

# Developments in the banking sector

by the Banking Supervision Department

The Hong Kong banking sector remained sound despite emerging signs of economic slowdown or decline in some economies and uncertainties in the US Federal Reserve's timing and pace of interest rate rises. In the first three quarters of 2014, retail banks' aggregate pre-tax operating profit rose by 6.4% compared with the same period last year. The net interest margin (NIM) remained unchanged during the same period. Retail banks' asset quality remained sound with their classified loan ratio edging down to 0.43% at the end of the third quarter of 2014 from 0.46% a quarter earlier. The consolidated capital adequacy ratio of locally incorporated authorized institutions (AIs) rose to 16.4%, well above the international minimum standard of 8%. The HKMA will continue to closely monitor developments in the banking sector and ensure that banks remain resilient in such uncertain external environment.

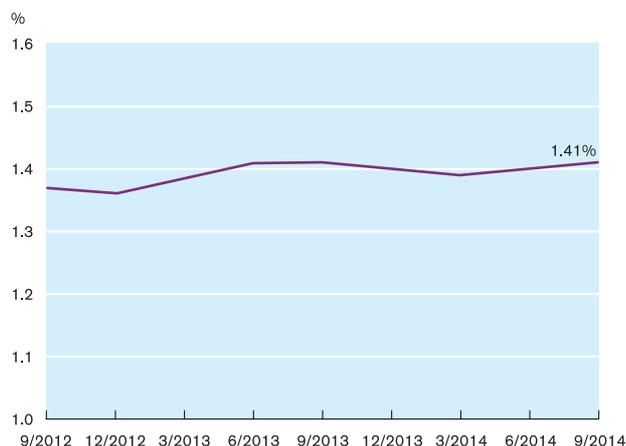
## HIGHLIGHTS OF KEY TRENDS

### Profitability grows moderately

Retail banks' Hong Kong offices registered a 6.4% increase in aggregate pre-tax operating profit in the first three quarters of 2014 compared with the same period last year. The rise was mainly attributable to the robust growth in net interest income (+15.2%), but partly offset by the increase in operating expenses (+10.3%).

CHART 1

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



Retail banks' profit margins remained largely stable. The year-to-date annualised NIM of retail banks was 1.41% in the first three quarters of 2014, unchanged as compared with the same period last year (Chart 1). It is worth noting that the funding cost of retail banks has steadily declined after reaching a recent high in June 2014, as indicated by a downward trend in composite interest rate since mid-2014 (Chart 2).

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 increased to 42.5% in the first three quarters of 2014 from 41.9% in the same period last year, as the increase in operating expenses (+10.3%) outpaced that of operating income (+8.8%) during the period.

## Asset quality remains sound

Retail banks' classified loan ratio marginally declined to 0.43% at the end of the third quarter of 2014 from 0.46% a quarter earlier (Table 1 and Chart 3). The decrease was mainly due to a 4.2% drop in classified loans coupled with a 1.0% increase in total loans during the quarter. The ratio of special mention loans also edged down to 1.04% from 1.05%. During the

same period, the ratio of overdue and rescheduled loans remained unchanged at 0.27%.

Despite the improvement in classified loan ratio, retail banks' net charge for debt provisions rose to HK\$3.7 billion in the first three quarters of 2014, compared with HK\$2.4 billion in the same period last year.

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 2014, the delinquency ratio of the credit card portfolio was steady at 0.22%, the same as in the previous quarter (Chart 4). The quarterly annualised charge-off ratio fell to 1.98% from 2.05% a quarter earlier.

CHART 3

### Asset quality of retail banks

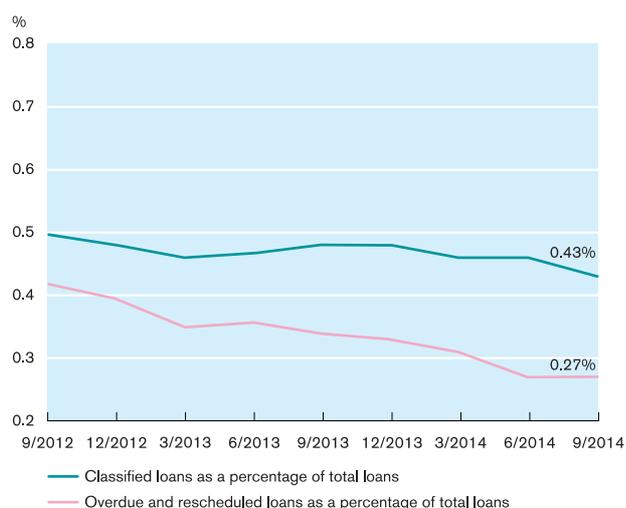


CHART 4

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

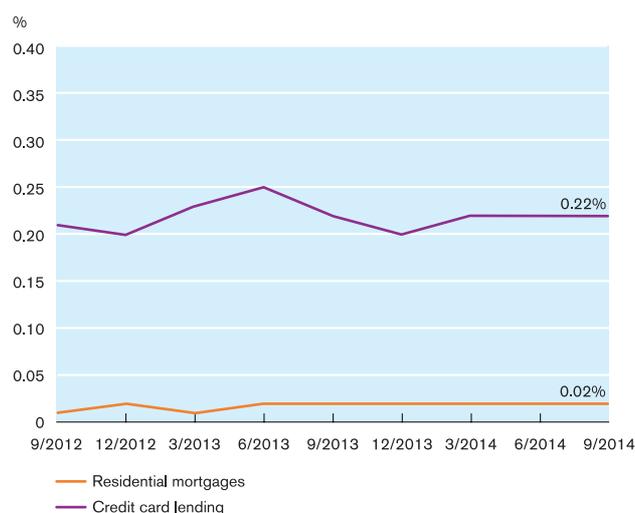


TABLE 1

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

	Sep 2013	Dec 2013	Mar 2014 (% of total loans)	Jun 2014	Sep 2014
<b>Special mention loans</b>	<b>1.27</b>	<b>1.20</b>	<b>1.12</b>	<b>1.05</b>	<b>1.04</b>
<b>Classified loans (gross)</b>	<b>0.48</b>	<b>0.48</b>	<b>0.46</b>	<b>0.46</b>	<b>0.43</b>
of which					
Substandard	0.24	0.22	0.22	0.21	0.19
Doubtful	0.21	0.22	0.21	0.22	0.22
Loss	0.03	0.03	0.03	0.03	0.03
<b>Classified loans (net of specific provisions)</b>	<b>0.35</b>	<b>0.34</b>	<b>0.34</b>	<b>0.33</b>	<b>0.31</b>
<b>Overdue &gt; 3 months and rescheduled loans</b>	<b>0.34</b>	<b>0.33</b>	<b>0.31</b>	<b>0.27</b>	<b>0.27</b>
of which					
Overdue > 3 months	0.23	0.23	0.23	0.21	0.22
Rescheduled loans	0.11	0.10	0.08	0.05	0.05

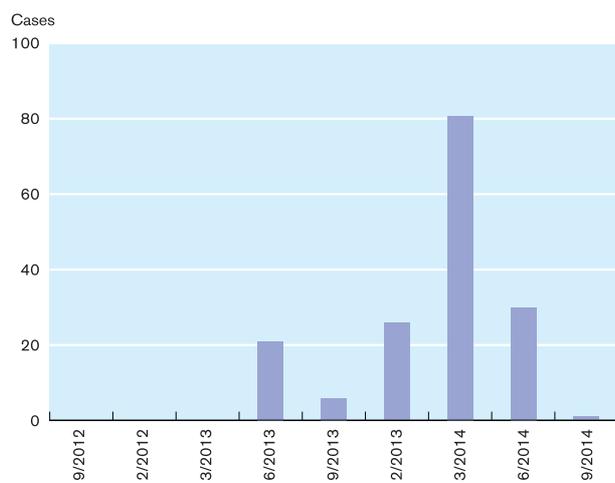
\* Period-end figures covering the Hong Kong offices and overseas branches of the banks.

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

The credit quality of surveyed Als' residential mortgage lending also remained good, with the delinquency ratio standing at 0.02% at the end of September 2014 (Chart 4). The estimated number of residential mortgage loans in negative equity dropped to 1 case at the end of September 2014 from 30 cases a quarter earlier (Chart 5).

CHART 5

## Residential mortgage loans in negative equity



## Loan-to-deposit ratios decrease

Retail banks' total loans and advances and total deposits rose by 0.9% and 2.4% respectively in the third quarter of 2014. As a result, the all currencies loan-to-deposit ratio of retail banks decreased to 57.7% at the end of September 2014 from 58.6% a quarter earlier (Chart 6).

During the same period, retail banks' Hong Kong dollar loans and advances remained fairly stable while the Hong Kong dollar deposits expanded by 1.3%. Consequently, the Hong Kong dollar loan-to-deposit ratio of retail banks decreased to 73.5% at the end of September 2014 from 74.5% a quarter earlier (Chart 7).

CHART 6

## Total loans and deposits of retail banks

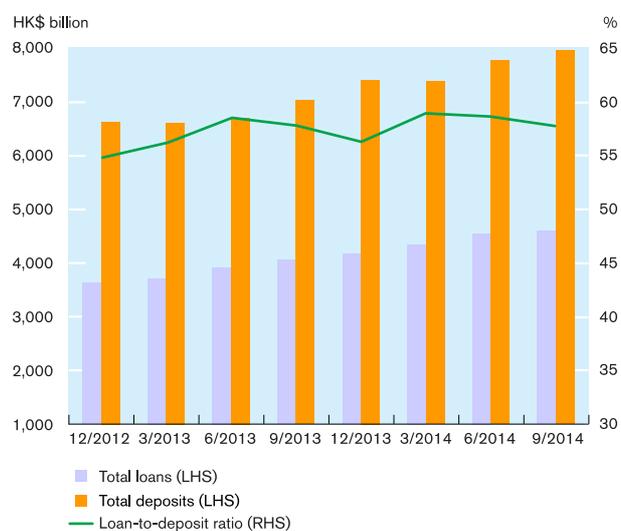
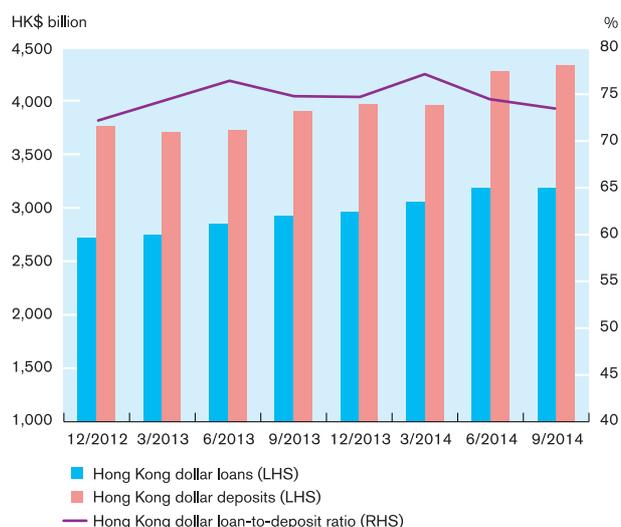


CHART 7

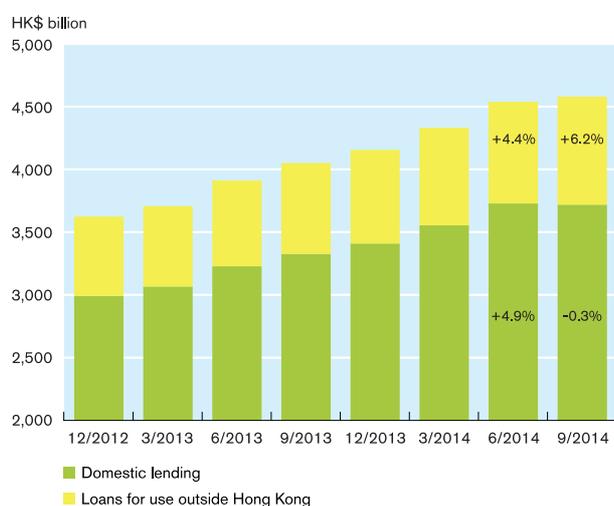
## Hong Kong dollar loans and deposits of retail banks



## Domestic lending edges down but loans for use outside Hong Kong rise

Retail banks' domestic lending (loans for use in Hong Kong plus trade finance) decreased slightly by 0.3% in the third quarter of 2014 after a 4.9% increase in the previous quarter (Chart 8). Loans for use outside Hong Kong expanded a further 6.2% after an increase of 4.4% a quarter earlier.

**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 of retail banks, the percentage changes in the amount of credit extended to the key economic sectors in the third quarter of 2014 were:

Wholesale and retail trade	+ 5.9%
Manufacturing	+ 4.0%
Property lending	+ 1.5%
Trade finance	- 7.6%

## Mainland-related lending and non-bank exposures

For the banking sector as a whole, total Mainland-related lending increased by 3.4% to HK\$3,058 billion (14.7% of total assets) at the end of the third quarter of 2014 from HK\$2,956 billion (14.4% of total assets) at the end of the second quarter (Table 2 to 5).

**TABLE 2**  
Mainland-related lending

	Jun 2014 HK\$bn	Sep 2014 HK\$bn
Mainland-related loans excluding trade finance	2,546	2,639
Trade finance	410	419
<b>Total</b>	<b>2,956</b>	<b>3,058</b>

**TABLE 3**  
Mainland-related lending by type of AIs

	Jun 2014 HK\$bn	Sep 2014 HK\$bn
Overseas-incorporated AIs	1,263	1,311
Locally-incorporated AIs <sup>1</sup>	1,164	1,205
Mainland banking subsidiaries of locally-incorporated AIs	530	542
<b>Total</b>	<b>2,956</b>	<b>3,058</b>

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

**TABLE 4**  
Mainland-related lending by type of borrowers

	Jun 2014 HK\$bn	Sep 2014 HK\$bn
Mainland state-owned entities	1,480	1,424
Mainland private entities	562	567
Non-Mainland entities	914	1,067
<b>Total</b>	<b>2,956</b>	<b>3,058</b>

**TABLE 5**  
Other non-bank exposures

	Jun 2014 HK\$bn	Sep 2014 HK\$bn
Negotiable debt instruments and other on-balance sheet exposures	584	597
Off-balance sheet exposures	396	435
<b>Total</b>	<b>980</b>	<b>1,033</b>

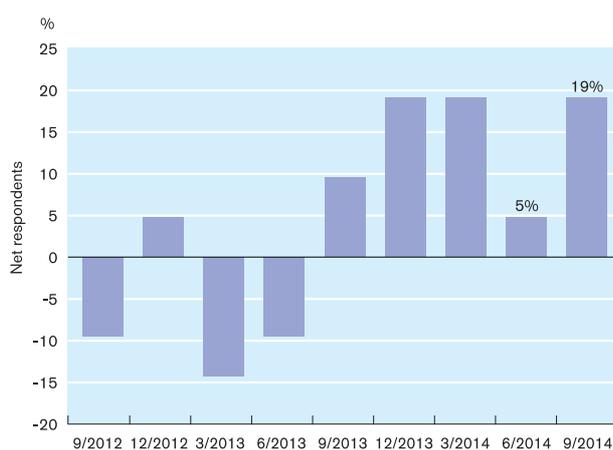
Note: Figures may not add up to total due to rounding.

## Surveyed AIs anticipate stable loan demand

The HKMA's Opinion Survey of Credit Condition Outlook conducted in September 2014 showed that most of the surveyed AIs (81%) expected loan demand to remain the same in the next three months. Majority of the remaining AIs anticipated an increase in loan demand (Chart 9), particularly for consumer lending (other than residential mortgage lending) and loans to non-bank Mainland entities. Nevertheless, a considerable portion of the surveyed AIs anticipated lower demand for property related lending.

CHART 9

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



Note:

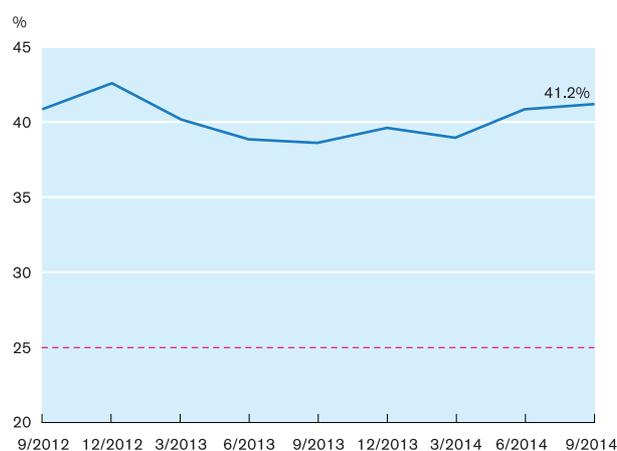
Net respondents refer to the percentage of respondents expecting loan demand to increase minus the percentage expecting loan demand to decline.

## Average liquidity ratio increases

The quarterly average liquidity ratio of retail banks increased to 41.2% in the third quarter of 2014 from 40.8% in the previous quarter, as the growth of liquefiable assets outpaced that of qualifying liabilities. 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 rose to 16.4% at the end of the third quarter this year, well above the international minimum standard of 8% (Chart 11).

CHART 11

### Capital adequacy ratio of locally incorporated AIs



From next year onwards, this Chapter on "Developments in the Banking Sector" will be more focused on publication of banking statistics (in form of tables and charts) for readers' ease of reference.

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> (%)

	Sep 2013	Jun 2014	Sep 2014
<b>Interest rate</b>			
1-month HIBOR fixing <sup>2</sup> (quarterly average)	0.21	0.21	0.22
3-month HIBOR fixing (quarterly average)	0.38	0.37	0.37
BLR <sup>3</sup> and 1-month HIBOR fixing spread (quarterly average)	4.79	4.79	4.78
BLR and 3-month HIBOR fixing spread (quarterly average)	4.62	4.63	4.63
Composite interest rate <sup>4</sup>	0.32	0.47	0.40
<b>Retail banks</b>			
<b>Balance sheet developments<sup>5</sup></b>			
Total deposits	4.9	5.3	2.4
Hong Kong dollar	4.9	7.9	1.3
Foreign currency	4.9	2.4	3.7
Total loans	3.5	4.8	0.9
Domestic lending <sup>6</sup>	3.0	4.9	-0.3
Loans for use outside Hong Kong <sup>7</sup>	5.9	4.4	6.2
Negotiable instruments			
Negotiable certificates of deposit (NCD) issued	5.3	-3.3	-3.9
Negotiable debt instruments held (excluding NCD)	8.8	5.3	-0.4
<b>Asset quality<sup>8</sup></b>			
As a percentage of total loans			
Pass loans	98.25	98.50	98.53
Special mention loans	1.27	1.05	1.04
Classified loans <sup>9</sup> (gross)	0.48	0.46	0.43
Classified loans (net) <sup>10</sup>	0.35	0.33	0.31
Overdue > 3 months and rescheduled loans	0.34	0.27	0.27
<b>Profitability</b>			
Bad debt charge as percentage of average total assets <sup>11</sup>	0.03	0.05	0.05
Net interest margin <sup>11</sup>	1.41	1.40	1.41
Cost-to-income ratio <sup>12</sup>	41.9	42.7	42.5
<b>Liquidity ratio (quarterly average)</b>	38.6	40.8	41.2
<b>Surveyed institutions</b>			
<b>Asset quality</b>			
Delinquency ratio of residential mortgage loans	0.02	0.02	0.02
Credit card lending			
Delinquency ratio	0.22	0.22	0.22
Charge-off ratio — quarterly annualised	2.09	2.05	1.98
— year-to-date annualised	1.93	1.90	1.90
<b>All locally incorporated AIs</b>			
<b>Capital adequacy ratio (consolidated)<sup>13</sup></b>	16.1	16.1	16.4

## 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.