

# Developments in the Banking Sector

by Banking Supervision Department

## HIGHLIGHTS OF KEY TRENDS

### Banking sector performance

The aggregate pre-tax operating profit of retail banks' Hong Kong operations increased substantially by 32.9% in the first quarter of 2018, compared with the same period last year. The strong performance was mainly due to a 23.7% increase in net interest income and a 17.9% growth in fee and commission income. These increases more than offset a 75.9% decline in income from investments held for trading and a 4.7% growth in operating expenses (Table 1).

Retail banks' net interest margin widened to 1.52% in the first quarter of 2018 from 1.38% in the same period of 2017 (Chart 1).

Total loans of the banking sector increased by 3.6% in the first quarter of 2018, after growing by 2.9% in the previous quarter (Chart 4). As total loans grew faster than total deposits, the loan-to-deposit ratio of the banking sector rose further to 74.8% at end-March 2018 from 73.0% a quarter earlier (Chart 5).

The banking sector's Mainland-related lending increased by 5.3% in the first quarter to HK\$4,409 billion (16.9% of total assets) at end-March 2018, from HK\$4,188 billion (16.7% of total assets) at end-December 2017 (Table 2).

The loan quality of the banking sector stayed healthy, with the classified loan ratio decreasing slightly to 0.65% at end-March 2018 from 0.67% a quarter earlier (Table 3a). Retail banks' classified loan ratio edged up to 0.55% from 0.54% over the same period (Table 3b).

The classified loan ratio of the banking sector's Mainland-related lending decreased to 0.60% at end-March 2018 from 0.68% a quarter earlier (Table 3a). The classified loan ratio of retail banks' Mainland-related lending decreased to 0.68% from 0.75% during the same period (Table 3b).

The key performance indicators of the banking sector are provided in the Appendix.

### Profitability

TABLE 1

Profitability of retail banks' Hong Kong offices

Key items	Q1 2018 vs. Q1 2017	
	Percentage change	Contribution to the percentage change in profitability (ppt)
Net interest income	+23.7%	+24.4
Fee and commission income	+17.9%	+8.0
Income from investments held for trading	-75.9%	-3.0
Total operating expenses	+4.7%	-3.4
<b>Pre-tax operating profit</b>	<b>+32.9%</b>	

CHART 1

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

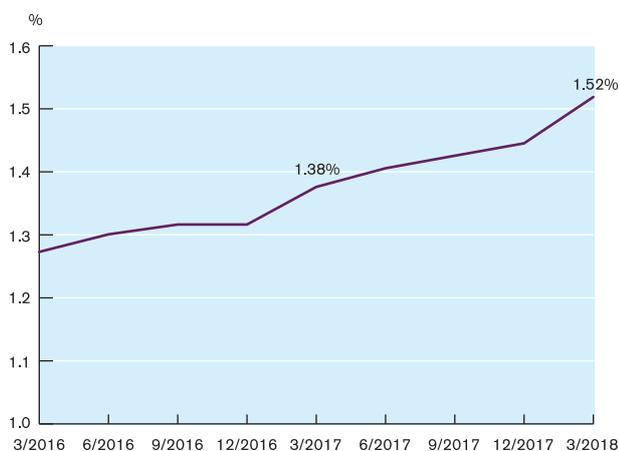


CHART 3

Cost-to-income ratio (year-to-date) of retail banks declined

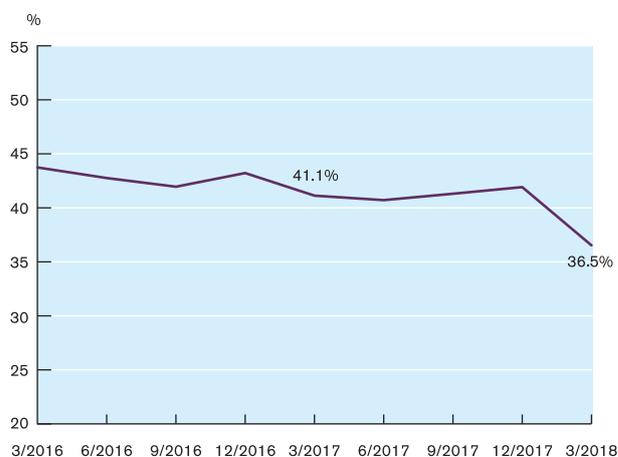
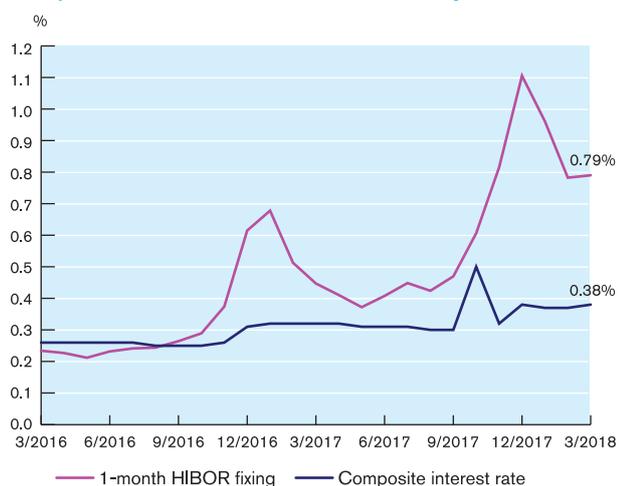


CHART 2

Hong Kong-dollar interbank interest rates declined but remained higher than the average level in 2017; the composite interest rate remained broadly stable



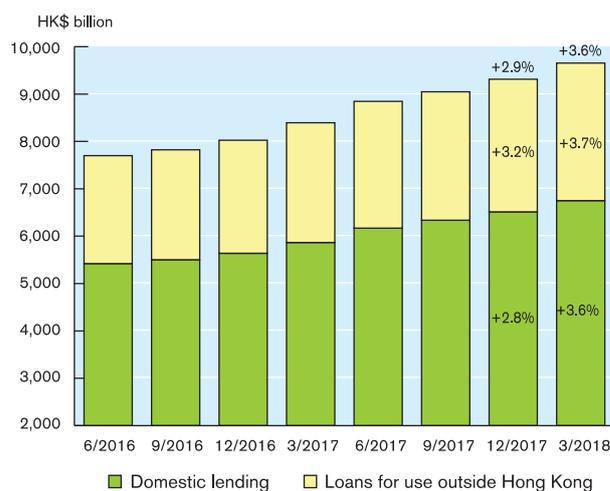
Notes:

1. HIBOR fixing (monthly average) refers to the Hong Kong Interbank Offered Rates released by the Hong Kong Association of Banks.
2. Composite interest rate is a weighted average interest rate of all Hong Kong-dollar interest-bearing liabilities of retail banks.

## Loans and deposits

CHART 4

Growth in both domestic lending and loans for use outside Hong Kong accelerated



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 quarter-on-quarter growth rate.

CHART 5

### Total loans grew faster than total deposits in the first quarter of 2018

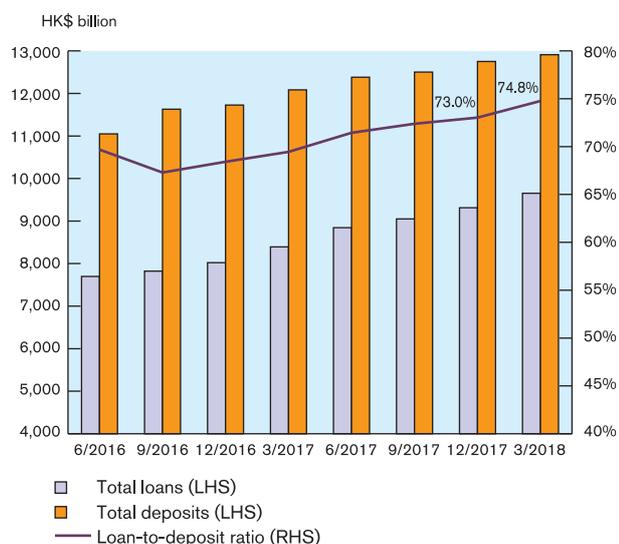
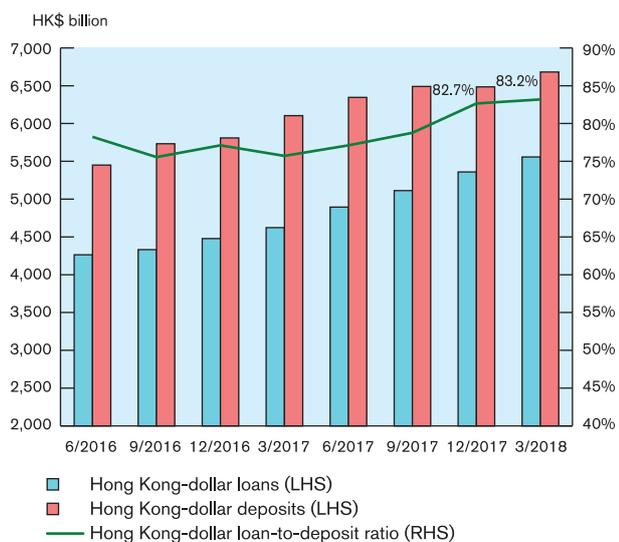


CHART 6

### Hong Kong-dollar loans also grew faster than Hong Kong-dollar deposits in the first quarter of 2018

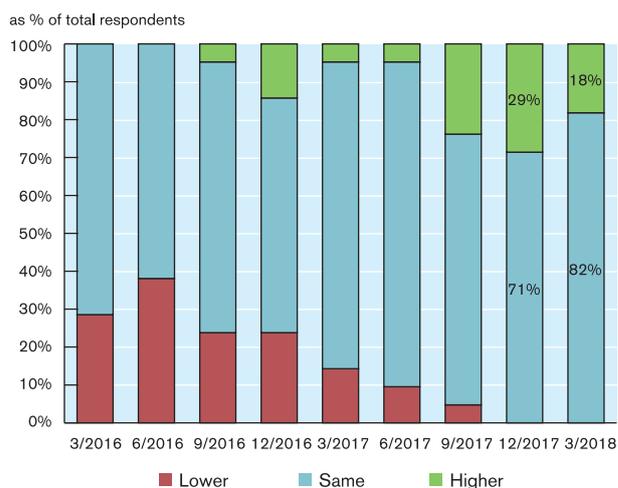


Within domestic lending, the percentage changes in the amount of credit extended to the key economic sectors in the first quarter of 2018 were:

Key items	Mar 2018 vs. Dec 2017
	Percentage change
Electricity and gas	+9.4%
Loans to private individuals (excluding credit card advances and residential mortgage loans)	+7.7%
Financial concerns	+6.1%
Trade finance	+5.7%
Wholesale & retail trade	+4.9%
Property lending	+2.4%
<b>Domestic lending</b>	<b>+3.6%</b>

CHART 7

### Most of the respondents to the HKMA Opinion Survey on Credit Condition Outlook expected loan demand to stay the same in the next three months



Expectation of loan demand to change in the next 3 months relative to the past 3 months

## Mainland-related lending

TABLE 2

### Mainland-related lending

	Dec 2017 HK\$bn	Mar 2018 HK\$bn
Mainland-related loans excluding trade finance	3,878	4,068
Trade finance	310	341
<b>Total</b>	<b>4,188</b>	<b>4,409</b>

## Asset quality

TABLE 3a

### Quality of loans and advances of the banking sector\*

	Mar 2017	Jun 2017	Sep 2017	Dec 2017	Mar 2018
	<i>% of total loans</i>				
<b>Special mention loans</b>	<b>1.74</b>	<b>1.45</b>	<b>1.44</b>	<b>1.36</b>	<b>1.28</b>
<b>Classified loans (gross)</b>	<b>0.83</b>	<b>0.84</b>	<b>0.79</b>	<b>0.67</b>	<b>0.65</b>
of which:					
Substandard	0.22	0.23	0.21	0.20	0.21
Doubtful	0.50	0.50	0.47	0.38	0.38
Loss	0.11	0.11	0.11	0.08	0.07
<b>Classified loans (net of specific provisions)</b>	<b>0.50</b>	<b>0.47</b>	<b>0.42</b>	<b>0.35</b>	<b>0.34</b>
<b>Overdue &gt; 3 months and rescheduled loans</b>	<b>0.68</b>	<b>0.61</b>	<b>0.61</b>	<b>0.52</b>	<b>0.48</b>
of which:					
Overdue > 3 months	0.61	0.56	0.56	0.47	0.43
Rescheduled loans	0.06	0.05	0.05	0.05	0.05
	<i>% of Mainland-related lending</i>				
<b>Classified loans (gross) of Mainland-related lending**</b>	<b>0.78</b>	<b>0.88</b>	<b>0.84</b>	<b>0.68</b>	<b>0.60</b>

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

\* Unless stated otherwise, figures covered all authorized institutions (AIs)' Hong Kong offices, as well as locally incorporated AIs' overseas branches and major overseas subsidiaries.

\*\* Figures covered all AIs' Hong Kong offices, as well as locally incorporated AIs' Mainland branches and subsidiaries.

TABLE 3b

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

	Mar 2017	Jun 2017	Sep 2017	Dec 2017	Mar 2018
	<i>% of total loans</i>				
<b>Special mention loans</b>	<b>1.35</b>	<b>1.10</b>	<b>1.02</b>	<b>1.03</b>	<b>1.09</b>
<b>Classified loans (gross)</b>	<b>0.70</b>	<b>0.68</b>	<b>0.62</b>	<b>0.54</b>	<b>0.55</b>
of which:					
Substandard	0.20	0.19	0.15	0.17	0.19
Doubtful	0.47	0.46	0.44	0.35	0.33
Loss	0.03	0.03	0.03	0.03	0.03
<b>Classified loans (net of specific provisions)</b>	<b>0.48</b>	<b>0.45</b>	<b>0.40</b>	<b>0.35</b>	<b>0.35</b>
<b>Overdue &gt; 3 months and rescheduled loans</b>	<b>0.54</b>	<b>0.46</b>	<b>0.45</b>	<b>0.40</b>	<b>0.39</b>
of which:					
Overdue > 3 months	0.45	0.39	0.38	0.34	0.32
Rescheduled loans	0.09	0.07	0.07	0.06	0.07
	<i>% of Mainland-related lending</i>				
<b>Classified loans (gross) of Mainland-related lending**</b>	<b>0.85</b>	<b>0.86</b>	<b>0.83</b>	<b>0.75</b>	<b>0.68</b>

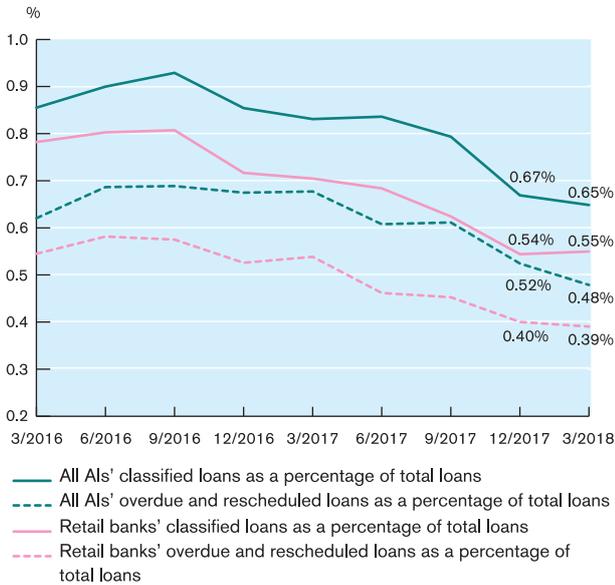
Note: Figures may not add up to total due to rounding.

\* Unless stated otherwise, figures covered retail banks' Hong Kong offices, as well as locally incorporated retail banks' overseas branches and major overseas subsidiaries.

\*\* Figures covered retail banks' Hong Kong offices, as well as locally incorporated retail banks' Mainland branches and subsidiaries.

CHART 8

Loan quality remained healthy



Note: Figures covered Hong Kong offices, overseas branches and major overseas subsidiaries.

CHART 9

Delinquency ratios of residential mortgages and credit card lending stayed at low levels

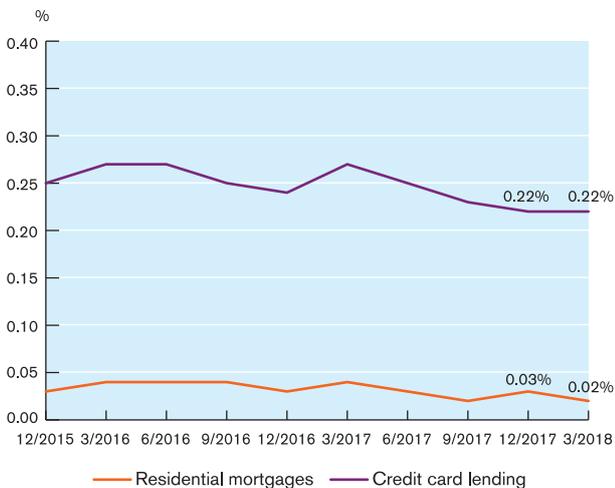
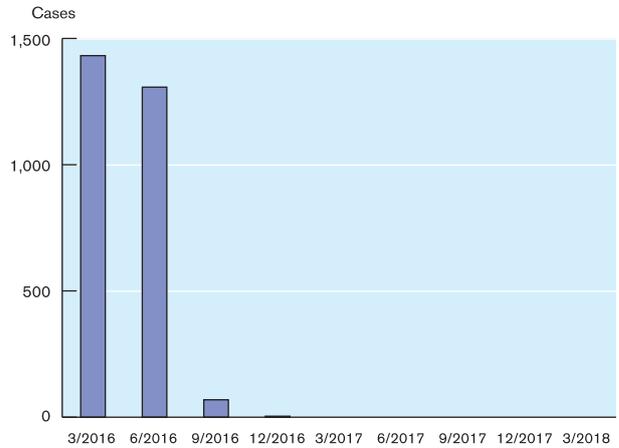


CHART 10

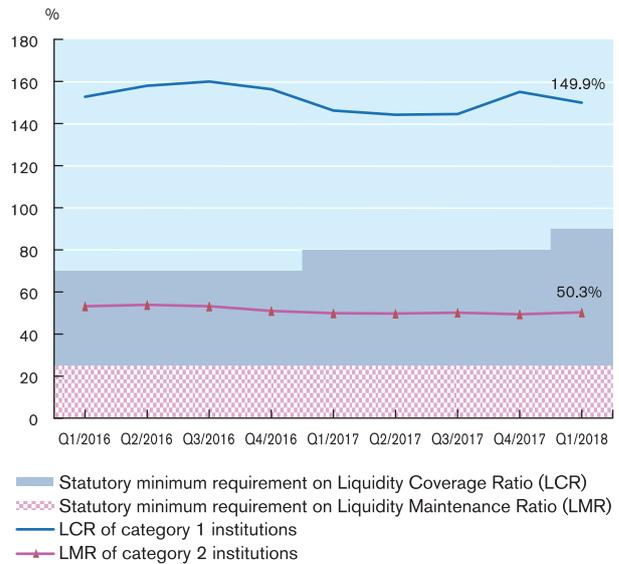
Surveyed AIs continued to report no residential mortgage loans in negative equity



Liquidity conditions

CHART 11

Liquidity positions of AIs remained sound

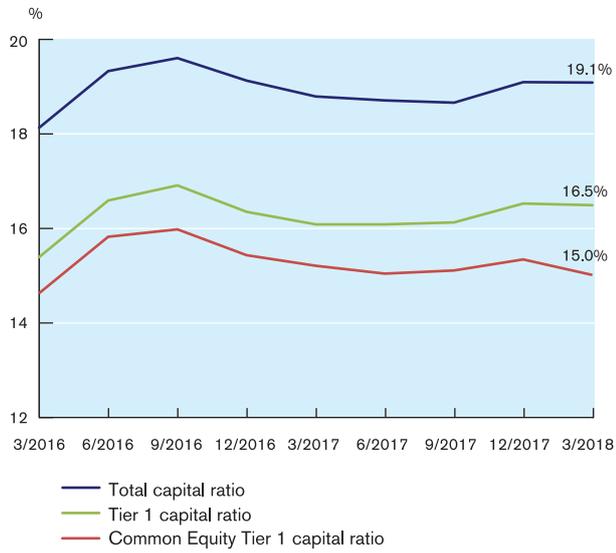


Note: For a category 1 institution, the statutory minimum requirement of the LCR applicable for 2018 is 90%. A category 2 institution must maintain a LMR of not less than 25% on average in each calendar month.

## Capital adequacy

**CHART 12**

Locally incorporated AIs continued to be well capitalised



## APPENDIX

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

	Mar 2017	Dec 2017	Mar 2018
<b>Interest rates</b>			
1-month HIBOR fixing <sup>2</sup> (quarterly average)	0.55	0.84	0.84
3-month HIBOR fixing (quarterly average)	0.97	1.04	1.16
BLR <sup>3</sup> and 1-month HIBOR fixing spread (quarterly average)	4.45	4.16	4.16
BLR and 3-month HIBOR fixing spread (quarterly average)	4.03	3.96	3.84
Composite interest rate <sup>4</sup>	0.32	0.38	0.38
	<b>All AIs</b>		
<b>Balance sheet developments<sup>5</sup></b>			
Total deposits	3.0	2.0	1.2
Hong Kong dollar	5.1	-0.1	3.0
Foreign currency	1.0	4.3	-0.6
Total loans	4.6	2.9	3.6
Domestic lending <sup>6</sup>	4.0	2.8	3.6
Loans for use outside Hong Kong <sup>7</sup>	6.0	3.2	3.7
Negotiable instruments			
Negotiable certificates of deposit (NCDs) issued	7.4	3.3	-5.6
Negotiable debt instruments held (excluding NCDs)	1.4	3.0	5.9
<b>Asset quality</b>			
As a percentage of total loans <sup>8</sup>			
Pass loans	97.43	97.97	98.07
Special mention loans	1.74	1.36	1.28
Classified loans <sup>9</sup> (gross)	0.83	0.67	0.65
Classified loans (net) <sup>10</sup>	0.50	0.35	0.34
Overdue > 3 months and rescheduled loans	0.68	0.52	0.48
Classified loan ratio (gross) of Mainland related lending <sup>11</sup>	0.78	0.68	0.60
<b>Liquidity ratios (quarterly average, consolidated)</b>			
Liquidity Coverage Ratio — applicable to category 1 institutions	146.2	155.1	149.9
Liquidity Maintenance Ratio — applicable to category 2 institutions	49.9	49.4	50.3
	<b>Retail banks</b>		
<b>Profitability</b>			
Loan impairment charges as a percentage of average total assets (year-to-date annualised)	0.06	0.06	-0.01
Net interest margin (year-to-date annualised)	1.38	1.45	1.52
Cost-to-income ratio (year-to-date)	41.1	41.9	36.5
	<b>Surveyed institutions</b>		
<b>Asset quality</b>			
Delinquency ratio of residential mortgage loans	0.04	0.03	0.02
Credit card lending			
Delinquency ratio	0.27	0.22	0.22
Charge-off ratio — quarterly annualised	1.88	1.64	1.64
— year-to-date annualised	1.88	1.75	1.64
	<b>All locally incorporated AIs</b>		
<b>Capital adequacy (consolidated)</b>			
Common Equity Tier 1 capital ratio	15.2	15.4	15.0
Tier 1 capital ratio	16.1	16.6	16.5
Total capital ratio	18.8	19.1	19.1

## Notes:

1. Figures are related to Hong Kong offices only except where otherwise stated.
2. The Hong Kong Interbank Offered 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 on 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 all Als' Hong Kong offices, as well as locally incorporated Als' overseas branches and major overseas subsidiaries.
9. Classified loans are those loans graded as "substandard", "doubtful" or "loss".
10. Net of specific provisions/individual impairment allowances.
11. Figures are related to all Als' Hong Kong offices, as well as locally incorporated Als' Mainland branches and subsidiaries.