

Developments in the Banking Sector

by the Banking Supervision Department

HIGHLIGHTS OF KEY TRENDS

Banking sector performance

Overview

- The Hong Kong banking sector continued to be profitable and resilient despite increasing uncertainties in both the global and domestic economic environments. Asset quality stayed healthy. Liquidity and capital positions remained robust with significant buffers to withstand potential shocks.

Profitability

- The aggregate pre-tax operating profit of retail banks rose by 1.8% in the first three quarters of 2019 compared with the same period last year. Increases in net interest income (+8.3%) and income from investments held for trading (+588.4%) were partly offset by a decrease in income from foreign exchange and derivatives operations (-30.2%) and an increase in total operating expenses (+4.1%) (Exhibit 1). With higher interest rate levels in the market, retail banks' net interest margin widened further to 1.64% in the first three quarters of 2019 from 1.60% in the same period of 2018 (Exhibit 2).

Balance sheet trends

- Total loans of the banking sector grew by 1.7% in the third quarter of 2019 (Exhibit 5). Among the total, loans for use in Hong Kong grew by 2.2%, loans for use outside Hong Kong rose by 1.4%, while trade finance decreased by 1.9%. The banking sector's Mainland-related lending grew by 1.3% in the third quarter of 2019 to HK\$4,625 billion (17.2% of total assets), from HK\$4,568 billion (17.1% of total assets) a quarter earlier (Exhibit 9).

- Total deposits of the banking sector remained stable in the third quarter of 2019 (Exhibit 6). Among the total, Hong Kong dollar deposits decreased by 1.0% while US dollar deposits increased by 1.5%. The decline in Hong Kong dollar deposits reflected in part the less buoyant fund-raising activities during the quarter. The fluctuations are within normal ranges, and more recent figures showed that Hong Kong dollar deposits increased by 0.4% in October as compared with end-September 2019. Overall, total deposits and Hong Kong dollar deposits increased by 2.6% and 3.0% respectively up to end-October 2019 since the beginning of the year.

Loan quality, liquidity conditions and capital adequacy

- The loan quality of the banking sector continued to hold up well. The classified loan ratio edged down to 0.56% at the end of September from 0.57% a quarter earlier. The classified loan ratio for Mainland-related lending also remained stable during the same period (Exhibit 10).
- The banking sector remained liquid and well capitalised. The average Liquidity Coverage Ratio of category 1 institutions was 153.0% in the third quarter of 2019, well above the statutory minimum requirement of 100%. The average Liquidity Maintenance Ratio of category 2 institutions was 54.5% during the same period, also well above the statutory minimum requirement of 25% (Exhibit 15). The total capital ratio of locally incorporated authorized institutions (AIs) stood at 20.6% at the end of September 2019 (Exhibit 17).

Results of surveys on debt securities and off-balance sheet exposures to derivatives and securitisations

- Holdings of debt securities by the banking sector continued to increase and the credit quality of these securities remained healthy. The total market value of debt securities held by the surveyed AIs¹ increased by 11.8% to HK\$5,683 billion at the end of September 2019, from HK\$5,081 billion a year ago (Exhibit 19). Over 96% of the debt securities holdings were of investment grade (Exhibit 20), with most being issued by sovereigns and banks (Exhibit 21).

- Driven by customer demand and hedging needs, the total notional amount of outstanding derivatives contracts held by all AIs rose by 27.9% to HK\$141 trillion at the end of June 2019, from HK\$110 trillion a year earlier (Exhibit 22). Over-the-counter (OTC) swap and forward contracts continued to account for over 90% of the total notional amount of all outstanding derivatives contracts at the end of June 2019 (Exhibit 23). Over 98% of these were foreign exchange and interest rate contracts (Exhibit 24). The off-balance sheet securitisation exposures of AIs remained insignificant, with the aggregate amount of exposures totalling HK\$5.2 billion at the end of June 2019.

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

Banking sector performance

Profitability

Exhibit 1

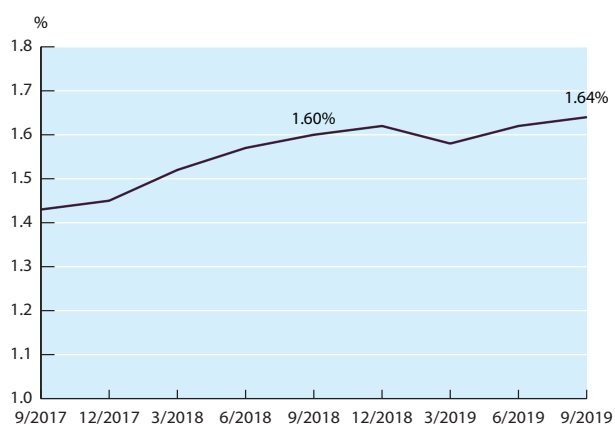
Pre-tax operating profit of retail banks' Hong Kong offices

Key items	Change of pre-tax operating profit Q1-Q3 2018 vs Q1-Q3 2019	
	Percentage change	Contribution to the percentage change in pre-tax operating profit (ppt)
Net interest income	+8.3%	+8.8
Income from investments held for trading	+588.4%	+5.1
Income from foreign exchange and derivatives operations	-30.2%	-4.2
Total operating expenses	+4.1%	-2.6
Pre-tax operating profit	+1.8%	

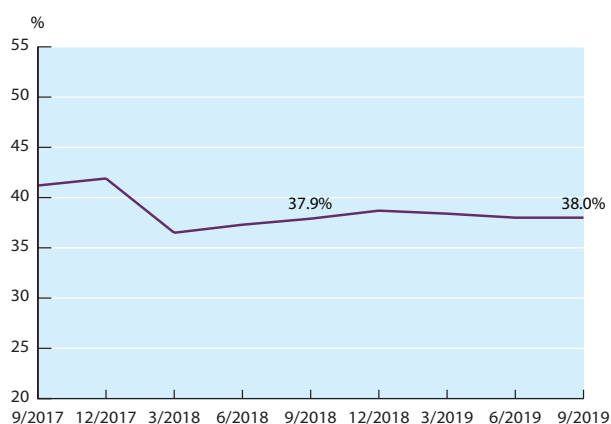
¹ This survey covers all licensed banks and restricted licence banks.

Exhibit 2

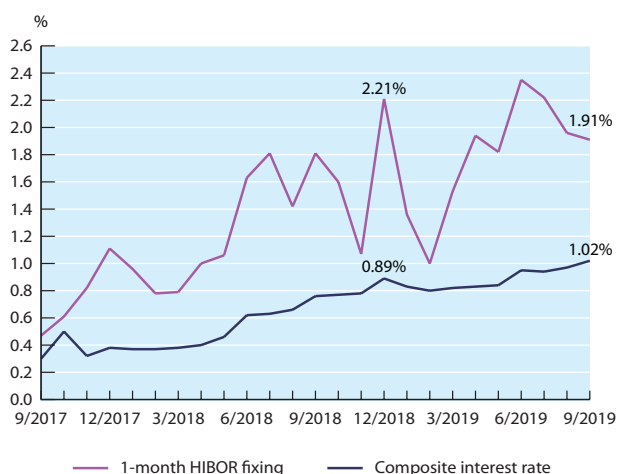
Net interest margin (year-to-date annualised) of retail banks widened further in the first three quarters of 2019 compared with the same period last year

**Exhibit 4**

Cost-to-income ratio (year-to-date) of retail banks edged up in the first three quarters of 2019 compared with the same period last year

**Exhibit 3**

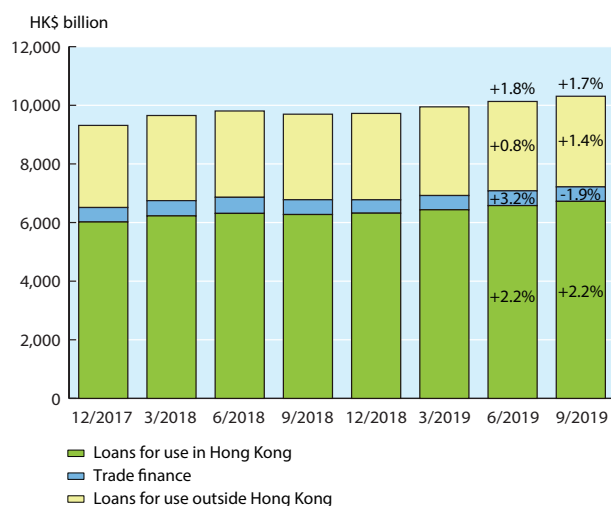
Hong Kong-dollar interbank interest rates remained volatile, while the composite interest rate increased further to 1.02% at end-September 2019

**Notes:**

1. HIBOR fixing (monthly average) refers to the Hong Kong Interbank Offered Rates released by the Hong Kong Association of Banks.
2. The composite interest rate is a weighted average interest rate of all Hong Kong-dollar interest-bearing liabilities of retail banks.
3. Since June 2019, the composite interest rate has been calculated based on the new local "Interest rate risk in the banking book" (IRRBB) framework. As such, the figures are not strictly comparable with those of previous months.

Loans and deposits**Exhibit 5**

Credit grew slightly in the third quarter of 2019

**Notes:**

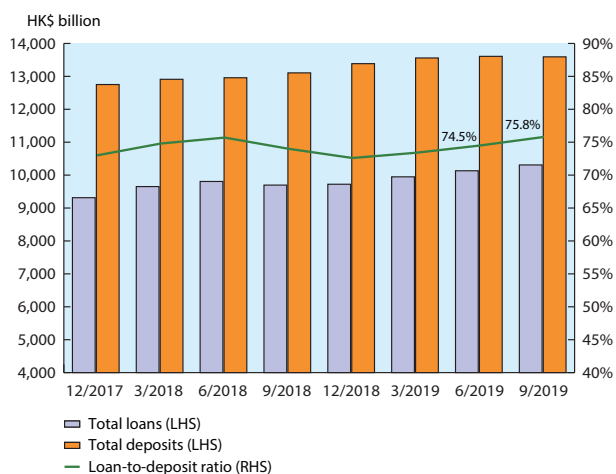
1. "Loans for use outside Hong Kong" include "others" (i.e. unallocated).
2. Percentage denotes quarter-on-quarter growth rate.

Within loans for use in Hong Kong, the percentage changes in the amount of credit extended to the key economic sectors in the third quarter of 2019 were:

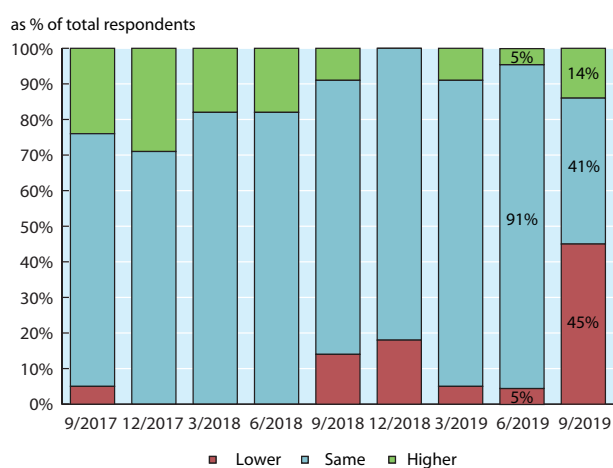
Key items	Change of loans for use in Hong Kong in the third quarter of 2019	
	Percentage change	Contribution to the percentage change in loans for use in Hong Kong (ppt)
Property lending	+1.8%	+0.8
Information technology	+23.3%	+0.4
Loans to private individuals (excluding credit card advances and residential mortgage loans)	+4.5%	+0.4
Loans for use in Hong Kong	+2.2%	

Exhibit 6

Total loans grew slightly while total deposits remained stable in the third quarter of 2019

**Exhibit 8**

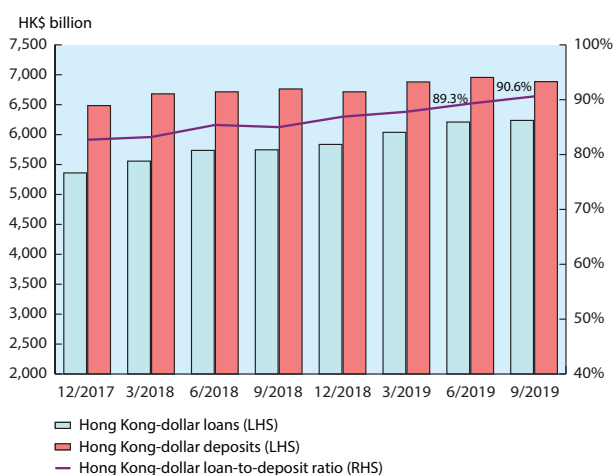
The share of respondents to the Hong Kong Monetary Authority Opinion Survey on Credit Conditions Outlook who expected loan demand to weaken in the next three months had increased



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

Exhibit 7

Hong Kong-dollar loans grew moderately while Hong Kong-dollar deposits edged down in the third quarter of 2019



Mainland-related lending

Exhibit 9

Mainland-related lending

	Jun 2019 HK\$bn	Sep 2019 HK\$bn
Mainland-related loans excluding trade finance	4,227	4,296
Trade finance	341	330
Total	4,568	4,625

Loan quality

Exhibit 10

Quality of loans and advances of the banking sector*

	Sep 2018	Dec 2018	Mar 2019	Jun 2019	Sep 2019
	<i>% of total loans</i>				
Special mention loans	1.31	1.32	1.28	1.31	1.32
Classified loans (gross)	0.60	0.55	0.56	0.57	0.56
of which:					
Substandard	0.23	0.20	0.16	0.19	0.19
Doubtful	0.31	0.29	0.31	0.30	0.28
Loss	0.07	0.06	0.09	0.08	0.09
Classified loans (net of specific provisions)	0.32	0.26	0.28	0.26	0.25
Overdue > 3 months and rescheduled loans	0.38	0.36	0.41	0.39	0.40
of which:					
Overdue > 3 months	0.34	0.33	0.38	0.36	0.37
Rescheduled loans	0.04	0.03	0.03	0.03	0.03
	<i>% of Mainland-related lending</i>				
Classified loans (gross) of Mainland-related lending**	0.64	0.55	0.63	0.70	0.71

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

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

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

Exhibit 11

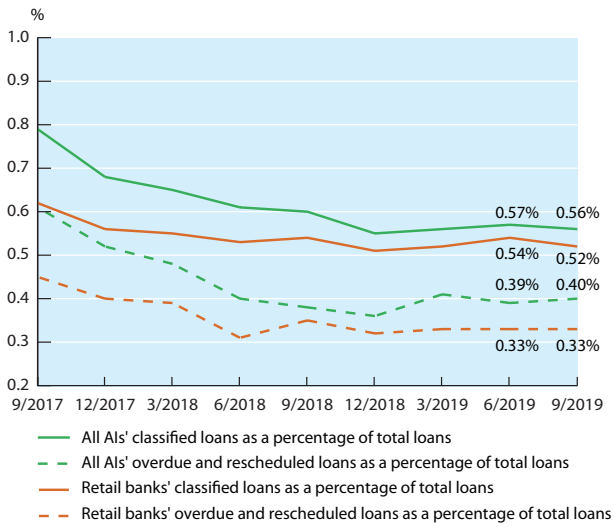
Quality of loans and advances of retail banks*

	Sep 2018	Dec 2018	Mar 2019	Jun 2019	Sep 2019
	<i>% of total loans</i>				
Special mention loans	1.09	1.21	1.20	1.20	1.16
Classified loans (gross)	0.54	0.51	0.52	0.54	0.52
of which:					
Substandard	0.20	0.19	0.18	0.21	0.19
Doubtful	0.31	0.29	0.31	0.30	0.28
Loss	0.04	0.03	0.03	0.03	0.05
Classified loans (net of specific provisions)	0.34	0.30	0.32	0.29	0.27
Overdue > 3 months and rescheduled loans	0.35	0.32	0.33	0.33	0.33
of which:					
Overdue > 3 months	0.29	0.28	0.30	0.29	0.30
Rescheduled loans	0.05	0.04	0.04	0.04	0.04
	<i>% of Mainland-related lending</i>				
Classified loans (gross) of Mainland-related lending**	0.74	0.63	0.75	0.85	0.86

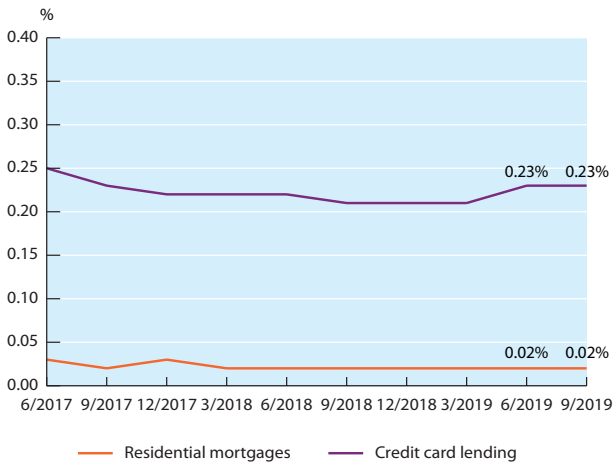
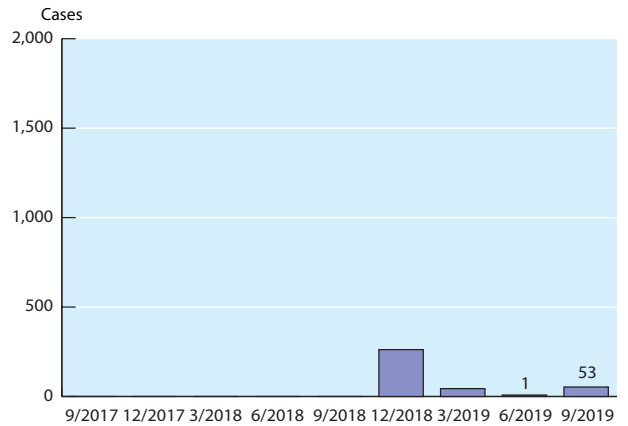
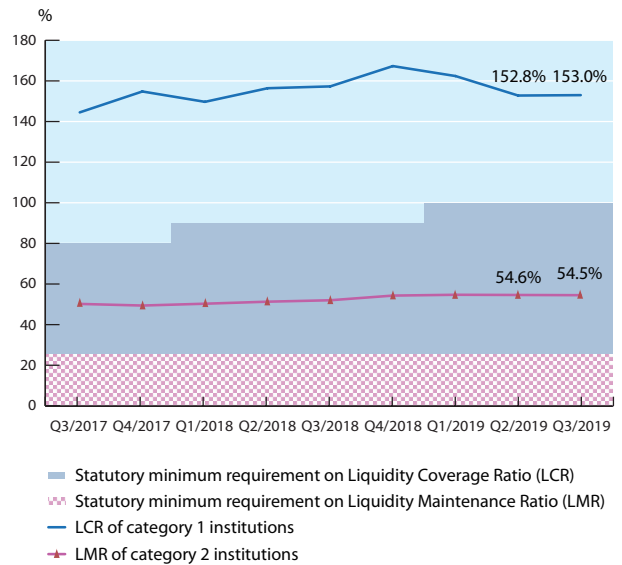
Note: Figures may not add up to total due to rounding.

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

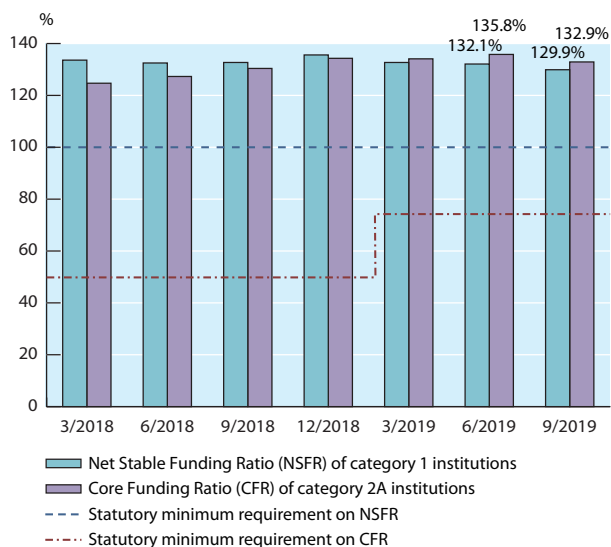
** Figures covered retail banks' Hong Kong offices, as well as locally incorporated retail banks' Mainland branches and subsidiaries.

Exhibit 12**Classified loan ratios and overdue and rescheduled loan ratios remained at low levels**

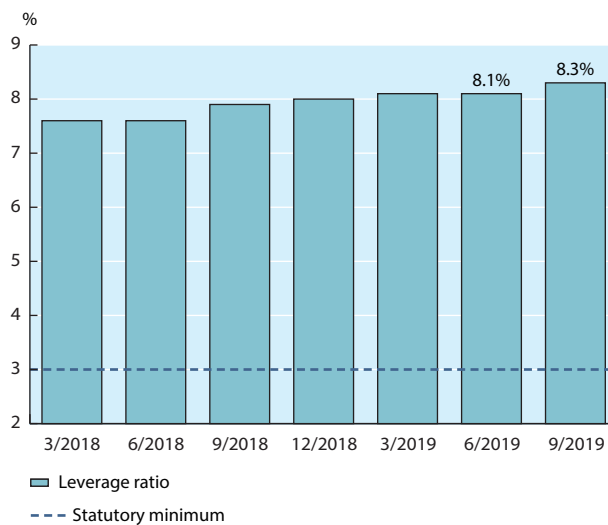
Note: Figures covered Hong Kong offices, overseas branches and major overseas subsidiaries.

Exhibit 13**Delinquency ratios of residential mortgages and credit card lending also stayed at low levels****Exhibit 14****The number of negative equity cases rose slightly to 53 in the third quarter of 2019****Liquidity conditions****Exhibit 15****Liquidity positions of AIs continued to be robust**

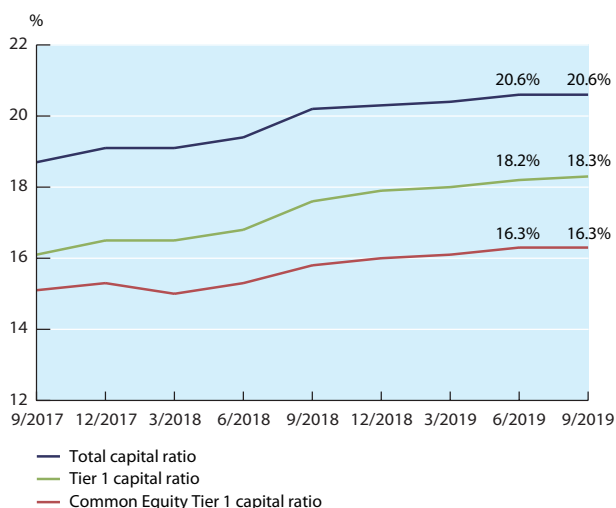
Note: For a category 1 institution, the statutory minimum requirement of the LCR applicable for 2019 is 100%. A category 2 institution must maintain a LMR of not less than 25% on average in each calendar month.

Exhibit 16**Funding positions of AIs remained stable**

Note: For a category 1 institution, the statutory minimum requirement of the NSFR is 100%. A category 2A institution must maintain a CFR of not less than 50% on average in each calendar month during 2018. The minimum CFR rose to 75% starting from 1 January 2019.

Exhibit 18**Leverage ratio stayed at a healthy level**

Note: Leverage ratio is defined as the ratio of Tier 1 capital to an exposure measure, where the exposure measure includes both on-balance sheet and off-balance sheet exposures. All locally incorporated AIs are required to maintain a leverage ratio of not less than 3%.

Capital adequacy**Exhibit 17****Capital positions of locally incorporated AIs remained strong**

Results of surveys on debt securities and off-balance sheet exposures to derivatives and securitisations

Debt securities held²

Exhibit 19

Surveyed AIs reported a moderate growth in their holdings of debt securities

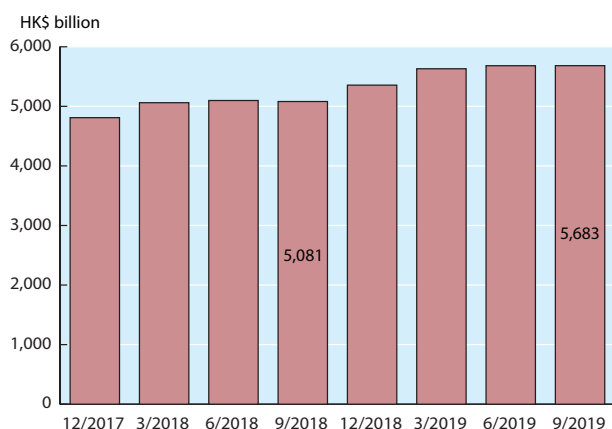


Exhibit 20

Debt securities held by surveyed AIs were predominantly investment grade securities

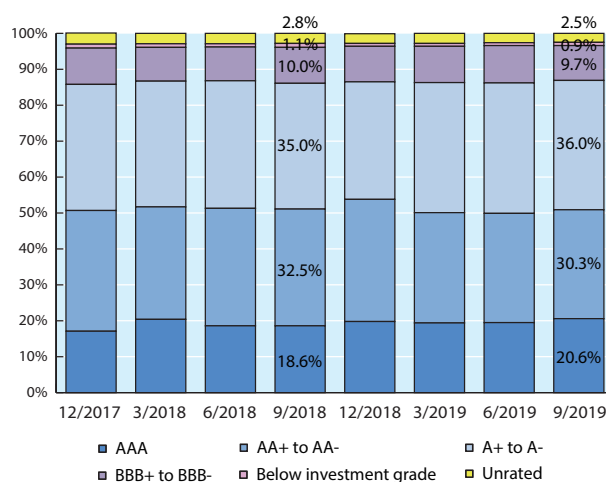


Exhibit 21

Most of the debt securities were issued by sovereigns and banks

(% of total)	All surveyed AIs							
	Dec 2017	Mar 2018	Jun 2018	Sep 2018	Dec 2018	Mar 2019	Jun 2019	Sep 2019
Part 1: Debt securities other than securitisation products³								
Sovereigns, of which:	47.6%	49.1%	49.5%	47.2%	49.4%	48.0%	47.3%	48.4%
Exchange Fund bills and notes	23.8%	22.9%	22.6%	22.4%	22.2%	20.4%	20.5%	20.9%
US Treasury bills, notes and bonds	6.6%	8.3%	8.4%	8.2%	9.8%	9.3%	9.2%	9.8%
Public sector entities	5.3%	5.8%	5.6%	5.7%	5.5%	5.6%	5.6%	5.8%
Banks	29.5%	27.6%	27.7%	29.7%	28.2%	28.8%	28.7%	26.9%
Corporates	10.8%	11.0%	10.6%	10.6%	10.2%	10.7%	11.1%	11.5%
Others	4.8%	4.7%	4.7%	4.7%	4.6%	4.7%	4.7%	4.9%
Part 2: Securitisation products								
Total securitisation products	1.9%	1.8%	2.0%	2.1%	2.1%	2.2%	2.7%	2.6%

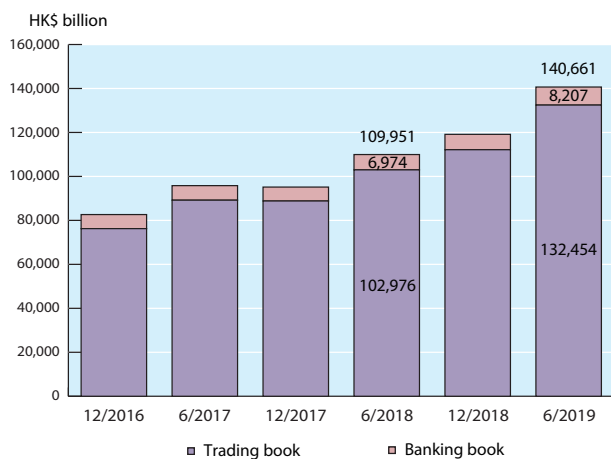
² This section presents the results of the Survey on Debt Securities Held by all licensed banks and restricted licence banks. The results cover the banking book and trading book positions of surveyed AIs' Hong Kong offices and their overseas branches. Figures shown may not add up to total due to rounding.

³ Securitisation products include asset-backed securities, mortgage-backed securities, collateralised debt obligations, notes issued by structured investment vehicles, asset-backed commercial papers, and other similar structured credit products.

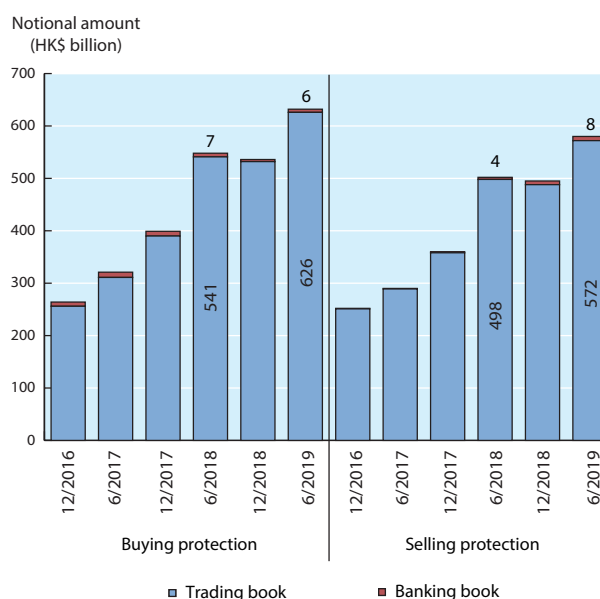
Exposures to Derivatives⁴

Exhibit 22

Total notional amount of all outstanding derivatives contracts increased


Exhibit 25

The notional amount of credit derivatives contracts increased but continued to account for only a small share of total derivatives contracts held


Exhibit 23

OTC swap and forward contracts continued to account for over 90% of total derivatives contracts held by AIs

(% of total)	All AIs					
	Dec 2016	Jun 2017	Dec 2017	Jun 2018	Dec 2018	Jun 2019
Derivatives product						
Exchange-traded derivatives	2.1%	2.7%	2.0%	1.8%	1.5%	1.0%
OTC derivatives	97.9%	97.3%	98.0%	98.2%	98.5%	99.0%
of which:						
Forwards	32.2%	32.0%	28.6%	27.7%	26.0%	24.8%
Swaps	60.4%	60.0%	64.0%	64.1%	67.7%	69.0%
Options	3.9%	3.8%	3.6%	3.8%	3.0%	3.1%
Credit derivatives	0.6%	0.6%	0.8%	1.0%	0.9%	0.9%
Others	0.8%	0.9%	1.0%	1.7%	0.9%	1.3%

Exhibit 24

Derivatives contracts held were predominantly foreign exchange and interest rate contracts

(% of total)	All AIs					
	Dec 2016	Jun 2017	Dec 2017	Jun 2018	Dec 2018	Jun 2019
Underlying risk						
Interest rate risk	38.9%	40.9%	45.4%	43.8%	44.7%	49.1%
Foreign exchange risk	59.4%	57.4%	52.6%	54.2%	53.7%	49.2%
Equity risk	0.9%	1.0%	1.1%	0.9%	0.6%	0.7%
Commodity risk	0.1%	0.1%	0.1%	0.1%	0.0%	0.1%
Credit risk	0.6%	0.6%	0.8%	1.0%	0.9%	0.9%
Other risks	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

⁴ This section presents the results of the Survey on Off-balance Sheet Exposures in Derivatives and Securitisation Transactions. The results cover the banking book and trading book positions of all AIs' Hong Kong offices and their overseas branches. Figures may not add up to total due to rounding.

APPENDIX

KEY PERFORMANCE INDICATORS OF THE BANKING SECTOR¹ (%)

	Sep 2018	Jun 2019	Sep 2019
Interest rates			
1-month HIBOR fixing ² (quarterly average)	1.68	2.04	2.03
3-month HIBOR fixing (quarterly average)	2.00	2.11	2.32
BLR ³ and 1-month HIBOR fixing spread (quarterly average)	3.32	3.09	3.10
BLR and 3-month HIBOR fixing spread (quarterly average)	3.00	3.02	2.81
Composite interest rate ^{4,5}	0.76	0.95	1.02
Balance sheet developments⁶	All AIs		
Total deposits	1.1	0.4	-0.1
Hong Kong dollar	0.7	1.1	-1.0
Foreign currency	1.6	-0.4	0.8
Total loans	-1.1	1.8	1.7
Domestic lending ⁷	-1.2	2.3	1.9
Loans for use outside Hong Kong ⁸	-0.9	0.8	1.4
Negotiable instruments			
Negotiable certificates of deposit (NCDs) issued	-1.1	1.1	-5.7
Negotiable debt instruments held (excluding NCDs)	-1.5	1.1	1.2
Asset quality			
As a percentage of total loans ⁹			
Pass loans	98.09	98.12	98.12
Special mention loans	1.31	1.31	1.32
Classified loans ¹⁰ (gross)	0.60	0.57	0.56
Classified loans (net) ¹¹	0.32	0.26	0.25
Overdue > 3 months and rescheduled loans	0.38	0.39	0.40
Classified loan ratio (gross) of Mainland related lending ¹²	0.64	0.70	0.71
Liquidity ratios (consolidated)			
Liquidity Coverage Ratio — applicable to category 1 institutions (quarterly average)	157.3	152.8	153.0
Liquidity Maintenance Ratio — applicable to category 2 institutions (quarterly average)	52.0	54.6	54.5
Net Stable Funding Ratio — applicable to category 1 institutions	132.7	132.1	129.9
Core Funding Ratio — applicable to category 2A institutions	130.4	135.8	132.9
Profitability	Retail banks		
Loan impairment charges as a percentage of average total assets (year-to-date annualised)	0.03	0.05	0.06
Net interest margin (year-to-date annualised)	1.60	1.62	1.64
Cost-to-income ratio (year-to-date)	37.9	38.0	38.0
Asset quality	Surveyed institutions		
Delinquency ratio of residential mortgage loans	0.02	0.02	0.02
Credit card lending			
Delinquency ratio	0.21	0.23	0.23
Charge-off ratio — quarterly annualised	1.64	1.58	1.76
— year-to-date annualised	1.59	1.52	1.58
Capital adequacy (consolidated)	All locally incorporated AIs		
Common Equity Tier 1 capital ratio	15.8	16.3	16.3
Tier 1 capital ratio	17.6	18.2	18.3
Total capital ratio	20.2	20.6	20.6
Leverage ratio	7.9	8.1	8.3

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. Since June 2019, the composite interest rate has been calculated based on the new local IRRBB framework. As such, the June figure is not strictly comparable with those of previous months.
6. Quarterly change.
7. Loans for use in Hong Kong plus trade finance.
8. Including "others" (i.e. unallocated).
9. Figures are related to all AIs' Hong Kong offices, as well as locally incorporated AIs' overseas branches and major overseas subsidiaries.
10. Classified loans are those loans graded as "substandard", "doubtful" or "loss".
11. Net of specific provisions/individual impairment allowances.
12. Figures are related to all AIs' Hong Kong offices, as well as locally incorporated AIs' Mainland branches and subsidiaries.