

Developments in the banking sector

by the Banking Supervision Department

The aggregate pre-tax operating profit of retail banks' Hong Kong offices for the first three quarters of 2011 rose by 22.2% compared with the same period last year. Strong income growth boosted retail banks' profitability during the period. The net interest margin of retail banks remained narrow, albeit with a small increase in the third quarter to 1.27%. The consolidated capital adequacy ratio of locally incorporated authorized institutions was 15.7% at the end of September, well above the minimum international standard of 8%.

HIGHLIGHTS OF KEY TRENDS

Profitability strengthens

The 22.2% increase in the aggregate pre-tax operating profit of retail banks' Hong Kong offices in the first three quarters was largely due to growth in net interest income, and income from foreign exchange operations, and fees and commissions.

Retail banks' profit margins widened slightly during the quarter although the trend level remained low. The quarterly annualised net interest margin (NIM) of retail banks rose to 1.27% in 2011Q3 from 1.19% in Q2 and 1.23% in Q1 (Chart 1). The increase reflected banks' recent pricing strategies to raise their loan spreads, including their residential mortgage loan portfolios. Funding costs, as indicated by the composite interest rate (Chart 2), trended higher as retail banks offered higher interest rates to attract customer deposits.

CHART 1

Retail banks' net interest margin
(quarterly annualised)

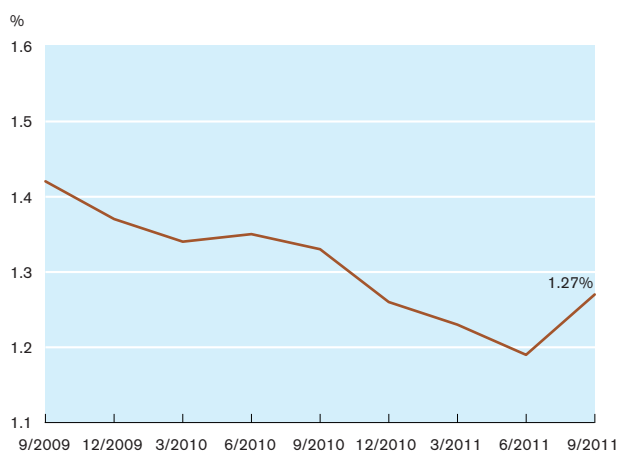
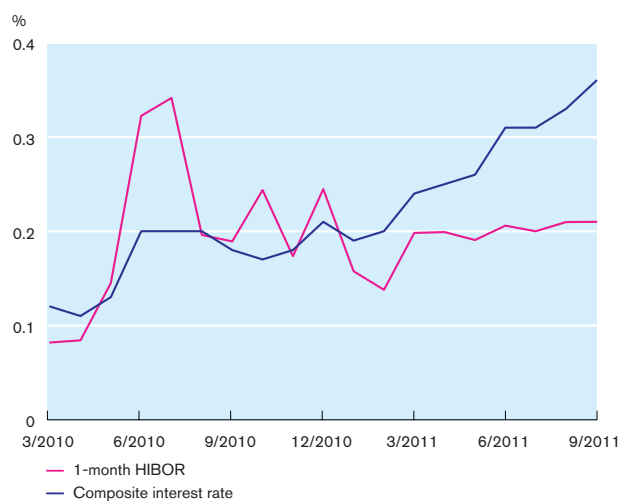


CHART 2

Interest rates



Notes:

- 1 HIBOR refers to Hong Kong Interbank Offered Rate and is a monthly average figure.
- 2 Composite interest rate reflects the average cost of funds.

Income from fees and commissions surged by 12.0% in the first three quarters of 2011 compared with the same period a year ago.

The cost-to-income ratio of retail banks fell to 45.9% in the same period compared with 49.7% a year earlier, as income increased at a faster pace than expenses.

The net charge for debt provisions was HK\$1.9 billion in the review period, up from HK\$1.4 billion at the same time last year.

Asset quality remains sound

Retail banks' classified loan ratio decreased to 0.60% at the end of September from 0.61% at the end of June, even though classified loans increased slightly by 0.2% during the quarter (Table 1 and Chart 3). The ratio of overdue and rescheduled loans also fell to 0.47% from 0.48% at the end of June.

The HKMA's quarterly Credit Card Lending Survey showed the quality of surveyed institutions' credit card portfolios remained solid. The delinquency ratio of the credit card portfolio fell to 0.18% from 0.20% at the end of June 2011 (Chart 4). The quarterly annualised charge-off ratio increased to 1.70% from 1.57% in 2011 Q2. The levels were low from an historical perspective.

CHART 3

Asset quality of retail banks

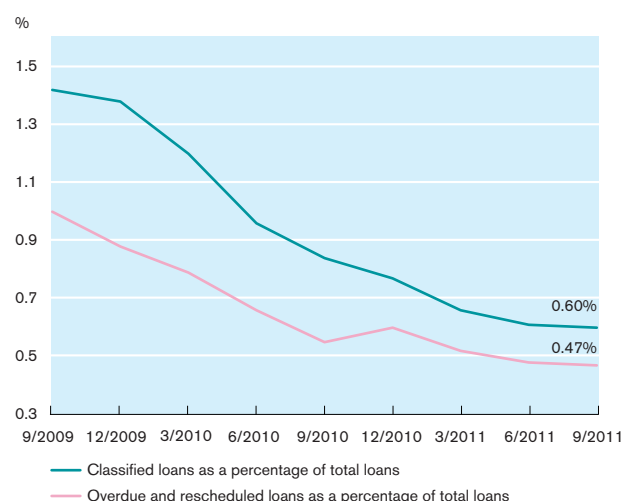


CHART 4

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

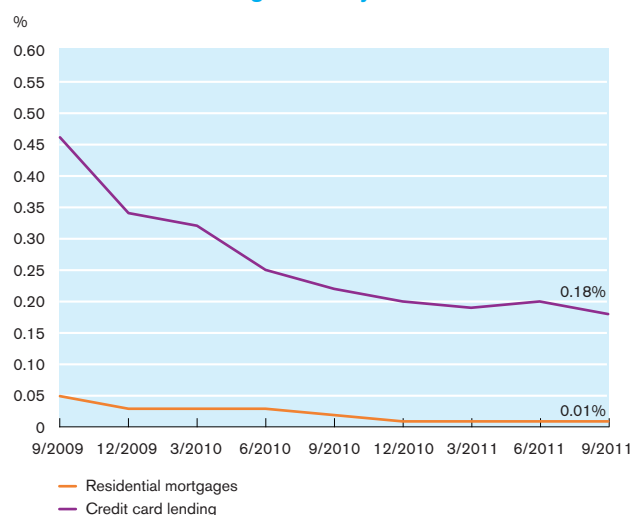


TABLE 1

Quality of loans and advances of retail banks*

% of total loans	Sep 2010	Dec 2010	Mar 2011	Jun 2011	Sep 2011
	(% of total loans)				
Special mention loans	1.43	1.28	1.17	1.19	1.19
Classified loans (gross)	0.84	0.77	0.66	0.61	0.60
of which					
Substandard	0.30	0.27	0.23	0.22	0.22
Doubtful	0.47	0.44	0.38	0.34	0.34
Loss	0.08	0.06	0.05	0.05	0.04
Classified loans (net of specific provisions)	0.50	0.45	0.39	0.37	0.35
Overdue > 3 months and rescheduled loans	0.55	0.60	0.52	0.48	0.47
of which					
Overdue > 3 months	0.40	0.44	0.38	0.36	0.34
Rescheduled loans	0.16	0.15	0.14	0.12	0.13

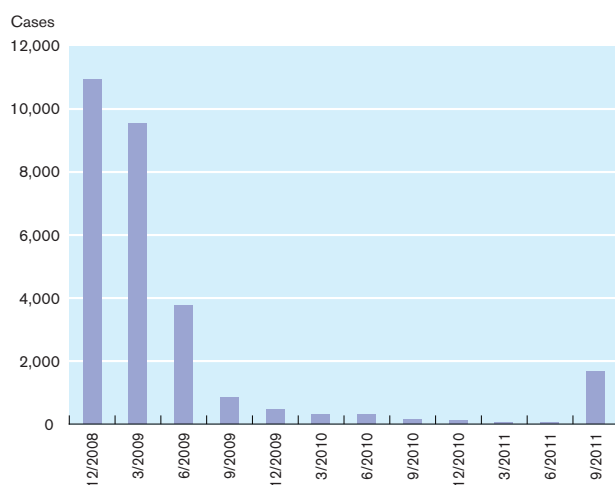
* Period-end figures covering the Hong Kong offices and overseas branches of the banks.

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

The credit quality of surveyed institutions' residential mortgage lending continued to be sound, with the delinquency ratio unchanged at 0.01% at the end of September (Chart 4). While the outstanding number of residential mortgage loans in negative equity rebounded to 1,653 at the end of September, from 48 at the end of June (Chart 5), the number was still lower than the peak recorded in December 2008.

CHART 5

Residential mortgage loans in negative equity



Loan-to-deposit ratios rise

Retail banks' total loans and advances expanded by 2.5% in 2011 Q3, while customer deposits grew by 1.0%. As a result, the overall loan-to-deposit ratio of retail banks rose to 56.8% at the end of September from 55.9% at the end of June (Chart 6). Hong Kong dollar loans grew by 2.4% while Hong Kong dollar deposits fell by 0.8%. Therefore, the Hong Kong dollar loan-to-deposit ratio rose to 77.9% from 75.4% at the end of June (Chart 7).

CHART 6

Retail banks' total loans and customer deposits

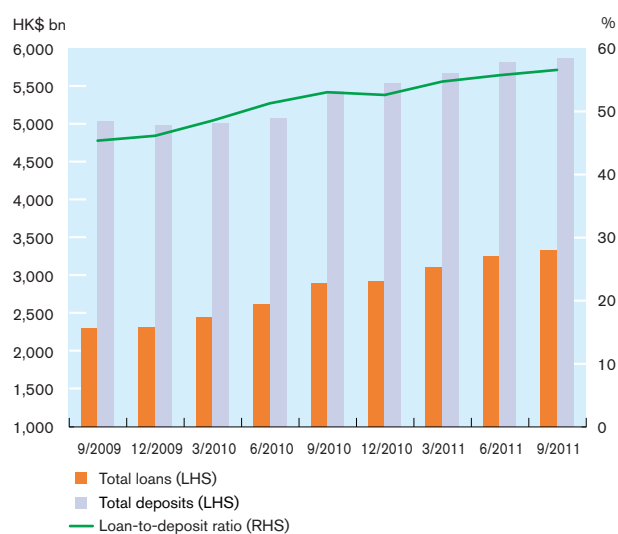
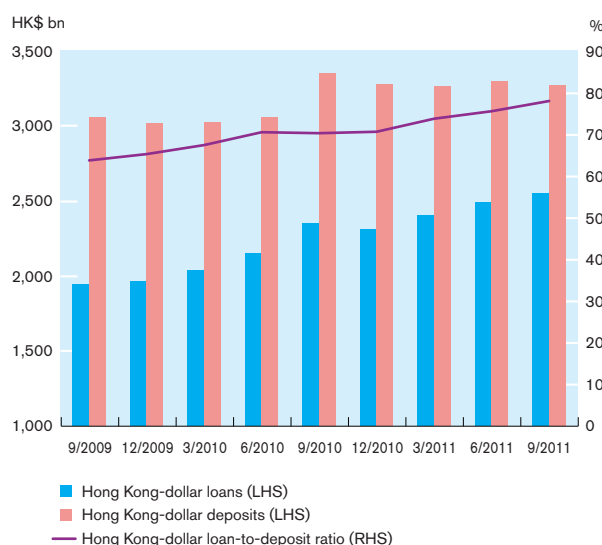


CHART 7

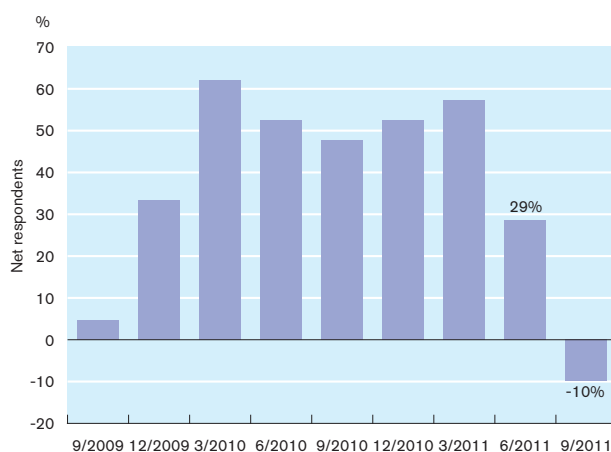
Retail banks' Hong Kong-dollar loans and customer deposits



The loan-to-deposit ratios are expected to moderate in the coming months. According to the HKMA Opinion Survey of Credit Condition Outlook conducted in September 2011, more surveyed AIs anticipated loan demand to decline in the next three months (Chart 8). A considerable portion of the respondent AIs expected a reduction in demand for residential mortgage lending and property investment lending.

CHART 8

Expectation of loan demand in the next three months



Note:

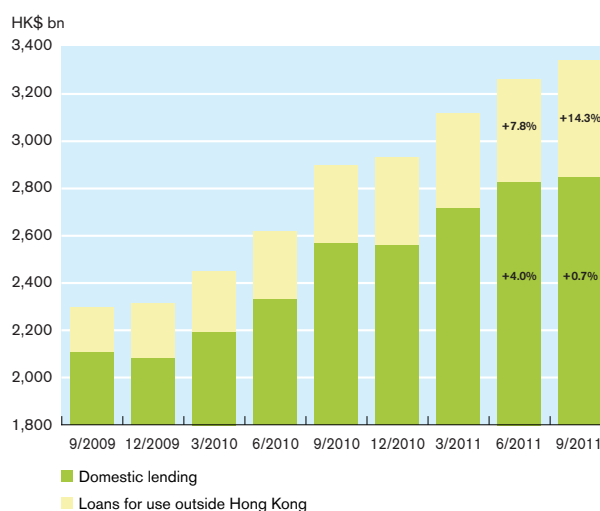
Net respondents refer to the percentage of respondents expecting loan demand to increase minus the percentage expecting loan demand to decline.

Domestic lending and loans for use outside Hong Kong rise

Retail banks' domestic lending (loans for use in Hong Kong plus trade finance) showed signs of moderation in 2011 Q3, growing by 0.7% during the quarter after rising 4.0% in Q2 (Chart 9). On the other hand, loans for use outside Hong Kong expanded by 14.3% in 2011 Q3 after an increase of 7.8% in Q2.

CHART 9

Loans and advances of retail banks



Notes:

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

The percentage changes in the amount of credit extended to different economic sectors are shown below:

Wholesale and retail trade	+0.4%
Manufacturing	+1.2%
Trade finance	-1.0%
Property lending	+0.5%

Retail banks' total non-bank China exposures¹ rose to HK\$1,477.4 billion (14.7% of total assets) at the end of September from HK\$1,427.0 billion (14.5% of total assets) at the end of June. For the banking sector as a whole, non-bank China exposures increased to HK\$2,195.1 billion (13.9% of total assets) from HK\$2,030.4 billion (13.3% of total assets) in the same period.

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

Average liquidity ratio remains above statutory minimum

The quarterly average liquidity ratio of retail banks fell marginally to 35.8% in 2011 Q3 from 36.2% in Q2, but was still above the statutory minimum of 25% (Chart 10).

Als remain well capitalised

The consolidated capital adequacy ratio of locally incorporated Als fell slightly to 15.7% at the end of September from 15.9% at the end of June, but the ratio remained well above the minimum international standard of 8% (Chart 11). The decline was due to increased bank and corporate exposures during the quarter even though a few banks strengthened their capital positions by raising share capital. The decline also reflected the increase in banks' regulatory reserves requested by the HKMA as a countercyclical measure.

A table of key performance indicators of the banking sector is at the Appendix.

CHART 10
Retail banks' liquidity ratio (quarterly average)

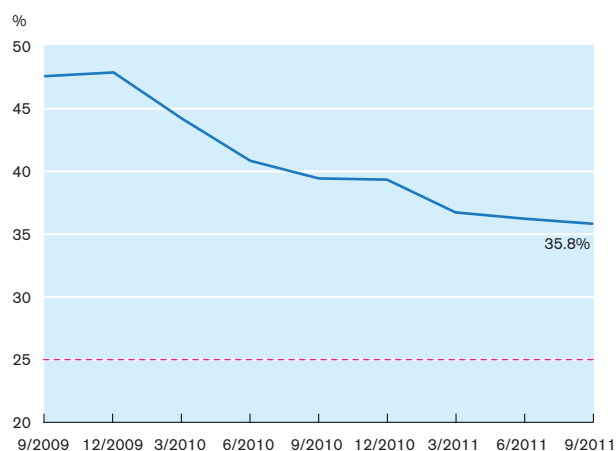
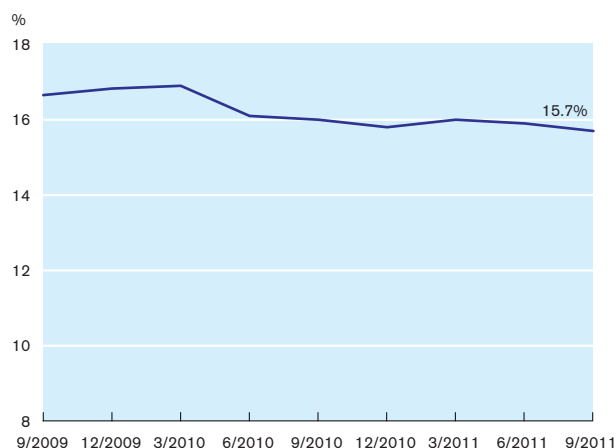


CHART 11
Capital adequacy ratio of locally incorporated Als



APPENDIX

KEY PERFORMANCE INDICATORS OF THE BANKING SECTOR¹ (%)

	Sep 2010	Jun 2011	Sep 2011
Interest rate			
1-month HIBOR ² (quarterly average)	0.24	0.20	0.21
3-month HIBOR (quarterly average)	0.33	0.26	0.27
BLR ³ and 1-month HIBOR spread (quarterly average)	4.76	4.80	4.79
BLR and 3-month HIBOR spread (quarterly average)	4.67	4.74	4.73
Composite interest rate ⁴	0.18	0.31	0.36
Retail banks			
Balance sheet developments⁵			
Total deposits	7.0	2.6	1.0
Hong Kong dollar	9.6	1.2	-0.8
Foreign currency	3.0	4.5	3.3
Total loans	10.7	4.5 ^r	2.5
Domestic lending ⁶	10.1 ^r	4.0 ^r	0.7
Loans for use outside Hong Kong ⁷	15.6 ^r	7.8 ^r	14.3
Negotiable instruments			
Negotiable certificates of deposit (NCD) issued	10.9	47.1	19.7
Negotiable debt instruments held (excluding NCD)	3.9	4.9 ^r	-0.2
Asset quality⁸			
As a percentage of total loans			
Pass loans	97.72	98.20	98.21
Special mention loans	1.43	1.19	1.19
Classified loans ⁹ (gross)	0.84	0.61	0.60
Classified loans (net) ¹⁰	0.50	0.37 ^r	0.35
Overdue > 3 months and rescheduled loans	0.55	0.48	0.47
Profitability			
Bad debt charge as percentage of average total assets ¹¹	0.03	0.02 ^r	0.03
Net interest margin ¹¹	1.34	1.21	1.23
Cost-to-income ratio ¹²	49.7	43.6 ^r	45.9
Liquidity ratio (quarterly average)	39.4	36.2	35.8
Surveyed institutions			
Asset quality			
Delinquency ratio of residential mortgage loans	0.02	0.01	0.01
Credit-card lending			
Delinquency ratio	0.22	0.20	0.18
Charge-off ratio — quarterly annualised	1.92	1.57	1.70
— year-to-date annualised	2.13	1.53	1.56
All locally incorporated AIs			
Capital adequacy ratio (consolidated)	16.0 ^r	15.9	15.7

Notes:

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

² With reference to the Hong Kong dollar Interest Settlement Rates 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 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.

^r Revised figure.