

Developments in the Banking Sector

by Banking Supervision Department

HIGHLIGHTS OF KEY TRENDS

Banking sector performance

Overview

- The Hong Kong banking sector remained resilient in the first quarter of 2022, despite the challenges posed by the fifth wave of the COVID-19 pandemic. The capital and liquidity positions of banks continued to be robust. The classified loan ratio edged up, but still remained at a healthy level by both historical and international standards.

Profitability

- The aggregate pre-tax operating profit of retail banks declined by 27.2% year on year in the first quarter of 2022 (Exhibit 1). The drop was mainly driven by a decline in income from fees and commissions and an increase in loss in investments held for trading. Bad debt provisions also increased compared to a year ago. This was partly offset by an increase in income from foreign exchange and derivatives operations. Compared with 2021, the net interest margin of retail banks remained broadly stable at 0.98% (Exhibit 2).

Balance sheet trends

- Total loans of the banking sector rose by 1.2% in the first quarter of 2022 (Exhibit 5). Among the total, loans for use in Hong Kong and trade finance increased by 1.4% and 9.6% respectively, while loans for use outside Hong Kong edged down by 0.4%. Mainland-related lending also grew by 3.3% to HK\$4,881 billion (16.2% of total assets) during the same period (Exhibit 6).

- Banking deposits remained stable. Total deposits rose by 1.1% in the first quarter of 2022 (Exhibit 7), with Hong Kong dollar deposits growing by 2.2%.

Loan quality, liquidity conditions and capital adequacy

- The classified loan ratio of the banking sector increased to 0.98% at the end of March 2022 from 0.88% a quarter earlier. The classified loan ratio for Mainland-related lending also increased to 1.15% from 0.86% (Exhibit 10). During the same period, the delinquency ratio of credit card lending rose to 0.26% from 0.20% while that of residential mortgage loans remained largely stable at 0.04% (Exhibit 12).
- The banking sector continued to be liquid and well capitalised. The average Liquidity Coverage Ratio of category 1 institutions was 155.0% in the first quarter of 2022, well above the statutory minimum requirement of 100% (Exhibit 14). Total capital ratio of locally incorporated authorized institutions (AIs) stood at 19.7% at the end of March 2022 (Exhibit 16), 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 2021 vs Q1 2022	
	Percentage change	Contribution to the percentage change in pre-tax operating profit (ppt)
Income from fees and commissions	-21.8%	-13.6
Loan impairment charges*	+252.3%	-10.9
Loss in investments held for trading*	+491.8%	-6.9
Income from foreign exchange and derivatives operations	+23.2%	+6.7
Pre-tax operating profit	-27.2%	-27.2

* In absolute terms, loan impairment charges and loss in investments held for trading rose by HK\$3.6 billion and HK\$2.3 billion respectively.

Exhibit 2

Net interest margin (year-to-date annualised) of retail banks remained broadly steady in the first quarter of 2022 compared with the same period last year

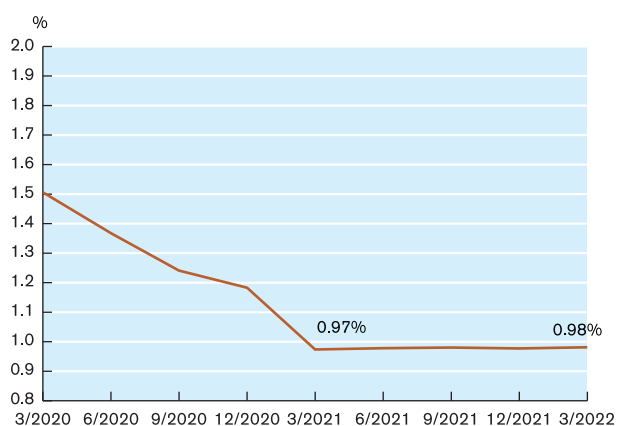
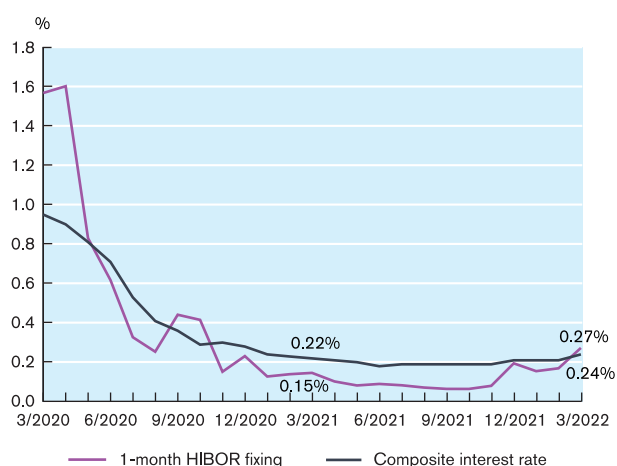


Exhibit 3

Hong Kong dollar interbank interest rates and composite interest rate increased to 0.27% and 0.24% respectively in March 2022 compared with a year ago

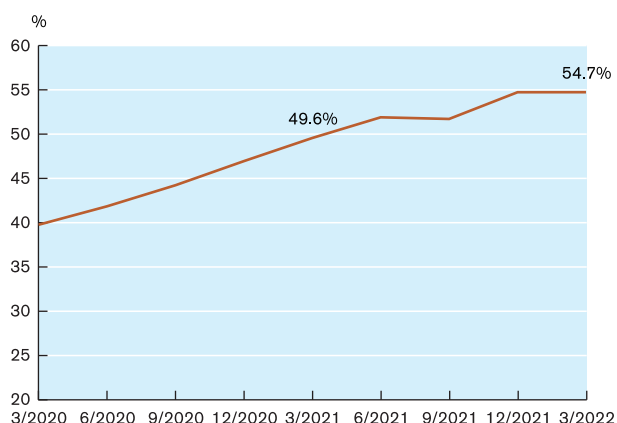


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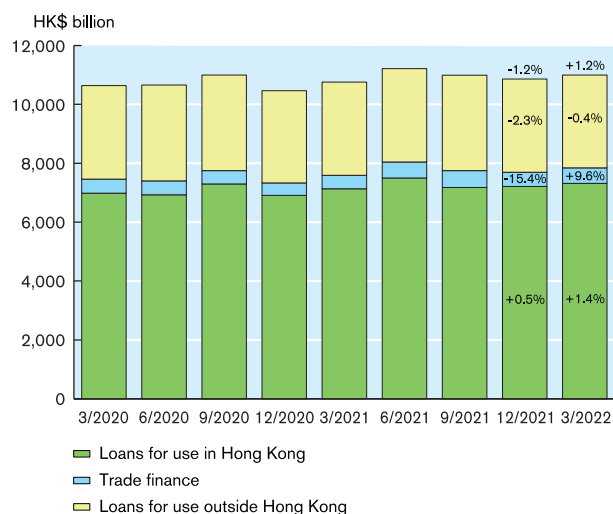
1. HIBOR fixing (monthly average) refers to the Hong Kong Interbank Offered Rates released by the Hong Kong Association of Banks.
2. The composite interest rate is a weighted average interest rate of all Hong Kong dollar interest-bearing liabilities of retail banks.

Exhibit 4

The cost-to-income ratio (year-to-date) of retail banks rose in the first quarter of 2022

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

Total loans increased by 1.2% in the first quarter of 2022



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 first quarter of 2022 were:

Key items	Change in loans for use in Hong Kong in the first quarter of 2022	
	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)	+1.6%	+0.8
Wholesale and retail trade	+8.1%	+0.4
Financial companies excluding stockbrokers (mainly investment companies)	+2.0%	+0.2
Transportation and transport equipment	-6.2%	-0.3
Loans for use in Hong Kong	+1.4%	+1.4

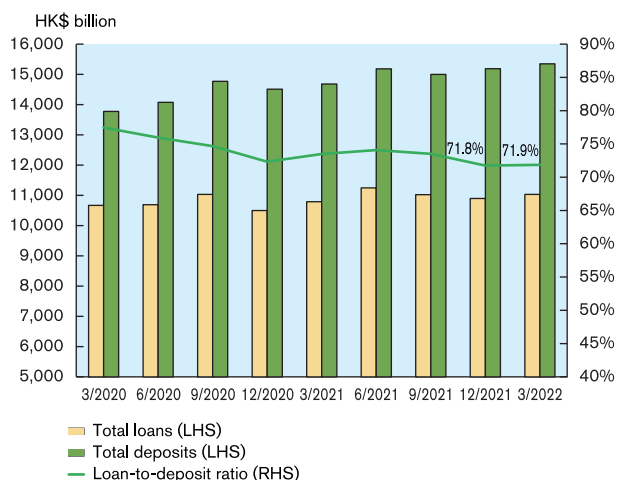
Exhibit 6

Mainland-related lending

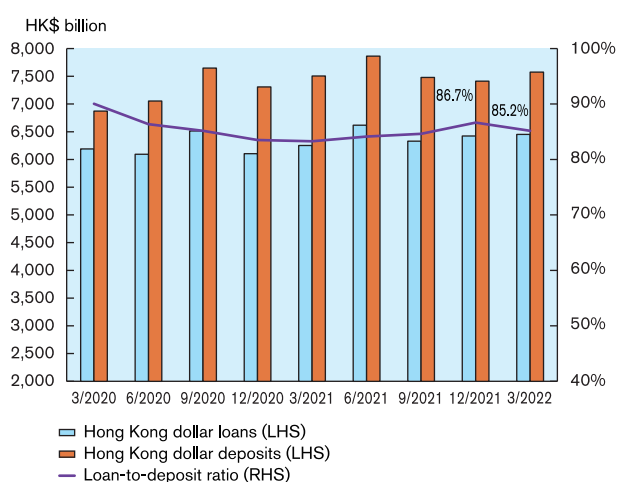
	Dec 2021 HK\$ billion	Mar 2022 HK\$ billion
Mainland-related loans excluding trade finance	4,410	4,495
Trade finance	315	385
Total	4,725	4,881

Exhibit 7

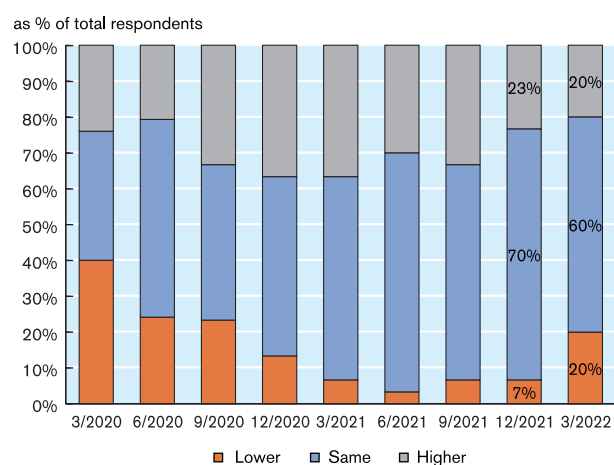
Both total loans and total deposits increased in the first quarter of 2022

**Exhibit 8**

The Hong Kong dollar loan-to-deposit ratio dropped in the first quarter of 2022, with Hong Kong dollar deposits increasing at a faster pace than Hong Kong dollar loans

**Exhibit 9**

A majority of respondents to the Hong Kong Monetary Authority Opinion Survey on Credit Conditions Outlook expected loan demand to remain the same 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 2021	Jun 2021	Sep 2021	Dec 2021	Mar 2022
	<i>% of total loans</i>				
Special mention loans	1.60	1.48	1.50	1.54	1.65
Classified loans (gross)	0.89	0.86	0.81	0.88	0.98
of which:					
Substandard	0.32	0.31	0.26	0.34	0.40
Doubtful	0.53	0.49	0.48	0.48	0.50
Loss	0.04	0.06	0.07	0.06	0.08
Classified loans (net of specific provisions)	0.50	0.47	0.43	0.48	0.56
Overdue > 3 months and rescheduled loans	0.61	0.59	0.60	0.56	0.59
of which:					
Overdue > 3 months	0.57	0.53	0.54	0.46	0.46
Rescheduled loans	0.03	0.06	0.07	0.10	0.14
	<i>% of Mainland-related lending</i>				
Classified loans (gross) of Mainland-related lending**	0.88	0.84	0.78	0.86	1.15

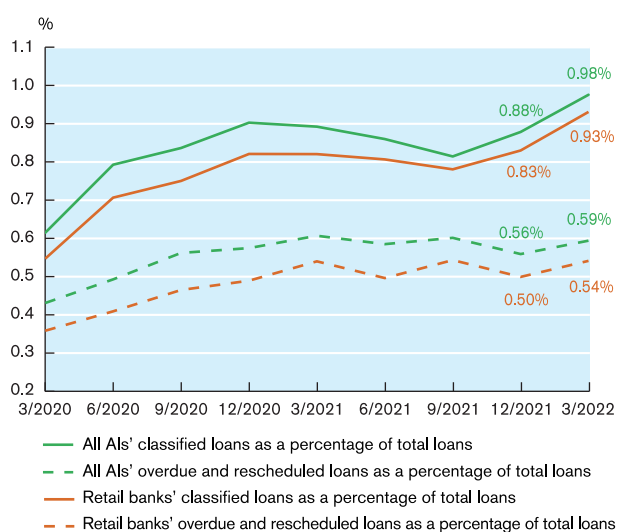
Note: Figures may not add up to total due to rounding.

* 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

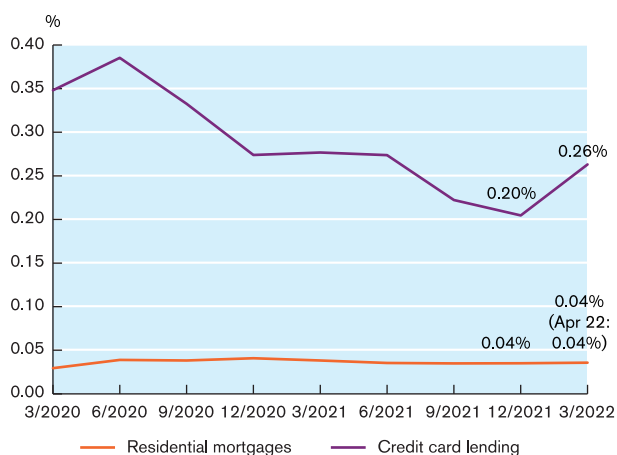
The banking sector's overall asset quality deteriorated in the first quarter of 2022, but still remained at a healthy level



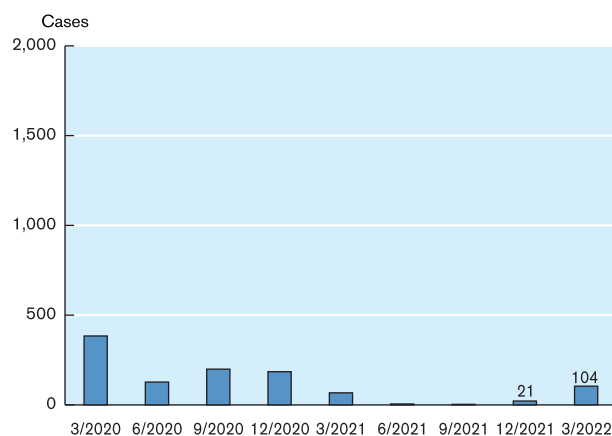
Note: Figures covered Hong Kong offices, overseas branches and major overseas subsidiaries.

Exhibit 12

Delinquency ratio of residential mortgages remained largely stable while that of credit card lending rose

**Exhibit 13**

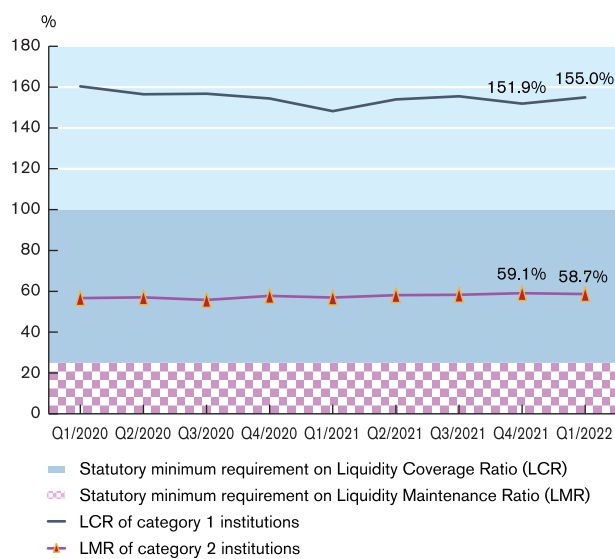
The number of negative equity cases increased in the first quarter of 2022



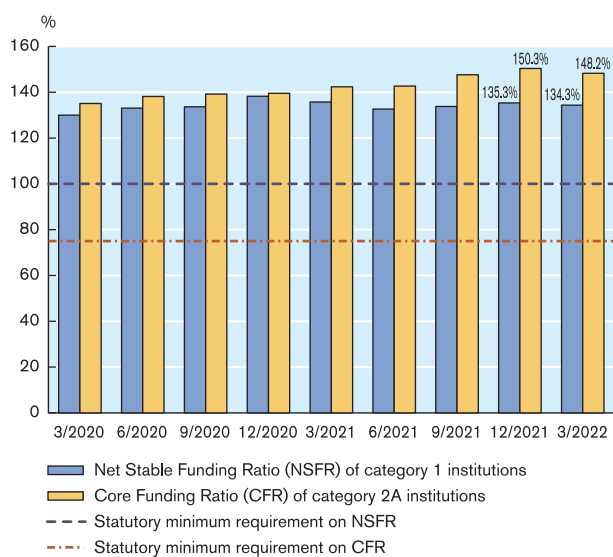
Liquidity conditions

Exhibit 14

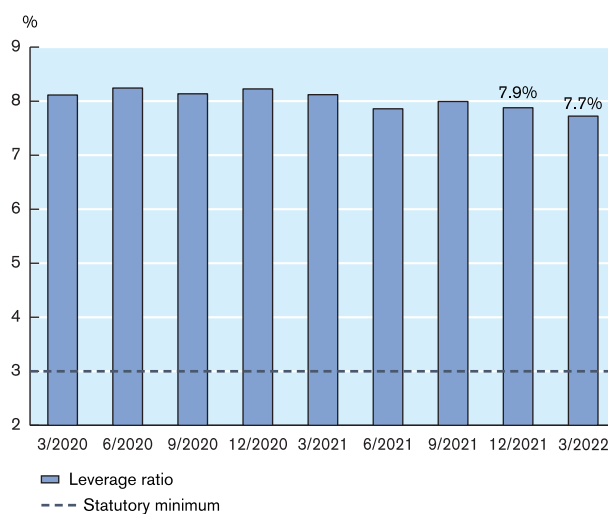
Liquidity positions of AIs remained robust



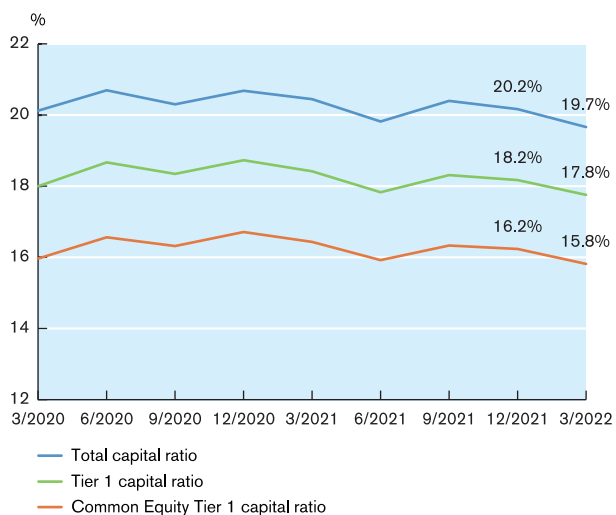
Note: For a category 1 institution, the statutory minimum requirement of the LCR is 100%. A category 2 institution must maintain an LMR of not less than 25% on average in each calendar month.

Exhibit 15**Funding positions of AIs remained largely 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 17**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 16****Capital positions of locally incorporated AIs remained sound**

APPENDIX

KEY PERFORMANCE INDICATORS OF THE BANKING SECTOR¹ (%)

	Mar 2021	Dec 2021	Mar 2022
Interest rates			
1-month HIBOR fixing ² (quarterly average)	0.14	0.11	0.20
3-month HIBOR fixing (quarterly average)	0.24	0.20	0.41
BLR ³ and 1-month HIBOR fixing spread (quarterly average)	4.86	4.89	4.80
BLR and 3-month HIBOR fixing spread (quarterly average)	4.76	4.80	4.59
Composite interest rate ⁴	0.22	0.21	0.24
Balance sheet developments⁵	All AIs		
Total deposits	+1.2	+1.2	+1.1
Hong Kong dollar	+2.7	-0.9	+2.2
Foreign currency	-0.4	+3.3	+0.0
Total loans	+2.8	-1.2	+1.2
Domestic lending ⁶	+3.5	-0.7	+1.9
Loans for use outside Hong Kong ⁷	+1.0	-2.3	-0.4
Negotiable instruments			
Negotiable certificates of deposit (NCDs) issued	-8.0	+1.1	-9.7
Negotiable debt instruments held (excluding NCDs)	-0.8	+3.7	-0.5
Asset quality			
As a percentage of total loans ⁸			
Pass loans	97.50	97.58	97.38
Special mention loans	1.60	1.54	1.65
Classified loans ⁹ (gross)	0.89	0.88	0.98
Classified loans (net) ¹⁰	0.50	0.48	0.56
Overdue > 3 months and rescheduled loans	0.61	0.56	0.59
Classified loan ratio (gross) of Mainland related lending ¹¹	0.88	0.86	1.15
Liquidity ratios (consolidated)			
Liquidity Coverage Ratio — applicable to category 1 institutions (quarterly average)	148.2	151.9	155.0
Liquidity Maintenance Ratio — applicable to category 2 institutions (quarterly average)	56.9	59.1	58.7
Net Stable Funding Ratio — applicable to category 1 institutions	135.7	135.3	134.3
Core Funding Ratio — applicable to category 2A institutions	142.3	150.3	148.2
Profitability	Retail banks		
Loan impairment charges as a percentage of average total assets (year-to-date annualised)	0.03	0.08	0.11
Net interest margin (year-to-date annualised)	0.97	0.98	0.98
Cost-to-income ratio (year-to-date)	49.6	54.7	54.7
Asset quality	Surveyed institutions		
Delinquency ratio of residential mortgage loans	0.04	0.04	0.04
Credit card lending			
Delinquency ratio	0.28	0.20	0.26
Charge-off ratio — quarterly annualised	2.08	1.53	1.50
— year-to-date annualised	2.08	1.75	1.50
Capital adequacy (consolidated)	All locally incorporated AIs		
Common Equity Tier 1 capital ratio	16.4	16.2	15.8
Tier 1 capital ratio	18.4	18.2	17.8
Total capital ratio	20.4	20.2	19.7
Leverage ratio	8.1	7.9	7.7

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 AI's 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 AI's Mainland branches and subsidiaries.