

# Developments in the banking sector

by the Banking Supervision Department

## HIGHLIGHTS OF KEY TRENDS

### Banking sector performance

The aggregate pre-tax operating profit of retail banks' Hong Kong offices rose notably by 19.7% in the first quarter of 2017 compared with the same period last year. The strong performance was broad-based, with net interest income increasing by 16.2% and fee and commission income by 10.8% year-on-year (Table 1).

Retail banks' net interest margin widened to 1.38% in the first quarter of 2017 from 1.28% in the same period of 2016 (Chart 1), thanks to a rise in market interest rates (Chart 2).

The loan-to-deposit ratio of the banking sector edged up to 69.5% at end-March 2017 from 68.4% a quarter earlier (Chart 4), as total loans grew faster than total deposits. Total loans increased by 4.6% in the first quarter, with loans for use in Hong Kong (including trade finance) rising by 4.0% and loans for use outside Hong Kong by 6.1% (Chart 6).

The banking sector's Mainland-related lending increased by 6.7% in the first quarter to HK\$3,804 billion (16.3% of total assets) at end-March 2017, from HK\$3,564 billion (15.6% of total assets) at end-December 2016 (Table 2).

The loan quality of the banking sector remained good, with the classified loan ratio edging down to 0.83% at end-March from 0.85% a quarter ago (Table 3a). Similarly, retail banks' classified loan ratio fell slightly to 0.70% from 0.72% over the same period (Table 3b).

The classified loan ratio of the banking sector's Mainland-related lending also decreased slightly to 0.79% at end-March 2017 from 0.80% a quarter

earlier (Table 3a). The classified loan ratio of retail banks' Mainland-related lending increased to 0.85% from 0.82% during the same period (Table 3b).

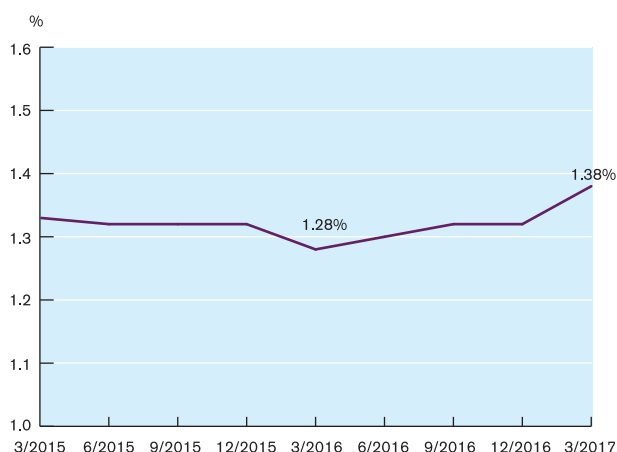
The key performance indicators of the banking sector are provided in the Appendix.

### Profitability

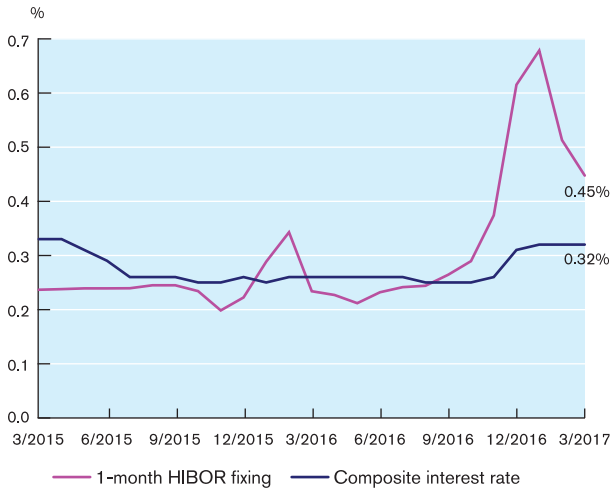
**TABLE 1**  
Profitability of retail banks' Hong Kong offices

Key items	Q1 2017 vs. Q1 2016	
	Percentage change	Contribution to the percentage change in profitability (ppt)
Net interest income	+16.2%	+17.2
Fee and commission income	+10.8%	+5.2
Total operating expenses	+5.3%	-4.4
<b>Pre-tax operating profit</b>	<b>+19.7%</b>	

**CHART 1**  
Net interest margin (year-to-date annualised) of retail banks widened



### Hong Kong-dollar interbank interest rates dropped but remained at elevated levels; the composite interest rate edged up

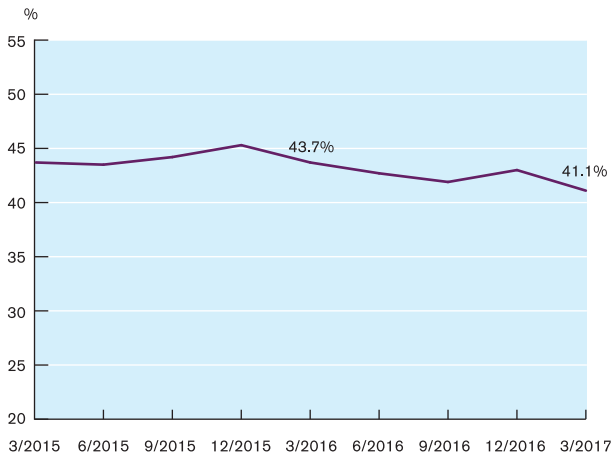


## Notes:

1. HIBOR fixing (monthly average) refers to the Hong Kong Interbank Offered Rates released by the Hong Kong Association of Banks.
2. Composite interest rate is a weighted average interest rate of all Hong Kong-dollar interest-bearing liabilities of retail banks.

## CHART 3

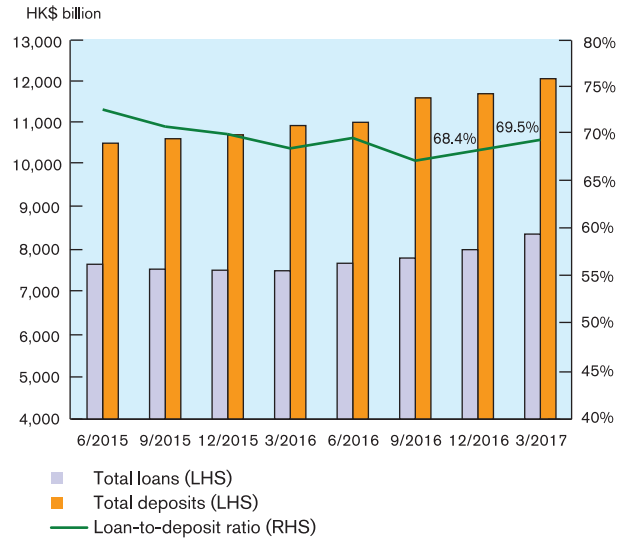
### Cost-to-income ratio (year-to-date) of retail banks declined



## Loans and deposits

## CHART 4

### Total loans of the banking sector expanded at a faster pace than total deposits



## CHART 5

### Hong Kong-dollar loans grew at a slower pace than Hong Kong-dollar deposits

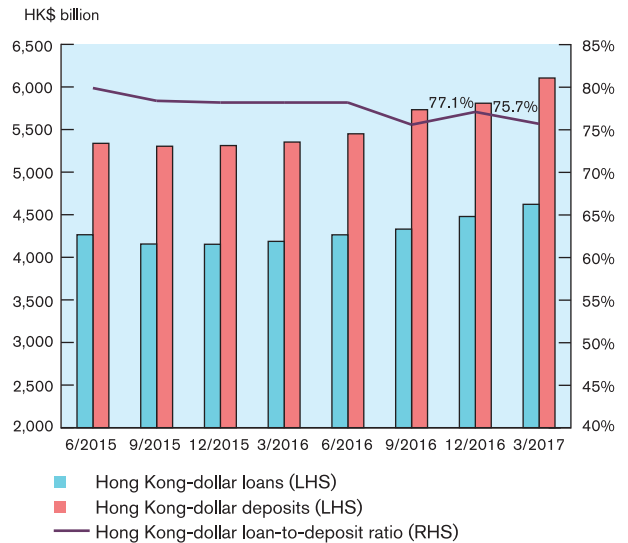
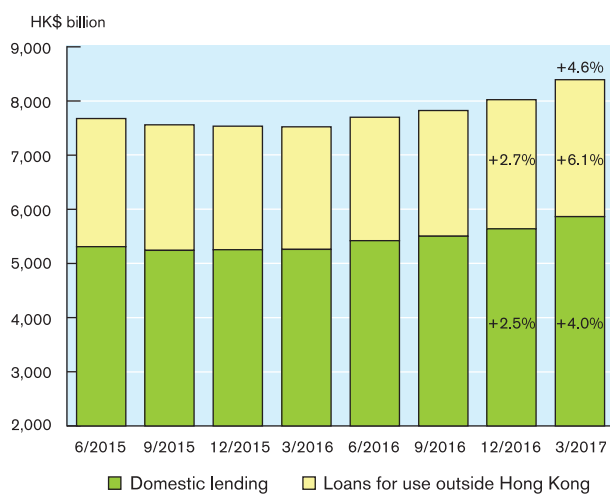


CHART 6

### Growth in domestic lending and loans for use outside Hong Kong accelerated



## Notes:

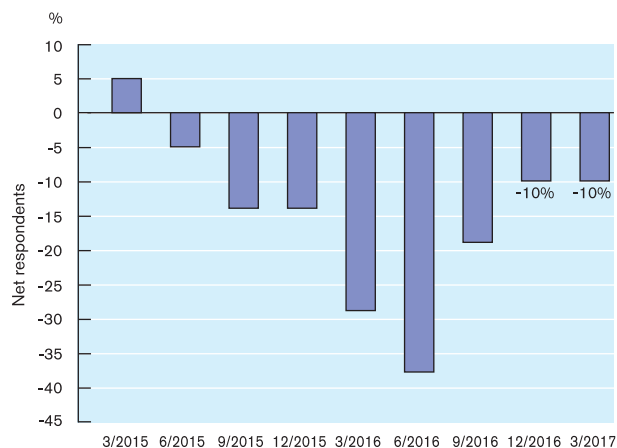
- 1 "Domestic lending" is defined as loans for use in Hong Kong plus trade finance.
- 2 "Loans for use outside Hong Kong" include "others" (i.e. unallocated).
- 3 Percentage denotes a quarterly growth rate.

Within domestic lending, the percentage changes in the amount of credit extended to the key economic sectors in the first quarter of 2017 were:

Financial concerns	+12.1%
Transport and transport equipment	+5.1%
Manufacturing	+4.6%
Property lending	+3.4%
Trade finance	+2.6%

CHART 7

### More than 80% of the respondents expected loan demand to remain stable in the next three months; of the remaining respondents, more expected loan demand to decline in the next three months than those expecting an increase



Note: Net respondents refer to the percentage of surveyed banks expecting loan demand to increase minus the percentage expecting loan demand to decline.

## Mainland-related lending

TABLE 2

### Mainland-related lending

	Dec 2016 HK\$bn	Mar 2017 HK\$bn
Mainland-related loans excluding trade finance	3,292	3,505
Trade finance	273	299
<b>Total</b>	<b>3,564</b>	<b>3,804</b>

## Asset quality

TABLE 3a

### Quality of loans and advances of the banking sector\*

	Mar 2016	Jun 2016	Sep 2016	Dec 2016	Mar 2017
	<i>% of total loans</i>				
<b>Special mention loans</b>	<b>1.82</b>	<b>1.74</b>	<b>1.80</b>	<b>1.82</b>	<b>1.66</b>
<b>Classified loans (gross)</b>	<b>0.86</b>	<b>0.90</b>	<b>0.93</b>	<b>0.85</b>	<b>0.83</b>
of which:					
Substandard	0.37	0.37	0.31	0.24	0.22
Doubtful	0.43	0.45	0.54	0.54	0.50
Loss	0.06	0.07	0.07	0.07	0.11
<b>Classified loans (net of specific provisions)</b>	<b>0.56</b>	<b>0.58</b>	<b>0.57</b>	<b>0.50</b>	<b>0.50</b>
<b>Overdue &gt; 3 months and rescheduled loans</b>	<b>0.62</b>	<b>0.69</b>	<b>0.69</b>	<b>0.67</b>	<b>0.66</b>
of which:					
Overdue > 3 months	0.57	0.62	0.63	0.61	0.60
Rescheduled loans	0.05	0.06	0.06	0.06	0.06
	<i>% of Mainland-related lending</i>				
<b>Classified loans (gross) of Mainland-related lending**</b>	<b>0.89</b>	<b>0.87</b>	<b>0.85</b>	<b>0.80</b>	<b>0.79</b>

Note: Figures may not add up to total due to rounding.

\* Unless stated otherwise, figures covered all authorized institutions' (AIs) Hong Kong offices, as well as locally incorporated AIs' overseas branches and major overseas subsidiaries.

\*\* Figures covered all AIs' Hong Kong offices, as well as locally incorporated AIs' Mainland branches and subsidiaries.

TABLE 3b

### Quality of loans and advances of retail banks\*

	Mar 2016	Jun 2016	Sep 2016	Dec 2016	Mar 2017
	<i>% of total loans</i>				
<b>Special mention loans</b>	<b>1.45</b>	<b>1.40</b>	<b>1.51</b>	<b>1.53</b>	<b>1.35</b>
<b>Classified loans (gross)</b>	<b>0.78</b>	<b>0.80</b>	<b>0.81</b>	<b>0.72</b>	<b>0.70</b>
of which:					
Substandard	0.33	0.31	0.28	0.21	0.20
Doubtful	0.41	0.45	0.49	0.48	0.47
Loss	0.04	0.04	0.04	0.03	0.03
<b>Classified loans (net of specific provisions)</b>	<b>0.56</b>	<b>0.56</b>	<b>0.55</b>	<b>0.48</b>	<b>0.48</b>
<b>Overdue &gt; 3 months and rescheduled loans</b>	<b>0.54</b>	<b>0.58</b>	<b>0.57</b>	<b>0.53</b>	<b>0.54</b>
of which:					
Overdue > 3 months	0.49	0.50	0.49	0.44	0.45
Rescheduled loans	0.06	0.08	0.08	0.09	0.09
	<i>% of Mainland-related lending</i>				
<b>Classified loans (gross) of Mainland-related lending**</b>	<b>0.94</b>	<b>0.92</b>	<b>0.89</b>	<b>0.82</b>	<b>0.85</b>

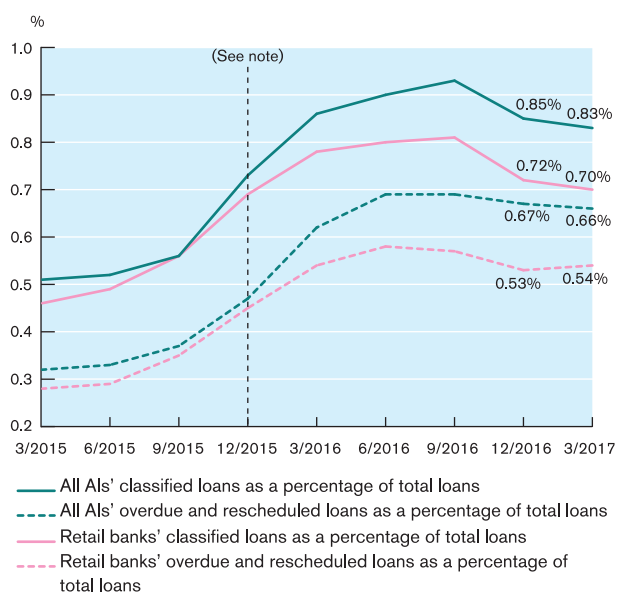
Note: Figures may not add up to total due to rounding.

\* Unless stated otherwise, figures covered retail banks' Hong Kong offices, as well as locally incorporated retail banks' overseas branches and major overseas subsidiaries.

\*\* Figures covered retail banks' Hong Kong offices, as well as locally incorporated retail banks' Mainland branches and subsidiaries.

CHART 8

**Classified loan ratios edged down as growth in total loans outpaced a slight increase in classified loans**



Note: Figures prior to December 2015 covered Hong Kong offices and overseas branches. Starting from December 2015, the coverage was expanded to include major overseas subsidiaries.

CHART 9

**Delinquency ratios of residential mortgages and credit card lending rose slightly but continued to stay at low levels**

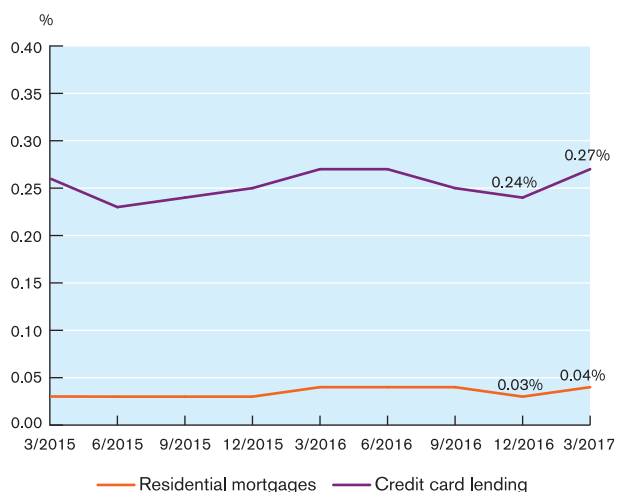
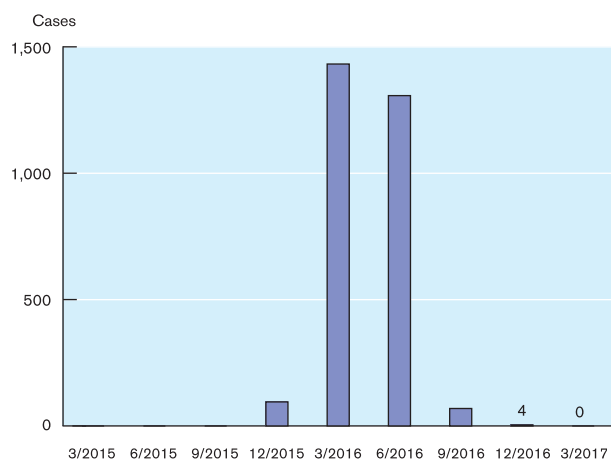


CHART 10

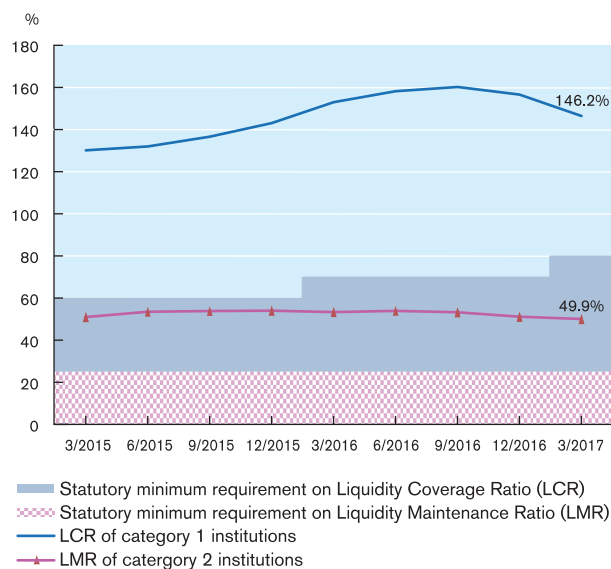
**Surveyed AIs reported no residential mortgage loans in negative equity**



## Liquidity conditions

CHART 11

**Liquidity positions of AIs were generally sound**

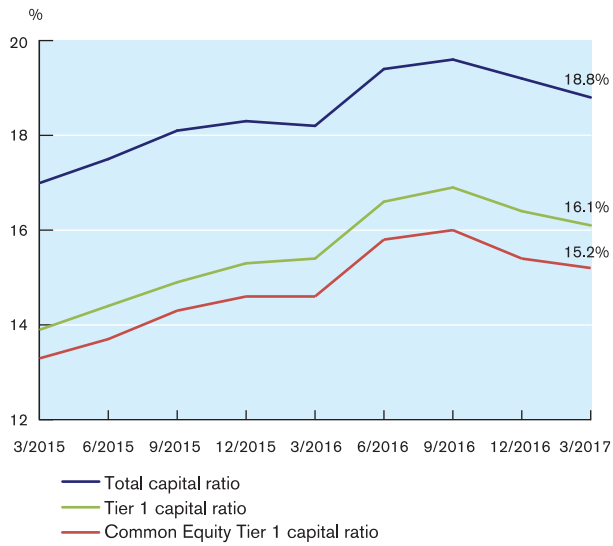


Note: For a category 1 institution, the statutory minimum requirement of the LCR applicable for 2017 is 80%. A category 2 institution must maintain the LMR of not less than 25% on average in each calendar month.

## Capital adequacy

### CHART 12

The consolidated capital adequacy ratios of locally incorporated AIs fell slightly but AIs remained well capitalised



## APPENDIX

KEY PERFORMANCE INDICATORS OF THE BANKING SECTOR<sup>1</sup> (%)

	Mar 2016	Dec 2016	Mar 2017
<b>Interest rates</b>			
1-month HIBOR fixing <sup>2</sup> (quarterly average)	0.29	0.43	0.55
3-month HIBOR fixing (quarterly average)	0.58	0.71	0.97
BLR <sup>3</sup> and 1-month HIBOR fixing spread (quarterly average)	4.71	4.57	4.45
BLR and 3-month HIBOR fixing spread (quarterly average)	4.42	4.29	4.03
Composite interest rate <sup>4</sup>	0.26	0.31	0.32
<b>All AIs</b>			
<b>Balance sheet developments<sup>5</sup></b>			
Total deposits	2.1	0.9	3.0
Hong Kong dollar	0.8	1.3	5.1
Foreign currency	3.3	0.4	1.0
Total loans	-0.2	2.5	4.6
Domestic lending <sup>6</sup>	0.1	2.5	4.0
Loans for use outside Hong Kong <sup>7</sup>	-0.8	2.7	6.1
Negotiable instruments			
Negotiable certificates of deposit (NCDs) issued	-11.6	2.1	7.4
Negotiable debt instruments held (excluding NCDs)	2.1	-0.6	1.4
<b>Asset quality</b>			
As a percentage of total loans <sup>8</sup>			
Pass loans	97.32	97.32	97.51
Special mention loans	1.82	1.82	1.66
Classified loans <sup>9</sup> (gross)	0.86	0.85	0.83
Classified loans (net) <sup>10</sup>	0.56	0.50	0.50
Overdue > 3 months and rescheduled loans	0.62	0.67	0.66
Classified loan ratio (gross) of Mainland related lending <sup>11</sup>	0.89	0.80	0.79
<b>Liquidity ratios (quarterly average, consolidated)</b>			
Liquidity Coverage Ratio — category 1 institutions	152.7	156.3	146.2
Liquidity Maintenance Ratio — category 2 institutions	53.2	51.0	49.9
<b>Retail banks</b>			
<b>Profitability</b>			
Loan impairment charges as a percentage of average total assets <sup>12</sup>	0.07	0.07	0.06
Net interest margin <sup>12</sup>	1.28	1.32	1.38
Cost-to-income ratio <sup>13</sup>	43.7	43.0	41.1
<b>Surveyed institutions</b>			
<b>Asset quality</b>			
Delinquency ratio of residential mortgage loans	0.04	0.03	0.04
Credit card lending			
Delinquency ratio	0.27	0.24	0.27
Charge-off ratio — quarterly annualised	1.91	1.89	1.88
— year-to-date annualised	1.91	1.92	1.88
<b>All locally incorporated AIs</b>			
<b>Capital adequacy (consolidated)</b>			
Common Equity Tier 1 capital ratio	14.6	15.4	15.2
Tier 1 capital ratio	15.4	16.4	16.1
Total capital ratio	18.2	19.2	18.8

## Notes:

1. Figures are related to Hong Kong offices only except where otherwise stated.
2. The Hong Kong Interbank Offered Rates are released by the Hong Kong Association of Banks.
3. With reference to the rate quoted by The Hongkong and Shanghai Banking Corporation Limited.
4. The composite interest rate is a weighted average interest rate of all Hong Kong-dollar interest-bearing liabilities, which include deposits from customers, amounts due to banks, negotiable certificates of deposit and other debt instruments, and Hong Kong-dollar non-interest-bearing demand deposits on the books of banks. Further details can be found on the HKMA website.
5. Quarterly change.
6. Loans for use in Hong Kong plus trade finance.
7. Including "others" (i.e. unallocated).
8. Figures are related to all Als' Hong Kong offices, as well as locally incorporated Als' overseas branches and major overseas subsidiaries.
9. Classified loans are those loans graded as "substandard", "doubtful" or "loss".
10. Net of specific provisions/individual impairment allowances.
11. Figures are related to all Als' Hong Kong offices, as well as locally incorporated Als' Mainland branches and subsidiaries.
12. Year-to-date annualised.
13. Year-to-date figures.