

# Developments in the banking sector

*by the Banking Supervision Department*

The Hong Kong banking sector remained robust despite developments in the euro area which led to increased market volatility. In the first quarter of 2012, retail banks' aggregate pre-tax operating profit rose by 8.6% compared with a year ago. Net interest margin improved during the period. The consolidated capital adequacy ratio of locally incorporated authorized institutions (AIs) rose to 15.9% at the end of March, well above the minimum international standard of 8%. Given the increasingly uncertain market outlook, the HKMA will continue to closely monitor developments in the banking sector and ensure that AIs remain comfortably liquid to withstand the impact of significant market volatility.

## HIGHLIGHTS OF KEY TRENDS

### Profitability improves

In 2012 Q1 the aggregate pre-tax operating profit of retail banks' Hong Kong offices rose by 8.6%, mainly as a result of benign growth in net interest income, trading income and income from fees and commissions.

Retail banks' profit margins improved during the quarter. The quarterly annualised net interest margin (NIM) of retail banks rose to 1.31% in 2012 Q1, from 1.27% in 2011 Q4 (Chart 1). The increase in NIM mainly reflected banks' reduced funding costs, as indicated by the composite interest rate, which trended lower in the first quarter as price competition for customer deposits eased (Chart 2).

CHART 1

Net interest margin of retail banks  
(quarterly annualised)

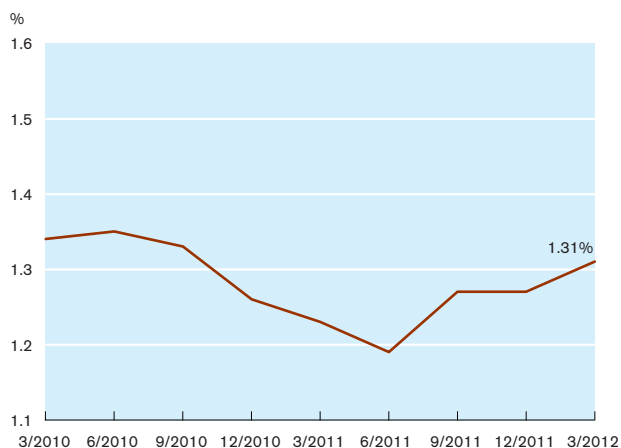
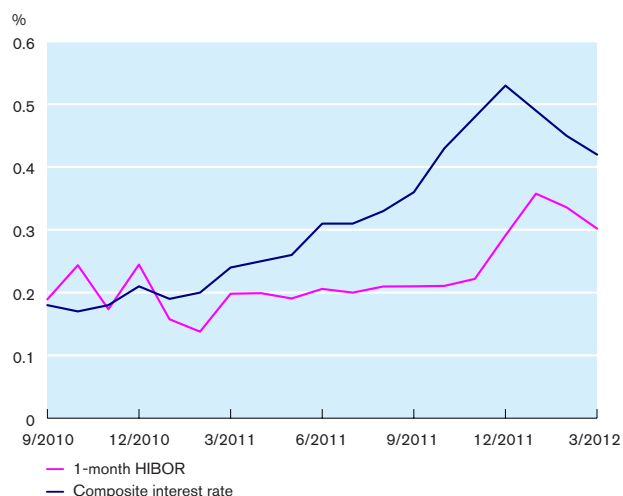


CHART 2

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.

The cost-to-income ratio of retail banks stayed at 46.0% in 2012 Q1, which was comparable to the level a year earlier, as income and expenses increased at a similar pace during the period.

Retail banks' net charge for debt provisions amounted to HK\$143 million in 2012 Q1 compared with HK\$242 million a year ago. The decrease was due to improving asset quality.

## Asset quality remains sound

Retail banks' classified loan ratio declined further to 0.57% at the end of 2012 Q1 from 0.59% at the end of 2011, mainly due to a 2.5% decrease in classified loans during the quarter. The ratio of overdue and rescheduled loans remained unchanged at 0.49% (Table 1 and Chart 3).

According to the HKMA Credit Card Lending Survey, the quality of surveyed institutions' credit card portfolios remained sound. The delinquency ratio of the credit card portfolios edged up slightly to 0.21% at the end of 2012 Q1 from 0.19% at the end of 2011 (Chart 4). During the same period, the quarterly annualised charge-off ratio advanced to 1.59% from 1.51%. Despite the mild increases, these ratios were still close to historical lows.

CHART 3

### Asset quality of retail banks

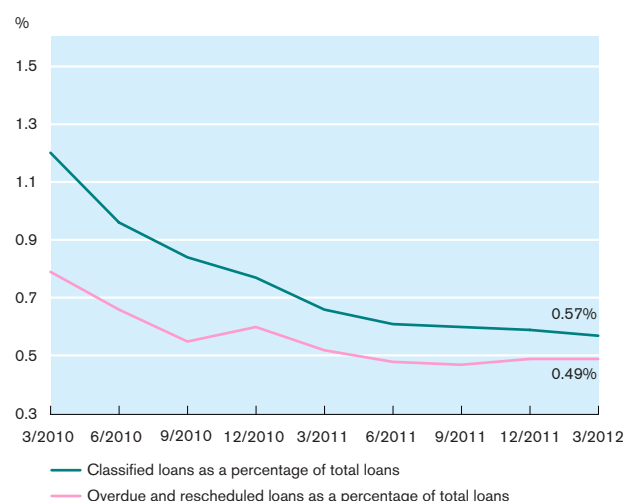


CHART 4

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

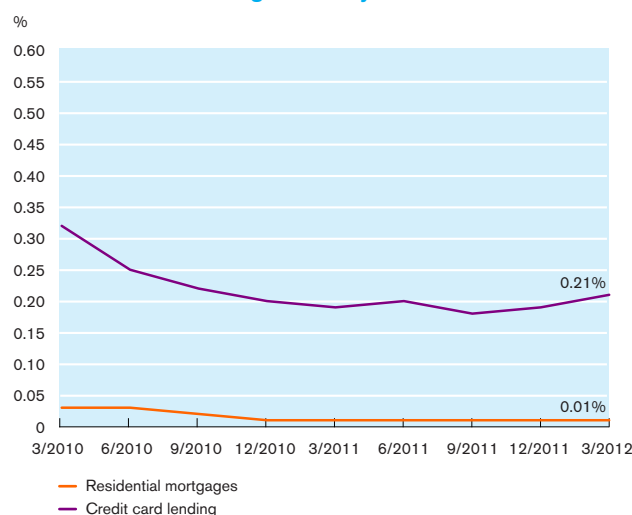


TABLE 1

### Quality of loans and advances of retail banks\*

	Mar 2011	Jun 2011	Sep 2011 (% of total loans)	Dec 2011	Mar 2012
<b>Special mention loans</b>	<b>1.17</b>	<b>1.19</b>	<b>1.19</b>	<b>1.13</b>	<b>1.27</b>
<b>Classified loans (gross)</b>	<b>0.66</b>	<b>0.61</b>	<b>0.60</b>	<b>0.59</b>	<b>0.57</b>
of which					
Substandard	0.23	0.22	0.22	0.22	0.19
Doubtful	0.38	0.34	0.34	0.33	0.34
Loss	0.05	0.05	0.04	0.04	0.04
<b>Classified loans (net of specific provisions)</b>	<b>0.39</b>	<b>0.37</b>	<b>0.35</b>	<b>0.34</b>	<b>0.32</b>
<b>Overdue &gt; 3 months and rescheduled loans</b>	<b>0.52</b>	<b>0.48</b>	<b>0.47</b>	<b>0.49</b>	<b>0.49</b>
of which					
Overdue > 3 months	0.38	0.36	0.34	0.37	0.39
Rescheduled loans	0.14	0.12	0.13	0.12	0.09

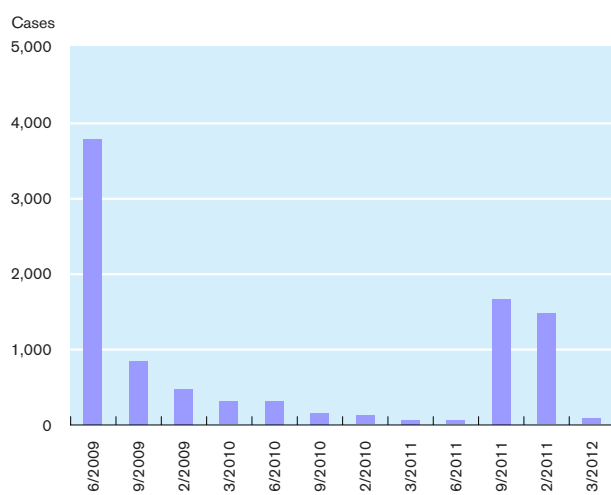
\* Period-end figures covering the Hong Kong offices and overseas branches of the banks.

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

The credit quality of surveyed institutions' residential mortgage lending continued to be sound, with delinquency ratio unchanged at 0.01% at the end of 2012 Q1 (Chart 4). With higher residential property prices, the outstanding number of residential mortgage loans in negative equity declined further to 78 at the end of 2012 Q1 from 1,465 three months earlier (Chart 5).

CHART 5

## Residential mortgage loans in negative equity



## Loan-to-deposit ratios decrease

Retail banks' total loans and advances expanded by 1.1% in 2012 Q1, while customer deposits grew by 1.4%. As a result, their overall loan-to-deposit ratio lowered to 55.2% at the end of 2012 Q1 from 55.3% at the end of 2011 (Chart 6). During the same period, Hong Kong dollar loans grew by 0.1%, while Hong Kong dollar deposits increased by 2.9%. Consequently, the Hong Kong dollar loan-to-deposit ratio fell to 74.1% from 76.2% (Chart 7).

CHART 6

## Total loans and customer deposits of retail banks

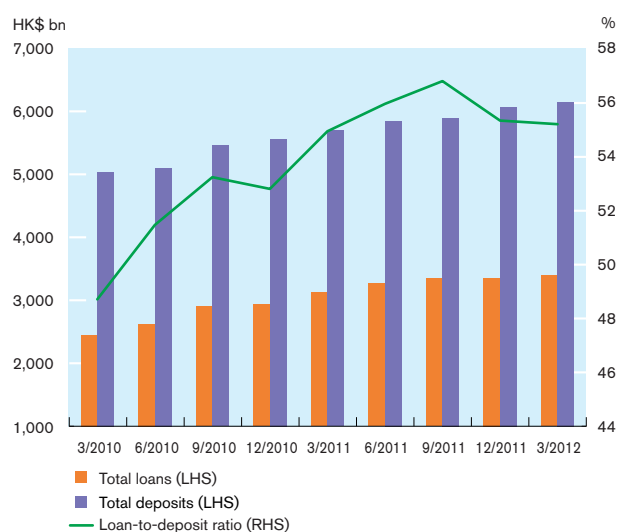
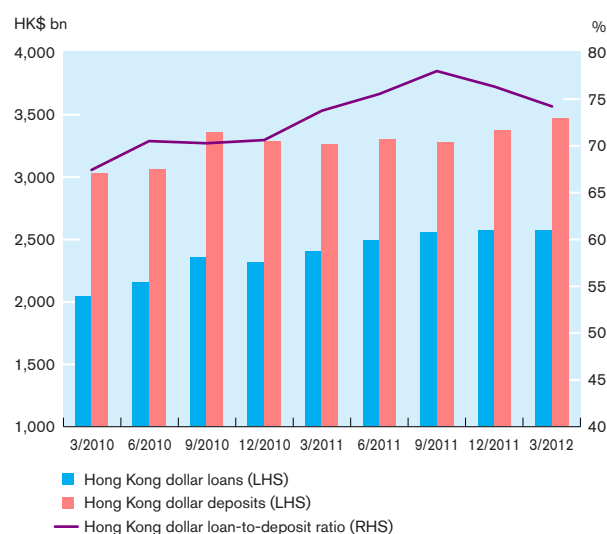


CHART 7

## Hong Kong dollar loans and customer deposits of retail banks

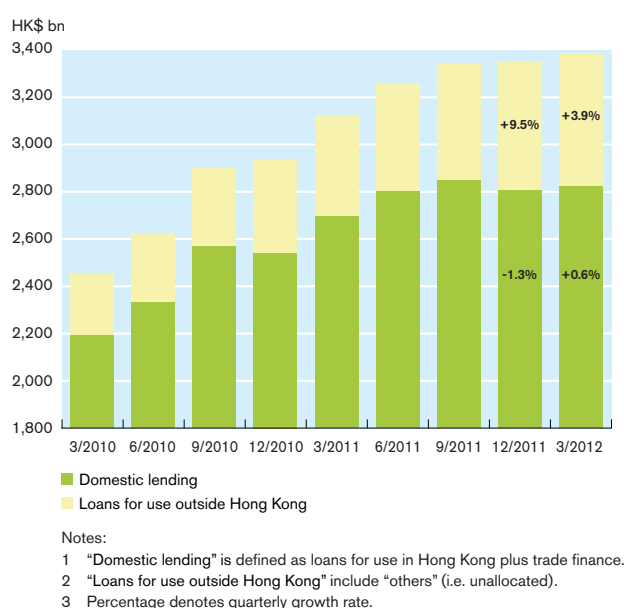


## Domestic lending and loans for use outside Hong Kong rise

Retail banks' domestic lending (loans for use in Hong Kong plus trade finance) rebounded by 0.6% in 2012 Q1 after dropping by 1.3% in 2011 Q4 (Chart 8). Loans for use outside Hong Kong expanded further by 3.9% in 2012 Q1 after increasing by 9.5% in the previous quarter.

CHART 8

Loans and advances of retail banks



Within domestic lending, the percentage changes in the amount of credit extended to key economic sectors are shown below:

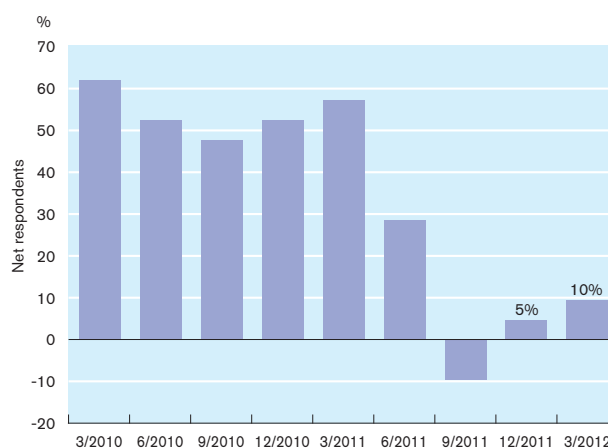
Wholesale and retail trade	+3.2%
Manufacturing	+1.3%
Trade finance	-0.5%
Property lending	-0.6%

Retail banks' total non-bank Mainland exposures<sup>1</sup> rose to HK\$1,586.5 billion (15.6% of total assets) at the end of 2012 Q1 from HK\$1,571.5 billion (15.8% of total assets) at the end of 2011. For the banking sector as a whole, non-bank Mainland exposures increased to HK\$2,455.4 billion (15.3% of total assets) from HK\$2,329.5 billion (14.9% of total assets) in the same period.

According to the HKMA Opinion Survey of Credit Condition Outlook conducted in March, more surveyed AIs anticipated loan demand to increase in the next three months (Chart 9). A considerable portion of the respondent AIs expected stronger demand for loans for use outside Hong Kong and loans to non-bank Mainland entities, although a reduction in demand for property lending was anticipated.

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.

<sup>1</sup> Including exposures booked in the retail banks' banking subsidiaries in Mainland China.

## Average liquidity ratio increases

The quarterly average liquidity ratio of retail banks rose to 40.6% in 2012 Q1 from 38.0% in 2011 Q4, and was well above the statutory minimum of 25% (Chart 10).

## Als remain well capitalised

The consolidated capital adequacy ratio of locally incorporated Als increased to 15.9% at the end of 2012 Q1 from 15.8% at the end of 2011, well above the minimum international standard of 8% (Chart 11). The increase was due to a faster increase in the capital base, as a result of higher reserves, than in risk-weighted exposures.

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

CHART 10

Liquidity ratio of retail banks (quarterly average)

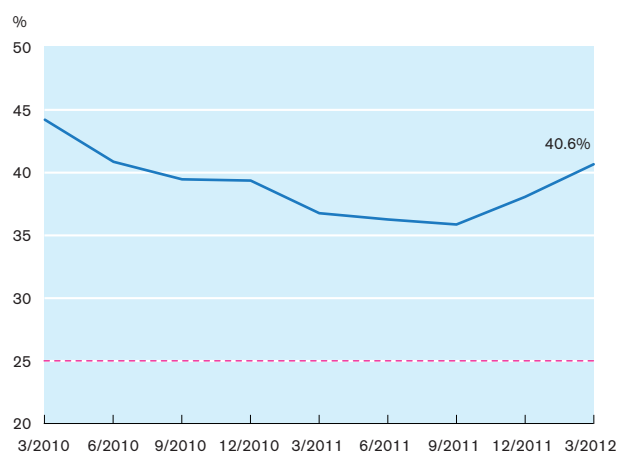
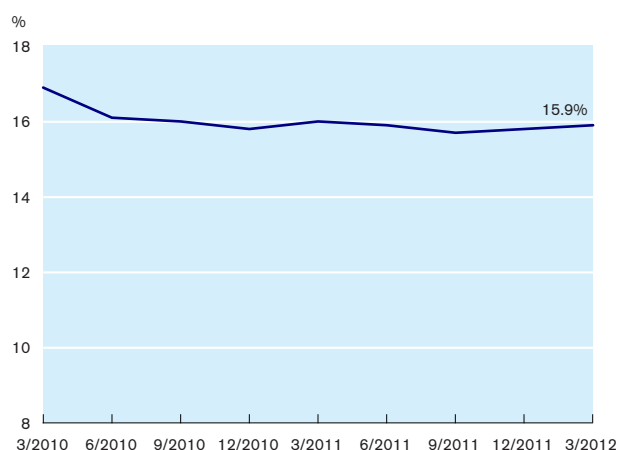


CHART 11

Capital adequacy ratio of locally incorporated Als



## APPENDIX

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

	Mar 2011	Dec 2011	Mar 2012
<b>Interest rate</b>			
1-month HIBOR <sup>2</sup> (quarterly average)	0.16	0.24	0.33
3-month HIBOR (quarterly average)	0.23	0.31	0.40
BLR <sup>3</sup> and 1-month HIBOR spread (quarterly average)	4.84	4.76	4.67
BLR and 3-month HIBOR spread (quarterly average)	4.77	4.69	4.60
Composite interest rate <sup>4</sup>	0.24	0.53	0.42
<b>Retail banks</b>			
<b>Balance sheet developments<sup>5</sup></b>			
Total deposits	2.3	2.9	1.4
Hong Kong dollar	-0.6 <sup>r</sup>	3.0	2.9
Foreign currency	6.4	2.8	-0.5
Total loans	6.4	0.3	1.1
Domestic lending <sup>6</sup>	6.1 <sup>r</sup>	-1.3	0.6
Loans for use outside Hong Kong <sup>7</sup>	8.4 <sup>r</sup>	9.5	3.9
Negotiable instruments			
Negotiable certificates of deposit (NCD) issued	39.8	5.4 <sup>r</sup>	8.2
Negotiable debt instruments held (excluding NCD)	-3.7	2.3	2.3
<b>Asset quality<sup>8</sup></b>			
As a percentage of total loans			
Pass loans	98.17	98.28 <sup>r</sup>	98.17
Special mention loans	1.17	1.13 <sup>r</sup>	1.27
Classified loans <sup>9</sup> (gross)	0.66	0.59	0.57
Classified loans (net) <sup>10</sup>	0.39	0.34 <sup>r</sup>	0.32
Overdue > 3 months and rescheduled loans	0.52	0.49	0.49
<b>Profitability</b>			
Bad debt charge as percentage of average total assets <sup>11</sup>	0.01	0.03	0.01
Net interest margin <sup>11</sup>	1.23	1.24 <sup>r</sup>	1.31
Cost-to-income ratio <sup>12</sup>	46.0	46.7 <sup>r</sup>	46.0
<b>Liquidity ratio (quarterly average)</b>	36.7	38.0	40.6
<b>Surveyed institutions</b>			
<b>Asset quality</b>			
Delinquency ratio of residential mortgage loans	0.01	0.01	0.01
Credit-card lending			
Delinquency ratio	0.19	0.19	0.21
Charge-off ratio — quarterly annualised	1.55	1.51	1.59
— year-to-date annualised	1.55	1.49	1.59
<b>All locally incorporated AIs</b>			
<b>Capital adequacy ratio (consolidated)</b>	16.0	15.8	15.9

## Notes:

<sup>1</sup> Figures are related to Hong Kong office(s) only except where otherwise stated.<sup>2</sup> With reference to the Hong Kong dollar Interest Settlement Rates 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> Includes "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>r</sup> Revised figure.