

# Developments in the banking sector

*by the Banking Supervision Department*

## Highlights of key trends

- The aggregate pre-tax operating profit of retail banks' Hong Kong offices fell by 4.1% in the first quarter of 2015 compared with the same period last year. Despite steady growth of net interest income (+5.2%), the rising operating expenses (+10.8%) weighed on retail banks' profitability.
- The year-to-date annualised net interest margin of retail banks narrowed to 1.33% in the first quarter from 1.39% a year ago (Chart 1), partly due to the fact that retail banks invested their funds in lower-yielding assets amid robust deposit growth.
- Retail banks' total loans and advances and total deposits rose by 5.9% and 3.2% respectively in the first quarter. The robust growth in total loans was mainly driven by the initial public offering (IPO) loans straddling the end of March. During the same period, retail banks' Hong Kong dollar loans and advances grew by 7.7% while the Hong Kong dollar deposits expanded by 6.7% (Charts 7 and 8).
- For the banking sector as a whole, total Mainland-related lending increased by 4.6% to HK\$3,361 billion (15.6% of total assets) at the end of the first quarter from HK\$3,212 billion (15.3% of total assets) at the end of 2014 (Tables 2 to 5).
- Starting from 1 January 2015, authorized institutions (AIs) in Hong Kong implemented the new liquidity requirements in accordance with the Basel III framework. In the first quarter, the quarterly average liquidity coverage ratio of category 1 institutions was 129.9% (well above the 60% minimum requirement for 2015). For category 2 institutions, their quarterly average liquidity maintenance ratio was 50.8% (well above the 25% minimum requirement) (Table 6).

Separately, a table of key performance indicators of the banking sector can be found in the Appendix.

## Profitability

CHART 1

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

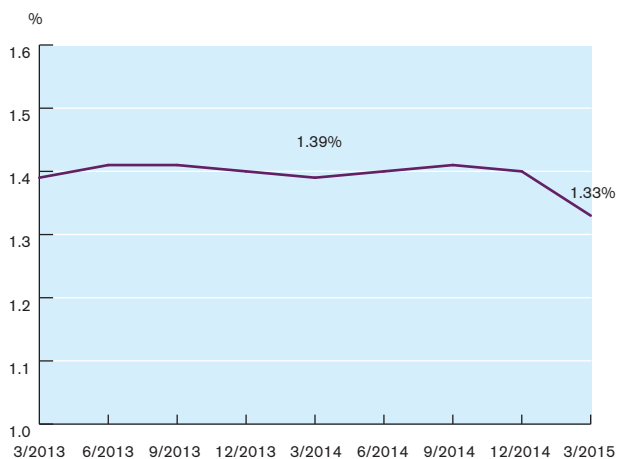
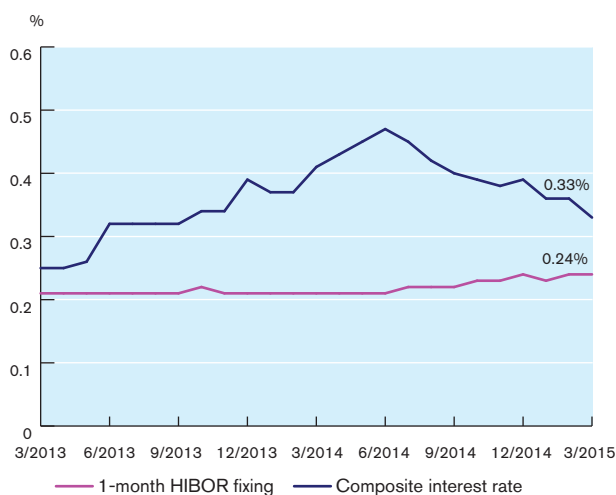


CHART 2

Interest rates



Notes:

- 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.
- Composite interest rate is a weighted average interest rate of all Hong Kong dollar interest bearing liabilities.

TABLE 1

Quality of loans and advances of retail banks\*

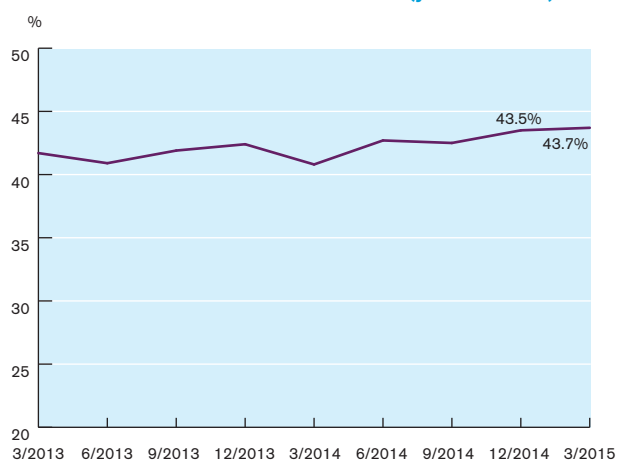
	Mar 2014	Jun 2014	Sep 2014	Dec 2014	Mar 2015
			% of total loans		
<b>Special mention loans</b>	<b>1.12</b>	<b>1.05</b>	<b>1.04</b>	<b>0.99</b>	<b>1.14</b>
<b>Classified loans (gross)</b>	<b>0.46</b>	<b>0.46</b>	<b>0.43</b>	<b>0.45</b>	<b>0.46</b>
of which					
Substandard	0.22	0.21	0.19	0.19	0.20
Doubtful	0.21	0.22	0.22	0.23	0.24
Loss	0.03	0.03	0.03	0.02	0.03
<b>Classified loans (net of specific provisions)</b>	<b>0.34</b>	<b>0.33</b>	<b>0.31</b>	<b>0.31</b>	<b>0.32</b>
<b>Overdue &gt; 3 months and rescheduled loans</b>	<b>0.31</b>	<b>0.27</b>	<b>0.27</b>	<b>0.29</b>	<b>0.28</b>
of which					
Overdue > 3 months	0.23	0.21	0.22	0.23	0.23
Rescheduled loans	0.08	0.05	0.05	0.06	0.05

\* 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.

CHART 3

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



## Asset quality

CHART 4

Asset quality of retail banks

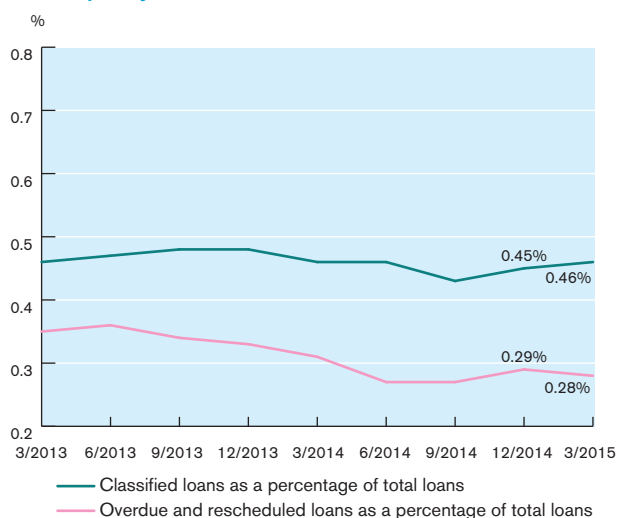


CHART 5

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

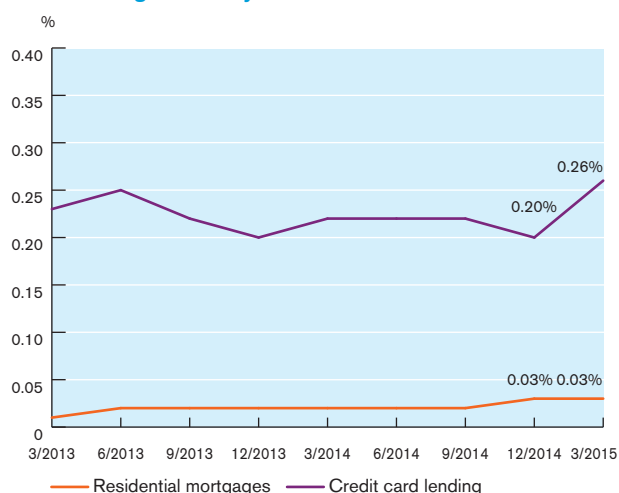


CHART 8

## Hong Kong dollar loans and deposits of retail banks

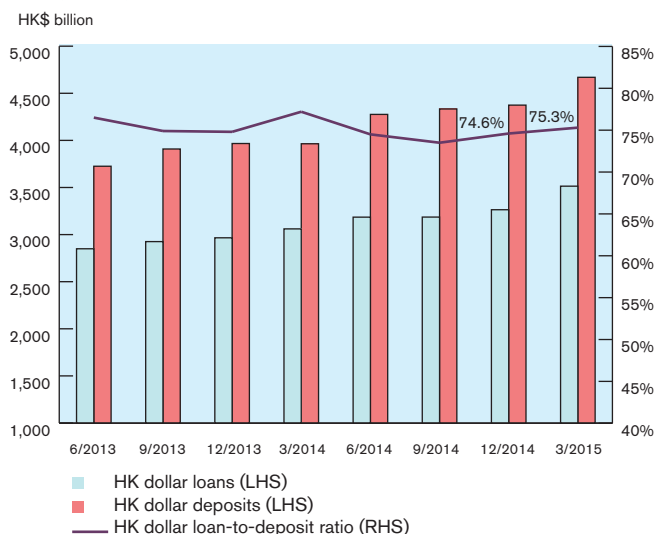


CHART 6

## Residential mortgage loans in negative equity

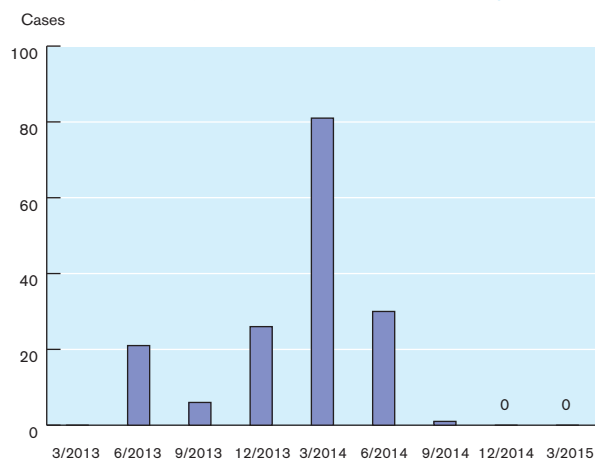
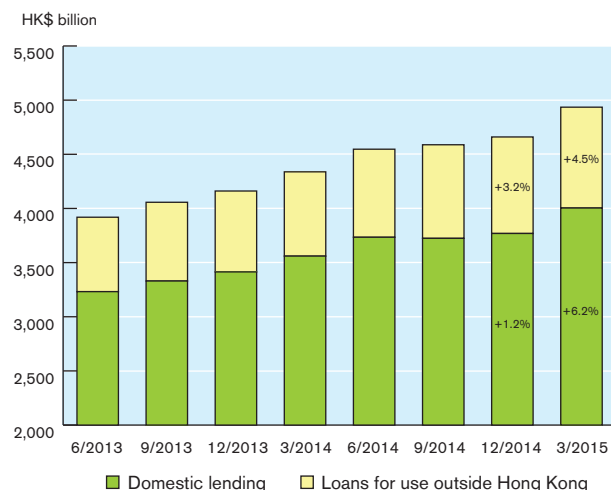


CHART 9

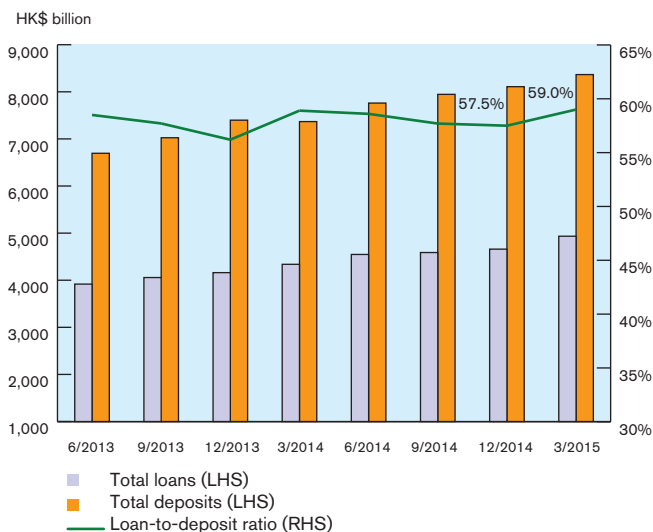
## Loans and advances of retail banks



## Loans and deposits

CHART 7

## Total loans and deposits of retail banks



## Notes:

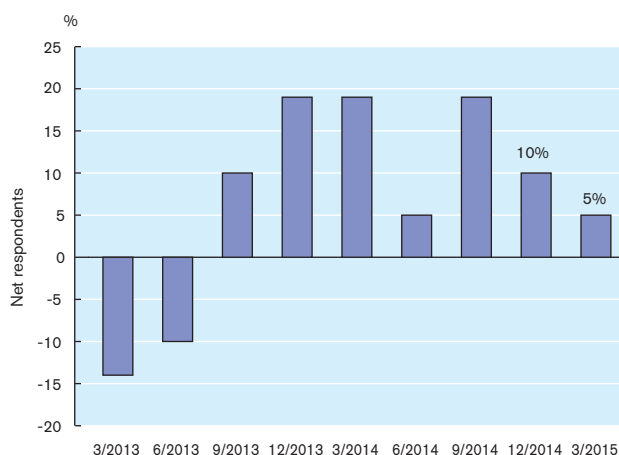
- 1 "Domestic lending" is defined as loans for use in Hong Kong plus trade finance.
- 2 "Loans for use outside Hong Kong" include "others" (i.e. unallocated).
- 3 Percentage denotes quarterly growth rate.

Within domestic lending of retail banks, the percentage changes in the amount of credit extended to the key economic sectors in the first quarter of 2015 were:

Property lending	+2.0%
Wholesale and retail trade	+1.6%
Trade finance	-1.9%
Manufacturing	-3.6%

CHART 10

## 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.

## Mainland-related lending and non-bank exposures

TABLE 2

## Mainland-related lending

	Dec 2014 HK\$bn	Mar 2015 HK\$bn
Mainland-related loans excluding trade finance	2,858	2,986
Trade finance	354	376
<b>Total</b>	<b>3,212</b>	<b>3,361</b>

TABLE 3

## Mainland-related lending by type of AIs

	Dec 2014 HK\$bn	Mar 2015 HK\$bn
Overseas-incorporated AIs	1,377	1,459
Locally-incorporated AIs <sup>1</sup>	1,294	1,352
Mainland banking subsidiaries of locally-incorporated AIs	542	551
<b>Total</b>	<b>3,212</b>	<b>3,361</b>

<sup>1</sup> Including loans booked in the Mainland branches of locally-incorporated AIs

TABLE 4

## Mainland-related lending by type of borrowers

	Dec 2014 HK\$bn	Mar 2015 HK\$bn
Mainland state-owned entities	1,472	1,576
Mainland private entities	584	635
Non-Mainland entities	1,157	1,150
<b>Total</b>	<b>3,212</b>	<b>3,361</b>

TABLE 5

## Other non-bank exposures

	Dec 2014 HK\$bn	Mar 2015 HK\$bn
Negotiable debt instruments and other on-balance sheet exposures	636	607
Off-balance sheet exposures	395	358
<b>Total</b>	<b>1,031</b>	<b>965</b>

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

## Liquidity conditions

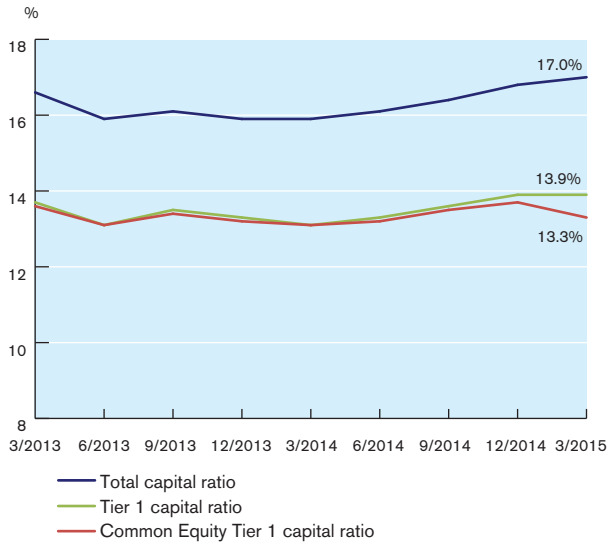
TABLE 6

## Liquidity ratios

Quarterly average ratios	Jun-14	Sep-14	Dec-14	Mar-15
Liquidity coverage ratio (Consolidated) – Category 1 institutions	n.a.	n.a.	n.a.	129.9%
Liquidity maintenance ratio (Consolidated) – Category 2 institutions	n.a.	n.a.	n.a.	50.8%
Liquidity ratio (Hong Kong Offices) – Retail banks	40.8%	41.2%	41.1%	n.a.

Note: For a category 1 institution, the minimum requirement for Liquidity Coverage Ratio began at 60% on 1 January 2015, rising in equal annual steps of 10 percentage points to reach 100% on 1 January 2019. A category 2 institution must maintain a Liquidity Maintenance Ratio of not less than 25% on average in each calendar month.

## Capital Adequacy

**CHART 11****Capital adequacy ratios of locally incorporated AIs**

## APPENDIX

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

	Mar 2014	Dec 2014	Mar 2015
<b>Interest rate</b>			
1-month HIBOR fixing <sup>2</sup> (quarterly average)	0.21	0.23	0.24
3-month HIBOR fixing (quarterly average)	0.38	0.38	0.39
BLR <sup>3</sup> and 1-month HIBOR fixing spread (quarterly average)	4.79	4.77	4.76
BLR and 3-month HIBOR fixing spread (quarterly average)	4.62	4.62	4.61
Composite interest rate <sup>4</sup>	0.41	0.39	0.33
<b>Retail banks</b>			
<b>Balance sheet developments<sup>5</sup></b>			
Total deposits	-0.4	2.1	3.2
Hong Kong dollar	-0.1	0.9	6.7
Foreign currency	-0.8	3.4	-1.0
Total loans	4.3	1.6	5.9
Domestic lending <sup>6</sup>	4.3	1.2	6.2
Loans for use outside Hong Kong <sup>7</sup>	4.2	3.2	4.5
Negotiable instruments			
Negotiable certificates of deposit (NCD) issued	16.5	-4.6	9.6
Negotiable debt instruments held (excluding NCD)	-5.8	-2.7	4.5
<b>Asset quality<sup>8</sup></b>			
As a percentage of total loans			
Pass loans	98.42	98.56	98.39
Special mention loans	1.12	0.99	1.14
Classified loans <sup>9</sup> (gross)	0.46	0.45	0.46
Classified loans (net) <sup>10</sup>	0.34	0.31	0.32
Overdue > 3 months and rescheduled loans	0.31	0.29	0.28
<b>Profitability</b>			
Bad debt charge as percentage of average total assets <sup>11</sup>	0.04	0.05	0.06
Net interest margin <sup>11</sup>	1.39	1.40	1.33
Cost-to-income ratio <sup>12</sup>	40.8	43.5	43.7
<b>All AIs</b>			
<b>Liquidity ratios (quarterly average, consolidated)<sup>13</sup></b>			
Liquidity coverage ratio — Category 1 institutions	n.a.	n.a.	129.9
Liquidity maintenance ratio — Category 2 institutions	n.a.	n.a.	50.8
<b>Surveyed institutions</b>			
<b>Asset quality</b>			
Delinquency ratio of residential mortgage loans	0.02	0.03	0.03
Credit card lending			
Delinquency ratio	0.22	0.20	0.26
Charge-off ratio — quarterly annualised	1.85	1.85	1.80
— year-to-date annualised	1.85	1.83	1.80
<b>All locally incorporated AIs</b>			
<b>Capital adequacy (consolidated)</b>			
Common Equity Tier 1 capital ratio	13.1	13.7	13.3
Tier 1 capital ratio	13.1	13.9	13.9
Total capital ratio	15.9	16.8	17.0

## Notes:

- <sup>1</sup> Figures are related to Hong Kong office(s) only except where otherwise stated.
- <sup>2</sup> The Hong Kong Dollar Interest Settlement Rates are released by the Hong Kong Association of Banks.
- <sup>3</sup> With reference to the rate quoted by The Hongkong and Shanghai Banking Corporation Limited.
- <sup>4</sup> 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.
- <sup>5</sup> Quarterly change.
- <sup>6</sup> Loans for use in Hong Kong plus trade finance.
- <sup>7</sup> Including "others" (i.e. unallocated).
- <sup>8</sup> Figures are related to retail banks' Hong Kong office(s) and overseas branches.
- <sup>9</sup> Classified loans are those loans graded as "substandard", "doubtful" or "loss".
- <sup>10</sup> Net of specific provisions/individual impairment allowances.
- <sup>11</sup> Year-to-date annualised.
- <sup>12</sup> Year-to-date figures.
- <sup>13</sup> A new data series was introduced for liquidity ratios which are defined in accordance with the Basel III framework starting from January 2015. For a category 1 institution, the minimum requirement for Liquidity Coverage Ratio began at 60% on 1 January 2015, rising in equal annual steps of 10 percentage points to reach 100% on 1 January 2019. A category 2 institution must maintain a Liquidity Maintenance Ratio of not less than 25% on average in each calendar month.