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Michael Sia Hello everybody and welcome to our second-quarter briefing for the buy and sell sides.

Nick Lord (Morgan Stanley) You did 12.5% ROE in the first half. The suggestion from Sok Hui was that it remains stable from here. But if NIM is going to continue going up, on the expectation of more rate hikes in 2019, why wouldn't ROE also continue going up?

Piyush Gupta It will go up. We did 13% in the first quarter because of an $86 million property disposal gain. I said then that 13% is not the underlying level, that if you take that out, we're about 12.5%. As we go forward, as NIM flows through, ROE will increase, which is why I've given guidance of 13%. But between 13% and 14%, a lot of things have to happen.

We've done a lot more work around understanding NIM. The impact from rate increases takes up to three years. A certain percentage of our loan book reprices in the short term, but a large part of it reprices after one year, two years and three years. Hence, the NIM impact flows through over three years.

Harsh Modi (JPM) Could you explain more on the flow-through?

Piyush Gupta Loans that are pegged to Sor and Sibor get repriced within a few months. But others such as housing loans based on fixed deposit rates, or loans based on administered rates or fixed rates, take longer. About one-third of our book reprices in the short term while the rest takes longer.

Robert Kong (Citi) Can I ask you about the rising cost of deposits, which moved up almost the same amount as loan yields during the quarter. Where are the cost pressures? I know part of the reason is the US-dollar liquid buffer.

Piyush Gupta First of all, deposit costs didn't go up as much as loan yields. If you take both trade and non-trade loans, yields went up 18 basis points while deposit costs rose 13 basis points; that's why NIM went up. You have to expect deposit costs to go up as Libor was up by 30-40 basis points during the quarter, which affected fixed deposit pricing. We were not able to price all of the deposit cost increases into trade loans, which is why we didn't grow them as we couldn't make a return.

Chng Sok Hui Another point is that we ran down our commercial papers during the quarter and replaced them with fixed deposits. While the cost of both is the same, instead of being reflected under 'other borrowings' in the Performance Summary, it now goes under customer deposits, which contributed to the effect of higher deposit costs.

Piyush Gupta We ran down commercial papers by SGD 5 billion and increased US-dollar fixed deposits by SGD 10 billion.

Robert Kong Could you comment a bit on the quarterly results for Hong Kong? You spoke about the first-half performance, but I think the second quarter was lower than the first quarter.

Piyush Gupta It was lower because of the SGD 86 million property gain in the first quarter. [Other non-interest income] was also lower.

Chng Sok Hui Hong Kong benefitted from the rise in Hibor, which had a more significant impact in the second quarter than the first quarter.

Robert Kong Your adjustment from Stage 1 to Stage 2 ECL was pretty modest. I wonder how you think about the process if the world gets worse. You're supposed to be very forward looking on this.

Chng Sok Hui PWC helped us to benchmark against other institutions that adopted IFRS 9. Consistent with the other banks, Stage 2 accounts for about 5% of our loan book but about 95% of the ECL. When a loan moves from Stage 1 to Stage 2, we see a significant lift in ECL, multiple times of the Stage 1 ECL. This is the intended objective so that when a loan goes into Stage 3, the specific allowance charges taken are partially offset by what was already provided in Stage 2. So far, the models are working well.

On top of that, we have an overlay to see what in the environment may not have been completely factored in the models. So we took additional ECL on account of trade tensions. I would say we've been very conservative in our estimates.

Piyush Gupta The ECL methodology relies so much on assumptions – first, on the macro environment, then on how much of the portfolio will migrate to Stage 2. Sok Hui did one thing that I thought was quite helpful. We got an external provider to provide a Z-risk engine to derive a forward-looking world view based on a range of exogenous variables, which are then used to compute Stage 2 ECL. When we compared the results with other banks using PWC benchmarks, we were at the conservative end of the spectrum. We had the second-highest ECL among all the banks surveyed in terms of Stage 1 and 2 ECL.

Chng Sok Hui The engine is based on the wisdom of the crowd as it uses market prices. You don't sit around and try and guess interest rates or GDP. We then layer on cycle adjustments by sector and by country. Overall, it's a better model as it is less subject to individual opinions of the world at a particular point in time.

Harsh Modi On the subject of cost of funds – if you look at Libor, it has not really moved in the last six months.

Piyush Gupta That's invalid. Three-month Libor rose 41 basis points between the first and second quarters. Hibor was up by 53 basis points, Sor 34 by basis points and Sibor by 23 basis points. Our fixed deposit rates are driven by the market. By the way, there doesn't seem to be any problem with US-dollar liquidity in the region.

Harsh Modi RWA has been pretty well managed and CET-1 is at 13.6%. What did you do there? How do we think about your ideal CET-1 number?

Chng Sok Hui We did some optimisation. For market risk, we put through system changes to net long and short positions more effectively. That was one of drivers of RWA optimisation. We always look at where efficiencies are. A lot of them tend to come from linking data more closely.

Piyush Gupta We looked at areas where our RWA efficiency was lower than our competitors. One thing that stood out was market risk and we realised that we were not netting as effectively. Another area where our model is still inefficient is in private banking. It's a fairly large book, about SGD 50 billion, but it takes time for us to get regulatory approval.

Chng Sok Hui The other reason for this quarter's RWA optimisation was that we understood our ANZ portfolio a lot better. When we brought in the ANZ portfolio we assumed the worst rating as the basis for setting aside capital. As we gained familiarity with the portfolio, we were able to bring it in line with our own models.

Kevin Kwek (Bernstein) The market has come to expect your cost-income ratio to go towards 40%. I hear you on the income side. On expenses, is 2019 still a fair expectation that that side of the equation will work.

Piyush Gupta Our underlying cost-income improvement of half a percentage point a year is still on track. For the second quarter, if ANZ is excluded, underlying costs were up 5%. We might have to make investments next year if the subsidisation in India comes through in October or November this year. We plan to scale up distribution quite rapidly, which will cause a drag on the cost-income ratio. We've given an indication that we want to add about 20 branches and a further 100 points such as kiosks to support SME and cash management. If we do eventually frontload that expansion, it will incur costs upfront.

Aakash Rawat (UBS) On trading income, you said it's possible you can go back to a steady state in your coming quarters. Do you also think you might reverse some of the losses you saw this quarter?

Piyush Gupta Some we will. The bond swap spreads are out of the money because of Singapore rates. For the credit portfolio, if the credit spreads come back down, some of the losses will reverse.

Aakash Rawat The tax rate appears higher than in previous quarters. Is that one-off or has something changed?

Chng Sok Hui It is due to the weak Treasury Markets performance. Some components of that business are taxed at a favourable rate of 5%.

Piyush Gupta The Treasury Markets segment had a SGD 50 million loss this quarter. We haven't seen it before.

Aakash Rawat Wealth Management fee income fell from SGD 331 million in the first quarter to $300 million, which was expected given the softer markets. But do you see further downside in the coming quarters?

Piyush Gupta The third quarter has started off fine. But if there continues to be uncertainty, if the equity markets are soft, then the wealth business suffers. People invest a lot more in buoyant equity markets.

Tan Su Shan Piyush is right. The good news is when markets are bad, RMs have the capacity to acquire clients and carry out wealth planning to generate stickier relationships and higher recurring fees. The key is sustainable long-term growth, which comes from continuing to acquire customers and to deepen and widen relationships.

Anand Swaminathan (BAML) AUM growth in the second quarter was quite strong. Does it mean net new money was strong, because it could not have been driven by market movements?

Tan Su Shan Net new money was quite good. The RMs' scorecard is focused on getting net new money from both existing and new clients. We're also segmenting both the higher end and the lower end better.

Melissa Kuang (GS) In terms of the net new money, is it mainly local money or from Asia or the West?

Tan Su Shan It's across the board. We are seeing growth from Singapore, Greater China and the international global non-resident Indian market.

Melissa Kuang Sing-dollar deposits came down quite a bit in the second quarter. Can you provide some colour? Is the liquidity buffer you have built sufficient for the second half?

Piyush Gupta We replaced SGD 5 billion of commercial papers, then added another SGD 5 billion, resulting in SGD 10 billion of US-dollar fixed deposits. If the loan book doesn't grow as fast because trade loans are unattractive then we might have too much liquidity. If trade loans are attractive and we can grow it, then we will start growing deposits again.

For Singapore-dollar deposits, there was a SGD 5 billion decline, comprising SGD 1 billion in fixed deposits, SGD 1 billion in savings and SGD 3 billion in current accounts. We had transitory current accounts at the end of the first quarter and some of it flowed out. For the system, savings deposits in Singapore are down for the quarter. One reason is money flowing into Singapore savings bonds, which offer attractive yields. The second is probably some conversion to USD, which happens when it is strengthening.

Aakash Rawat You said trade loans are not repricing yet. What do you think is the reason?

Piyush Gupta It's hard to call. I noticed Bill Winters [of Standard Chartered] also commented that trade margins were tight. I'm seeing the same thing because my guys want to do trade finance at levels that I think is absurd. I told them I don't want the business. So this is not a US-dollar liquidity crisis. People have been willing and able to fund dollars and lend for trade at 20-basis-point margins. I'm not sure whether this is only the time being and that trade loans could price up over time.

Danny Goh (Credit Suisse) You mentioned that the decline in Treasury Markets income was partly structural. If so, will you respond to it by lowering costs going forward to attain your cost-income ratio targets?

Piyush Gupta [The structural decline in Treasury Markets income I'm talking about is not significant relative to the Group's total income.] It's not an amount that we've got to fundamentally make up for. Can we tighten costs at the margin? We can, from digitalisation.

Marcus Chua (Nomura) On Harsh's point regarding CET-1. It seems that the RWA optimisation can still continue into next year. With CET-1 at 13.6%, could there potentially be more dividends?

Chng Sok Hui It depends on several factors, including foreign exchange – because if the dollar strengthens there will be an RWA impact – and RWA optimisations that we talked about earlier.

Robert Kong How much of your housing loans is for investment purposes? What's the rough split in your building construction loans between developers and other companies like REITs? For the SGD 31 billion of non-housing consumer loans, how much is property-related such as equity-type lending.

Piyush Gupta Eighty-six percent of our Singapore housing loans are for owner-occupation by number of loans and 80% by value of loans.

Michael Sia 60-70% of the property and construction portfolio is for REITs or income generation.

Piyush Gupta We don't have home equity in the non-housing consumer category.

Anand Swaminathan Is it possible to see further writebacks for oil and gas support service exposures in the second half?

Piyush Gupta This second-quarter write-back was for one ship. While sector charter utilisation is picking up, margins are not, so we're not seeing meaningful improvement in cash flow. But given where we've written down the collateral to, it is possible to get write-backs as ships get sold. Most of the ships in our portfolio are of relatively low value, so if they are transacted at SGD 10 million-20 million, the write-backs will be less than the SGD 65 million in the second quarter.

Harsh Modi NPL formation went up this quarter, I guess there was one particularly large account, but settlements also went up, which is I guess is that ship.

Piyush Gupta We also had a settlement in India.

Harsh Modi For NPL movements, should we revert to lower numbers on both of formation and settlement?

Piyush Gupta NPL formation is sometimes episodic, so if a weak case tips over, we'll see a pick-up in NPL formation. Same in reverse for recoveries and repayments. There are a bunch of cases where if something is resolved we'll see a meaningful movement.

Chng Sok Hui One other thing to note is movements for consumer banking loans, which become NPLs when late payments cross 90 days but subsequently revert to performing when payments are made. So this behaviour routinely inflates both sides. We are considering how to change the disclosure to better represent underlying NPL movements.

Ken Ang (Macquarie) If trade margins don't improve, how fast can you reduce expensive deposits? Are you letting these fixed deposits run off or are you keeping them to grow loans?

Piyush Gupta A lot of the fixed deposits are short term and can be rolled over quickly. We have an asset-liability committee meeting tomorrow and we'll take stock of it then.

Aakash Rawat For the netting of long and short positions for RWA optimisation, are you the first bank to do it or is it a fairly standard practice?

Piyush Gupta We learned from other banks who are doing it.

Harsh Modi On the dividend, how do we think about the CET-1 range of 12.5-13.5% on the one hand and the sustainability of absolute dividend on the other?

Piyush Gupta I don't have a formula for it. It is judgmental. We have gone from 60 cents to SGD 1.20, there's no reason to increase it again for the coming year. I want the dividend to be sustainable. We'll keep growing the dividend over time while keeping to a range of capital we think is appropriate.

Harsh Modi If capital ratios are above your target range, rather than paying a higher dividend, will you do a bolt-on acquisition instead?

Piyush Gupta You're saying that I'll buy something just because I have the money. I've run the bank for ten years. I haven't done that and I'm not going to start now.

Krishna Guha (Jefferies) Where is the increase in Wealth Management headcount coming from? For non-trade corporate loans, are you able to increase pricing?

Tan Su Shan The increase in Wealth Management headcount was due to the ANZ acquisition. ANZ had a private bank in Taiwan and Indonesia, which we've re-branded as Treasures Private Client. We've also started to do a broader refresh of the product proposition for Treasures Private Client. A lot of the headcount increase is for the front office but there are also some at the back end.

Piyush Gupta We're adding headcount in Hong Kong because that's doing well. We're also adding in Singapore, the international markets, and in Indonesia and Taiwan. The good thing is that a new RM pays for himself rapidly because productivity is high. It's just that we have to do it at a measured pace so it doesn't get out of control.

On corporate loan pricing, it's mixed. Property-related loans are harder to move up pricing fully, so we've taken some margin compression in that segment. But in other parts we've been able to price up. Overall, loan spreads are holding.

Leng Seng Choon (RHB) On the reduction in your guidance for trade loan growth, is it coming from Greater China? Also, what is the credit risk for trade loans, particularly for China?

Piyush Gupta The bulk of our China trade books is backed by China policy banks so I am not concerned about them. There is also a part that is due to major commodities houses, where there are also no credit issues. Market volumes are not coming off, but it is pricing that is under pressure.

Harsh Modi On digibank, the competitive intensity seems to be way higher in India than in Indonesia. In two or three years' time, do you think you'll achieve more profitable growth in Indonesia compared to India?

Piyush Gupta I think so. Margins in Indonesia are much better than in India. I pay 3.5% for deposits in Indonesia and lend at 6.5%, so I make a 3% spread. In India, I used to make a loss, now I can make 60 basis points. In India I've got to make it up on with mutual fund sales. In Indonesia, I start out at 3% and so it's likely to be more profitable.

Harsh Modi What about scalability?

Piyush Gupta We were less targeted about our customer selection in India. We have two million customers, of which 700,000-800,000 have full savings accounts, others with light savings and so on. The 80-20 rule applies: 20% of the customers are profitable but as you go down the curve there are a lot who are not. While we can eventually make some of them profitable, there is a tail end where we might find value from their data but I think is very hard to make money on. We did one culling of these customers six months ago. Learning from this experience, we're a lot more segmented about customer acquisition in Indonesia. We're acquiring fewer customers but they're more profitable upfront.

Danny Goh How should we think about longer-term credit costs, especially with rates continuing to rise? At what point will we see strains on credit costs?

Piyush Gupta A large part of our exposure is in large corporates. I think they are not so sensitive to higher interest rates as they have multiple lines of business. The housing loan book is not fundamentally susceptible. The 30- and 90-day delinquencies on Singapore housing loans are lower this quarter than last quarter. The SME and unsecured consumer exposures are more susceptible to higher interest rates. SME delinquencies are edging up so you will see some flow-through to NPLs and credit costs. Even so it is segment-specific and also SME exposures are secured. For unsecured consumer exposures, which are now larger because of the ANZ add-ons in Indonesia and Taiwan, I think you will also see a pick-up in credit costs as rates go up.

Danny Goh So we probably should expect the 20 basis points of SP to trend towards 25 basis points.

Piyush Gupta I've been maintaining this. I expect to see 25-27 basis points.

Gurpreet Sahi (GS) I have a medium-term question around virtual banking or fintech developments here in Hong Kong. Do you see any impact on payments or credit cards given that new entrants could come in and we have a faster payment service being offered by the industry?

Piyush Gupta I think there is likely to be an impact. But I think it could turn out to be good news for us because it is the big players that should worry. The three or four incumbents with 90% market share are the ones most at risk of being dislocated. We fancy ourselves as a disruptor in Hong Kong, much like the virtual banks and fintechs. If anything, we might be able to improve our position.

Gurpreet Sahi Would you have to give back more to consumers on their credit cards?

Piyush Gupta I think you're already seeing that. A shift from credit cards to unsecured loans and debt consolidation has been happening systematically in Hong Kong for the past five years. The effective interest rate has been coming down as more outstanding amounts have gone into consolidated debt portfolios.

Second, do we wind up with lower merchant discount rates (MDR) with more electronic payments? There might be a little of it, but contrary to general belief MDR is not a big source of earnings for the banking system after factoring in the cost of rewards for consumers and the fees paid to Visa and Mastercard. So any decline in MDR rates would not be material.

Harsh Modi Which areas will incremental technology spend be in over the next 12-18 months? We talked about data last time.

Piyush Gupta Data has been harder than I had originally thought, and it's not just the technology. There are other things such as the data governance process, the data clean-up process, the physical process of migrating the data from old systems into a data lake. They are going to take two or three years. We're adding people and capacity to do work around this, which will increase expenses.

Harsh Modi Despite that, you are still comfortable with a cost-income ratio improvement of 50 basis points a year?

Piyush Gupta I will maybe spend SGD 30 million on data this year. It might go up several tens of million dollars in later years. It is not massive but it will add to expenses.

Asheefa Sarangi (CLSA) How much are you spending on cybersecurity? Second, you mentioned you might be able to cut ten branches in Singapore. Is there any capacity to change the footprint even more?

Piyush Gupta I don't have precise costs for cybersecurity on hand. We have a cybersecurity control centre, so the costs are obvious. But we also have peripheral technologies such as data surveillance and so on.

On branch closures, I don't think we can go much faster. We've got to be conscious of social sensitivities. When we close a branch, we have to do it in a way that doesn't create a lot of pushback.

Aakash Rawat You said the short-term is a bit cloudy, but over the medium-term what ROE range will you be comfortable with?

Piyush Gupta We gave the guidance in November last year that higher interest rates and a lower cost-income ratio can give us a line of sight to 13% ROE. Getting to 14% [requires more time].

Aakash Rawat Does the property slowdown help wealth management because people have to deploy the money somewhere?

Tan Su Shan I think wealthy people who live here are considering alternatives to property as a long-term investment class. One option is REITs, which offer unlevered 6% yield that is not taxed and are liquid. If you're wrong, you can cut your losses. If you're right, you can take your profits any time. If you lever up, you can get higher yields.

We have also seen high-net-worth Asian clients shifting to commercial real estate. For example, they're buying in London because sterling has gone down quite a lot, particularly from Greater Chinese customers.

Michael Sia Thank you. See you next quarter.