

Developments in the Banking Sector

by Banking Supervision Department

HIGHLIGHTS OF KEY TRENDS

Banking sector performance

Overview

- The Hong Kong banking sector continued to be strong in the first quarter of 2021, notwithstanding the prolonged COVID-19 pandemic and its impacts on the global economy. Banks remained well-capitalised with robust liquidity positions. The asset quality of the banking sector was stable, with the classified loan ratio staying at a low level by both historical and international standards.

Profitability

- The banking sector continued to be profitable. The aggregate pre-tax operating profit of retail banks declined by 19.7% year on year in the first quarter (Exhibit 1), mainly attributable to a decrease in net interest income as retail banks' net interest margin narrowed (Exhibit 2). Increases in income from foreign exchange and derivatives operations and from fees and commissions, together with a decrease in loan impairment charges, helped offset some of the negative impact on profitability caused by the prevailing low interest rate environment.

Balance sheet trends

- The first quarter saw a broad-based growth in loans, as total loans of the banking sector expanded by 2.8% (Exhibit 5). Mainland-related lending grew by 4.4% to HK\$4,752 billion, which represented 16.4% of total assets (Exhibit 6).
- Total deposits grew by 1.2% in the first quarter (Exhibit 7), with Hong Kong dollar deposits increased by 2.7%. Fluctuations during the period were within normal ranges.

Loan quality, liquidity conditions and capital adequacy

- The classified loan ratio of the banking sector improved slightly to 0.89% at the end of the first quarter from 0.90% at end-2020. The classified loan ratio for Mainland-related lending also decreased to 0.88% from 0.96% (Exhibit 10). During the same period, the delinquency ratio of credit card lending edged up to 0.28% from 0.27%, while that of residential mortgage loans remained steady at 0.04% (Exhibit 13).
- Liquidity and capital positions of the banking sector remained strong. The average Liquidity Coverage Ratio of category 1 institutions was 148.2% in the first quarter, well above the statutory minimum requirement of 100% (Exhibit 15). The total capital ratio of locally incorporated authorized institutions (AIs) stood at 20.5% at the end of March 2021 (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 in pre-tax operating profit Q1 2020 vs Q1 2021	
	Percentage change	Contribution to the percentage change in pre-tax operating profit (ppt)
Income from foreign exchange and derivatives operations	+332.6%	+17.5
Income from fees and commissions	+19.9%	+8.2
Loan impairment charges	-62.2%	+5.5
Net interest income	-27.7%	-33.6
Pre-tax operating profit	-19.7%	-19.7

Exhibit 2

Net interest margin (year-to-date annualised) of retail banks narrowed in the first quarter of 2021 compared with the same period last year

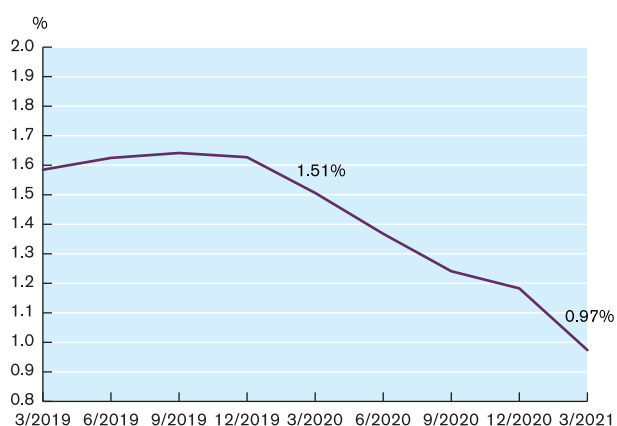
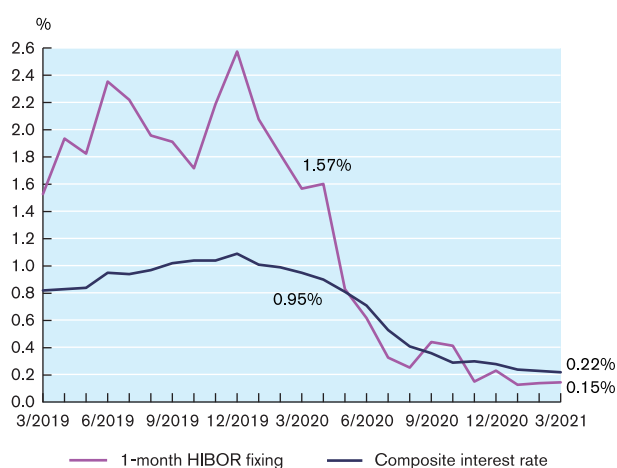


Exhibit 3

Hong Kong dollar interbank interest rates and composite interest rate decreased to 0.15% and 0.22% respectively in March 2021 compared with a year ago

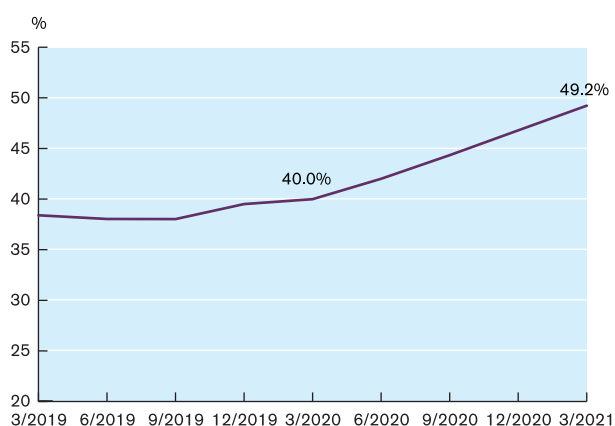


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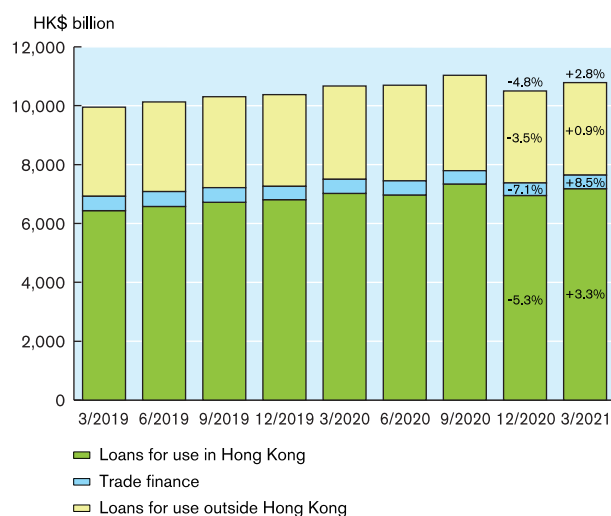
1. HIBOR fixing (monthly average) refers to the Hong Kong Interbank Offered Rates released by the Hong Kong Association of Banks.
2. The composite interest rate is a weighted average interest rate of all Hong Kong dollar interest-bearing liabilities of retail banks.
3. Since June 2019, the composite 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.

Exhibit 4

Cost-to-income ratio (year-to-date) of retail banks increased in the first quarter of 2021 compared with the same period last year

**Loans and deposits****Exhibit 5**

Total credit grew by 2.8% in the first quarter of 2021



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 2021 were:

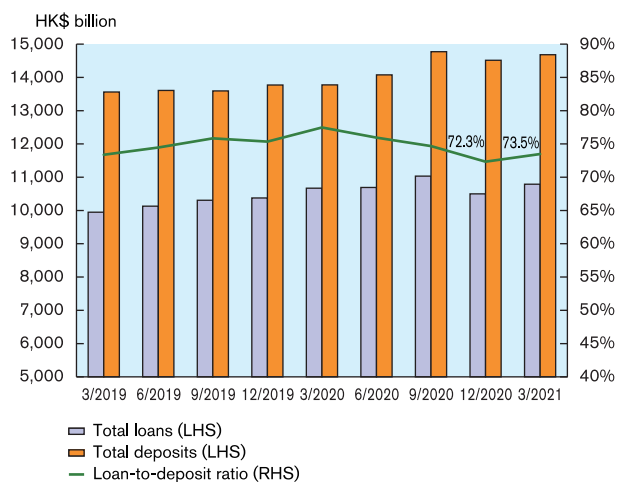
Key items	Change in loans for use in Hong Kong in the first quarter of 2021	
	Percentage change	Contribution to the percentage change in loans for use in Hong Kong (ppt)
Property lending (including residential mortgage loans and loans for property development and investment)	+2.4%	+1.1
Stockbrokers	+50.8%	+0.5
Financial companies excluding stockbrokers (mainly investment companies)	+2.4%	+0.3
Non-stockbroking companies and individuals for the purchase of shares	+21.6%	+0.3
Loans for use in Hong Kong	+3.3%	+3.3

Exhibit 6**Mainland-related lending**

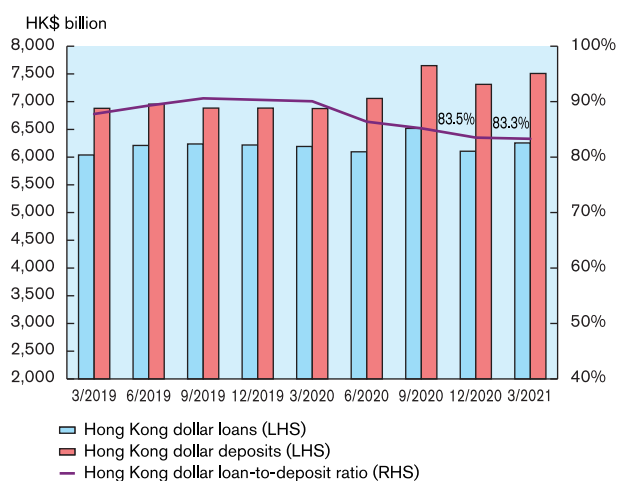
	Dec 2020 HK\$ billion	Mar 2021 HK\$ billion
Mainland-related loans excluding trade finance	4,292	4,440
Trade finance	261	312
Total	4,553	4,752

Exhibit 7

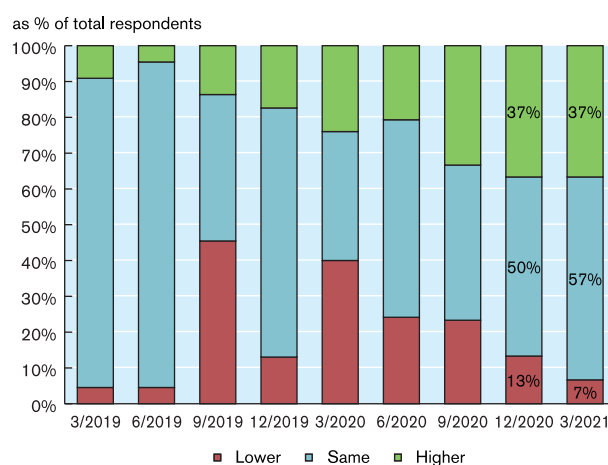
Both total loans and total deposits grew in the first quarter of 2021

**Exhibit 8**

Hong Kong dollar loan-to-deposit ratio edged down in the first quarter of 2021

**Exhibit 9**

A smaller 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 3 months relative to the past 3 months.

Loan quality

Exhibit 10

Quality of loans and advances of the banking sector*

	Mar 2020	Jun 2020	Sep 2020	Dec 2020	Mar 2021
	% of total loans				
Special mention loans	1.59	1.74	1.74	1.81	1.60
Classified loans (gross)	0.62	0.79	0.84	0.90	0.89
of which:					
Substandard	0.20	0.30	0.34	0.34	0.32
Doubtful	0.37	0.45	0.45	0.52	0.53
Loss	0.04	0.05	0.05	0.04	0.04
Classified loans (net of specific provisions)	0.31	0.43	0.47	0.50	0.50
Overdue > 3 months and rescheduled loans	0.43	0.49	0.56	0.57	0.60
of which:					
Overdue > 3 months	0.40	0.46	0.53	0.54	0.57
Rescheduled loans	0.03	0.03	0.03	0.03	0.03
	% of Mainland-related lending				
Classified loans (gross) of Mainland-related lending**	0.73	0.94	0.96	0.96	0.88

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

* Unless otherwise stated, 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 2020	Jun 2020	Sep 2020	Dec 2020	Mar 2021
	% of total loans				
Special mention loans	1.60	1.67	1.61	1.73	1.60
Classified loans (gross)	0.55	0.71	0.75	0.82	0.82
of which:					
Substandard	0.18	0.29	0.34	0.35	0.32
Doubtful	0.32	0.37	0.37	0.43	0.46
Loss	0.04	0.04	0.04	0.04	0.04
Classified loans (net of specific provisions)	0.29	0.39	0.43	0.45	0.46
Overdue > 3 months and rescheduled loans	0.36	0.41	0.47	0.49	0.53
of which:					
Overdue > 3 months	0.32	0.37	0.43	0.46	0.50
Rescheduled loans	0.03	0.04	0.04	0.03	0.03
	% of Mainland-related lending				
Classified loans (gross) of Mainland-related lending**	0.74	0.87	0.92	0.89	0.84

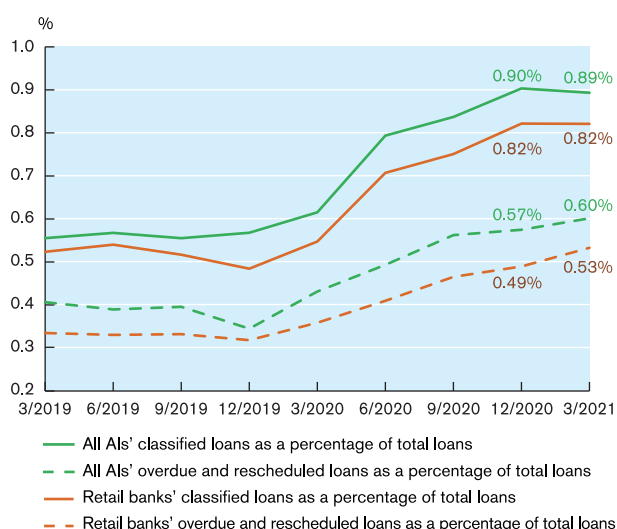
Note: Figures may not add up to total due to rounding.

* Unless otherwise stated, 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

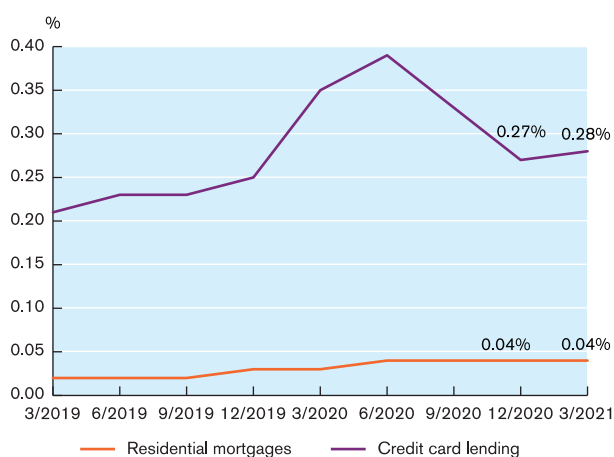
The banking sector's overall asset quality remained healthy by both historical and international standards



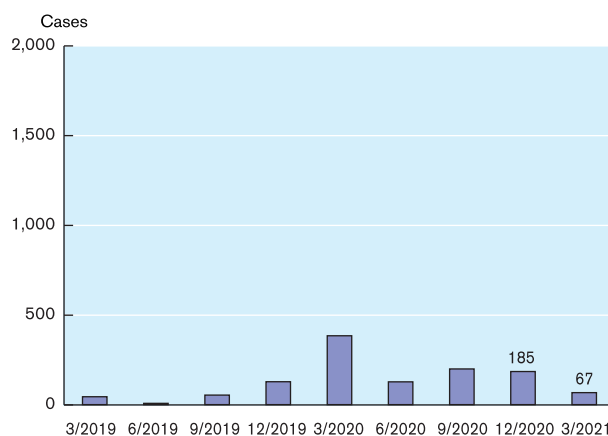
Note: Figures covered Hong Kong offices, overseas branches and major overseas subsidiaries.

Exhibit 13

Delinquency ratio of residential mortgages remained stable; delinquency ratio of credit card lending edged up

**Exhibit 14**

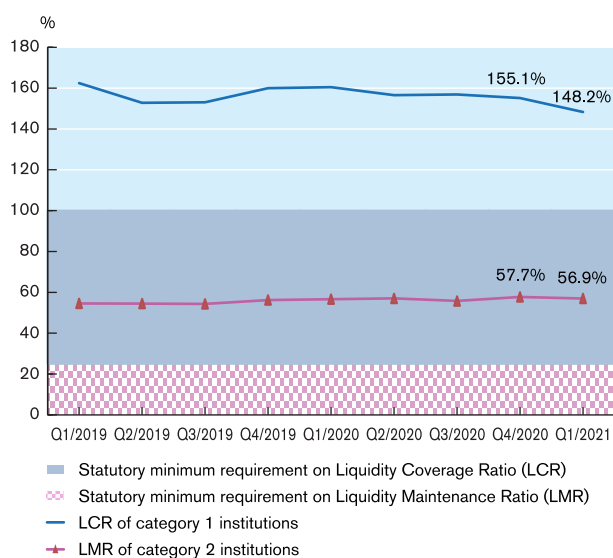
The number of negative equity cases decreased to 67 in the first quarter of 2021, mostly housing loans offered by banks to their employees and residential mortgage loans under the mortgage insurance programme



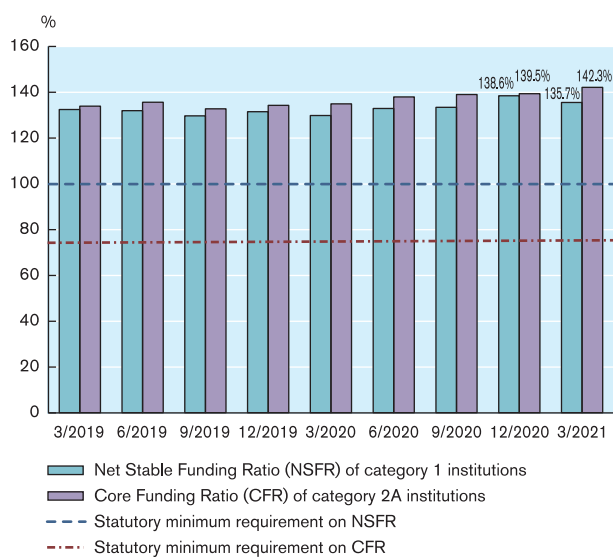
Liquidity conditions

Exhibit 15

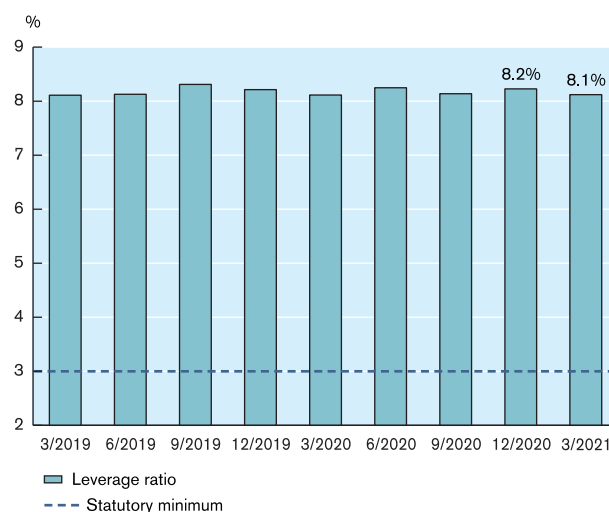
Liquidity positions of AIs remained sound



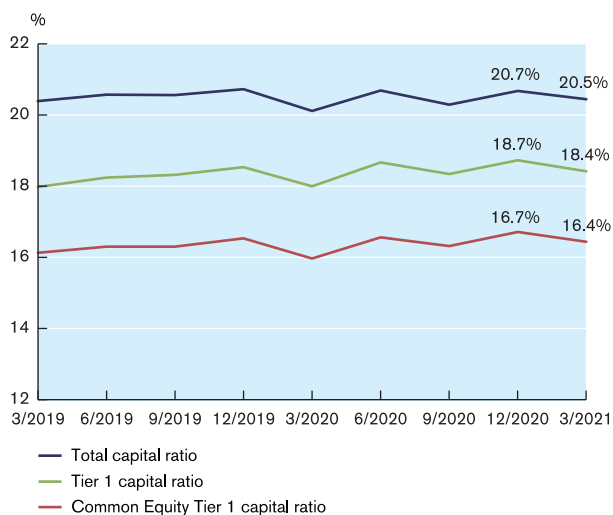
Note: For a category 1 institution, the statutory minimum requirement of the LCR is 100%. A category 2 institution must maintain an LMR of not less than 25% on average in each calendar month.

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 75% on average in each calendar month.

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 2020	Dec 2020	Mar 2021
Interest rates			
1-month HIBOR fixing ² (quarterly average)	1.82	0.27	0.14
3-month HIBOR fixing (quarterly average)	1.99	0.42	0.24
BLR ³ and 1-month HIBOR fixing spread (quarterly average)	3.18	4.73	4.86
BLR and 3-month HIBOR fixing spread (quarterly average)	3.01	4.58	4.76
Composite interest rate ⁴	0.95	0.28	0.22
Balance sheet developments⁵	All AIs		
Total deposits	0.0	-1.8	+1.2
Hong Kong dollar	-0.1	-4.4	+2.7
Foreign currency	+0.2	+1.1	-0.4
Total loans	+2.8	-4.8	+2.8
Domestic lending ⁶	+3.4	-5.4	+3.6
Loans for use outside Hong Kong ⁷	+1.6	-3.5	+0.9
Negotiable instruments			
Negotiable certificates of deposit (NCDs) issued	+6.7	+3.9	-8.0
Negotiable debt instruments held (excluding NCDs)	-3.2	+3.9	-0.8
Asset quality			
As a percentage of total loans ⁸			
Pass loans	97.79	97.29	97.50
Special mention loans	1.59	1.81	1.60
Classified loans ⁹ (gross)	0.62	0.90	0.89
Classified loans (net) ¹⁰	0.31	0.50	0.50
Overdue > 3 months and rescheduled loans	0.43	0.57	0.60
Classified loan ratio (gross) of Mainland related lending ¹¹	0.73	0.96	0.88
Liquidity ratios (consolidated)			
Liquidity Coverage Ratio — applicable to category 1 institutions (quarterly average)	160.4	155.1	148.2
Liquidity Maintenance Ratio — applicable to category 2 institutions (quarterly average)	56.6	57.7	56.9
Net Stable Funding Ratio — applicable to category 1 institutions	130.0	138.6	135.7
Core Funding Ratio — applicable to category 2A institutions	135.1	139.5	142.3
Profitability	Retail banks		
Loan impairment charges as a percentage of average total assets (year-to-date annualised)	0.09	0.12	0.03
Net interest margin (year-to-date annualised)	1.51	1.18	0.97
Cost-to-income ratio (year-to-date)	40.0	46.8	49.2
Asset quality	Surveyed institutions		
Delinquency ratio of residential mortgage loans	0.03	0.04	0.04
Credit card lending			
Delinquency ratio	0.35	0.27	0.28
Charge-off ratio — quarterly annualised	1.69	2.17	2.08
— year-to-date annualised	1.69	2.18	2.08
Capital adequacy (consolidated)	All locally incorporated AIs		
Common Equity Tier 1 capital ratio	16.0	16.7	16.4
Tier 1 capital ratio	18.0	18.7	18.4
Total capital ratio	20.1	20.7	20.5
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-rate-sensitive liabilities, which include deposits from customers, amounts due to banks, negotiable certificates of deposit and other debt instruments, and all other liabilities that do not involve any formal payment of interest but the values of which are sensitive to interest rate movements (such as 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.