

Developments in the Banking Sector

by Banking Supervision Department

HIGHLIGHTS OF KEY TRENDS

Banking sector performance

Overview

- Hong Kong banking sector remained resilient in the first quarter of 2020 despite the outbreak of the novel coronavirus (COVID-19). Liquidity and capital were ample, providing strong buffers for banks to withstand potential shocks. Asset quality remained solid by both historical and international standards, although signs of deterioration emerged reflecting a deepening downturn in the local and global economy.

Profitability

- The banking sector remained profitable in the first quarter, although profitability was lower than in the same period last year. The aggregate pre-tax operating profit of retail banks declined by 7.7% year-on-year in the first quarter of 2020, mainly attributable to a decrease in income from foreign exchange and derivatives operations (-51.6%), and an increase in loan impairment charges (+130.4%) (Exhibit 1) as banks made provisions for a potential deterioration in asset quality in a forward-looking way. With lower interest rate levels in the market, retail banks' net interest margin narrowed to 1.51% in the first quarter from 1.58% in the same period of 2019 (Exhibit 2).

Balance sheet trends

- Total loans of the banking sector grew by 2.8% in the first quarter (Exhibit 5). Loan growth was broad-based, with loans for use in Hong Kong, loans for use outside Hong Kong and trade finance growing by 3.2%, 1.6% and 6.1% respectively. Over the same period, the banking sector's Mainland-related lending grew by 4.4% to HK\$4,765 billion (17.1% of total assets) (Exhibit 6).
- Total deposits remained stable in the first quarter (Exhibit 7). Among the total, both Hong Kong dollar deposits and US dollar deposits only edged down by 0.1%. Fluctuations during the period were within normal ranges, and there was no noticeable outflow of funds from the banking system.

Loan quality, liquidity conditions and capital adequacy

- Amid the COVID-19 outbreak and widespread economic downturn, the asset quality of the banking sector showed signs of deterioration in the first quarter. The classified loan ratio and special mention loan ratio of the banking sector edged up to 0.62% and 1.59% respectively at the end of March 2020. Both ratios remained low by historical and international standards, which partly reflected the prudent credit risk management adopted by banks in Hong Kong. The classified loan ratio for Mainland-related lending edged down to 0.73% at the end of March from 0.75% a quarter earlier (Exhibit 10). During the same period, the delinquency ratio of credit card lending increased to 0.35% from 0.25%, while that of residential mortgage loans remained steady at merely 0.03% (Exhibit 13).

- Due to the negative impact of COVID-19 outbreak on borrowers' repayment ability, it is likely that the asset quality of banks may deteriorate in the coming quarters and hence their provisions for potential bad loans may increase further. The HKMA will closely monitor banks' asset quality, and has requested banks to uphold their loan classification standards to reflect any changes in asset quality in a timely manner.
- The liquidity and capital positions of the banking sector remained robust in the first quarter of 2020, providing strong buffers against asset quality deterioration and, more broadly, the

ongoing economic downturn. The average Liquidity Coverage Ratio of category 1 institutions was 160.4% in the first quarter, well above the statutory minimum requirement of 100%. The average Liquidity Maintenance Ratio of category 2 institutions was 56.8% 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 20.1% at the end of March 2020 (Exhibit 17), well above the international minimum requirement of 8%.

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

Profitability

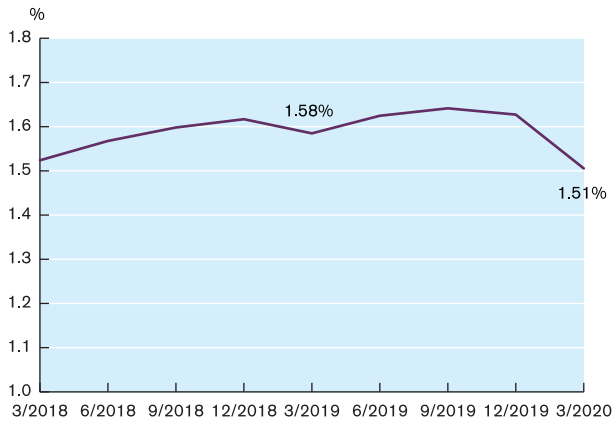
Exhibit 1

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

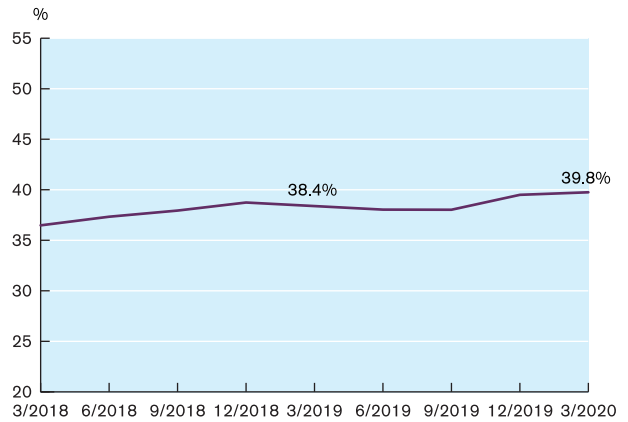
Key items	Change of pre-tax operating profit Q1 2019 vs Q1 2020	
	Percentage change	Contribution to the percentage change in pre-tax operating profit (ppt)
Income from investments held for trading	+54.9%	+3.7
Dividends from subsidiaries / associates	+163.4%	+1.4
Income from foreign exchange and derivatives operations	-51.6%	-5.1
Loan impairment charges	+130.4%	-4.2
Total operating expenses	+3.0%	-1.9
Net interest income	-0.6%	-0.7
Pre-tax operating profit	-7.7%	-7.7%

Exhibit 2

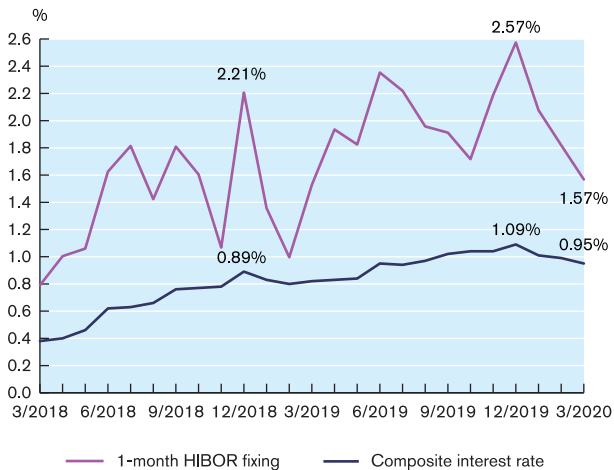
Net interest margin (year-to-date annualised) of retail banks narrowed in the first quarter of 2020 compared with the same period last year

**Exhibit 4**

Cost-to-income ratio (year-to-date) of retail banks edged up in the first quarter of 2020 compared with the same period last year

**Exhibit 3**

Hong Kong-dollar interbank interest rates decreased by 100 bps during the first quarter of 2020; the composite interest rate stood at 0.95% at end-March 2020



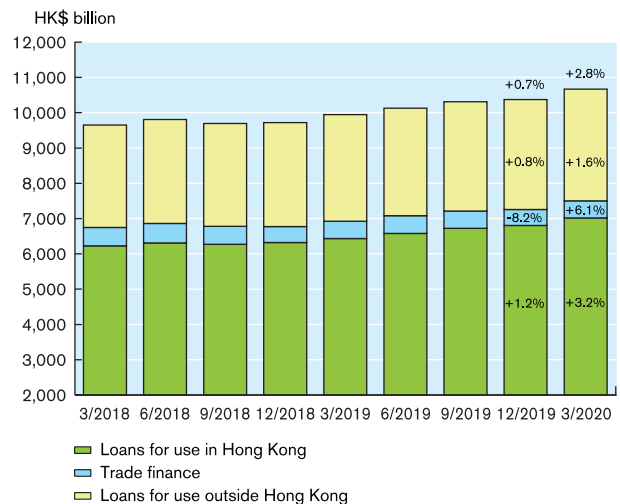
— 1-month HIBOR fixing — Composite interest rate

Notes:

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

Total credit grew by 2.8% in the first quarter of 2020



■ Loans for use in Hong Kong
■ Trade finance
■ Loans for use outside Hong Kong

Notes:

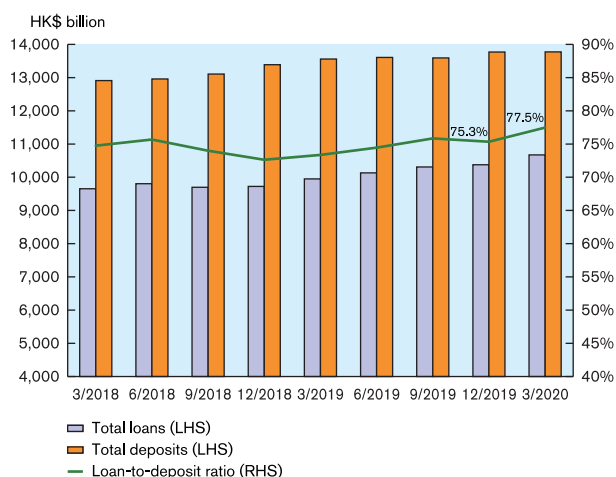
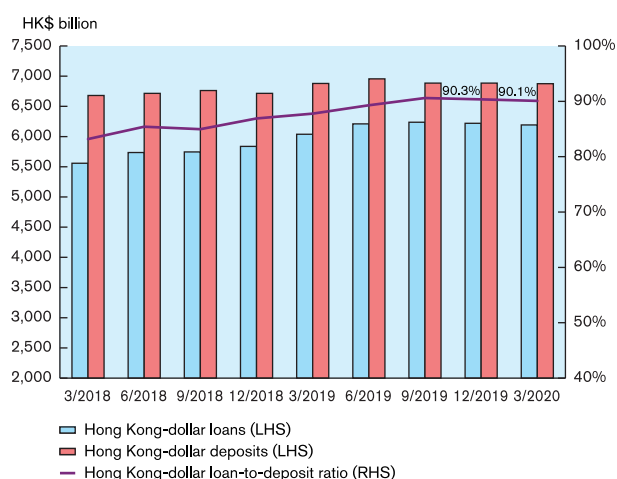
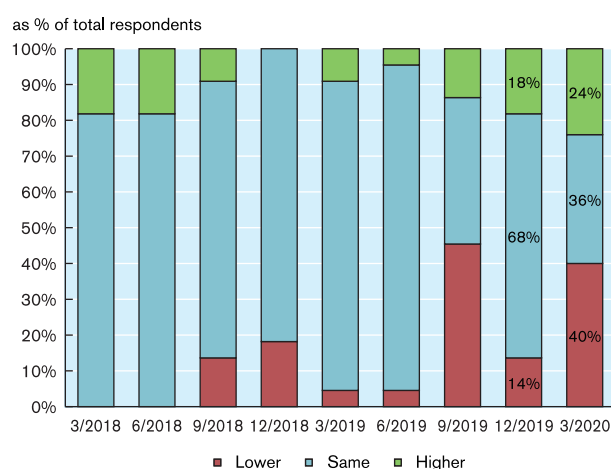
- "Loans for use outside Hong Kong" include "others" (i.e. unallocated).
- Percentage denotes quarter-on-quarter growth rate.

Within loans for use in Hong Kong, the percentage changes in the amount of credit extended to the key economic sectors in the first quarter of 2020 were:

Key items	Change of loans for use in Hong Kong in the first quarter of 2020	
	Percentage change	Contribution to the percentage change in loans for use in Hong Kong (ppt)
Financial companies excluding stockbrokers (mainly investment companies)	+7.6%	+1.0
Property lending (including residential mortgage loans and loans for property development and investment)	+2.1%	+0.9
Electricity and gas	+16.0%	+0.3
Loans for use in Hong Kong	+3.2%	+3.2%

Exhibit 6**Mainland-related lending**

	Dec 2019 HK\$bn	Mar 2020 HK\$bn
Mainland-related loans excluding trade finance	4,271	4,435
Trade finance	292	330
Total	4,564	4,765

Exhibit 7**Total loans grew moderately while total deposits remained stable in the first quarter of 2020****Exhibit 8****Hong Kong-dollar loan-to-deposit ratio edged down in the first quarter of 2020****Exhibit 9****A higher share of respondents to the Hong Kong Monetary Authority Opinion Survey on Credit Conditions Outlook expected loan demand to weaken in the next three months**

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

Loan quality

Exhibit 10

Quality of loans and advances of the banking sector*

	Mar 2019	Jun 2019	Sep 2019	Dec 2019	Mar 2020
	<i>% of total loans</i>				
Special mention loans	1.28	1.31	1.32	1.33	1.59
Classified loans (gross)	0.56	0.57	0.56	0.57	0.62
of which:					
Substandard	0.16	0.19	0.19	0.22	0.20
Doubtful	0.31	0.30	0.28	0.30	0.37
Loss	0.09	0.08	0.09	0.04	0.04
Classified loans (net of specific provisions)	0.28	0.26	0.25	0.28	0.31
Overdue > 3 months and rescheduled loans	0.41	0.39	0.40	0.34	0.43
of which:					
Overdue > 3 months	0.38	0.36	0.37	0.32	0.40
Rescheduled loans	0.03	0.03	0.03	0.03	0.03
	<i>% of Mainland-related lending</i>				
Classified loans (gross) of Mainland-related lending**	0.63	0.70	0.71	0.75	0.73

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*

	Mar 2019	Jun 2019	Sep 2019	Dec 2019	Mar 2020
	<i>% of total loans</i>				
Special mention loans	1.20	1.20	1.16	1.27	1.60
Classified loans (gross)	0.52	0.54	0.52	0.48	0.55
of which:					
Substandard	0.18	0.21	0.19	0.19	0.18
Doubtful	0.31	0.30	0.28	0.27	0.32
Loss	0.03	0.03	0.05	0.03	0.04
Classified loans (net of specific provisions)	0.32	0.29	0.27	0.25	0.29
Overdue > 3 months and rescheduled loans	0.33	0.33	0.33	0.32	0.36
of which:					
Overdue > 3 months	0.30	0.29	0.30	0.28	0.32
Rescheduled loans	0.04	0.04	0.04	0.04	0.03
	<i>% of Mainland-related lending</i>				
Classified loans (gross) of Mainland-related lending**	0.75	0.85	0.86	0.79	0.74

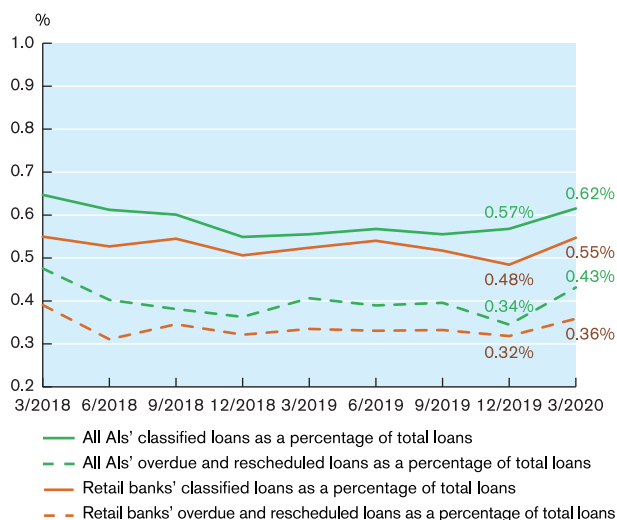
Note: Figures may not add up to total due to rounding.

* 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

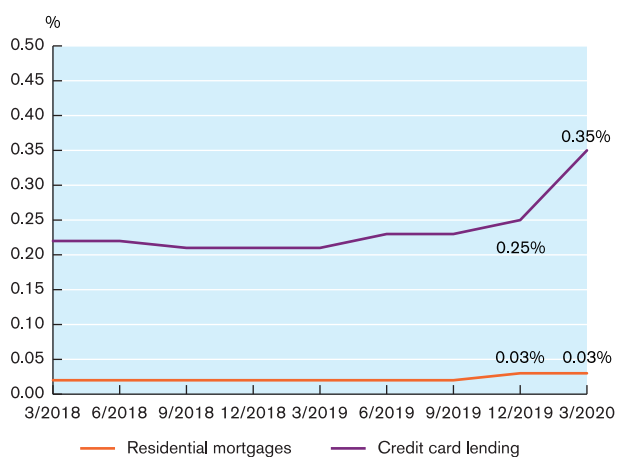
The banking sector's overall asset quality remained solid by both historical and international standards, although both classified loan ratios and overdue and rescheduled loan ratios had increased



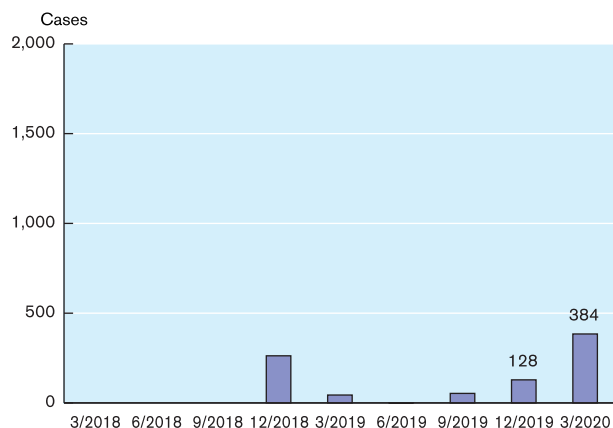
Note: Figures covered Hong Kong offices, overseas branches and major overseas subsidiaries.

Exhibit 13

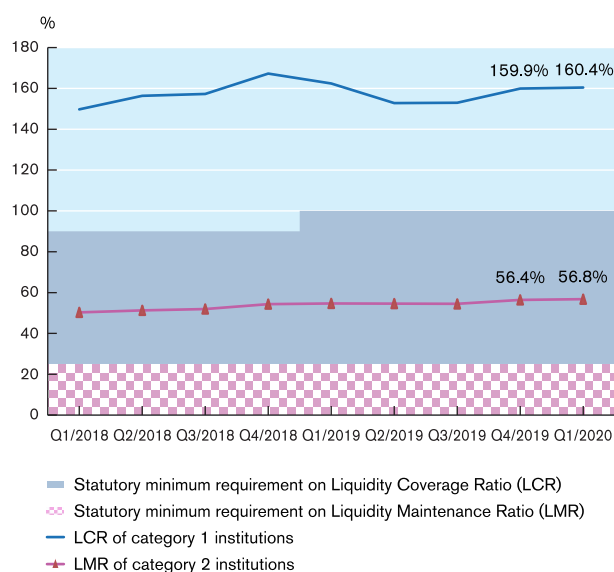
Delinquency ratio of residential mortgages remained stable; delinquency ratio of credit card lending increased but remained at a low level by historical standards

**Exhibit 14**

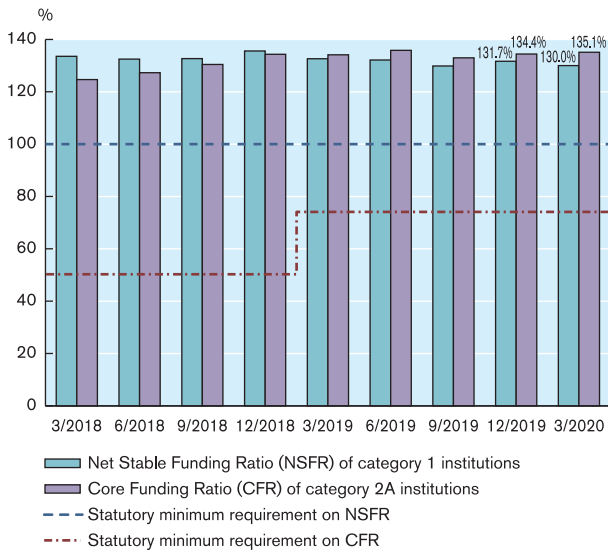
The number of negative equity cases increased to 384 in the first quarter of 2020, mostly housing loans offered by banks to their employees and residential mortgage loans under the mortgage insurance programme

**Liquidity conditions****Exhibit 15**

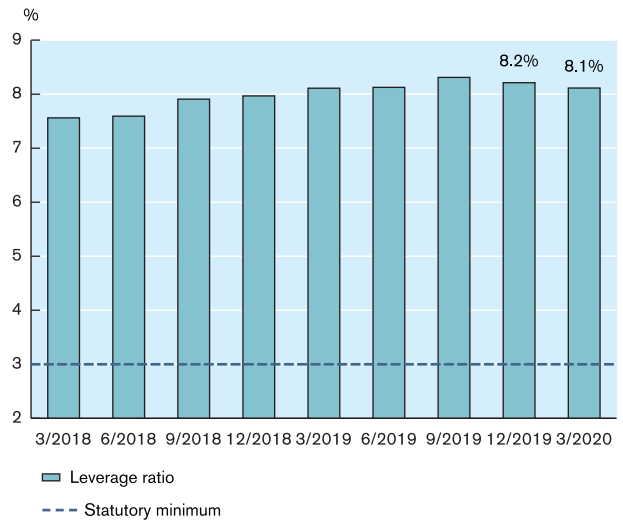
Liquidity positions of AIs remained sound



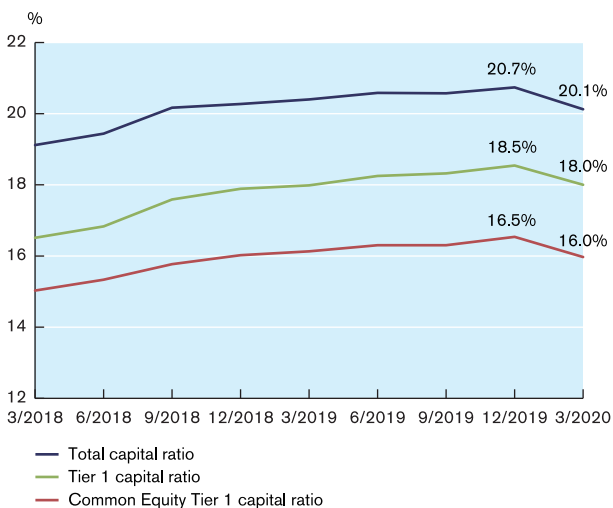
Note: For a category 1 institution, the statutory minimum requirement of the LCR applicable for 2019 onwards is 100%. A category 2 institution must maintain a LMR of not less than 25% on average in each calendar month.

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 remained 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 continued to be strong**

APPENDIX

KEY PERFORMANCE INDICATORS OF THE BANKING SECTOR¹ (%)

	Mar 2019	Dec 2019	Mar 2020
Interest rates			
1-month HIBOR fixing ² (quarterly average)	1.29	2.16	1.82
3-month HIBOR fixing (quarterly average)	1.74	2.30	1.99
BLR ³ and 1-month HIBOR fixing spread (quarterly average)	3.84	2.88	3.18
BLR and 3-month HIBOR fixing spread (quarterly average)	3.39	2.74	3.01
Composite interest rate ^{4,5}	0.82	1.09	0.95
Balance sheet developments⁶	All AIs		
Total deposits	1.3	1.3	0.0
Hong Kong dollar	2.4	0.0	-0.1
Foreign currency	0.1	2.7	0.2
Total loans	2.3	0.7	2.8
Domestic lending ⁷	2.2	0.6	3.4
Loans for use outside Hong Kong ⁸	2.7	0.8	1.6
Negotiable instruments			
Negotiable certificates of deposit (NCDs) issued	-4.1	7.8	6.7
Negotiable debt instruments held (excluding NCDs)	3.9	-0.4	-3.2
Asset quality			
As a percentage of total loans ⁹			
Pass loans	98.17	98.10	97.79
Special mention loans	1.28	1.33	1.59
Classified loans ¹⁰ (gross)	0.56	0.57	0.62
Classified loans (net) ¹¹	0.28	0.28	0.31
Overdue > 3 months and rescheduled loans	0.41	0.34	0.43
Classified loan ratio (gross) of Mainland related lending ¹²	0.63	0.75	0.73
Liquidity ratios (consolidated)			
Liquidity Coverage Ratio — applicable to category 1 institutions (quarterly average)	162.4	159.9	160.4
Liquidity Maintenance Ratio — applicable to category 2 institutions (quarterly average)	54.7	56.4	56.8
Net Stable Funding Ratio — applicable to category 1 institutions	132.7	131.7	130.0
Core Funding Ratio — applicable to category 2A institutions	134.1	134.4	135.1
Profitability	Retail banks		
Loan impairment charges as a percentage of average total assets (year-to-date annualised)	0.04	0.08	0.09
Net interest margin (year-to-date annualised)	1.58	1.63	1.51
Cost-to-income ratio (year-to-date)	38.4	39.5	39.8
Asset quality	Surveyed institutions		
Delinquency ratio of residential mortgage loans	0.02	0.03	0.03
Credit card lending			
Delinquency ratio	0.21	0.25	0.35
Charge-off ratio — quarterly annualised	1.52	1.64	1.69
— year-to-date annualised	1.52	1.57	1.69
Capital adequacy (consolidated)	All locally incorporated AIs		
Common Equity Tier 1 capital ratio	16.1	16.5	16.0
Tier 1 capital ratio	18.0	18.5	18.0
Total capital ratio	20.4	20.7	20.1
Leverage ratio	8.1	8.2	8.1

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. Since June 2019, the composite interest rate has been calculated based on the new local IRRBB framework. As such, the figures since June 2019 are 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 Als' Hong Kong offices, as well as locally incorporated Als' 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 Als' Hong Kong offices, as well as locally incorporated Als' Mainland branches and subsidiaries.