

# Developments in the banking sector

by the Banking Supervision Department

The Hong Kong banking sector remained sound despite the US Federal Reserve's further tapering of its asset purchase programme and the uncertain external environment. In the first quarter of 2014, retail banks' aggregate pre-tax operating profit rose by 10.7% compared with the same period last year. The net interest margin (NIM) remained unchanged during the same period. Retail banks' classified loan ratio edged down to 0.46% at the end of the first quarter of 2014 from 0.48% at the end of previous quarter. The consolidated capital adequacy ratio of locally incorporated authorized institutions (AIs) was maintained at 15.9% at the end of the first 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 challenging market environment.

## HIGHLIGHTS OF KEY TRENDS

### Profitability strengthens

The 10.7% increase in the aggregate pre-tax operating profit of retail banks' Hong Kong offices in the first quarter of 2014 was mainly due to robust growth in net interest income, which was up by 15.7% compared with a year ago. Retail banks' profit margins remained quite stable. The year-to-date

annualised NIM of retail banks was 1.39% in the first quarter, unchanged compared with the same period last year (Chart 1). The relatively steady NIM reflected that banks managed to increase their yields to offset the effect of higher funding costs, as indicated by an upward trend in composite interest rate since the second quarter of 2013 (Chart 2).

CHART 1

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

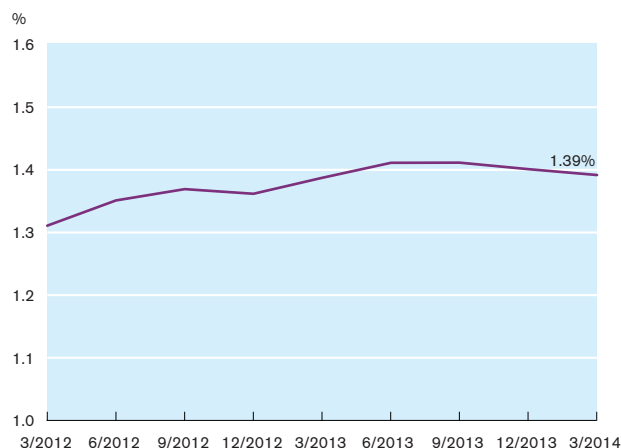
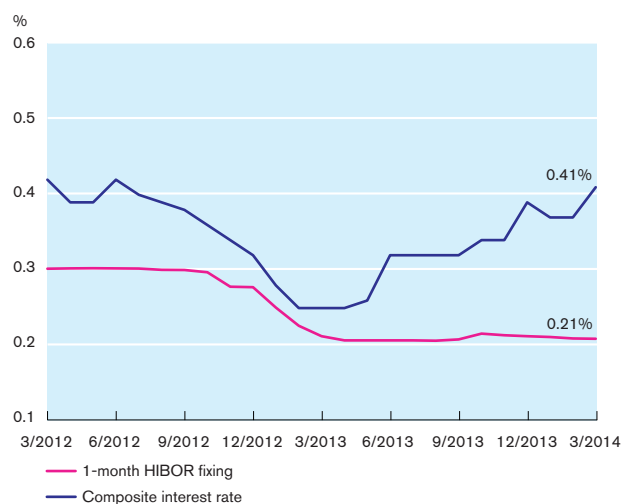


CHART 2

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 40.8% in the first quarter of 2014 from 41.7% a year earlier, as the increase in operating income (+10.3%) outpaced that of operating expenses (+8.0%) during the period.

## Asset quality remains sound

Retail banks' classified loan ratio edged down to 0.46% at the end of the first quarter of 2014, compared with 0.48% a quarter earlier. The decrease was mainly due to a faster pace of growth in total loans (+4.3%) than in the aggregate amount of classified loans (+1.4%) during the quarter (Table 1 and Chart 3). During the same period, the ratio of special mention loans dropped

to 1.12% from 1.20%, and the ratio of overdue and rescheduled loans reduced to 0.31% from 0.33%.

Retail banks' net charge for debt provisions amounted to HK\$0.9 billion in the first quarter, compared with HK\$0.5 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 first quarter of 2014, the delinquency ratio of the credit card portfolio edged up to 0.22% from 0.20% in the previous quarter (Chart 4). During the same period, the quarterly annualised charge-off ratio remained at 1.85%. These ratios were still at low level by historical standards.

CHART 3

Asset quality of retail banks

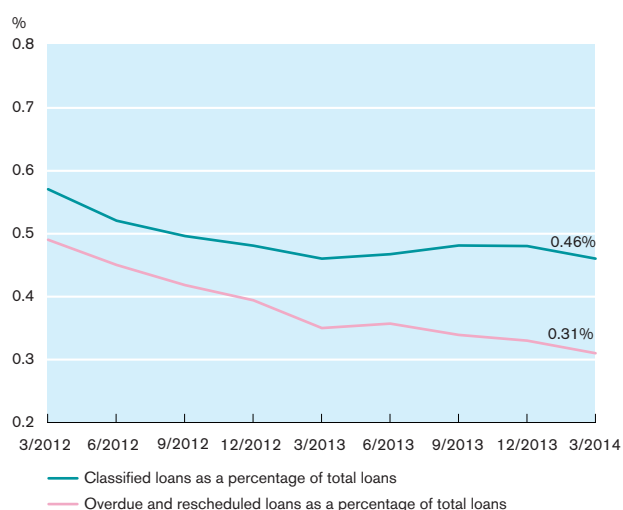


CHART 4

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

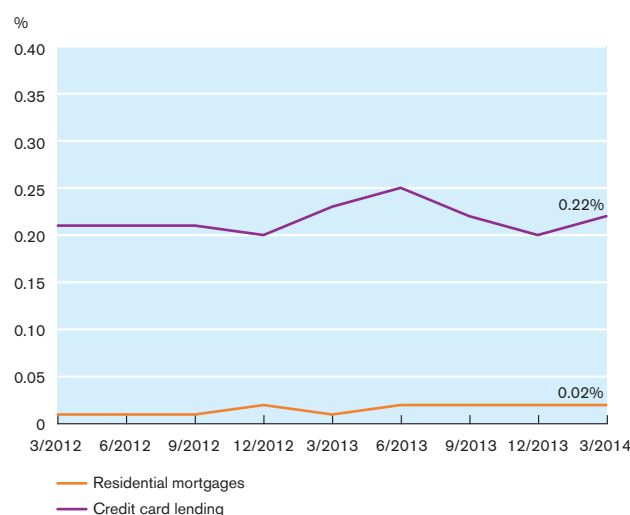


TABLE 1

Quality of loans and advances of retail banks\*

	Mar 2013	Jun 2013	Sep 2013 (% of total loans)	Dec 2013	Mar 2014
<b>Special mention loans</b>	<b>1.22</b>	<b>1.11</b>	<b>1.27</b>	<b>1.20</b>	<b>1.12</b>
<b>Classified loans (gross)</b>	<b>0.46</b>	<b>0.47</b>	<b>0.48</b>	<b>0.48</b>	<b>0.46</b>
of which					
Substandard	0.21	0.22	0.24	0.22	0.22
Doubtful	0.22	0.21	0.21	0.22	0.21
Loss	0.03	0.03	0.03	0.03	0.03
<b>Classified loans (net of specific provisions)</b>	<b>0.32</b>	<b>0.33</b>	<b>0.35</b>	<b>0.34</b>	<b>0.34</b>
<b>Overdue &gt; 3 months and rescheduled loans</b>	<b>0.35</b>	<b>0.36</b>	<b>0.34</b>	<b>0.33</b>	<b>0.31</b>
of which					
Overdue > 3 months	0.26	0.24	0.23	0.23	0.23
Rescheduled loans	0.09	0.12	0.11	0.10	0.08

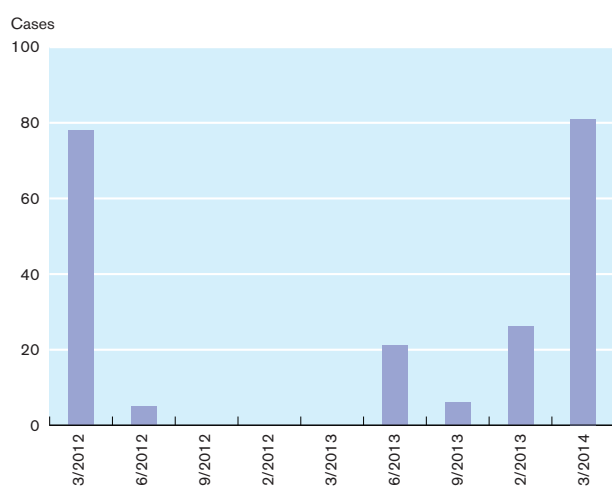
\* Period-end figures covering the Hong Kong offices and overseas branches of the banks.

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 first quarter (Chart 4). The estimated number of residential mortgage loans in negative equity increased to 81 cases at the end of March from 26 cases at the end of December 2013 (Chart 5).

CHART 5

## Residential mortgage loans in negative equity



## Loan-to-deposit ratios increase

Retail banks' total loans and advances rose by 4.3% but total deposits dropped by 0.4% in the first quarter of 2014 compared with a quarter earlier. As a result, their overall loan-to-deposit ratio increased to 58.9% at the end of March from 56.2% at the end of December 2013 (Chart 6). During the same period, Hong Kong dollar loans and advances rose by 3.2% while Hong Kong dollar deposits edged down by 0.1%, resulting in an increase of Hong Kong dollar loan-to-deposit ratio to 77.2% from 74.8% (Chart 7).

CHART 6

## Total loans and deposits of retail banks

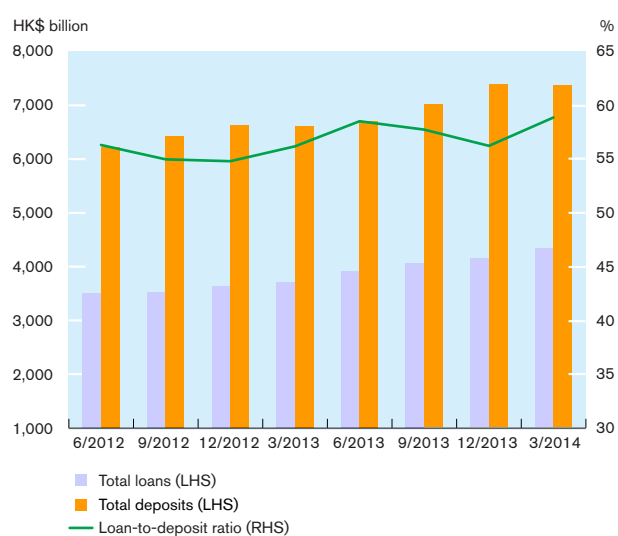
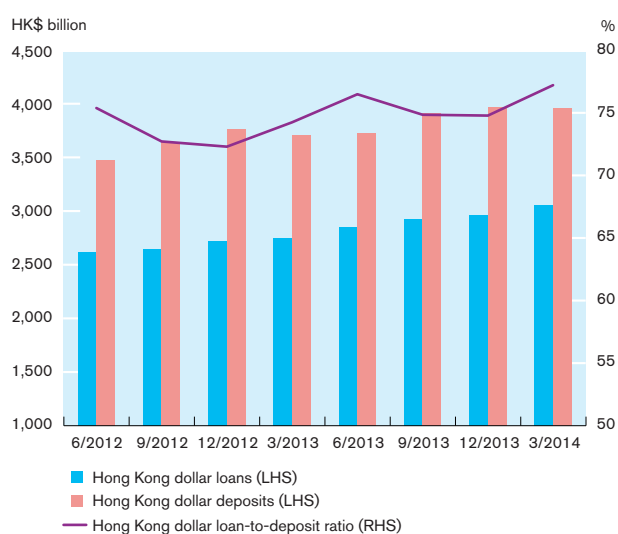


CHART 7

## Hong Kong dollar loans and deposits of retail banks

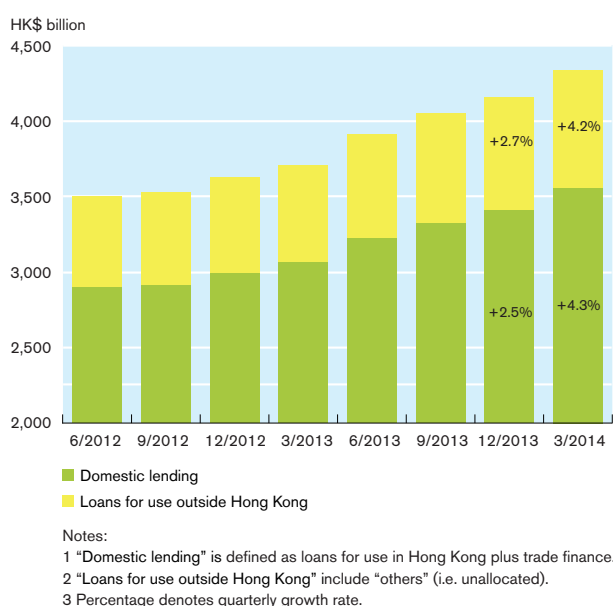


## Domestic lending and loans for use outside Hong Kong rise

Retail banks' domestic lending (loans for use in Hong Kong plus trade finance) rose by 4.3% in the first quarter of 2014 after a 2.5% growth in the previous quarter (Chart 8). Loans for use outside Hong Kong grew by 4.2% following a 2.7% increase 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 the key economic sectors in the first quarter of 2014 were:

Manufacturing	+ 7.7%
Wholesale and retail trade	+ 6.6%
Property lending	+ 1.3%
Trade finance	+ 0.6%

## Mainland-related lending and non-bank exposures

For the banking sector as a whole, total Mainland-related lending increased by 10.8% to HK\$2,867 billion (14.4% of total assets) at the end of first quarter of 2014 from HK\$2,589 billion (13.3% of total assets) at the end of 2013 (Tables 2 to 5).

TABLE 2

### Mainland-related lending

	Dec 2013 HK\$bn	Mar 2014 HK\$bn
Mainland-related loans excluding trade finance	2,276	2,461
Trade finance	313	406
<b>Total</b>	<b>2,589</b>	<b>2,867</b>

TABLE 3

### Mainland-related lending by type of AIs

	Dec 2013 HK\$bn	Mar 2014 HK\$bn
Overseas-incorporated AIs	1,116	1,244
Locally-incorporated AIs <sup>1</sup>	972	1,111
Mainland banking subsidiaries of locally-incorporated AIs	501	512
<b>Total</b>	<b>2,589</b>	<b>2,867</b>

<sup>1</sup> Including loans booked in the Mainland branches of locally-incorporated AIs

TABLE 4

### Mainland-related lending by type of borrowers

	Dec 2013 HK\$bn	Mar 2014 HK\$bn
Mainland non-private entities	1,290	1,453
Mainland private entities	488	528
Non-Mainland entities	811	886
<b>Total</b>	<b>2,589</b>	<b>2,867</b>

TABLE 5

### Other non-bank exposures

	Dec 2013 HK\$bn	Mar 2014 HK\$bn
Negotiable debt instruments and other on-balance sheet exposures	573	530
Off-balance sheet exposures	441	415
<b>Total</b>	<b>1,014</b>	<b>944</b>

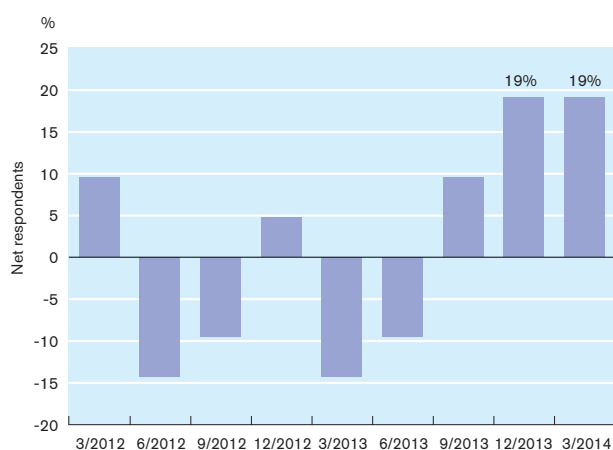
Note: Figures may not add up to total due to rounding.

## Surveyed AIs anticipate stable loan demand

The HKMA's Opinion Survey of Credit Condition Outlook conducted in March 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, syndicated loans as well as loans for use outside Hong Kong. Nevertheless, a considerable portion of the responding AIs anticipated weaker demand for property related lending.

CHART 9

### Expectation of loan demand in the next three months



Note:

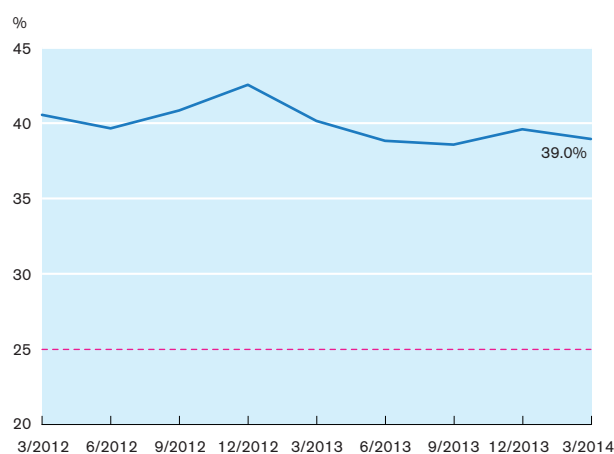
Net respondents refer to the percentage of respondents expecting loan demand to increase minus the percentage expecting loan demand to decline.

## Average liquidity ratio declines

The quarterly average liquidity ratio of retail banks slightly declined to 39.0% in the first quarter of 2014 from 39.6% 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).

CHART 10

### Liquidity ratio of retail banks (quarterly average)

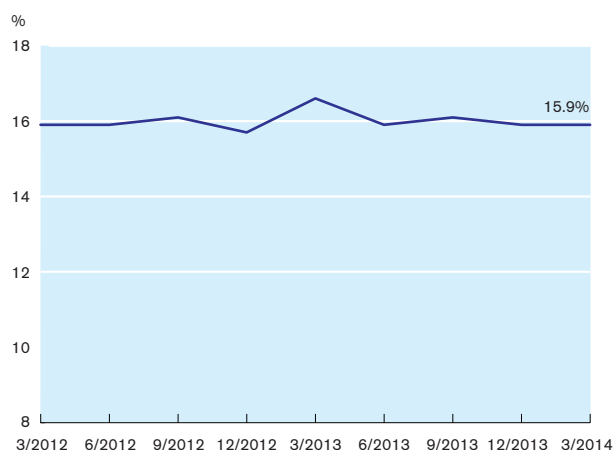


## AIs remain well capitalised

The consolidated capital adequacy ratio of locally incorporated AIs was maintained at 15.9% at the end of the first quarter this year, well above the minimum international standard of 8% (Chart 11).

CHART 11

### Capital adequacy ratio of locally incorporated AIs



A table of key performance indicators of the banking sector can be found in the Appendix.

## APPENDIX

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

	Mar 2013	Dec 2013	Mar 2014
<b>Interest rate</b>			
1-month HIBOR fixing <sup>2</sup> (quarterly average)	0.23	0.21	0.21
3-month HIBOR fixing (quarterly average)	0.39	0.38	0.38
BLR <sup>3</sup> and 1-month HIBOR fixing spread (quarterly average)	4.77	4.79	4.79
BLR and 3-month HIBOR fixing spread (quarterly average)	4.61	4.62	4.62
Composite interest rate <sup>4</sup>	0.25	0.39	0.41
<b>Retail banks</b>			
<b>Balance sheet developments<sup>5</sup></b>			
Total deposits	-0.3	5.3	-0.4
Hong Kong dollar	-1.6	1.5	-0.1
Foreign currency	1.5	10.1	-0.8
Total loans	2.2	2.6	4.3
Domestic lending <sup>6</sup>	2.5	2.5	4.3
Loans for use outside Hong Kong <sup>7</sup>	0.9	2.7	4.2
Negotiable instruments			
Negotiable certificates of deposit (NCD) issued	2.8	10.5	16.5
Negotiable debt instruments held (excluding NCD)	4.5	3.7	-5.8
<b>Asset quality<sup>8</sup></b>			
As a percentage of total loans			
Pass loans	98.32	98.33	98.42
Special mention loans	1.22	1.20	1.12
Classified loans <sup>9</sup> (gross)	0.46	0.48	0.46
Classified loans (net) <sup>10</sup>	0.32	0.34	0.34
Overdue > 3 months and rescheduled loans	0.35	0.33	0.31
<b>Profitability</b>			
Bad debt charge as percentage of average total assets <sup>11</sup>	0.02	0.04	0.04
Net interest margin <sup>11</sup>	1.39	1.40	1.39
Cost-to-income ratio <sup>12</sup>	41.7	42.4	40.8
<b>Liquidity ratio (quarterly average)</b>	40.2	39.6	39.0
<b>Surveyed institutions</b>			
<b>Asset quality</b>			
Delinquency ratio of residential mortgage loans	0.01	0.02	0.02
Credit card lending			
Delinquency ratio	0.23	0.20	0.22
Charge-off ratio — quarterly annualised	1.81	1.85	1.85
— year-to-date annualised	1.81	1.84	1.85
<b>All locally incorporated AIs</b>			
<b>Capital adequacy ratio (consolidated)<sup>13</sup></b>	16.6	15.9	15.9

## Notes:

<sup>1</sup> Figures are related to Hong Kong office(s) only except where otherwise stated.

<sup>2</sup> The Hong Kong dollar Interest Settlement Rates are 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> Including "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>13</sup> With effect from 1 January 2013, a revised capital adequacy framework (Basel III) was introduced for locally incorporated authorized institutions.