

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 resilient despite the uncertain and challenging macro-environment and heightened volatilities in the financial markets. The capital and liquidity positions of the Hong Kong banking sector are robust. The classified loan ratio increased, but still remained at a healthy level.

Profitability

- The aggregate pre-tax operating profit of retail banks declined by 11.7% year on year in the first three quarters of 2022 (Exhibit 1). This was mainly attributable to an increase in bad debt provisions and a decline in income from fees and commissions, which were partly offset by an increase in net interest income. The net interest margin of retail banks widened to 1.17% in the first three quarters of 2022, compared with 0.98% during the same period last year (Exhibit 2).

Balance sheet trends

- Total loans of the banking sector decreased by 1.5% in the third quarter of 2022 (Exhibit 5). Among the total, trade finance, loans for use outside Hong Kong and loans for use in Hong

Kong declined by 7.0%, 3.0% and 0.4% respectively. Mainland-related lending also decreased by 1.9% to HK\$4,714 billion (15.3% of total assets) during the same period (Exhibit 6).

- Banking deposits remained stable. Total deposits increased by 0.3% in the third quarter of 2022 (Exhibit 7), with US dollar deposits increasing by 4.0% and Hong Kong dollar deposits dropping by 2.7%.

Loan quality, liquidity conditions and capital adequacy

- The classified loan ratio of the banking sector increased to 1.19% at the end of September 2022 from 1.10% a quarter earlier. The classified loan ratio for Mainland-related lending also increased to 1.80% from 1.50% (Exhibit 10). During the same period, the delinquency ratio of credit card lending decreased to 0.24% from 0.25%, while that for residential mortgage loans decreased to 0.04% from 0.05% (Exhibit 12).
- The banking sector continued to be liquid and well capitalised. The average Liquidity Coverage Ratio of category 1 institutions was 156.3% in the third quarter of 2022, well above the statutory minimum requirement of 100% (Exhibit 14). Total capital ratio of locally incorporated authorized institutions (AIs) stood at 19.9% at the end of September 2022 (Exhibit 16), 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 decreased by 0.3% to HK\$6,103 billion at the end of September 2022 from HK\$6,121 billion a year ago (Exhibit 18). The credit quality of these securities remained high, as 97% of the debt securities holdings were investment grade (Exhibit 19). The issuers of these securities were mostly governments and banks (Exhibit 20).
- The total gross notional amount of outstanding derivatives contracts held by AIs increased by 18.7% to HK\$130 trillion at the end of June

2022 from HK\$110 trillion a year earlier (Exhibit 21). Over-the-counter (OTC) swap and forward contracts continued to represent the bulk of the contracts held, accounting for over 90% of the total notional amount of all outstanding derivatives contracts at the end of June 2022 (Exhibit 22). In terms of underlying assets, over 98% of these contracts were interest rate and foreign exchange contracts (Exhibit 23). The off-balance sheet securitisation exposures of AIs remained insignificant, with the aggregate amount of notional exposures totalling HK\$5 billion at the end of June 2022.

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

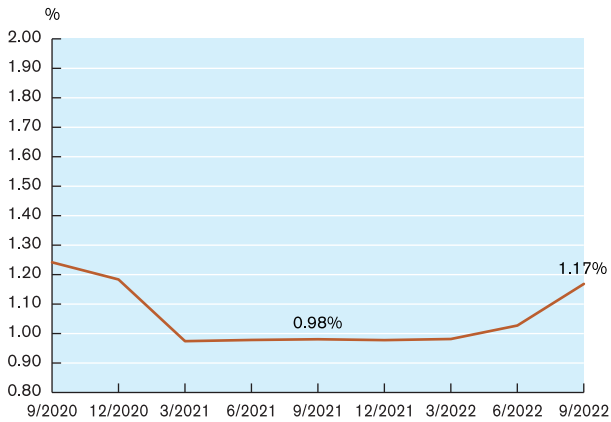
Key items	Change of pre-tax operating profit Q1-Q3 2021 vs Q1-Q3 2022	
	Percentage change	Contribution to the percentage change in pre-tax operating profit (ppt)
Net interest income	+19.8%	+23.4
Loan impairment charges*	+340.9%	-17.8
Income from fees and commissions	-21.6%	-13.3
Pre-tax operating profit	-11.7%	-11.7

* In absolute terms, loan impairment charges rose by HK\$16.3 billion, compared to an aggregate pre-tax operating profit of HK\$81.0 billion for all retail banks.

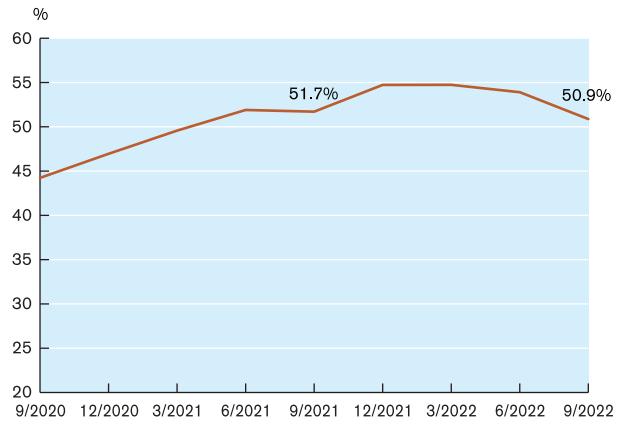
¹ This survey covers all licensed banks and restricted licence banks.

Exhibit 2

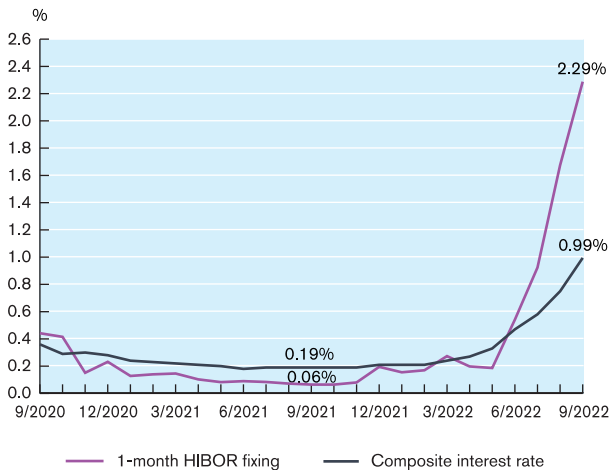
Net interest margin (year-to-date annualised) of retail banks widened in the first three quarters of 2022 compared with the same period last year

**Exhibit 4**

Cost-to-income ratio (year-to-date) of retail banks decreased in the first three quarters of 2022 compared with the same period last year

**Exhibit 3**

Both the Hong Kong dollar interbank interest rates and composite interest rate trended higher in the third quarter of 2022

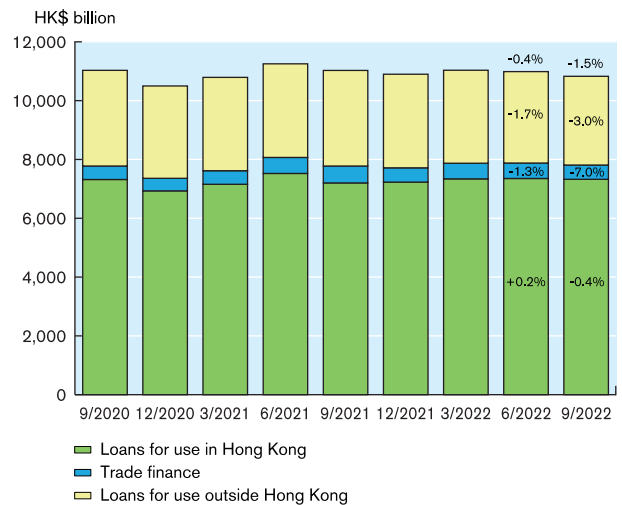


Notes:

- 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.

Loans and deposits**Exhibit 5**

Total loans decreased by 1.5% in the third quarter of 2022



Notes:

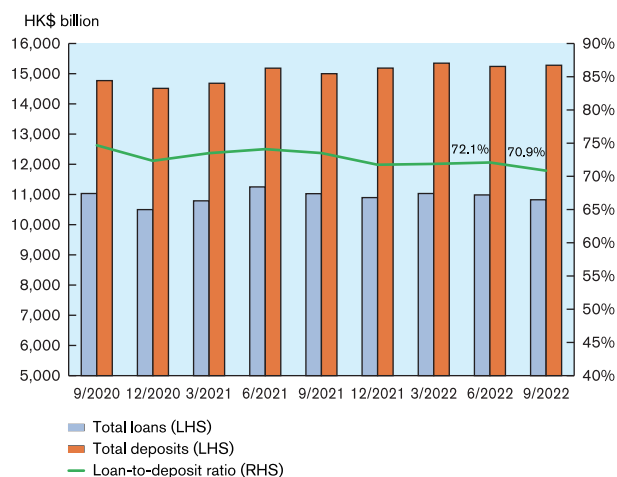
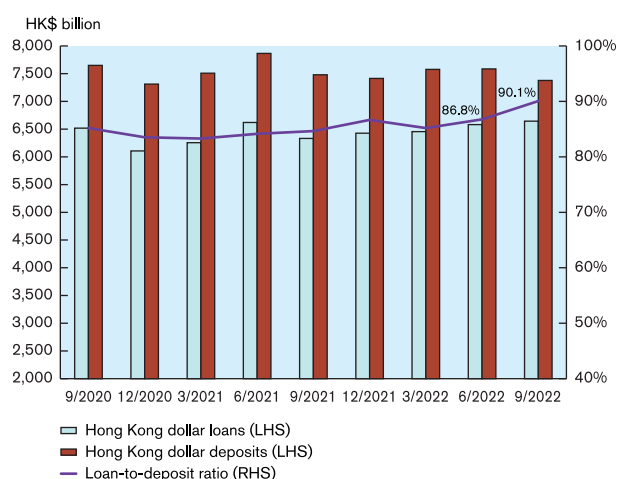
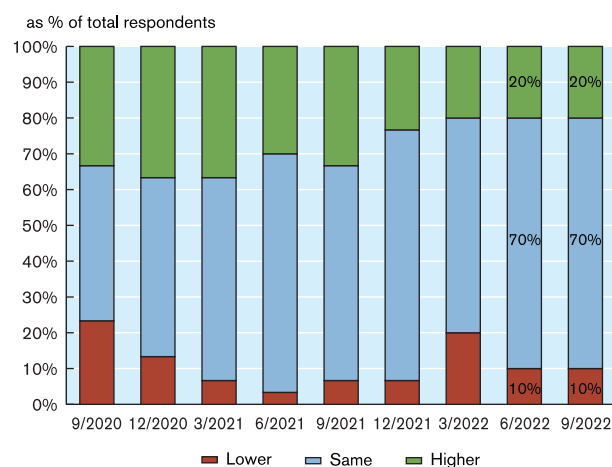
- "Loans for use outside Hong Kong" include "others" (i.e. unallocated).
- Percentage denotes quarter-on-quarter growth rate.

Within loans for use in Hong Kong, the percentage changes in the amount of credit extended to the key economic sectors in the third quarter of 2022 were:

Key items	Change in loans for use in Hong Kong in the third quarter of 2022	
	Percentage change	Contribution to the percentage change in loans for use in Hong Kong (ppt)
Loans to professionals & private individuals for other private purposes	-3.0%	-0.3
Wholesale and retail trade	-3.8%	-0.2
Non-stockbroking companies and individuals for the purchase of shares	-9.3%	-0.1
Loans for use in Hong Kong	-0.4%	-0.4

Exhibit 6**Mainland-related lending**

	Jun 2022 HK\$bn	Sep 2022 HK\$bn
Mainland-related loans excluding trade finance	4,429	4,388
Trade finance	377	326
Total	4,806	4,714

Exhibit 7**Total loan-to-deposit ratio dropped in the third quarter of 2022****Exhibit 8****Hong Kong dollar loan-to-deposit ratio went up in the third quarter of 2022****Exhibit 9****A majority of respondents to the Hong Kong Monetary Authority Opinion Survey on Credit Conditions Outlook expected loan demand to remain stable 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*

	Sep 2021	Dec 2021	Mar 2022	Jun 2022	Sep 2022
	<i>% of total loans</i>				
Special mention loans	1.50	1.55	1.66	1.79	1.73
Classified loans (gross)	0.81	0.88	0.98	1.10	1.19
of which:					
Substandard	0.26	0.34	0.40	0.49	0.54
Doubtful	0.48	0.48	0.50	0.54	0.56
Loss	0.07	0.06	0.08	0.08	0.09
Classified loans (net of specific provisions)	0.43	0.48	0.56	0.63	0.68
Overdue > 3 months and rescheduled loans	0.60	0.56	0.59	0.66	0.71
of which:					
Overdue > 3 months	0.54	0.46	0.46	0.53	0.58
Rescheduled loans	0.07	0.10	0.14	0.13	0.13
	<i>% of Mainland-related lending</i>				
Classified loans (gross) of Mainland-related lending**	0.78	0.86	1.15	1.50	1.80

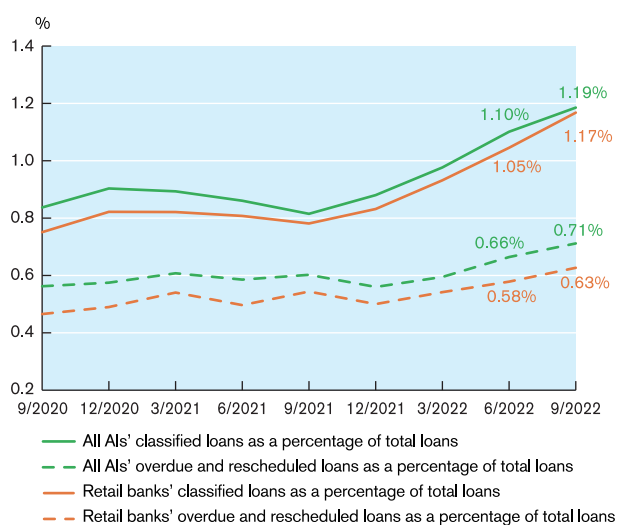
Note: Figures may not add up to total due to rounding.

* 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

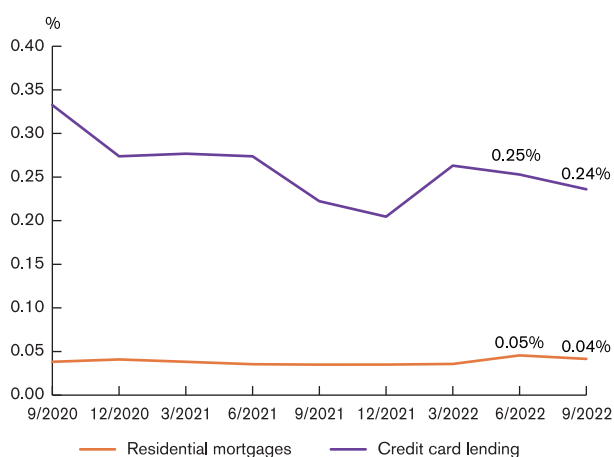
The banking sector's overall asset quality deteriorated in the third quarter of 2022, but remained at a healthy level



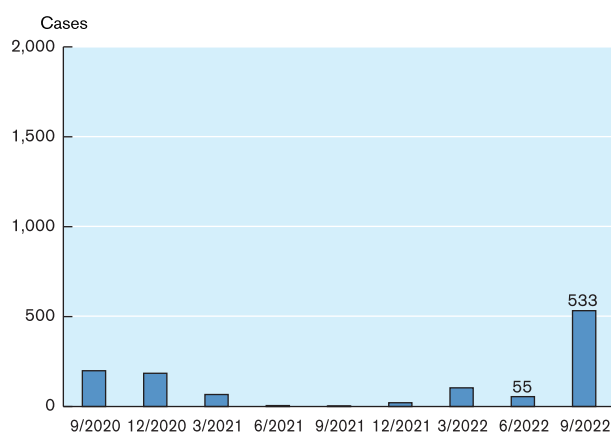
Note: Figures covered Hong Kong offices, overseas branches and major overseas subsidiaries.

Exhibit 12

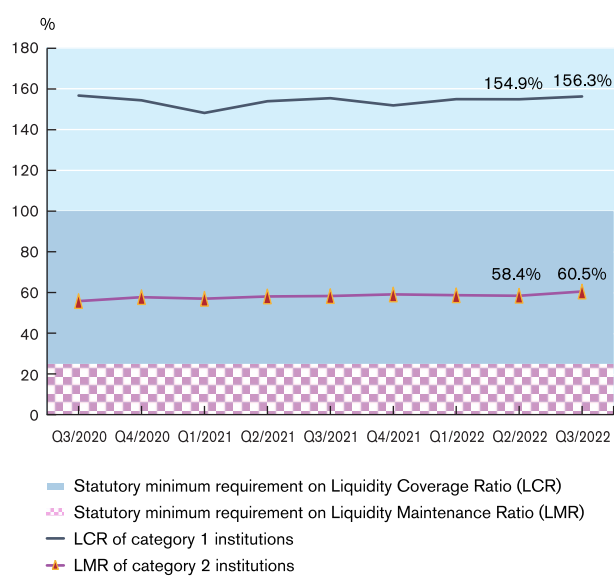
Delinquency ratios of residential mortgages and credit card lending edged down

**Exhibit 13**

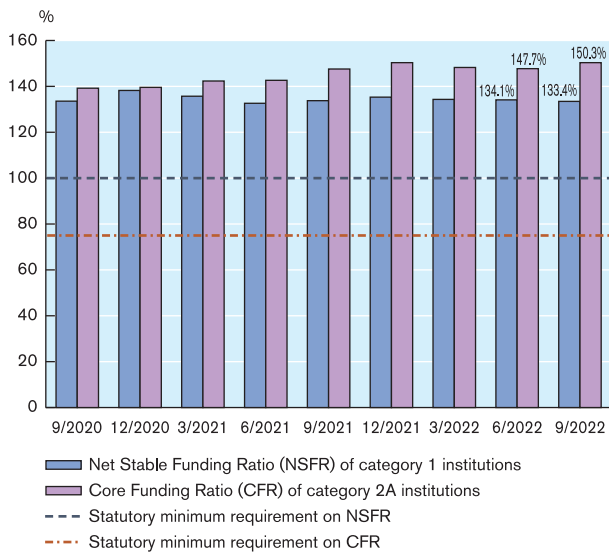
The number of negative equity cases increased in the third quarter of 2022

**Liquidity conditions****Exhibit 14**

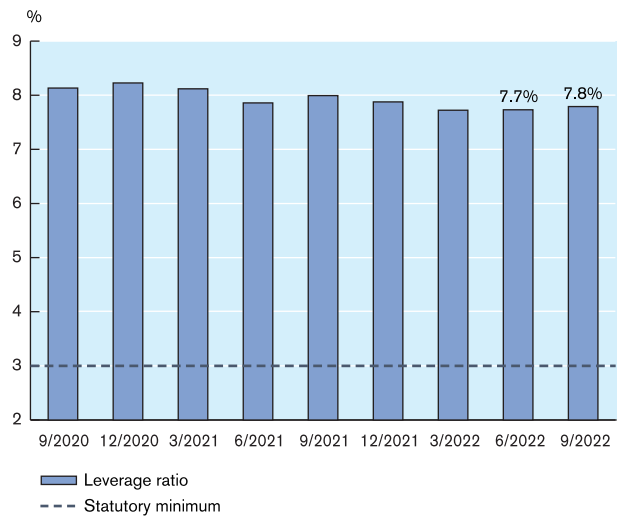
Liquidity positions of AIs remained robust



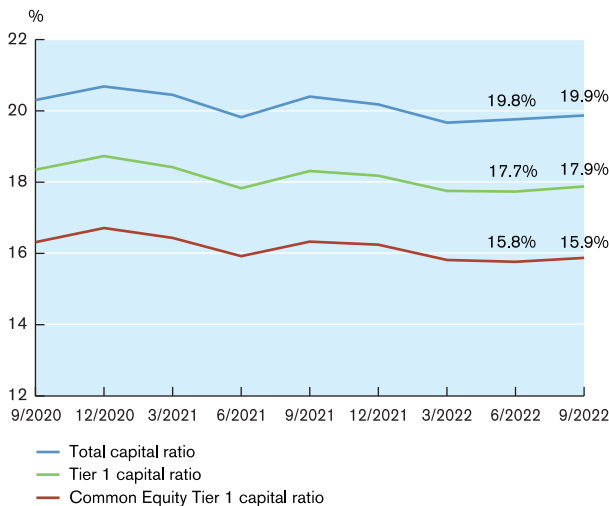
Note: For a category 1 institution, the statutory minimum requirement of the LCR is 100%. A category 2 institution must maintain an LMR of not less than 25% on average in each calendar month.

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 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 16****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 18

Surveyed AIs reported a slight decrease in their holdings of debt securities compared with a year ago

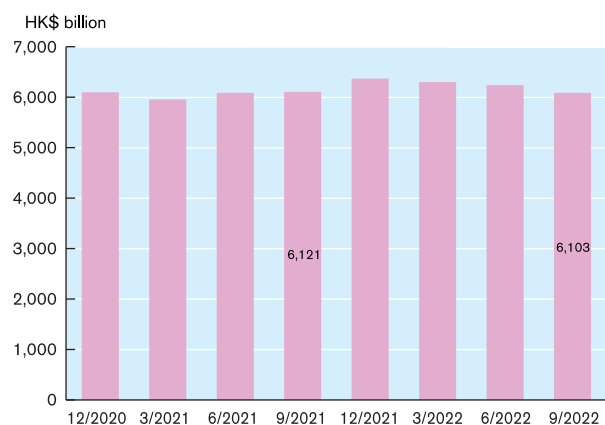


Exhibit 19

Debt securities held by surveyed AIs were predominantly investment grade securities

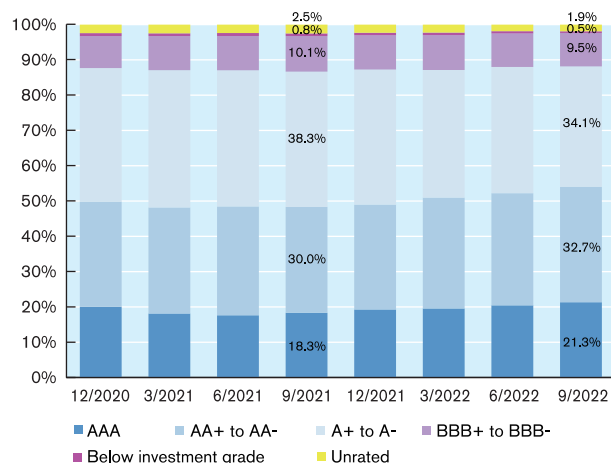


Exhibit 20

Most of the debt securities were issued by governments and banks

(% of total debt securities holdings)	All surveyed AIs							
	Dec 2020	Mar 2021	Jun 2021	Sep 2021	Dec 2021	Mar 2022	Jun 2022	Sep 2022
Types of instrument and issuer								
Part 1: Debt securities other than securitisation products³								
Governments and international organizations, of which:	49.0%	47.7%	47.3%	47.4%	49.2%	49.6%	50.0%	50.6%
Exchange Fund bills and notes	18.6%	19.3%	19.2%	19.2%	19.3%	20.7%	21.0%	22.2%
US Treasury bills, notes and bonds	7.4%	6.9%	6.9%	7.6%	8.6%	8.3%	9.2%	10.4%
Public sector entities	5.8%	6.2%	6.3%	6.3%	6.5%	6.9%	6.7%	6.7%
Banks	26.0%	26.1%	26.1%	25.1%	24.1%	23.3%	24.0%	23.9%
Corporates	12.4%	13.2%	13.5%	14.0%	13.3%	13.3%	12.4%	12.0%
Others	4.7%	5.0%	4.8%	4.9%	4.7%	4.7%	4.7%	4.5%
Part 2: Securitisation products								
Total securitisation products	2.0%	1.8%	2.0%	2.2%	2.2%	2.2%	2.3%	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 21

Total notional amount of all outstanding derivatives contracts increased

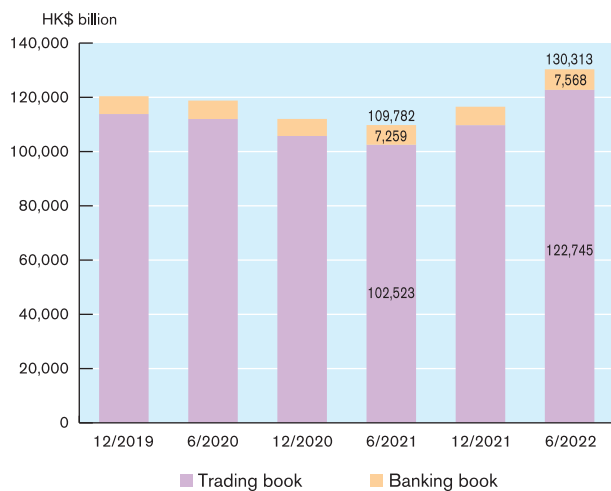


Exhibit 22

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

(% of total)	All AIs					
	Dec 2019	Jun 2020	Dec 2020	Jun 2021	Dec 2021	Jun 2022
Derivatives product						
Exchange-traded derivatives	0.7%	0.6%	0.6%	0.7%	0.8%	0.8%
OTC derivatives	99.3%	99.4%	99.4%	99.3%	99.2%	99.2%
of which:						
Forwards	25.1%	24.2%	25.2%	26.6%	24.5%	23.4%
Swaps	68.7%	68.5%	68.3%	66.1%	67.5%	69.0%
Options	2.9%	3.5%	3.4%	4.1%	4.3%	4.2%
Credit derivatives	0.7%	0.8%	0.7%	0.6%	0.5%	0.5%
Others	1.9%	2.4%	1.9%	1.9%	2.5%	2.1%

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.

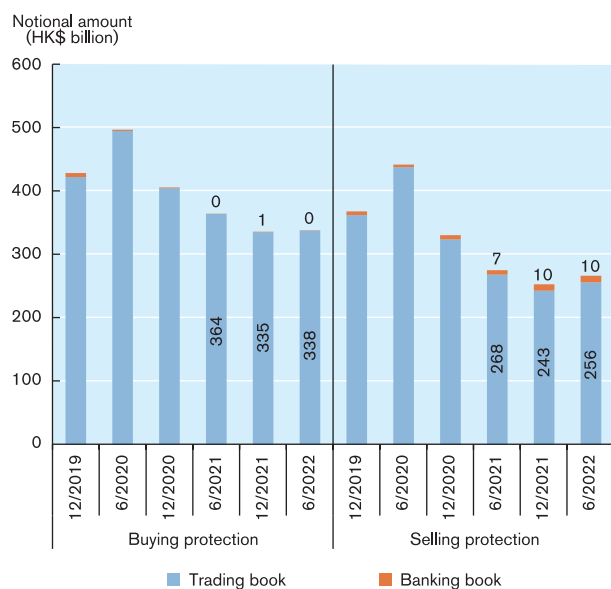
Exhibit 23

Derivatives contracts held were predominantly interest rate and foreign exchange contracts

(% of total) Underlying risk	All AIs					
	Dec 2019	Jun 2020	Dec 2020	Jun 2021	Dec 2021	Jun 2022
Interest rate risk	47.5%	47.4%	47.5%	46.6%	48.9%	49.7%
Foreign exchange risk	51.1%	50.9%	50.9%	51.7%	49.5%	49.0%
Equity risk	0.7%	0.8%	0.9%	0.9%	0.9%	0.7%
Commodity risk	0.0%	0.0%	0.1%	0.1%	0.1%	0.1%
Credit risk	0.7%	0.8%	0.7%	0.6%	0.5%	0.5%
Other risks	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

Exhibit 24

The notional amount of credit derivatives contracts shrank



APPENDIX

KEY PERFORMANCE INDICATORS OF THE BANKING SECTOR¹ (%)

	Sep 2021	Jun 2022	Sep 2022
Interest rates			
1-month HIBOR fixing ² (quarterly average)	0.07	0.31	1.63
3-month HIBOR fixing (quarterly average)	0.15	0.88	2.42
BLR ³ and 1-month HIBOR fixing spread (quarterly average)	4.93	4.69	3.41
BLR and 3-month HIBOR fixing spread (quarterly average)	4.85	4.12	2.62
Composite interest rate ⁴	0.19	0.47	0.99
Balance sheet developments⁵	All AIs		
Total deposits	-1.2	-0.7	+0.3
Hong Kong dollar	-4.9	+0.1	-2.7
Foreign currency	+2.8	-1.5	+3.2
Total loans	-2.0	-0.4	-1.5
Domestic lending ⁶	-3.6	+0.1	-0.8
Loans for use outside Hong Kong ⁷	+2.2	-1.7	-3.0
Negotiable instruments			
Negotiable certificates of deposit (NCDs) issued	-1.5	+8.1	-3.4
Negotiable debt instruments held (excluding NCDs)	+1.0	-1.2	-2.8
Asset quality			
As a percentage of total loans ⁸			
Pass loans	97.69	97.11	97.08
Special mention loans	1.50	1.79	1.73
Classified loans ⁹ (gross)	0.81	1.10	1.19
Classified loans (net) ¹⁰	0.43	0.63	0.68
Overdue > 3 months and rescheduled loans	0.60	0.66	0.71
Classified loan ratio (gross) of Mainland related lending ¹¹	0.78	1.50	1.80
Liquidity ratios (consolidated)			
Liquidity Coverage Ratio — applicable to category 1 institutions (quarterly average)	155.5	154.9	156.3
Liquidity Maintenance Ratio — applicable to category 2 institutions (quarterly average)	58.2	58.4	60.5
Net Stable Funding Ratio — applicable to category 1 institutions	133.8	134.1	133.4
Core Funding Ratio — applicable to category 2A institutions	147.6	147.7	150.3
Profitability	Retail banks		
Loan impairment charges as a percentage of average total assets (year-to-date annualised)	0.04	0.13	0.16
Net interest margin (year-to-date annualised)	0.98	1.03	1.17
Cost-to-income ratio (year-to-date)	51.7	53.9	50.9
Asset quality	Surveyed institutions		
Delinquency ratio of residential mortgage loans	0.03	0.05	0.04
Credit card lending			
Delinquency ratio	0.22	0.25	0.24
Charge-off ratio — quarterly annualised	1.84	1.88	1.68
— year-to-date annualised	1.90	1.59	1.59
Capital adequacy (consolidated)	All locally incorporated AIs		
Common Equity Tier 1 capital ratio	16.3	15.8	15.9
Tier 1 capital ratio	18.3	17.7	17.9
Total capital ratio	20.4	19.8	19.9
Leverage ratio	8.0	7.7	7.8

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 Al'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 Al's Mainland branches and subsidiaries.