

Developments in the banking sector

by the Banking Supervision Department

The Hong Kong banking sector remained robust despite the uncertain external environment. In the first quarter of 2013, retail banks' aggregate pre-tax operating profit rose by 21.8% compared with the same period last year and the net interest margin (NIM) widened further. Retail banks' classified loan ratio edged down further to 0.46% at the end of the first quarter of 2013 from 0.48% at the end of last year. The consolidated capital adequacy ratio of locally incorporated authorized institutions (AIs) rose to 16.6% at the end of March 2013, well above the minimum international standard of 8%. The improvement was due to a confluence of factors including increased capital base as a result of an increase in profits and the Basel III-related changes. The HKMA will continue to closely monitor developments in the banking sector and ensure that banks remain resilient amid continuing market uncertainties.

HIGHLIGHTS OF KEY TRENDS

Profitability strengthens

The 21.8% increase in the aggregate pre-tax operating profit of retail banks' Hong Kong offices in the first quarter of 2013 was mainly due to benign growth in net interest income, which was up by 12.0% compared with a year ago. Income from foreign exchange and derivatives operations as well as income from fees and commissions also contributed to the profit growth.

Retail banks' profit margins continued to improve. The annualised NIM of retail banks edged up to 1.39% in the first quarter of 2013 from 1.31% in the same quarter last year (Chart 1). The increase mainly reflected banks' reduced funding costs, as indicated by the composite interest rate which continued to trend lower in recent quarters (Chart 2). The improvement in the NIM was the major contributing factor to the growth in net interest income.

CHART 1

Net interest margin of retail banks
(year-to-date annualised)

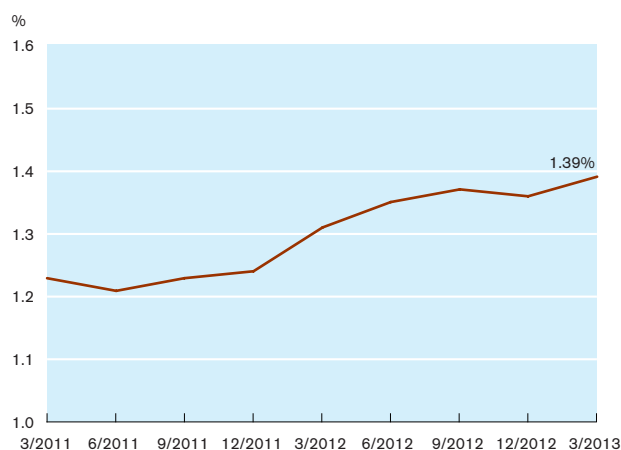
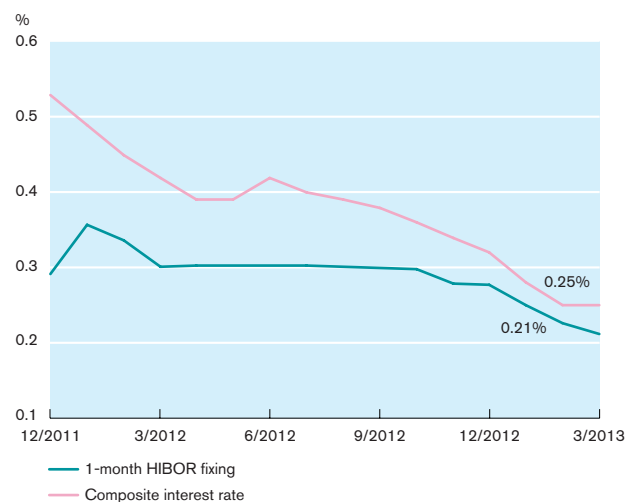


CHART 2
Interest rates



Notes:

- 1 HIBOR fixing refers to the Hong Kong dollar Interest Settlement Rates released by the Hong Kong Association of Banks and is a monthly average figure.
- 2 Composite interest rate reflects the average cost of funds.

The cost-to-income ratio of retail banks declined to 41.7% in the first quarter of 2013 from 46.0% in the same period last year, as the increase in operating income (+14.2%) outpaced that of operating expenses (+3.6%) during the period.

Asset quality remains sound

Retail banks' classified loan ratio continued its downward trend and reached 0.46% at the end of the first quarter of 2013, compared with 0.48% at the end of 2012. The improvement was mainly due to a 2.2% reduction in the aggregate amount of classified loans together with a 2.0% growth in total loans during the quarter (Table 1 and Chart 3). The ratio of overdue and rescheduled loans also reduced to 0.35% from 0.39% three months earlier. The ratio of special mention loans declined to 1.22% from 1.36% over the same period.

Retail banks' net charge for debt provisions amounted to HK\$0.5 billion in the first quarter of 2013, compared with HK\$2.0 billion in the previous quarter.

According to the HKMA Credit Card Lending Survey, the quality of surveyed institutions' credit card portfolios remained sound. At the end of the first quarter this year, the delinquency ratio of the credit card portfolio edged up to 0.23% from 0.20% in the previous quarter (Chart 4). During the same period, the quarterly annualised charge-off ratio reduced slightly to 1.81% from 1.82%. These ratios were still at low levels by historical standards.

CHART 3
Asset quality of retail banks

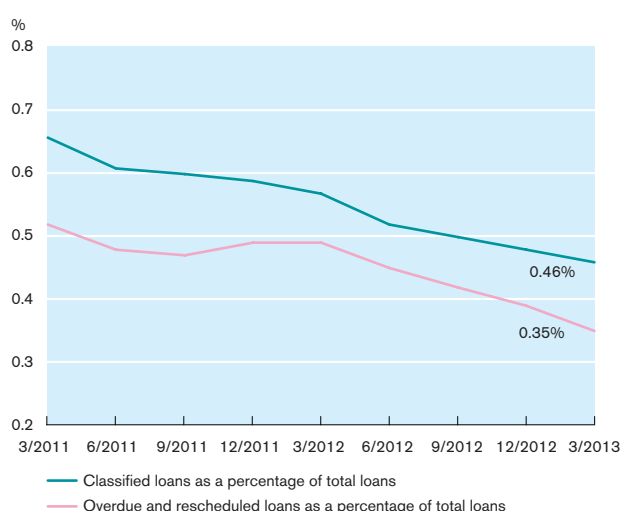


TABLE 1
Quality of loans and advances of retail banks*

	Mar 2012	Jun 2012	Sep 2012 (% of total loans)	Dec 2012	Mar 2013
Special mention loans	1.27	1.28	1.31	1.36	1.22
Classified loans (gross)	0.57	0.52	0.50	0.48	0.46
of which					
Substandard	0.19	0.17	0.16	0.20	0.21
Doubtful	0.34	0.32	0.30	0.24	0.22
Loss	0.04	0.04	0.04	0.04	0.03
Classified loans (net of specific provisions)	0.32	0.30	0.30	0.32	0.32
Overdue > 3 months and rescheduled loans	0.49	0.45	0.42	0.39	0.35
of which					
Overdue > 3 months	0.39	0.36	0.33	0.27	0.26
Rescheduled loans	0.09	0.09	0.09	0.12	0.09

* Period-end figures covering the Hong Kong offices and overseas branches of the banks.

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

The credit quality of surveyed AIs' residential mortgage lending also remained sound, with the delinquency ratio falling slightly to 0.01% at the end of the first quarter this year from 0.02% at the end of 2012 (Chart 4). The surveyed AIs have not reported any residential mortgage loans in negative equity since the end of September 2012 (Chart 5).

CHART 4

Delinquency ratios of residential mortgages and credit card lending of surveyed institutions

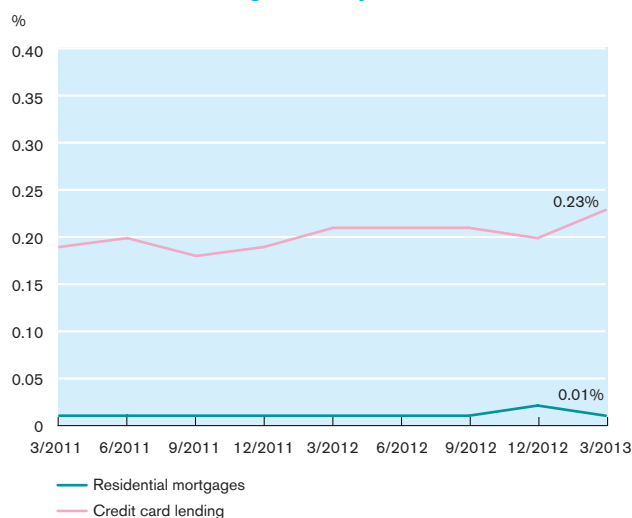
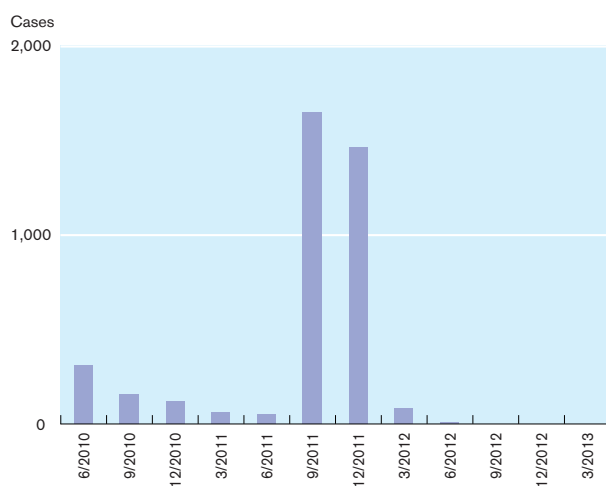


CHART 5

Residential mortgage loans in negative equity



Loan-to-deposit ratios rise

Retail banks' total loans and advances rose by 2.2% but total deposits declined by 0.3% in the first quarter of this year. As a result, their overall loan-to-deposit ratio increased to 56.2% from 54.8% at the end of 2012 (Chart 6). During the same period, Hong Kong dollar loans and advances rose by 1.0% while Hong Kong dollar deposits dropped by 1.6%, resulting in the Hong Kong dollar loan-to-deposit ratio climbing to 74.2% at the end of the first quarter from 72.3% three months earlier (Chart 7).

CHART 6

Total loans and deposits of retail banks

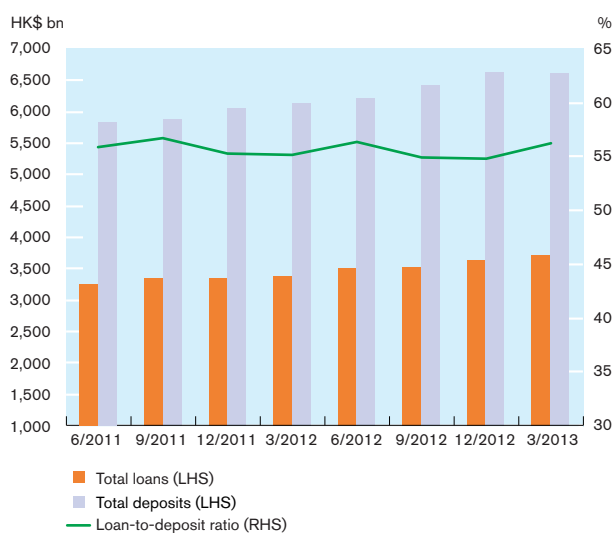
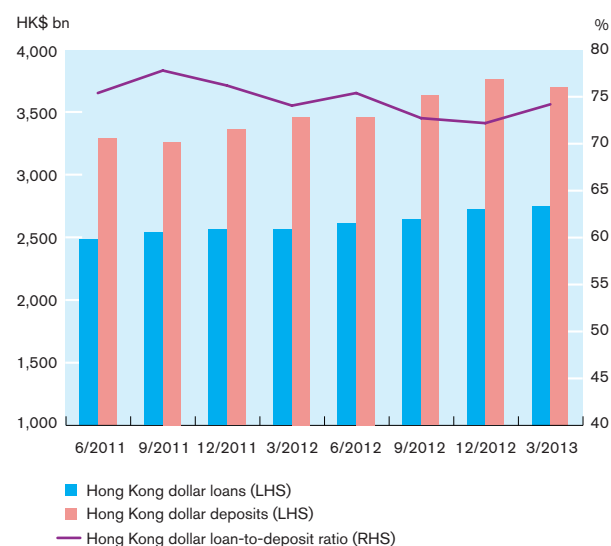


CHART 7

Hong Kong dollar loans and deposits of retail banks

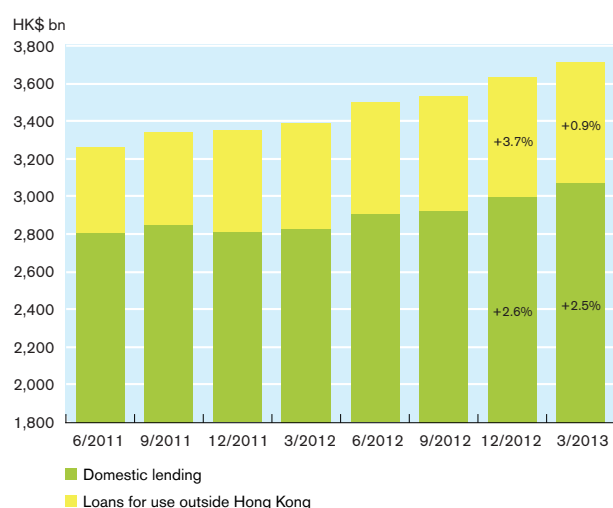


Domestic lending and loans for use outside Hong Kong rise

Retail banks' domestic lending (loans for use in Hong Kong plus trade finance) rose by 2.5% in the first quarter of 2013 after a 2.6% growth in the previous quarter (Chart 8). Growth in loans for use outside Hong Kong slowed to 0.9% following a 3.7% increase in the fourth quarter of 2012.

CHART 8

Loans and advances of retail banks



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 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 2013 are shown below:

Trade finance	+ 9.3%
Manufacturing	+ 3.7%
Property lending	+ 1.1%
Wholesale and retail trade	+ 0.9%

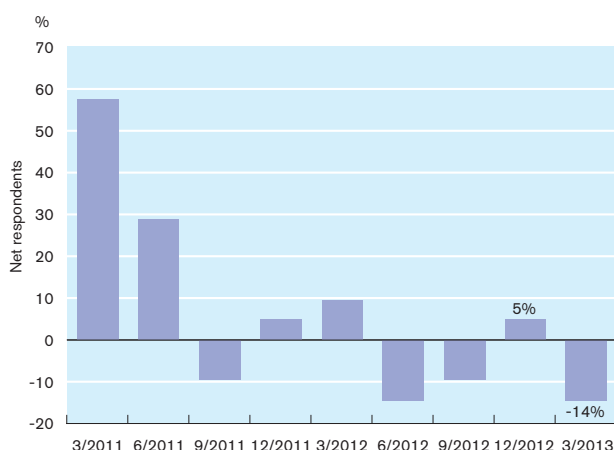
Retail banks' total non-bank Mainland exposures¹ increased by 2.8% to HK\$1,818 billion (16.7% of total assets) at the end of the first quarter this year from HK\$1,768 billion (16.4% of total assets) at the end of 2012. For the banking sector as a whole, non-bank Mainland exposures increased by 5.1% to HK\$2,867 billion (16.8% of total assets) from HK\$2,728 billion (16.2% of total assets) in the same period.

Surveyed AIs anticipate stable loan demand

The HKMA's Opinion Survey of Credit Condition Outlook conducted in March showed the bulk of the surveyed AIs (67%) expected loan demand to remain the same in the next three months. For the remainder, more AIs anticipated a decrease in loan demand (Chart 9), particularly for property financing. Nevertheless, a considerable portion of the responding AIs continued to anticipate stronger demand for loans to non-bank Mainland entities, loans for use outside Hong Kong, syndicated loans as well as trade finance.

CHART 9

Expectation of loan demand in the next three months



Note:

Net respondents refer to the percentage of respondents expecting loan demand to increase minus the percentage expecting loan demand to decline.

¹ Including exposures booked in the retail banks' banking subsidiaries in Mainland China.

Average liquidity ratio declines

The quarterly average liquidity ratio of retail banks declined to 40.2% in the first quarter of 2013 from 42.6% in the previous quarter. The decline was led by a decrease in liquefiable assets, especially interbank claims, as well as an increase in qualifying liabilities. The ratio was well above the statutory minimum of 25% (Chart 10).

Als remain well capitalised

The consolidated capital adequacy ratio of locally incorporated Als rose to 16.6% at the end of the first quarter this year from 15.7% three months earlier, well above the minimum international standard of 8% (Chart 11). This was mainly due to a faster growth in the capital base than in risk-weighted assets as a result of profit growth and the implementation of the Basel III standards on capital adequacy starting from January 2013.

A table of key performance indicators of the banking sector can be found in the Appendix.

CHART 10

Liquidity ratio of retail banks (quarterly average)

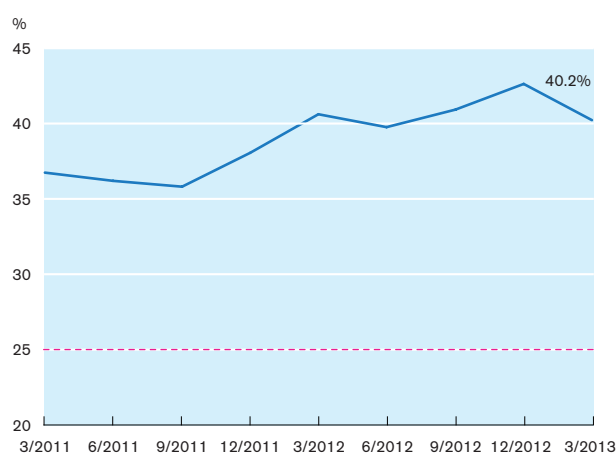
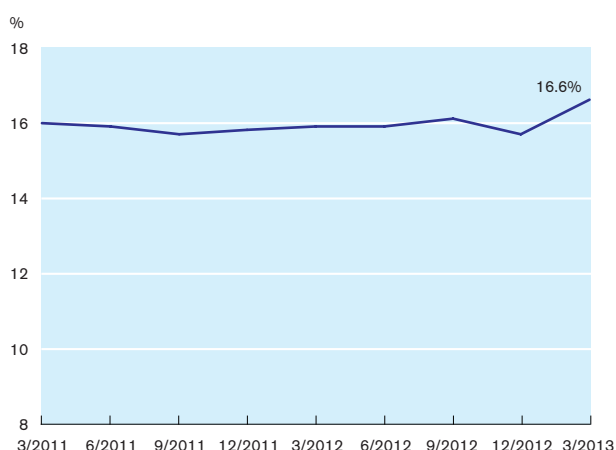


CHART 11

Capital adequacy ratio of locally incorporated Als



APPENDIX

KEY PERFORMANCE INDICATORS OF THE BANKING SECTOR¹ (%)

	Mar 2012	Dec 2012	Mar 2013
Interest rate			
1-month HIBOR fixing ² (quarterly average)	0.33	0.28	0.23
3-month HIBOR fixing (quarterly average)	0.40	0.40	0.39
BLR ³ and 1-month HIBOR fixing spread (quarterly average)	4.67	4.72	4.77
BLR and 3-month HIBOR fixing spread (quarterly average)	4.60	4.60	4.61
Composite interest rate ⁴	0.42	0.32	0.25
Retail banks			
Balance sheet developments⁵			
Total deposits	1.4	3.1	-0.3
Hong Kong dollar	2.9	3.5	-1.6
Foreign currency	-0.5	2.7 ^r	1.5
Total loans	1.1	2.8 ^r	2.2
Domestic lending ⁶	0.6	2.6 ^r	2.5
Loans for use outside Hong Kong ⁷	3.9	3.7 ^r	0.9
Negotiable instruments			
Negotiable certificates of deposit (NCD) issued	8.2	-2.8	2.8
Negotiable debt instruments held (excluding NCD)	2.3	6.8 ^r	4.5
Asset quality⁸			
As a percentage of total loans			
Pass loans	98.17	98.16	98.32
Special mention loans	1.27	1.36	1.22
Classified loans ⁹ (gross)	0.57	0.48 ^r	0.46
Classified loans (net) ¹⁰	0.32	0.32 ^r	0.32
Overdue > 3 months and rescheduled loans	0.49	0.39 ^r	0.35
Profitability			
Bad debt charge as percentage of average total assets ¹¹	0.01	0.04	0.02
Net interest margin ¹¹	1.31	1.36	1.39
Cost-to-income ratio ¹²	46.0	45.8 ^r	41.7
Liquidity ratio (quarterly average)	40.6	42.6	40.2
Surveyed institutions			
Asset quality			
Delinquency ratio of residential mortgage loans	0.01	0.02	0.01
Credit card lending			
Delinquency ratio	0.21	0.20	0.23
Charge-off ratio — quarterly annualised	1.59	1.82	1.81
— year-to-date annualised	1.59	1.70	1.81
All locally incorporated AIs			
Capital adequacy ratio (consolidated)¹³	15.9	15.7	16.6

Notes:

¹ Figures are related to Hong Kong office(s) only except where otherwise stated.

² The Hong Kong dollar Interest Settlement 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 in 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 retail banks' Hong Kong office(s) and overseas branches.

⁹ Classified loans are those loans graded as "substandard", "doubtful" or "loss".

¹⁰ Net of specific provisions/individual impairment allowances.

¹¹ Year-to-date annualised.

¹² Year-to-date figures.

¹³ For the implementation of the Basel III framework, all locally incorporated AIs are required to report their capital adequacy positions under the Banking (Capital) Rules starting from 1 January 2013.

^r Revised figure