of 100 basis points by about $500 million, $600 million year-to-date.

So we have been doing that, and we will continue to do that, assuming that we're able to find the right hedge accounting capabilities on the asset side and we're indeed able to model long term our deposits. So that's the answer on that one. In terms of capital measures, what we have been doing and will continue to do is a combination of hedges that we can put in place to reduce the capital intensity of some of the positions. We're also looking at distributing some of the assets that we have, and indeed some of the positions that are high capital intensity, and we also look at technical savings in the form of data and modelling. So we have been doing that all along this year, and we will continue to do that. There are basically about 20 basis points of opportunities there that we continue to pursue.

RICHARD O'CONNOR: Just to round out that question, Omar, we have been increasing our interest rate hedging steadily, led by Carlo and the team. That work continues and will be a multi-year journey, but, when you see the next interest rate sensitivity tables in February, you'll see we've reduced the downside by about 10% so far, but there's more work to do.

Obviously, interest rate includes an increase in the held-to-collect portfolio, but also other measures which Carlo and the team are taking, and that will be ongoing work, which you'll track every six months with our interest sensitivity tables starting in February.

EWEN STEVENSON: And maybe just a couple of other comments – that 20 basis points of additional benefit Carlo talked about – that's through the first half of next year. That's not all coming in Q4. And also just remember the way the PRA rules work on dividend accrual. We have to accrue for capital purposes at the top end of our pay-out ratio through the first three quarters, so we've already accrued just over 28 cents of dividend through the first three quarters of this year, and then, effectively, we do a true-up in the fourth quarter.

MATTHEW CLARK, MEDIOBANCA: Hi, everyone. So two questions. Firstly, coming back to China commercial real estate, I just wanted to understand, am I right in thinking that this is mostly located in Hang Seng Bank?

RICHARD O'CONNOR: No, it's quite equally spread between the two entities, but it's not just Hang Seng.

MATTHEW CLARK: Is there any material difference in terms of the stuff that is in Hang Seng versus the stuff that's within HBAP?

MARK PHIN: They've got disclosure as of the first half, which is reasonably good. You can work through that yourself, but we can go through it with you after the call.

RICHARD O'CONNOR: But that offshore book is a syndicated loan book, and both Hang Seng and HSBC have participated in that syndicated loan activity.

MATTHEW CLARK: And then the second question – also Hong Kong. Thanks for the margin commentary. I just wanted to understand if there's any particular difference in the dynamics between the US dollar deposit behaviour and the Hong Kong dollar deposit behaviour when you were talking about the mixed shift between savings and time deposits as the constraint on margin.

MING LAU: I think, if you look through the behaviour at this point, we're noticing the migration happening on both US dollar and Hong Kong dollar at this point, so it's consistent with what's happening in the market.

EWEN STEVENSON: Ming, historically, US dollar migration has been higher than Hong Kong dollar migration.

MING LAU: Well, pace of migration, I would say, is similar, but the starting point in terms of the US dollar portfolio has always been higher in terms of time deposit mix.

RICHARD O'CONNOR: You'd think that's logical because, obviously, the retail customer base in Hong Kong – their payroll goes into HSBC accounts, and that's in Hong Kong dollar, so that's obviously a difference to the US dollar book.

AMAN RAKKAR, BARCLAYS: I just wanted a question to return to the revenue and cost dynamic we've been discussing. I think there's a scenario that I can paint fairly plausibly where revenue growth stalls in 2024, particularly if the Fed was to cut rates towards the end of 2023, and you're talking about an underlying run rate for the costs of mid-single-digit plus. So there is a scenario, I think rather plausibly, where you could be staring at the prospect of negative jaws in 2024.

I'm just trying to think about to what extent would that be a problem in your mind. From a management point of view, is it fine because, actually,…you might do a 13% return on tangible equity next year, and, if jaws drifts, it's not such a big deal because you're quite capital generative. I guess the additional complication is that China and Hong Kong are not operating at full capacity right now, so are you minded to look through a temporary period of negative jaws because, actually, there's a high revenue run rate inherent in my business that I just need to discover?

I guess this question is probably more – I should probably direct it to Noel and Georges when they're with their feet under the table, but I'd be interested for your take on to what extent would negative jaws be an issue for you.

EWEN STEVENSON: Well, firstly, I think the underlying assumption that we're going to have a stalled revenue position in 2024 sounds a bit too negative. If you think about the core business, we've said that we expect loan growth to be mid-single-digit. Our Wealth franchise, in normalised markets, should be growing faster than that. So, putting interest rates to one side, you should be seeing slightly above mid-single-digit top line growth year on year.

If interest rates are falling, that probably implies a sharp fall in inflation expectations, which will then translate into much lower natural cost growth. As I said earlier, we think we need to be targeting – call it 2% to 3% productivity improvement year on year to be able to produce a core operating jaws. But I guess it depends on what the reason is to create that negative jaws. We had negative jaws in 2018, which was driven by a sharp fall in markets that happened at the tail end of the year. So I think it depends. We would like to think that the core business is able to produce core operating jaws from 2024 and beyond as a philosophy.

RICHARD O'CONNOR: And on costs, when we look at implied inflation and expected inflation rates for 2024, they're lower than what you've implied. And I would just remind you that, in our network in Asia and Middle East, inflation is lower than that, so we don't feel helpless. But we accept the challenge. We can't just be 2023 where you get above cost of equity return. We

need to maintain it over a number of years to obviously show that it's an enduring improvement in the franchise. So we accept the challenge.

EDWARD FIRTH, KBW: Just two quick questions. The first one was bringing you back to this trading book funding thing. I get the technical explanation for it, which is pretty clear, but, really, you and Standard Chartered seem to be the only banks that I've seen pretty much anywhere that are talking about this, and it does seem to have been a surprise in the sense that we didn't hear about this six months ago or when rates started rising. You weren't telling us, 'Look, watch out for the funding of the trading book.'

So is it possible just to give – is there something peculiar about your franchise or the way – or your accounting policies? Is there some sort of flexibility in terms of accounting policies that would mean that some banks are hedging that off against the trading book?

RICHARD O'CONNOR: Carlo will answer, but you obviously haven't read the JP Morgan or Barclays results, but that's another story. Carlo, over to you.

CARLO PELLERANI: The reason we weren't talking about it is because, at low rates, that impact was diminished. I'll hand over to Jon to discuss whether there's anything specific on the accounting policy, but maybe it's worthwhile demystifying this a little bit.

Maybe let me give you two examples of how this plays out. One example is we make markets on securities on behalf of our clients, and we have fixed income portfolio securities. That fixed income portfolio yields an interest rate that appears in the trading line, whereas the cost of funding of that, to the extent that we fund it unsecured, appears in the NII line. So it is just a carry that appears in trading versus NII. So there is nothing abstract about it; it's just a simple flip.

And another example that maybe is worthwhile highlighting is we have a High Quality Liquid Asset portfolio that we manage in Treasury. In Hong Kong, there are limited opportunities for us to deploy that in domestic Hong Kong dollar assets, so we swap that to other currencies: for example, yen. To the extent that we do that, we have an FX swap, and the carry appears in the trading line, whereas the cost appears in the NII line. So, again, it's just a carry that appears on the NII side. There is a carry cost that appears on the NII side versus a carry benefit that is in the trading side. It's just a pure mathematical difference between NII and trading income.

JON BINGHAM: It is a choice of whether you fund this portfolio from the trading book or banking book. As a universal bank with a commercial surplus, we see there's a lot of advantages net from funding it out to the banking book, and so you do see that replicated more in the universal bank model, but, in theory, we could fund it from the trading book. I suppose it would come out net on the revenue line, but the question is whether you'd get the same benefits, particularly where you've got a commercial surplus in the banking book.

EDWARD FIRTH: Just coming back to the China CRE – and I just wanted to ask this in a slightly different way. I get the technical explanation of exactly what's what, and where it is, and what's unsecured, and what's not, and the offshore, etc, but what I'm interested to know is, when you look at that, how did you end up with this exposure – because I guess China's CRE has been an overheating market, or was an overheating market, for some years. And I'm trying to think, when you did the lending, when you looked back at that, what was it that gave you comfort at the time that we wouldn't be in this situation?

And I suppose I ask that in the context of your broader book because, for the rest of the book, you're talking about the current economic scenario not being a major stress. You're talking about normalised impairments for the Group as a whole, and yet it seems that these circumstances have proved to be particularly painful for China's CRE. So I'm just trying to work out what is it that's different than what you expected when you lent the money, and what could we possibly learn from that across to how your book might perform more broadly?

MARTIN HAYTHORNE: The first point is in terms of how the book came to being, and the scale of it, and it's built – the start point of that is the size of the China commercial real estate importance in the China economy. And various researchers would analyse that slightly differently depending on how much of the supply chain you include in that, but it's broadly accepted to be somewhere around the quarter to a third of the economy in China prior to the

dislocation that we've seen over the last year. So, for us, that's obviously a significant part of a material market for us, and so there is a part of that book that is just the natural shape of our portfolio.

I think that it's also important just to think about that in the overall context, and I think we've previously said this is a $12 billion offshore exposure in a $1 trillion loan portfolio for the firm at large, so there's that context as well. So I think that's the context of it for us. It's an important element and an important sector for the economy in China, and we were part of the funding of that, as were other international and domestic banks and the bond market.

RICHARD O'CONNOR: It's not disproportionate versus either our Hong Kong book, or, indeed, our Hong Kong and China book added together. And Martin's given you the Group number as well, so it's not like we were overweight that sector versus that sector in – that market as a whole.

EDWARD FIRTH: So it's more of a representative – in terms of keeping your flag flying in China, you felt you had to do a certain share of that business, and that's how you ended up with it. Is that the way we should look at that?

EWEN STEVENSON: No, I don't think so. We can all look super smart in hindsight. Looking at it through today's lens, would you have had the same degree of exposure? Probably not, but there were a bunch of things that have happened in the China real estate market, not all of them to do with the underlying market conditions. Some of it was policy intervention that came into the market in late 2022 that had a significant impact on the liquidity in the sector, which did help accelerate some of the downturn that we'd seen at the time.

RICHARD O'CONNOR: We've done our stats over the years. We can obviously improve disclosure going forward, but it was to those on the so-called green list originally, it was tier one, tier two cities, and it was those who were expanding in Hong Kong and doing borrowing in Hong Kong in the offshore markets. There is some context there as well.

EWEN STEVENSON: We have been actively managing this portfolio for years, so for something like Evergrande we had no material losses. Why was that? Because we took a view several years ago to start reducing exposure to it.

RICHARD O'CONNOR: I'd better leave it there. Thanks, everyone. Thanks for your interest and attendance today, and, obviously, the IR team's around for any other questions. Have a good weekend.