

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 fell by 4.8% in the first quarter of 2016 compared with the same period last year. Income from fees and commissions dropped by 11% against a strong first quarter of 2015. Net interest income also declined by 2.7% (Table 1).

The net interest margin of retail banks narrowed to 1.28% in the first quarter from 1.33% in the same period a year ago (Chart 1). This was mainly attributable to a lower return on RMB-denominated assets and the investment of surplus funds by retail banks in lower-yielding assets such as government papers given the subdued demand for credit.

Volatility in Hong Kong dollar interbank interest rates increased in the first quarter amid heightened uncertainties in the financial markets. Nevertheless, the composite interest rate, a measure of the average cost of Hong Kong dollar funds for retail banks, remained broadly stable (Chart 2).

Retail banks' classified loan ratio rose to 0.78% at the end of the first quarter from 0.70% a quarter earlier, but remained at a low level by historical standards (Table 3).

For the banking sector as a whole, total Mainland-related lending increased by 0.4% to HK\$3,342 billion at the end of March from HK\$3,329 billion at the end of December 2015 (Table 2). The classified loan ratio of Mainland-related lending rose to 0.94% from 0.78% during the period (Table 3).

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 2016 vs Q1 2015
Net interest income	-2.7%
Fee and commission income	-11.0%
Other income	+7.6%
Pre-tax operating profit	-4.8%

CHART 1

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

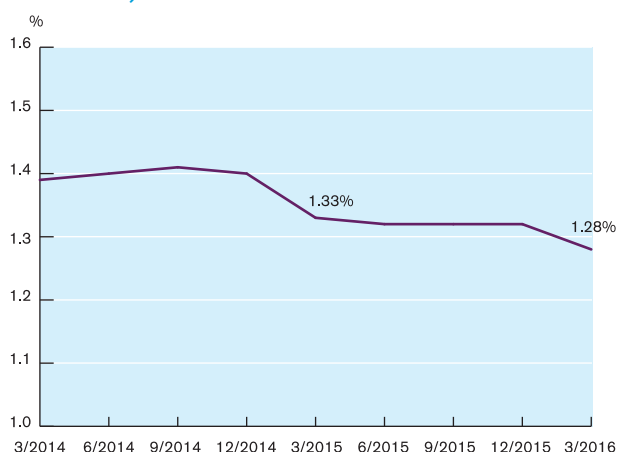
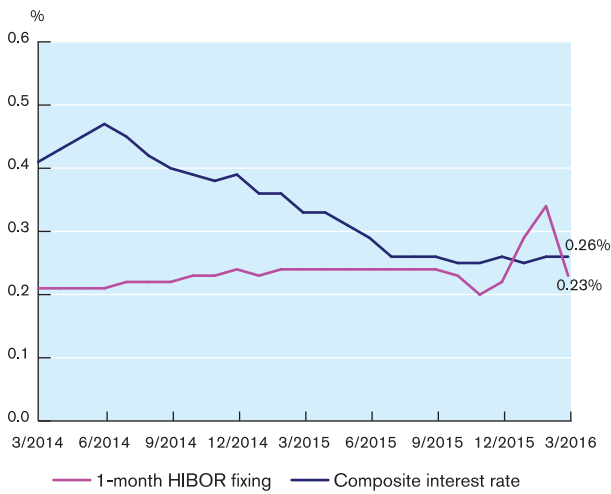


CHART 2

Volatility in Hong Kong dollar interbank interest rates increased amid heightened uncertainties in the financial markets

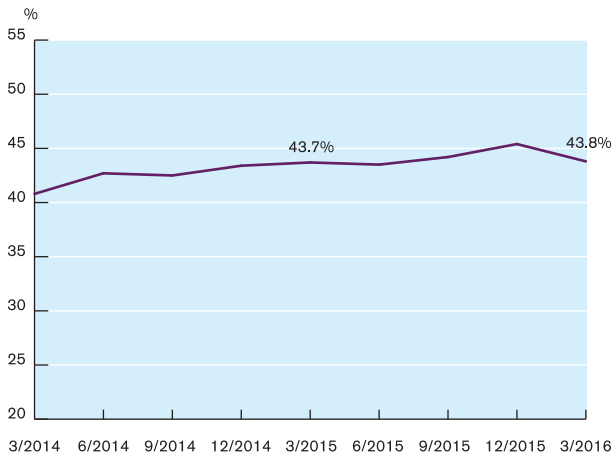


Notes:

1. HIBOR fixing refers to the Hong Kong Dollar Interbank Offered Rates released by the Hong Kong Association of Banks and is a monthly average figure.
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 of retail banks (year-to-date) remained stable



Loans and deposits

CHART 4

Retail banks' total deposits rose at a faster pace than total loans

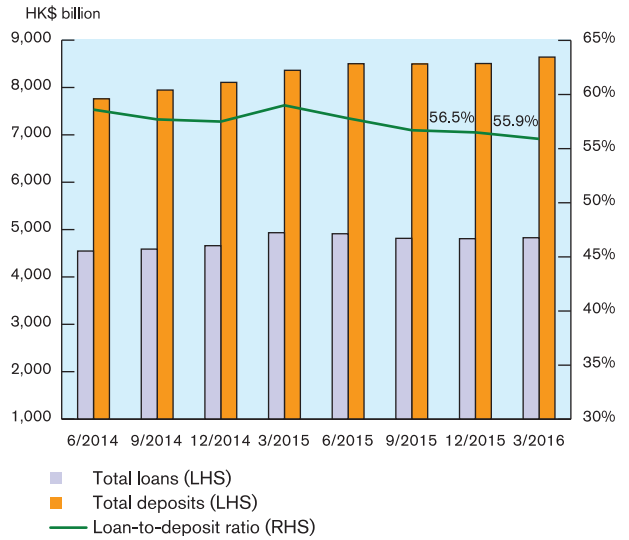


CHART 5

Hong Kong dollar loans and deposits of retail banks grew slightly

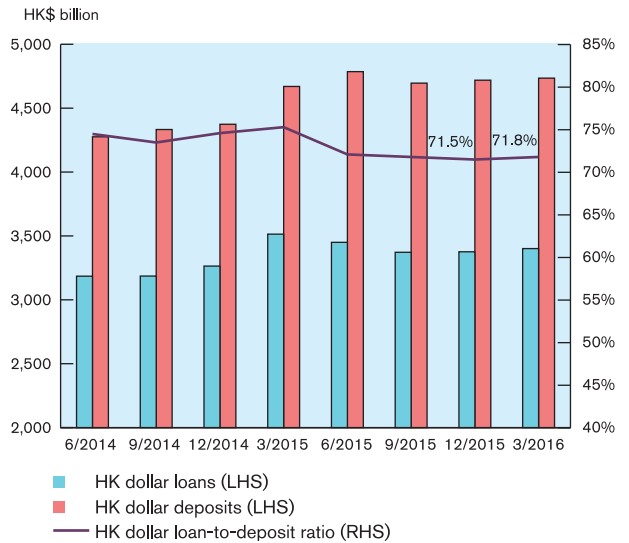
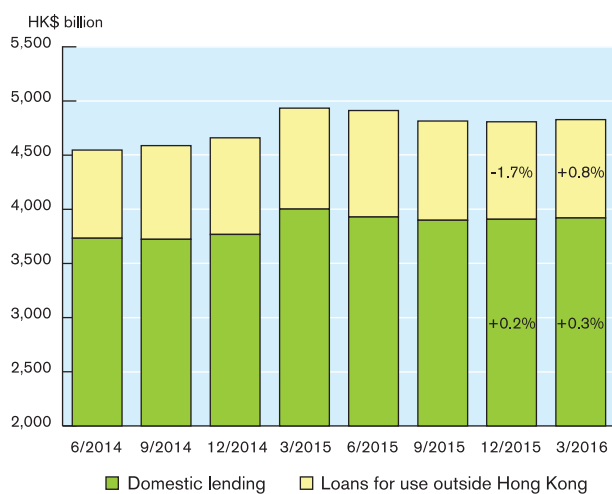


CHART 6

Both domestic lending and loans for use outside Hong Kong of retail banks edged up



Notes:

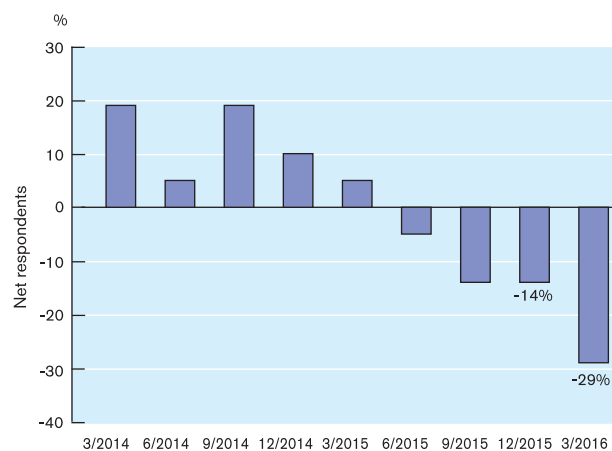
- 1 "Domestic lending" is defined as loans for use in Hong Kong plus trade finance.
- 2 "Loans for use outside Hong Kong" include "others" (i.e. unallocated).
- 3 Percentage denotes quarterly growth rate.

Within domestic lending, the percentage changes in the amount of credit extended to the key economic sectors in the first quarter of 2016 were:

Property lending	+1.6%
Wholesale and retail trade	-4.5%
Financial concerns	-5.2%
Trade finance	-6.5%

CHART 7

More respondents expected loan demand to decline 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

TABLE 2

Mainland-related lending

	Dec 2015 HK\$bn	Mar 2016 HK\$bn
Mainland-related loans excluding trade finance	3,053	3,042
Trade finance	276	300
Total	3,329	3,342

Asset quality

TABLE 3

Quality of loans and advances of retail banks*

	Mar 2015	Jun 2015	Sep 2015	Dec 2015	Mar 2016
	<i>% of total loans</i>				
Special mention loans	1.14	1.28	1.36	1.44	1.45
Classified loans (gross)	0.46	0.49	0.56	0.70	0.78
of which					
Substandard	0.20	0.25	0.27	0.32	0.33
Doubtful	0.24	0.21	0.27	0.34	0.41
Loss	0.03	0.03	0.02	0.04	0.04
Classified loans (net of specific provisions)	0.32	0.35	0.40	0.50	0.56
Overdue > 3 months and rescheduled loans	0.28	0.29	0.35	0.45	0.54
of which					
Overdue > 3 months	0.23	0.24	0.29	0.39	0.49
Rescheduled loans	0.05	0.06	0.06	0.06	0.06
	<i>% of Mainland-related lending</i>				
Classified loans (gross) of Mainland-related lending**	0.61	0.73	0.81	0.78	0.94

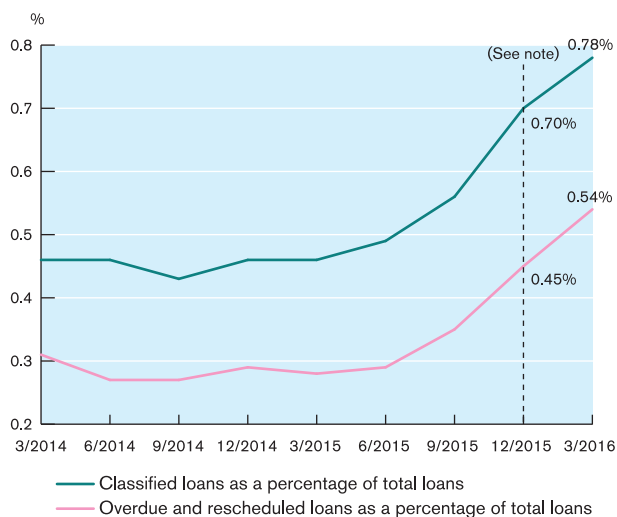
Note: Figures may not add up to total due to rounding.

* Figures prior to December 2015 covered retail banks' Hong Kong offices and overseas branches. Starting from December 2015, the coverage was expanded to include the banks' major overseas subsidiaries.

** Figures covered retail banks' Hong Kong offices, Mainland branches and subsidiaries.

CHART 8

Asset quality of retail banks' loan portfolio has slightly deteriorated in recent quarters but remained healthy by historical standards



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

CHART 9

Delinquency ratios of residential mortgages and credit card lending stayed at low levels

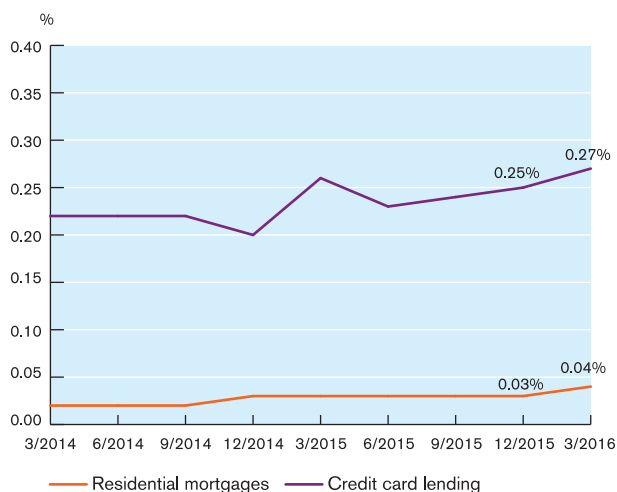
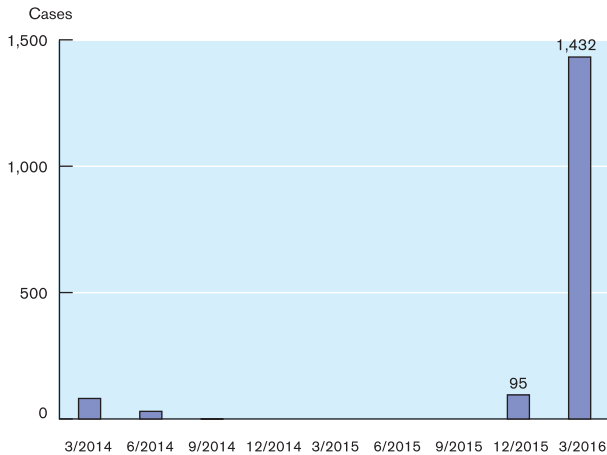


CHART 10

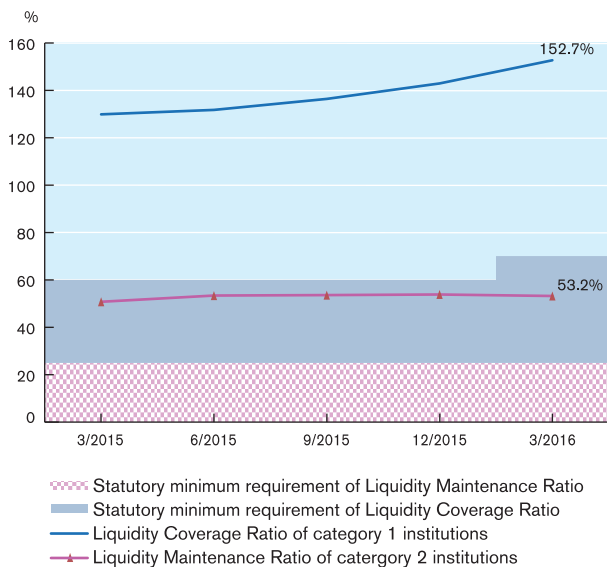
The number of residential mortgage loans in negative equity rose



Liquidity conditions

CHART 11

Liquidity ratios (quarterly average) remained well above the statutory minimum

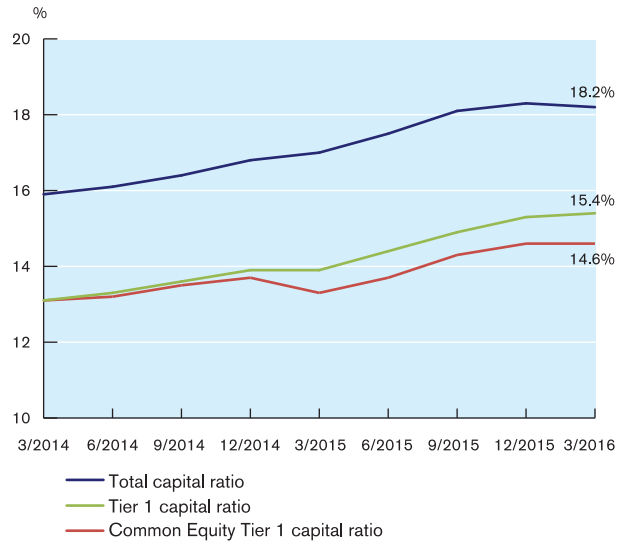


Note: For a category 1 institution, the statutory minimum requirement of Liquidity Coverage Ratio applicable for 2016 is 70%. A category 2 institution must maintain a Liquidity Maintenance Ratio of not less than 25% on average in each calendar month.

Capital adequacy

CHART 12

Locally incorporated authorized institutions remained well capitalised



Appendix

KEY PERFORMANCE INDICATORS OF THE BANKING SECTOR¹ (%)

	Mar 2015	Dec 2015	Mar 2016
Interest rates			
1-month HIBOR fixing ² (quarterly average)	0.24	0.22	0.29
3-month HIBOR fixing (quarterly average)	0.39	0.39	0.58
BLR ³ and 1-month HIBOR fixing spread (quarterly average)	4.76	4.78	4.71
BLR and 3-month HIBOR fixing spread (quarterly average)	4.61	4.61	4.42
Composite interest rate ⁴	0.33	0.26	0.26
Retail banks			
Balance sheet developments⁵			
Total deposits	3.1	0.1	1.6
Hong Kong dollar	6.7	0.5	0.3
Foreign currency	-1.1	-0.4	3.2
Total loans	5.9	-0.1	0.4
Domestic lending ⁶	6.2	0.2	0.3
Loans for use outside Hong Kong ⁷	4.5	-1.7	0.8
Negotiable instruments			
Negotiable certificates of deposit (NCDs) issued	9.6	3.9	-19.6
Negotiable debt instruments held (excluding NCDs)	4.7	-0.9	3.8
Asset quality			
As a percentage of total loans ⁸			
Pass loans	98.39	97.86	97.77
Special mention loans	1.14	1.44	1.45
Classified loans ⁹ (gross)	0.46	0.70	0.78
Classified loans (net) ¹⁰	0.32	0.50	0.56
Overdue > 3 months and rescheduled loans	0.28	0.45	0.54
Classified loan ratio (gross) of Mainland-related lending ¹¹	0.61	0.78	0.94
Profitability			
Loan impairment charges as percentage of average total assets ¹²	0.06	0.08	0.07
Net interest margin ¹²	1.33	1.32	1.28
Cost-to-income ratio ¹³	43.7	45.4	43.8
All AIs			
Liquidity ratios (quarterly average, consolidated)			
Liquidity Coverage Ratio — category 1 institutions	129.9	142.9	152.7
Liquidity Maintenance Ratio — category 2 institutions	50.8	53.9	53.2
Surveyed institutions			
Asset quality			
Delinquency ratio of residential mortgage loans	0.03	0.03	0.04
Credit card lending			
Delinquency ratio	0.26	0.25	0.27
Charge-off ratio — quarterly annualised	1.80	1.86	1.91
— year-to-date annualised	1.80	1.82	1.91
All locally incorporated AIs			
Capital adequacy (consolidated)			
Common Equity Tier 1 capital ratio	13.3	14.6	14.6
Tier 1 capital ratio	13.9	15.3	15.4
Total capital ratio	17.0	18.3	18.2

Notes:

- ¹ Figures are related to Hong Kong offices only except where otherwise stated.
- ² The Hong Kong Dollar 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 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 prior to December 2015 are related to retail banks' Hong Kong offices and overseas branches. Starting from December 2015, the coverage was expanded to include retail banks' 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 retail banks' Hong Kong offices, Mainland branches and subsidiaries.
- ¹² Year-to-date annualised.
- ¹³ Year-to-date figures.