

Developments in the Banking Sector

by Banking Supervision Department

HIGHLIGHTS OF KEY TRENDS

Banking sector performance

Overview

- The Hong Kong banking sector remained stable in the third quarter of 2021, notwithstanding persistent challenges arising from the COVID-19 pandemic. The capital and liquidity positions of the Hong Kong banking sector continued to be strong. Asset quality improved further, with the classified loan ratio dropping for three consecutive quarters and staying at a low level by both historical and international standards.

Profitability

- The prolonged low interest rate environment continued to weigh on banks' profitability. The aggregate pre-tax operating profit of retail banks declined by 12.9% year on year in the first three quarters (Exhibit 1), mainly attributable to a decrease in net interest income caused by narrowed net interest margin (Exhibit 2). This was partly offset by an increase in income from fees and commissions and a decrease in loan impairment charges.

Balance sheet trends

- Total loans of the banking sector declined by 2.0% in the third quarter of 2021 (Exhibit 5), mainly attributable to the high base effect arising from the initial public offering (IPO) activities straddling end-June. On a year-to-date basis, total loans

increased by 5.0% in the first nine months of 2021. Of the total, loans for use in Hong Kong declined by 4.2%, while loans for use outside Hong Kong and trade finance increased by 2.0% and 5.5% respectively in the third quarter of 2021. Mainland-related lending grew by 0.7% to HK\$4,915 billion (16.5% of total assets) in the third quarter of 2021 (Exhibit 6).

- Total deposits of the banking sector declined by 1.2% in the third quarter of 2021 (Exhibit 7), with Hong Kong dollar deposits decreasing by 4.9%, again mainly due to the high base effect arising from the IPO activities straddling end-June. On a year-to-date basis, total deposits and Hong Kong deposits increased by 3.4% and 2.3% respectively in the first nine months of 2021. Fluctuations during the period were within normal ranges.

Loan quality, liquidity conditions and capital adequacy

- The classified loan ratio of the banking sector further edged down to 0.81% at the end of the third quarter of 2021 from 0.86% a quarter earlier. The classified loan ratio for Mainland-related lending also improved to 0.77% at end-September from 0.84% at end-June 2021 (Exhibit 10). During the same period, the delinquency ratios of credit card lending and residential mortgage loans decreased to 0.22% and 0.03% respectively (Exhibit 13).

- The banking sector remained liquid and well capitalised. The average Liquidity Coverage Ratio of category 1 institutions was 155.5% in the third quarter of 2021, well above the statutory minimum requirement of 100% (Exhibit 15). The total capital ratio of locally incorporated authorized institutions (AIs) stood at 20.4% at the end of September 2021 (Exhibit 17), well above the international minimum requirement of 8%.

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

- The total market value of debt securities held by the surveyed AIs¹ increased by 4.9% to HK\$6,121 billion at the end of September 2021 from HK\$5,833 billion a year ago (Exhibit 19). The credit quality of these securities remained high, as over 96% of the debt securities holdings were investment grade (Exhibit 20). Most of these securities were issued by sovereigns and banks (Exhibit 21).

- The total gross notional amount of outstanding derivatives contracts held by AIs decreased by 7.6% to HK\$110 trillion at the end of June 2021 from HK\$119 trillion a year earlier (Exhibit 22), in part due to a decrease in customer demand for hedging as COVID-induced market volatility was subdued compared to last year. Over-the-counter (OTC) swap and forward contracts continued to dominate the contracts held, accounting for over 90% of the total notional amount of all outstanding derivatives contracts at the end of June 2021 (Exhibit 23). Among the derivatives contracts held, 98% were foreign exchange and interest rate contracts (Exhibit 24). The off-balance sheet securitisation exposures of AIs remained insignificant, with the aggregate amount of notional exposures totalling HK\$10 billion at the end of June 2021.

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

Profitability

Exhibit 1

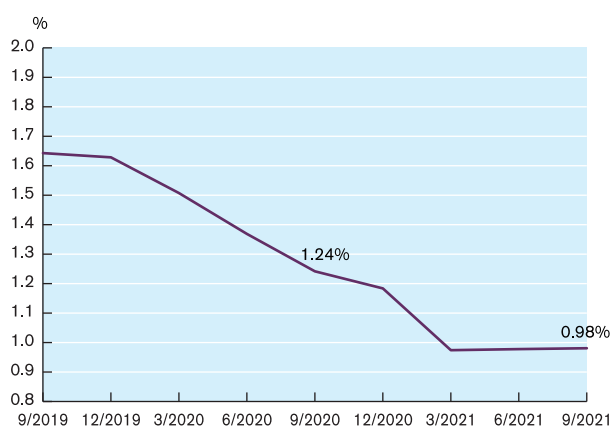
Pre-tax operating profit of retail banks' Hong Kong offices

Key items	Change in pre-tax operating profit Q1-Q3 2020 vs Q1-Q3 2021	
	Percentage change	Contribution to the percentage change in pre-tax operating profit (ppt)
Net interest income	-16.0%	-19.6
Total operating expenses	+8.6%	-7.8
Income from fees and commissions	+14.7%	+6.9
Loan impairment charges	-63.3%	+7.9
Pre-tax operating profit	-12.9%	-12.9

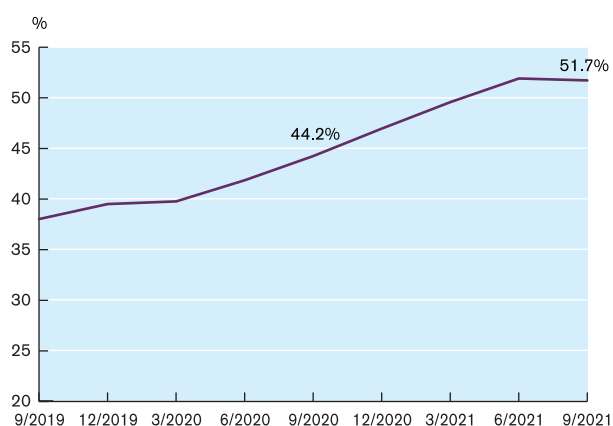
¹ This survey covers all licensed banks and restricted licence banks.

Exhibit 2

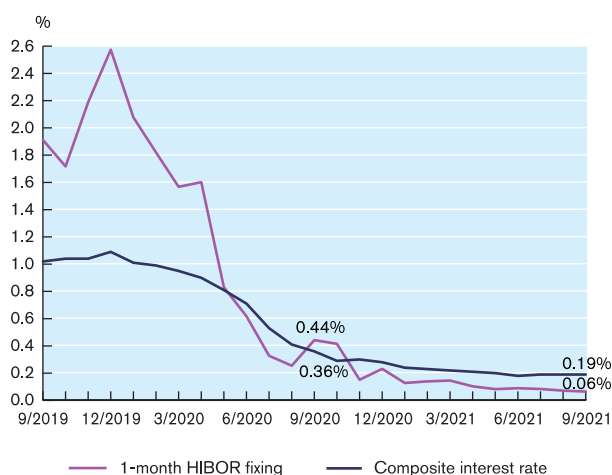
Net interest margin (year-to-date annualised) of retail banks narrowed in the first three quarters of 2021 compared with the same period last year

**Exhibit 4**

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

**Exhibit 3**

Hong Kong dollar interbank interest rates and composite interest rate decreased to 0.06% and 0.19% respectively at end-September 2021

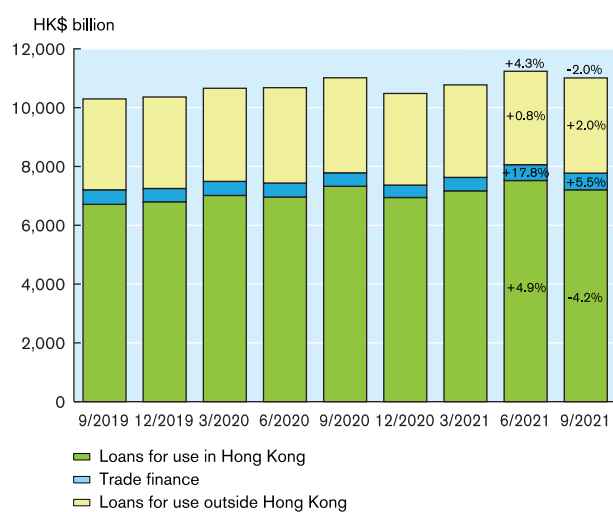


Notes:

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.

Loans and deposits**Exhibit 5**

Total loans decreased by 2.0% in the third quarter of 2021



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 2021 were:

Key items	Change in loans for use in Hong Kong in the third quarter of 2021	
	Percentage change	Contribution to the percentage change in loans for use in Hong Kong (ppt)
Stockbrokers	-77.6%	-2.9
Non-stockbroking companies and individuals for the purchase of shares	-52.0%	-1.4
Financial companies excluding stockbrokers (mainly investment companies)	-3.1%	-0.4
Property lending (including residential mortgage loans and loans for property development and investment)	+0.8%	+0.4
Loans for use in Hong Kong	-4.2%	-4.2

Mainland-related lending

Exhibit 6

Mainland-related lending

	Jun 2021 HK\$bn	Sep 2021 HK\$bn
Mainland-related loans excluding trade finance	4,501	4,508
Trade finance	380	407
Total	4,881	4,915

Exhibit 7

Both total loans and total deposits decreased in the third quarter of 2021

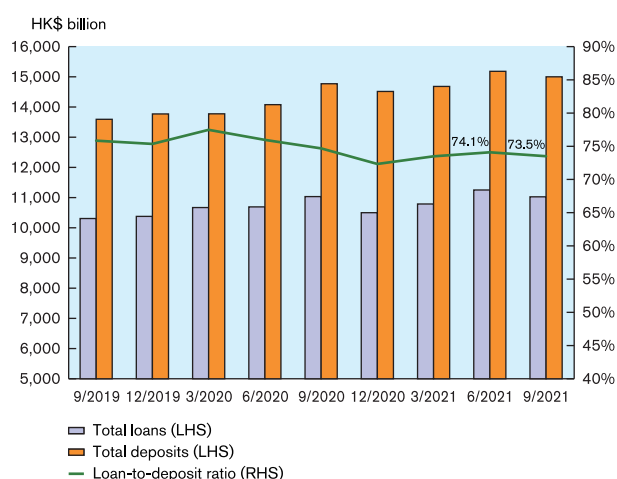


Exhibit 8

Hong Kong dollar loan-to-deposit ratio edged up in the third quarter of 2021

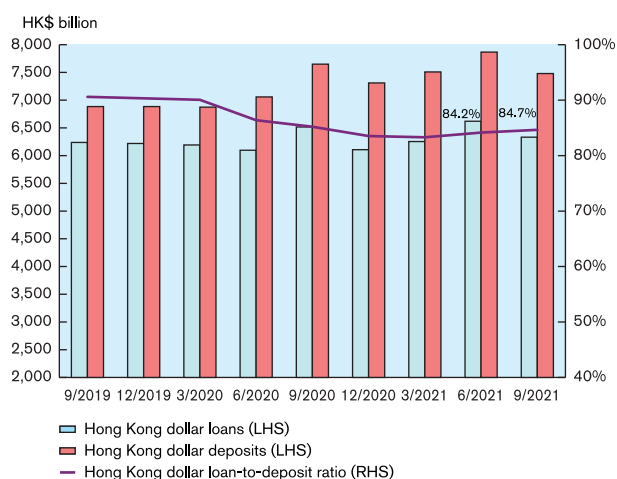
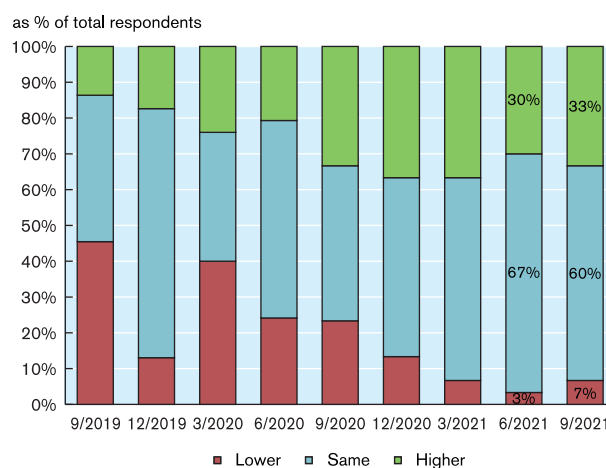


Exhibit 9

Mixed views were collected from respondents to the Hong Kong Monetary Authority Opinion Survey on Credit Conditions Outlook



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*

	Sep 2020	Dec 2020	Mar 2021	Jun 2021	Sep 2021
	% of total loans				
Special mention loans	1.74	1.81	1.60	1.47	1.49
Classified loans (gross)	0.84	0.90	0.89	0.86	0.81
of which:					
Substandard	0.34	0.34	0.32	0.31	0.26
Doubtful	0.45	0.52	0.53	0.49	0.48
Loss	0.05	0.04	0.04	0.06	0.07
Classified loans (net of specific provisions)	0.47	0.50	0.50	0.47	0.43
Overdue > 3 months and rescheduled loans	0.56	0.57	0.61	0.58	0.60
of which:					
Overdue > 3 months	0.53	0.54	0.57	0.53	0.54
Rescheduled loans	0.03	0.03	0.03	0.06	0.06
	% of Mainland-related lending				
Classified loans (gross) of Mainland-related lending**	0.96	0.96	0.88	0.84	0.77

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*

	Sep 2020	Dec 2020	Mar 2021	Jun 2021	Sep 2021
	% of total loans				
Special mention loans	1.61	1.73	1.60	1.42	1.48
Classified loans (gross)	0.75	0.82	0.82	0.81	0.78
of which:					
Substandard	0.34	0.35	0.32	0.32	0.27
Doubtful	0.37	0.43	0.46	0.45	0.46
Loss	0.04	0.04	0.04	0.04	0.04
Classified loans (net of specific provisions)	0.43	0.45	0.46	0.45	0.42
Overdue > 3 months and rescheduled loans	0.47	0.49	0.54	0.50	0.54
of which:					
Overdue > 3 months	0.43	0.46	0.51	0.47	0.50
Rescheduled loans	0.04	0.03	0.03	0.03	0.04
	% of Mainland-related lending				
Classified loans (gross) of Mainland-related lending**	0.92	0.89	0.84	0.79	0.77

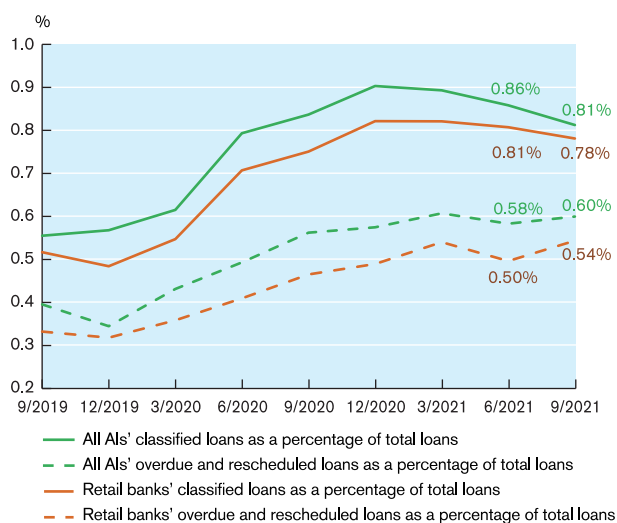
Note: Figures may not add up to total due to rounding.

* 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

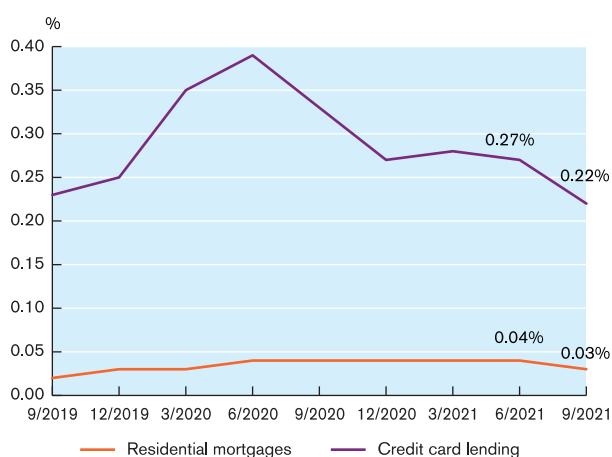
The banking sector's overall asset quality has continued to improve since the start of the year



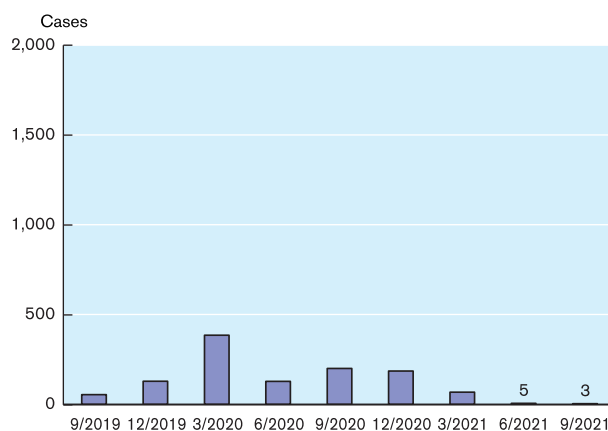
Note: Figures covered Hong Kong offices, overseas branches and major overseas subsidiaries.

Exhibit 13

Delinquency ratios of both residential mortgages and credit card lending edged down

**Exhibit 14**

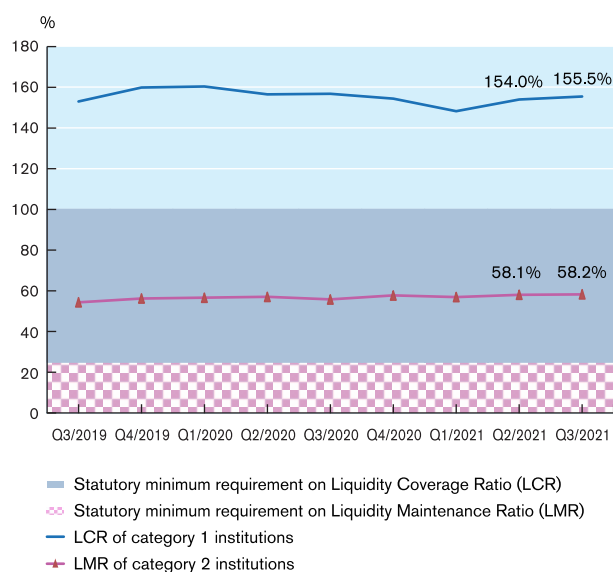
The number of negative equity cases decreased to 3 at end-September 2021



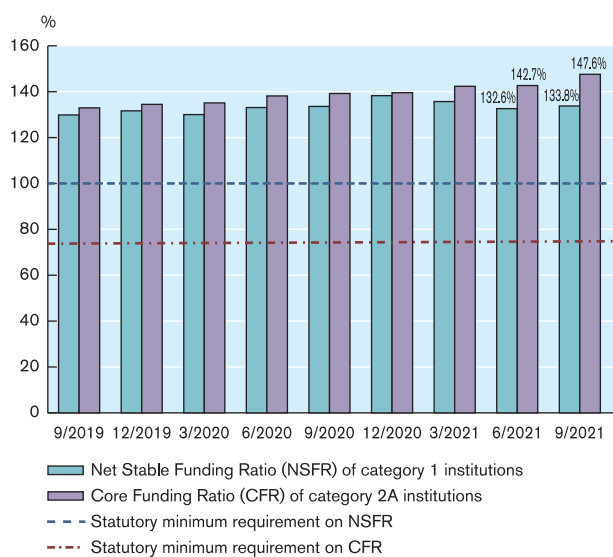
Liquidity conditions

Exhibit 15

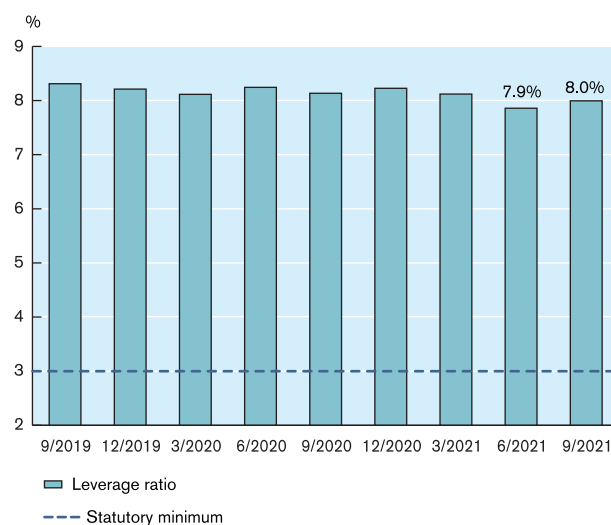
Liquidity positions remained sound



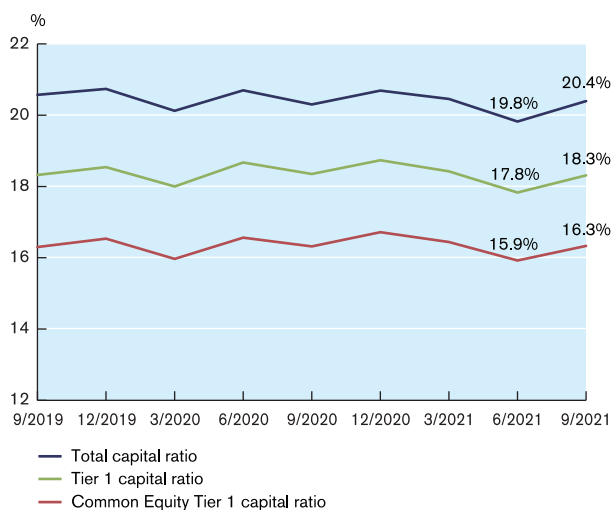
Note: For a category 1 institution, the statutory minimum requirement of the LCR is 100%. A category 2 institution must maintain an LMR of not less than 25% on average in each calendar month.

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 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 have strengthened**

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 increase in their holdings of debt securities compared with a year ago

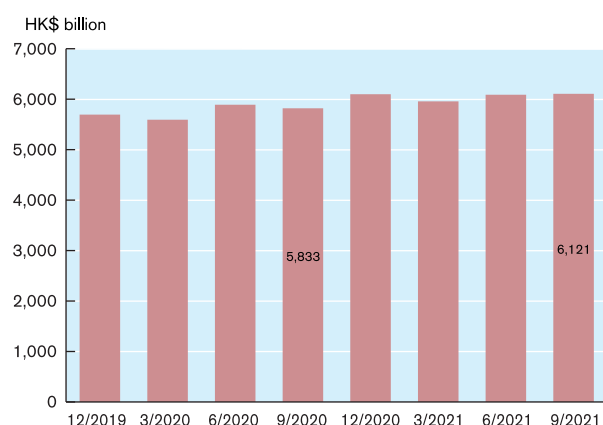


Exhibit 20

Debt securities held by surveyed AIs were predominantly investment-grade securities

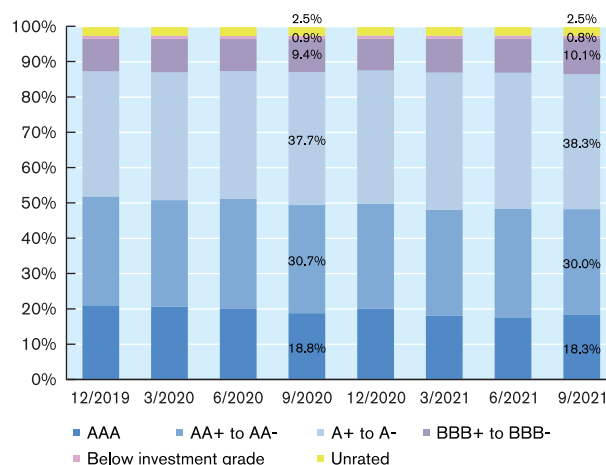


Exhibit 21

Most of the debt securities were issued by sovereigns and banks

(% of total)	All surveyed AIs							
Types of instrument and issuer	Dec 2019	Mar 2020	Jun 2020	Sep 2020	Dec 2020	Mar 2021	Jun 2021	Sep 2021
Part 1: Debt securities other than securitisation products³								
Sovereigns, of which:	49.6%	47.2%	48.0%	47.2%	49.0%	47.7%	47.3%	47.4%
Exchange Fund bills and notes	21.3%	21.4%	20.7%	20.1%	18.6%	19.3%	19.2%	19.2%
US Treasury bills, notes and bonds	9.3%	7.8%	7.4%	6.8%	7.4%	6.9%	6.9%	7.6%
Public-sector entities	5.5%	5.6%	5.8%	5.8%	5.8%	6.2%	6.3%	6.3%
Banks	26.1%	27.0%	26.6%	27.0%	26.0%	26.1%	26.1%	25.1%
Corporates	11.5%	12.2%	12.5%	12.9%	12.4%	13.2%	13.5%	14.0%
Others	4.7%	5.2%	4.7%	5.0%	4.7%	5.0%	4.8%	4.9%
Part 2: Securitisation products								
Total securitisation products	2.6%	2.8%	2.5%	2.1%	2.0%	1.8%	2.0%	2.2%

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 decreased

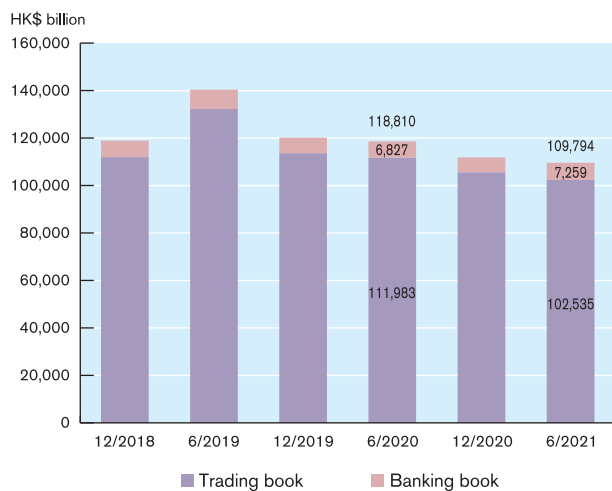


Exhibit 23

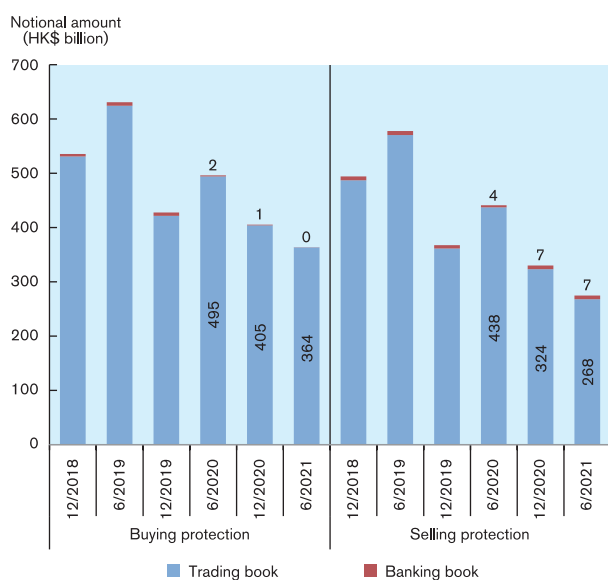
OTC swap and forward contracts continued to account for over 90% of total derivatives contracts held by AIs

(% of total)	All AIs					
Derivatives product	Dec 2018	Jun 2019	Dec 2019	Jun 2020	Dec 2020	Jun 2021
Exchange-traded derivatives	1.5%	1.0%	0.7%	0.6%	0.6%	0.7%
OTC derivatives	98.5%	99.0%	99.3%	99.4%	99.4%	99.3%
of which:						
Forwards	26.0%	24.8%	25.1%	24.2%	25.2%	26.6%
Swaps	67.7%	69.0%	68.7%	68.5%	68.3%	66.1%
Options	3.0%	3.1%	2.9%	3.5%	3.4%	4.1%
Credit derivatives	0.9%	0.9%	0.7%	0.8%	0.7%	0.6%
Others	0.9%	1.3%	1.9%	2.4%	1.9%	1.9%

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.

Exhibit 24**Derivatives contracts held were predominantly foreign exchange and interest rate contracts**

(% of total)	All AIs					
Underlying risk	Dec 2018	Jun 2019	Dec 2019	Jun 2020	Dec 2020	Jun 2021
Interest rate risk	44.7%	49.1%	47.5%	47.4%	47.5%	46.6%
Foreign exchange risk	53.7%	49.2%	51.1%	50.9%	50.9%	51.7%
Equity risk	0.6%	0.7%	0.7%	0.8%	0.9%	0.9%
Commodity risk	0.0%	0.1%	0.0%	0.0%	0.1%	0.1%
Credit risk	0.9%	0.9%	0.7%	0.8%	0.7%	0.6%
Other risks	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

Exhibit 25**The notional amount of credit derivatives contracts shrank**

APPENDIX

KEY PERFORMANCE INDICATORS OF THE BANKING SECTOR¹ (%)

	Sep 2020	Jun 2021	Sep 2021
Interest rates			
1-month HIBOR fixing ² (quarterly average)	0.34	0.09	0.07
3-month HIBOR fixing (quarterly average)	0.53	0.18	0.15
BLR ³ and 1-month HIBOR fixing spread (quarterly average)	4.66	4.91	4.93
BLR and 3-month HIBOR fixing spread (quarterly average)	4.47	4.82	4.85
Composite interest rate ⁴	0.36	0.18	0.19
Balance sheet developments⁵	All AIs		
Total deposits	+4.9	+3.4	-1.2
Hong Kong dollar	+8.4	+4.8	-4.9
Foreign currency	+1.5	+2.0	+2.8
Total loans	+3.2	+4.3	-2.0
Domestic lending ⁶	+4.7	+5.7	-3.5
Loans for use outside Hong Kong ⁷	-0.4	+0.8	+2.0
Negotiable instruments			
Negotiable certificates of deposit (NCDs) issued	-0.1	-4.5	-1.5
Negotiable debt instruments held (excluding NCDs)	+0.1	+2.5	+1.0
Asset quality			
As a percentage of total loans ⁸			
Pass loans	97.42	97.67	97.69
Special mention loans	1.74	1.47	1.49
Classified loans ⁹ (gross)	0.84	0.86	0.81
Classified loans (net) ¹⁰	0.47	0.47	0.43
Overdue > 3 months and rescheduled loans	0.56	0.58	0.60
Classified loan ratio (gross) of Mainland related lending ¹¹	0.96	0.84	0.77
Liquidity ratios (consolidated)			
Liquidity Coverage Ratio — applicable to category 1 institutions (quarterly average)	156.8	154.0	155.5
Liquidity Maintenance Ratio — applicable to category 2 institutions (quarterly average)	55.8	58.1	58.2
Net Stable Funding Ratio — applicable to category 1 institutions	133.6	132.6	133.8
Core Funding Ratio — applicable to category 2A institutions	139.2	142.7	147.6
Profitability	Retail banks		
Loan impairment charges as a percentage of average total assets (year-to-date annualised)	0.11	0.05	0.04
Net interest margin (year-to-date annualised)	1.24	0.98	0.98
Cost-to-income ratio (year-to-date)	44.2	51.9	51.7
Asset quality	Surveyed institutions		
Delinquency ratio of residential mortgage loans	0.04	0.04	0.03
Credit card lending			
Delinquency ratio	0.33	0.27	0.22
Charge-off ratio — quarterly annualised	2.53	1.87	1.84
— year-to-date annualised	2.28	1.94	1.90
Capital adequacy (consolidated)	All locally incorporated AIs		
Common Equity Tier 1 capital ratio	16.3	15.9	16.3
Tier 1 capital ratio	18.3	17.8	18.3
Total capital ratio	20.3	19.8	20.4
Leverage ratio	8.1	7.9	8.0

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.