

Developments in the banking sector

by the Banking Supervision Department

The Hong Kong banking sector remained robust despite the unfavourable external environment. In the first three quarters of 2012, retail banks' aggregate pre-tax operating profit rose by 13.9% compared with the same period last year. The net interest margin (NIM) remained stable in the third quarter. Retail banks' classified loan ratio edged down further to 0.50% at the end of the third quarter from 0.52% at the end of the previous quarter. The consolidated capital adequacy ratio of locally incorporated authorized institutions (AIs) rose to 16.1% at the end of the quarter, well above the minimum international standard of 8%. 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 13.9% increase in the aggregate pre-tax operating profit of retail banks' Hong Kong offices in the first three quarters was mainly due to benign growth in net interest income, which was up by 15.5% in the same period.

Retail banks' profit margins remained stable during the third quarter. The quarterly annualised NIM of retail banks stayed at 1.40% in Q3, following increases in two consecutive quarters (Chart 1). The NIM over the first three quarters rose by 12 basis points, mainly reflecting banks' reduced funding costs, as indicated by the composite interest rate which trended lower earlier in the year and stabilised in the third quarter (Chart 2). The improvement in the

CHART 1

Net interest margin of retail banks
(quarterly annualised)

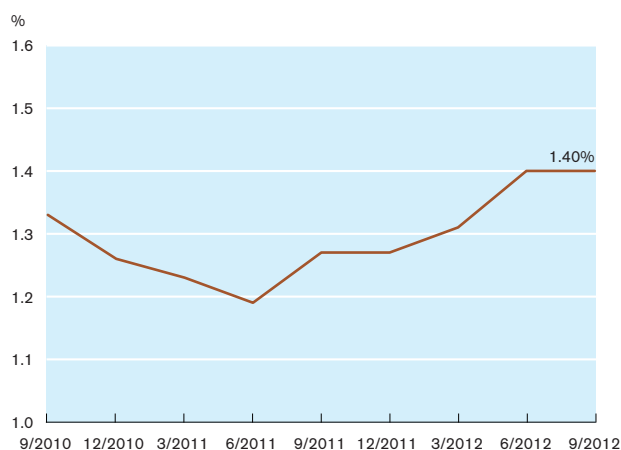
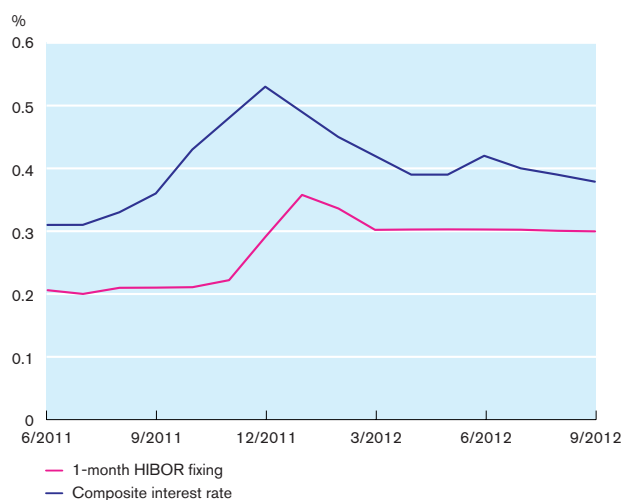


CHART 2

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.

NIM was the major contributing factor to the growth in net interest income.

The cost-to-income ratio of retail banks lowered to 44.9% in the first three quarters of 2012 from 45.9% in the same period last year, as the increase in operating income (+10.9%) outpaced that of operating expenses (+8.4%) during the period.

Retail banks' net charge for debt provisions amounted to HK\$1.5 billion in the first three quarters of 2012 compared with HK\$1.9 billion in the same period a year ago. The decrease was mainly due to improvements in asset quality.

Asset quality remains sound

Retail banks' classified loan ratio continued its downward trend and reached 0.50% at the end of 2012 Q3, compared with 0.52% at the end of the previous quarter. The improvement was mainly due to a 3.8% reduction in the aggregate amount of classified loans together with a 1.3% growth in total loans during the quarter (Table 1 and Chart 3). The ratio of overdue and rescheduled loans also reduced to 0.42% from 0.45% three months ago. The ratio of special mention loans rose slightly to 1.31% from 1.28% over the same period, but was still at a low level by historical standards.

According to the HKMA Credit Card Lending Survey, the quality of surveyed institutions' credit card portfolios remained at a sound level. At the end of 2012 Q3, the delinquency ratio of the credit card portfolio was unchanged at 0.21% (Chart 4). During the same period, the quarterly annualised charge-off ratio reduced to 1.70% from 1.81%. These ratios were still close to historical lows.

CHART 3
Asset quality of retail banks

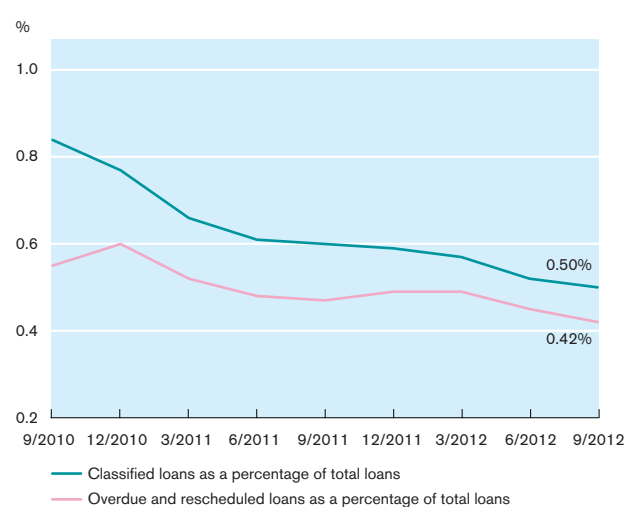


TABLE 1
Quality of loans and advances of retail banks*

	Sep 2011	Dec 2011	Mar 2012 (% of total loans)	Jun 2012	Sep 2012
Special mention loans	1.19	1.13	1.27	1.28	1.31
Classified loans (gross)	0.60	0.59	0.57	0.52	0.50
of which					
Substandard	0.22	0.22	0.19	0.17	0.16
Doubtful	0.34	0.33	0.34	0.32	0.30
Loss	0.04	0.04	0.04	0.04	0.04
Classified loans (net of specific provisions)	0.35	0.34	0.32	0.30	0.30
Overdue > 3 months and rescheduled loans	0.47	0.49	0.49	0.45	0.42
of which					
Overdue > 3 months	0.34	0.37	0.39	0.36	0.33
Rescheduled loans	0.13	0.12	0.09	0.09	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 Als' residential mortgage lending also remained sound, with the delinquency ratio continuing to hover at 0.01% at the end of the third quarter (Chart 4). With higher residential property prices, the surveyed Als did not report any residential mortgage loans in negative equity at the end of the quarter (Chart 5).

CHART 4

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

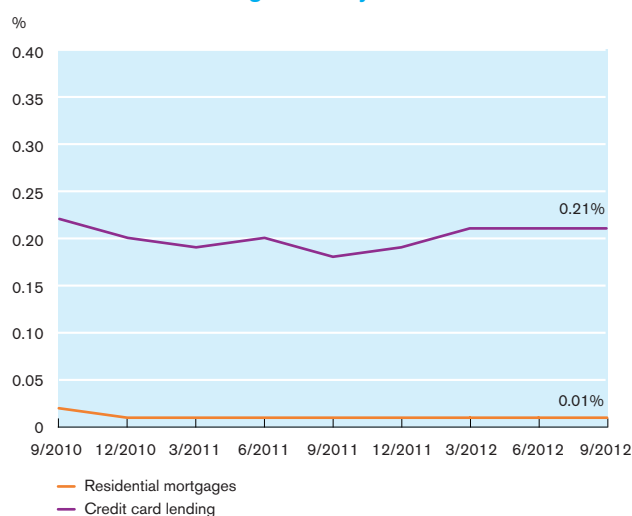
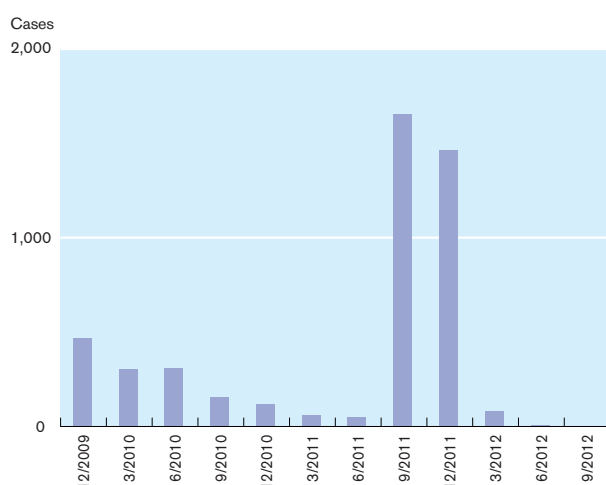


CHART 5

Residential mortgage loans in negative equity



Loan-to-deposit ratios decline

Retail banks' total loans and advances and total deposits rose by 0.7% and 3.2% respectively in 2012 Q3. As a result, their overall loan-to-deposit ratio decreased to 55.0% at the end of September from 56.3% at the end of the previous quarter (Chart 6). Hong Kong dollar loans and advances and Hong Kong dollar deposits rose by 1.1% and 4.9% respectively, resulting in the Hong Kong dollar loan-to-deposit ratio declining to 72.7% at the end of Q3 from 75.4% three months earlier (Chart 7).

CHART 6

Total loans and deposits of retail banks

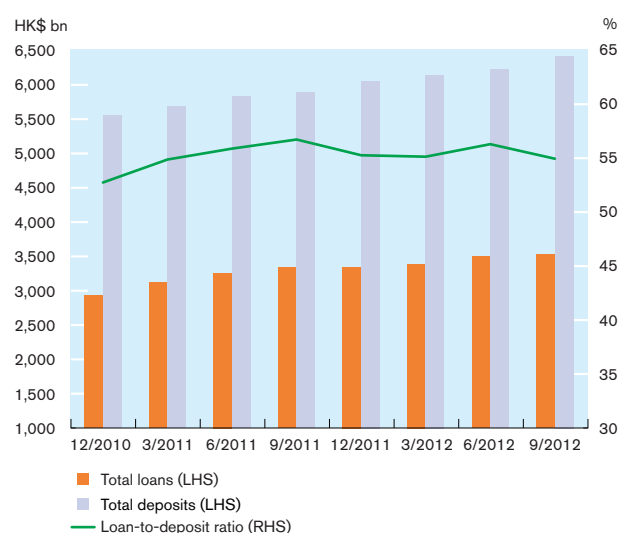
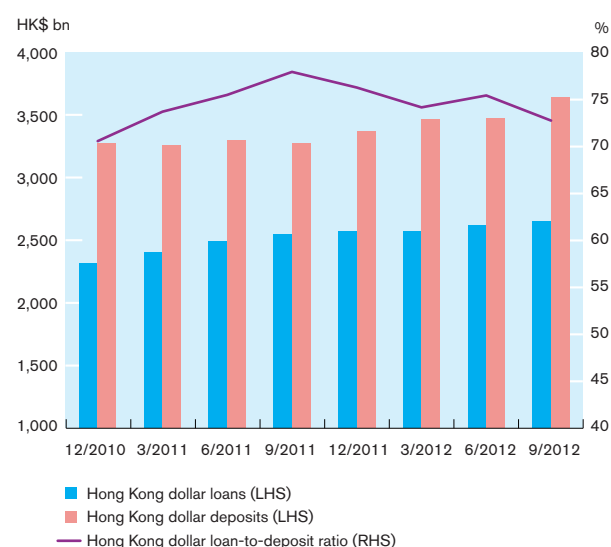


CHART 7

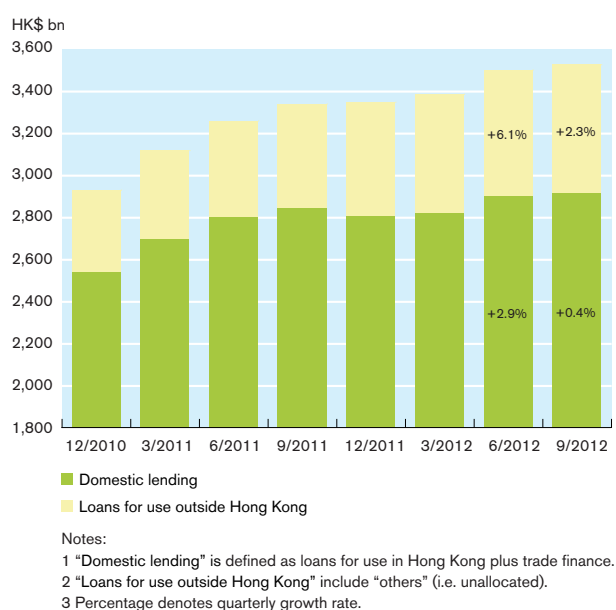
Hong Kong dollar loans and deposits of retail banks



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 0.4% in 2012 Q3 after a 2.9% growth in the second quarter (Chart 8). Loans for use outside Hong Kong expanded further by 2.3% following a 6.1% increase in Q2.

CHART 8
Loans and advances of retail banks



Within domestic lending, the percentage changes in the amount of credit extended to the key economic sectors in 2012 Q3 are shown below:

Property lending	+ 1.9%
Wholesale and retail trade	+ 1.0%
Manufacturing	- 3.2%
Trade finance	- 5.0%

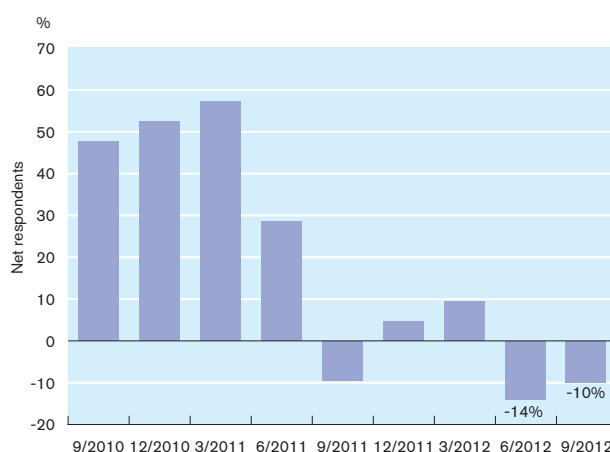
Retail banks' total non-bank Mainland exposures¹ dropped slightly by 0.7% to HK\$1,705 billion (16.2% of total assets) at the end of 2012 Q3 from HK\$1,717 billion (16.8% of total assets) at the end of Q2. For the banking sector as a whole, non-bank Mainland exposures increased by 1.9% to HK\$2,632 billion (16.2% of total assets) from HK\$2,582 billion (16.1% of total assets) in the same period.

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

Surveyed AIs anticipate stable loan demand

The HKMA's Opinion Survey of Credit Condition Outlook conducted in September showed the bulk of the surveyed AIs (71%) 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 and loans for use outside Hong Kong.

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.

Average liquidity ratio rebounds

The quarterly average liquidity ratio of retail banks rebounded to 40.9% in 2012 Q3 from 39.7% in Q2. The improvement was led by an increase in liquefiable assets, especially interbank claims. 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 16.1% at the end of 2012 Q3 from 15.9% three months earlier, well above the minimum international standard of 8% (Chart 11). This was due to a faster increase in the capital base than in risk-weighted assets.

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)

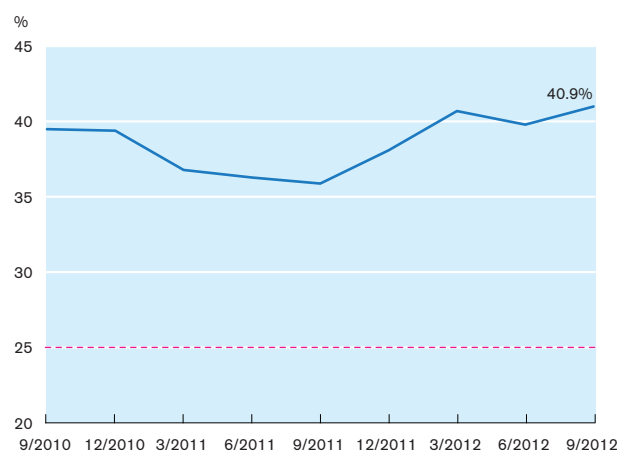
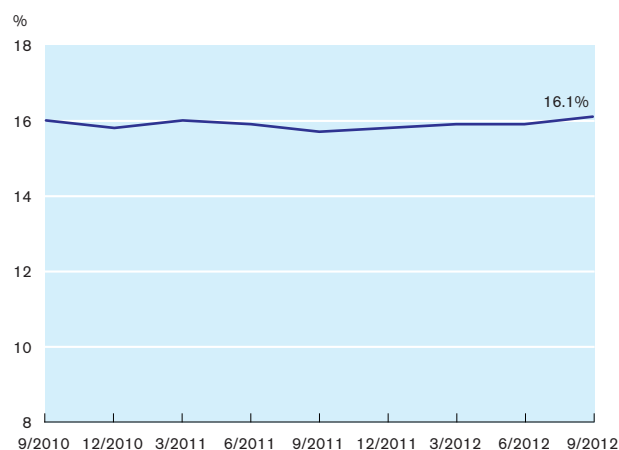


CHART 11

Capital adequacy ratio of locally incorporated Als



APPENDIX

KEY PERFORMANCE INDICATORS OF THE BANKING SECTOR¹ (%)

	Sep 2011	Jun 2012	Sep 2012
Interest rate			
1-month HIBOR fixing ² (quarterly average)	0.21	0.30	0.30
3-month HIBOR fixing (quarterly average)	0.27	0.40	0.40
BLR ³ and 1-month HIBOR fixing spread (quarterly average)	4.79	4.70	4.70
BLR and 3-month HIBOR fixing spread (quarterly average)	4.73	4.60	4.60
Composite interest rate ⁴	0.36	0.42	0.38
Retail banks			
Balance sheet developments⁵			
Total deposits	1.0	1.3	3.2
Hong Kong dollar	-0.8	0.2	4.9
Foreign currency	3.3	2.7	1.1
Total loans	2.5	3.4	0.7
Domestic lending ⁶	1.5	2.9	0.4
Loans for use outside Hong Kong ⁷	8.5	6.1	2.3
Negotiable instruments			
Negotiable certificates of deposit (NCD) issued	19.7	6.4	-7.7
Negotiable debt instruments held (excluding NCD)	-0.2	-2.8	3.6
Asset quality⁸			
As a percentage of total loans			
Pass loans	98.21	98.19	98.19
Special mention loans	1.19	1.28	1.31
Classified loans ⁹ (gross)	0.60	0.52	0.50
Classified loans (net) ¹⁰	0.35	0.30	0.30
Overdue > 3 months and rescheduled loans	0.47	0.45	0.42
Profitability			
Bad debt charge as percentage of average total assets ¹¹	0.03	0.01	0.02
Net interest margin ¹¹	1.23	1.35	1.37
Cost-to-income ratio ¹²	45.9	44.4	44.9
Liquidity ratio (quarterly average)	35.8	39.7	40.9
Surveyed institutions			
Asset quality			
Delinquency ratio of residential mortgage loans	0.01	0.01	0.01
Credit card lending			
Delinquency ratio	0.18	0.21	0.21
Charge-off ratio — quarterly annualised	1.70	1.81	1.70
— year-to-date annualised	1.56	1.67	1.66
All locally incorporated AIs			
Capital adequacy ratio (consolidated)	15.7	15.9	16.1

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.