

**2003 End-Year Review  
and  
Prospects and Priorities for 2004**

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**The Performance of the  
Banking Sector in 2003**

- Notwithstanding the impact of SARS in the second quarter, it is expected that the local banks performed quite well in 2003. Most recorded a positive growth in their profit after tax compared with 2002. This was mainly due to improved asset quality and increased investment income.
- The sector's customer deposits grew strongly (an increase of 7.5% in 2003 cf. -2.6% in 2002).
- Loans and advances to customers inside Hong Kong continued to contract, but by less than in 2002 (a decline of 1.3% in 2003 cf. 2.4% in 2002). The amounts outstanding of both residential mortgage lending and credit card lending fell between December 2002 and September 2003 (by 2.5% and 8% respectively). But new residential mortgage lending picked up towards the end of the year.
- The net interest margin contracted to 1.89% (Q3 2003 annualised) from more than 2.0% in 2002.
- Asset quality improved. The quality of corporate loans held up quite well and there was an improvement in the quality of consumer loans: classified loans fell from 5.04% (December 2002) to 4.53% (September 2003); the mortgage delinquency ratio improved from 1.06% (December 2002) to 0.97% (November 2003); and the credit card charge-off ratio improved from 13.45% (Q4 2002 annualised) to 9.85% (Q3 2003 annualised).
- A factor behind the improvement in consumer loan quality was the sharp fall in the daily average number of bankruptcy petitions to 56 in December 2003 from 96 in December 2002.
- The number and value of residential mortgage loans in negative equity grew in the early part of the year but declined strongly towards the end of the year as property prices recovered.
- The aggregate capital adequacy ratio of locally incorporated institutions remained strong at 15.6% (September 2003).
- Overall, the sector probably did better than might have been expected at the turn of the year – and certainly better than was feared at the time of the SARS outbreak.

## **The Outlook for the Banking Sector for 2004**

- Looking ahead, local banks are generally optimistic about the outlook for 2004.
- They expect to see a mild increase in their profits in 2004 and asset quality is expected to improve further. Perhaps classified loans may decline to a level below 4% of total loans.
- Banks also expect to see a mild growth in their loan books this year on account of business opportunities brought by CEPA, Mainland visitors (“individual visitors”) and the launch of renminbi business in Hong Kong.
- While the prospects for the economy suggest a more favourable economic environment for the banks, several other factors – such as increasing competition and uncertainty over interest rates – suggest that the operating environment will remain challenging.

## **The HKMA’s Supervisory Priorities for 2004**

- Our general aim will be to continue our close monitoring of authorized institutions’ (AIs’) financial position and performance, while also continuing to enhance our regulatory framework.
- We will further refine our risk-based approach (to which all local and foreign AIs are now subject).
- We will continue to increase the focus on non-banking risks, e.g. securities, insurance. A memorandum of understanding has been signed with the Insurance Authority and we will conduct reviews to ensure that proper internal controls are in place. We will also focus on private banking activities.
- We will continue to work with the industry on the development of contingency plans.
- On personal renminbi business, we will monitor developments closely and take necessary actions to satisfy ourselves that banks have appropriate procedures in place.
- We will further enhance our prudential guidelines in respect of major risk areas, such as liquidity and foreign exchange risk, with a view to encouraging banks to upgrade their risk management capabilities.
- We will increase the focus on institutions’ management of their interest rate and market risks.
- We will continue to improve our e-banking and technology risk supervisory framework and to work with the Police and the industry to counter e-banking fraud.
- We will continue to work with the industry to ensure that the initiatives on the Commercial Credit Reference Agency and the use of positive (personal) credit data progress satisfactorily.
- We will take forward the initiative to establish a Deposit Protection Scheme.
- We will finalise our Anti-Money Laundering and Terrorist Financing Supplement and Interpretative Notes.
- We will continue with the preparatory work for the implementation of “Basel II” in Hong Kong.