

Developments in the banking sector

by the Banking Supervision Department

The Hong Kong banking sector remained robust despite the uncertain external environment. In the first three quarters of 2013, retail banks' aggregate pre-tax operating profit rose by 17.9% compared with the same period last year. The net interest margin (NIM) widened further during the same period. Retail banks' classified loan ratio edged up to 0.48% at the end of the third quarter of 2013 from 0.47% 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 third 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 17.9% increase in the aggregate pre-tax operating profit of retail banks' Hong Kong offices in the first three quarters of 2013 was mainly due to benign growth in net interest income as well as the non-interest income, which were up by 11.4% and 14.1% respectively from the same period last year. For the non-interest income, income from fees and commissions and income from foreign exchange and derivatives operations contributed to the profit growth.

Retail banks' profit margins continued to improve. The year-to-date annualised NIM of retail banks edged up to 1.41% in the first three quarters of 2013 from 1.37% in the same period last year (Chart 1). The increase mainly reflected banks' reduced funding costs, as indicated by the composite interest rate which was still at a lower level when compared with that in 2012, although there was a rebound in the second quarter of 2013 (Chart 2). The improvement in the NIM was the major contributing factor to the growth in net interest income.

CHART 1

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

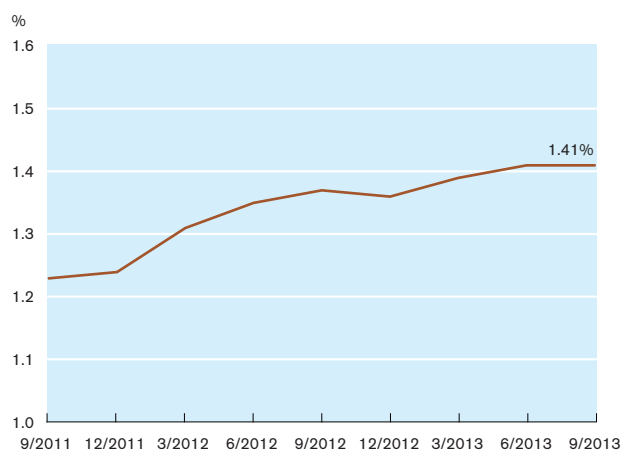
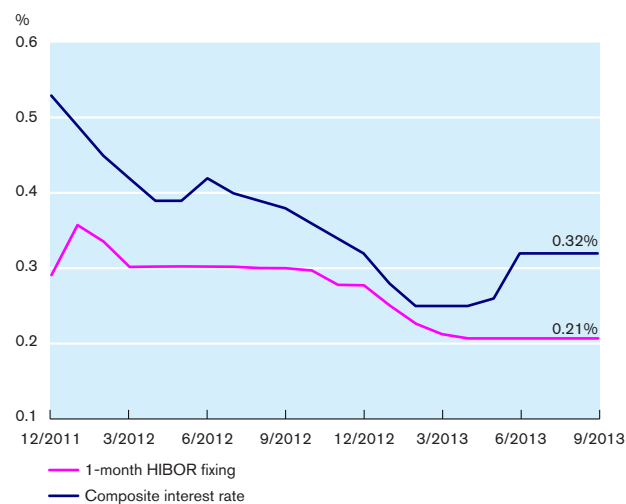


CHART 2
Interest rates



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.

The cost-to-income ratio of retail banks declined to 41.9% in the first three quarters of 2013 from 44.9% in the same period last year, as the increase in operating income (+12.6%) outpaced that of operating expenses (+5.1%) during the period.

Asset quality remains sound

Retail banks' classified loan ratio edged up slightly to 0.48% at the end of the third quarter of 2013, compared with 0.47% at the end of the previous quarter. The increase was mainly due to a 6.4% rise in the aggregate amount of classified loans together with a 3.4% growth in total loans during the quarter (Table 1 and Chart 3). The ratio of special mention loans rose to 1.27% from 1.11% over the same period. However, the ratio of overdue and rescheduled loans reduced to 0.34% from 0.36% a quarter earlier.

Retail banks' net charge for debt provisions amounted to HK\$2.4 billion in the first three quarters of 2013, compared with HK\$1.5 billion in the same period a year earlier.

According to the HKMA Credit Card Lending Survey, the quality of surveyed institutions' credit card portfolios remained sound. At the end of the third quarter of 2013, the delinquency ratio of the credit card portfolio edged down to 0.22% from 0.25% in the previous quarter (Chart 4). During the same period, the quarterly annualised charge-off ratio rose slightly to 2.09% from 2.06%. These ratios were still at low levels by historical standards.

CHART 3
Asset quality of retail banks

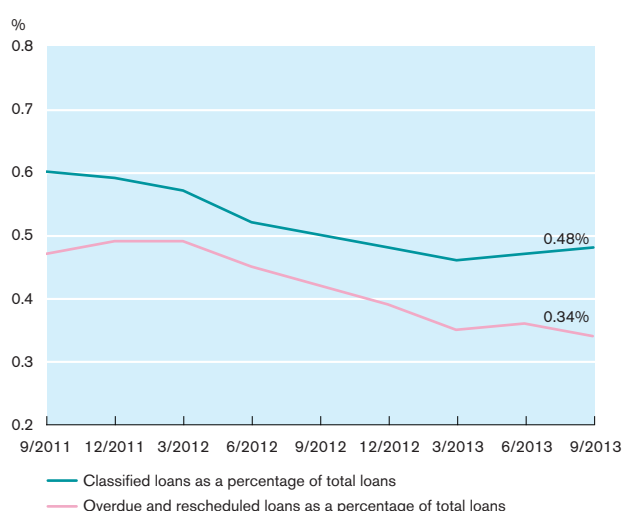


TABLE 1
Quality of loans and advances of retail banks*

	Sep 2012	Dec 2012	Mar 2013 (% of total loans)	Jun 2013	Sep 2013
Special mention loans	1.31	1.36	1.22	1.11	1.27
Classified loans (gross)	0.50	0.48	0.46	0.47	0.48
of which					
Substandard	0.16	0.20	0.21	0.22	0.24
Doubtful	0.30	0.24	0.22	0.21	0.21
Loss	0.04	0.04	0.03	0.03	0.03
Classified loans (net of specific provisions)	0.30	0.32	0.32	0.33	0.35
Overdue > 3 months and rescheduled loans	0.42	0.39	0.35	0.36	0.34
of which					
Overdue > 3 months	0.33	0.27	0.26	0.24	0.23
Rescheduled loans	0.09	0.12	0.09	0.12	0.11

* 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 AIs' residential mortgage lending also remained sound, with the delinquency ratio steady at 0.02% at the end of the third quarter this year (Chart 4). The estimated number of residential mortgage loans in negative equity decreased to six cases at the end of September from 21 cases at the end of June (Chart 5).

CHART 4

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

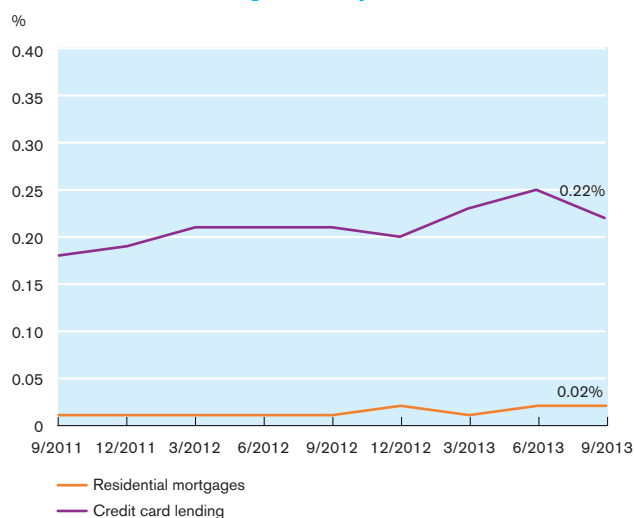
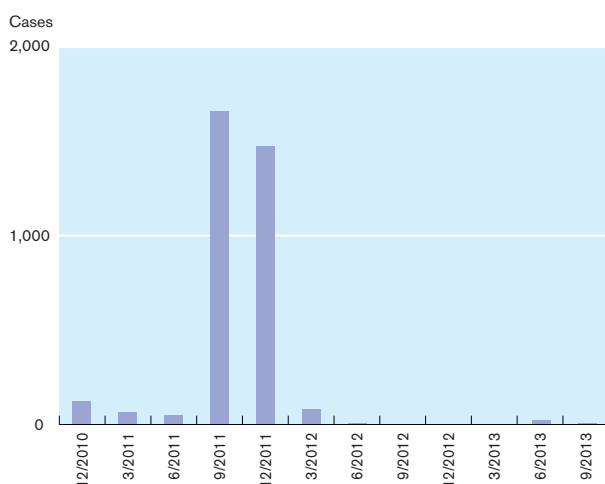


CHART 5

Residential mortgage loans in negative equity



Loan-to-deposit ratios decrease

Retail banks' total loans and advances rose by 3.5% while total deposits increased by 4.9% in the third quarter of 2013. As a result, their overall loan-to-deposit ratio decreased to 57.7% from 58.5% at the end of June (Chart 6). During the same period, Hong Kong dollar loans and advances rose by 2.7% while Hong Kong dollar deposits grew by 4.9%. Consequently, the Hong Kong dollar loan-to-deposit ratio declined to 74.9% at the end of the third quarter from 76.5% three months earlier (Chart 7).

CHART 6

Total loans and deposits of retail banks

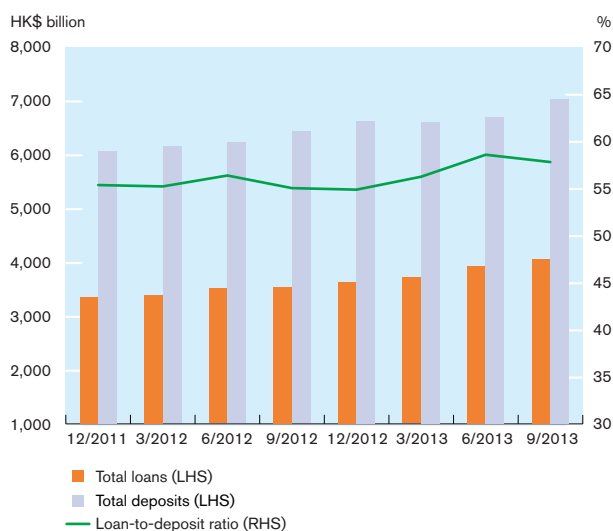
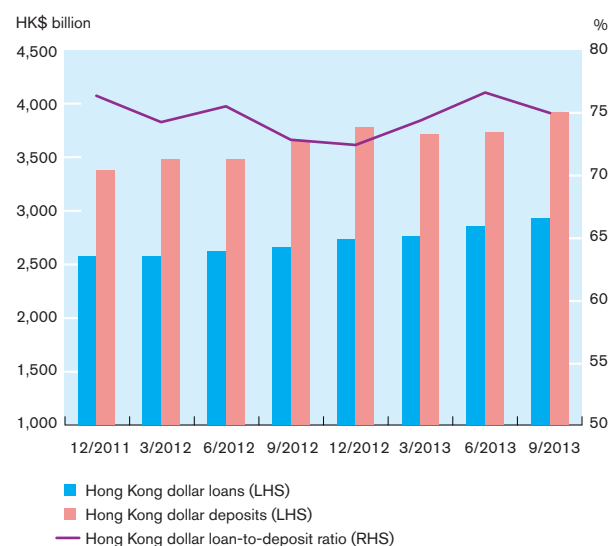


CHART 7

Hong Kong dollar loans and deposits of retail banks

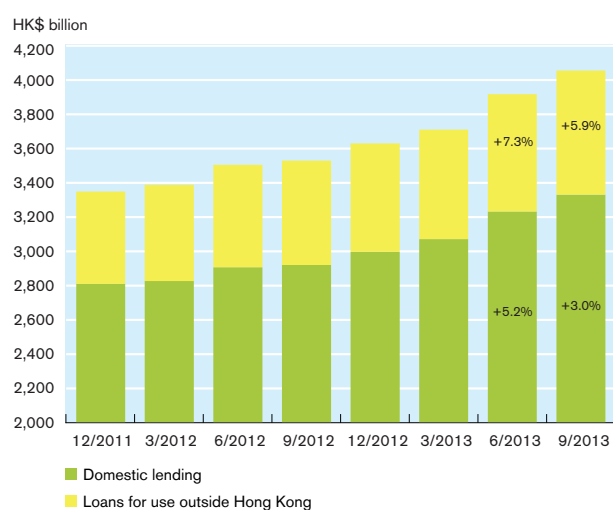


Domestic lending and loans for use outside Hong Kong rise

Retail banks' domestic lending (loans for use in Hong Kong plus trade finance) rose by 3.0% in the third quarter of 2013 after a 5.2% growth in the previous quarter (Chart 8). Growth in loans for use outside Hong Kong slowed down to 5.9% following a 7.3% increase in the previous quarter.

CHART 8

Loans and advances 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, the percentage changes in the amount of credit extended to the key economic sectors in the third quarter of 2013 are shown below:

Trade finance	+ 5.8%
Wholesale and retail trade	+ 5.0%
Property lending	+ 1.4%
Manufacturing	+ 0.2%

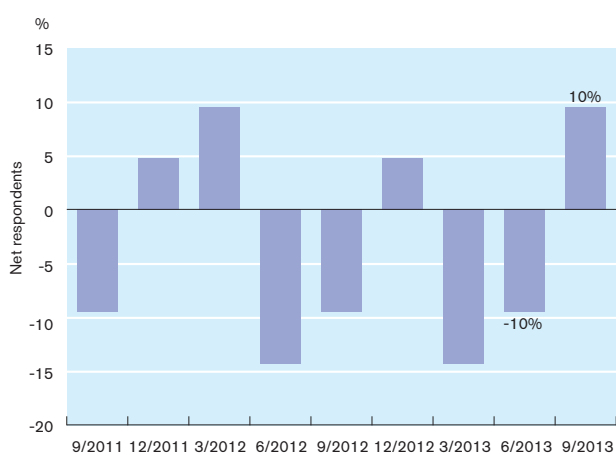
Retail banks' total non-bank Mainland exposures¹ increased by 8.2% to HK\$2,167 billion (18.0% of total assets) at the end of third quarter of 2013 from HK\$2,003 billion (18.2% of total assets) at the end of second quarter. For the banking sector as a whole, non-bank Mainland exposures increased by 9.0% to HK\$3,486 billion (18.6% of total assets) from HK\$3,197 billion (18.6% of total assets) in the same period.

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 an increase in loan demand (Chart 9), particularly for loans to non-bank Mainland entities, loans for use outside Hong Kong as well as consumer lending. Nevertheless, a considerable portion of the responding AIs anticipated weaker demand for property financing.

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.

¹ Starting from September 2013, a new quarterly banking return (MA(BS)20) is used to collect Mainland business activities data. There is a change in the basis in calculating the exposures as percentage of total assets. Please also note that the non-bank Mainland exposures include exposures booked in the retail banks' banking subsidiaries in Mainland China.

Average liquidity ratio declines

The quarterly average liquidity ratio of retail banks declined slightly to 38.6% in the third quarter of 2013 from 38.9% in the previous quarter.

The decline was led by an increase in qualifying liabilities, which outpaced that in liquefiable assets. 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 the third quarter this year from 15.9% three months earlier, well above the minimum international standard of 8% (Chart 11). This was mainly due to a faster growth in the capital base (+4.8%) than in risk-weighted assets (+3.4%).

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)

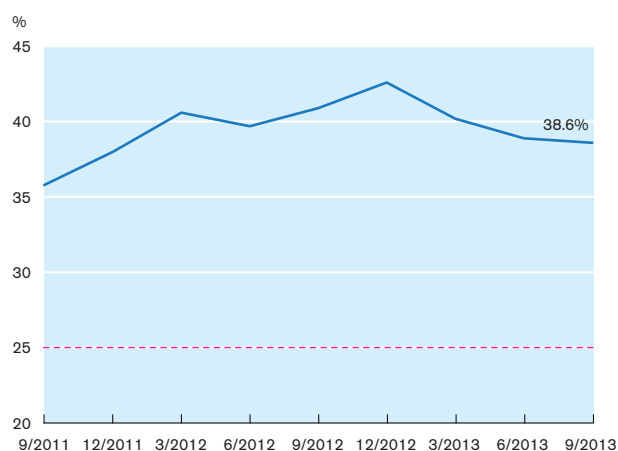
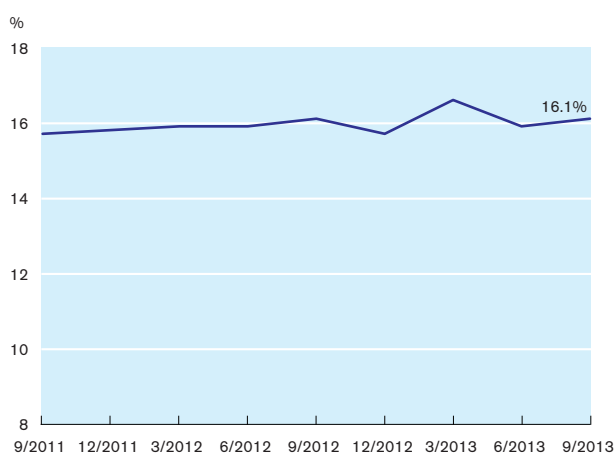


CHART 11

Capital adequacy ratio of locally incorporated Als



APPENDIX

KEY PERFORMANCE INDICATORS OF THE BANKING SECTOR¹ (%)

	Sep 2012	Jun 2013	Sep 2013
Interest rate			
1-month HIBOR fixing ² (quarterly average)	0.30	0.21	0.21
3-month HIBOR fixing (quarterly average)	0.40	0.38	0.38
BLR ³ and 1-month HIBOR fixing spread (quarterly average)	4.70	4.79	4.79
BLR and 3-month HIBOR fixing spread (quarterly average)	4.60	4.62	4.62
Composite interest rate ⁴	0.38	0.32	0.32
Retail banks			
Balance sheet developments⁵			
Total deposits	3.2	1.4	4.9
Hong Kong dollar	4.9	0.5	4.9
Foreign currency	1.1	2.5	4.9
Total loans	0.7	5.6	3.5
Domestic lending ⁶	0.4	5.2 ^r	3.0
Loans for use outside Hong Kong ⁷	2.2 ^r	7.3 ^r	5.9
Negotiable instruments			
Negotiable certificates of deposit (NCD) issued	-7.7	15.1	5.3
Negotiable debt instruments held (excluding NCD)	3.6	-0.3	8.8
Asset quality⁸			
As a percentage of total loans			
Pass loans	98.19	98.42 ^r	98.25
Special mention loans	1.31	1.11	1.27
Classified loans ⁹ (gross)	0.50	0.47 ^r	0.48
Classified loans (net) ¹⁰	0.30	0.33 ^r	0.35
Overdue > 3 months and rescheduled loans	0.42	0.36 ^r	0.34
Profitability			
Bad debt charge as percentage of average total assets ¹¹	0.02	0.03	0.03
Net interest margin ¹¹	1.37	1.41	1.41
Cost-to-income ratio ¹²	44.9	40.9	41.9
Liquidity ratio (quarterly average)	40.9	38.9	38.6
Surveyed institutions			
Asset quality			
Delinquency ratio of residential mortgage loans	0.01	0.02	0.02
Credit card lending			
Delinquency ratio	0.21	0.25	0.22
Charge-off ratio — quarterly annualised	1.83 ^r	2.06	2.09
— year-to-date annualised	1.75 ^r	1.88	1.93
All locally incorporated AIs			
Capital adequacy ratio (consolidated)¹³	16.1	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.

¹³ With effect from 1 January 2013, a revised capital adequacy framework (Basel III) was introduced for locally incorporated authorized institutions.

^r Revised figure