

Developments in the Banking Sector

by Banking Supervision Department

HIGHLIGHTS OF KEY TRENDS

Banking sector performance

Overview

- The Hong Kong banking sector remained strong and resilient. Banks in Hong Kong continued to maintain adequate capital and liquidity buffers. Despite an increase in the classified loan ratio, the asset quality of the banking sector stayed healthy.

Profitability

- The aggregate pre-tax operating profit of retail banks increased by 141.3% year on year in the first quarter of 2023 (Exhibit 1). The improvement in profit was mainly due to increases in net interest income and income from investments held for trading, coupled with a decrease in loan impairment charges. Against the backdrop of rising interest rates, the net interest margin of retail banks widened to 1.56% in the first quarter of 2023, compared with 0.98% during the same period last year (Exhibit 2).

Balance sheet trends

- Total loans of the banking sector rose by 0.9% in the first quarter of 2023 (Exhibit 5). Among the total, loans for use in Hong Kong increased by 1.5% while trade finance and loans for use outside Hong Kong declined by 0.9% and 0.4% respectively. Mainland-related lending also increased by 0.6% during the same period (Exhibit 6).

- Banking deposits remained stable. Total deposits increased by 0.5% in the first quarter of 2023, with Hong Kong dollar deposits growing by 2.6%. The overall loan-to-deposit ratio edged up to 68.7% at the end of March 2023 from 68.5% a quarter earlier (Exhibit 7).

Loan quality, liquidity conditions and capital adequacy

- The classified loan ratio of the banking sector increased to 1.45% at the end of March 2023 from 1.38% a quarter earlier. The classified loan ratio for Mainland-related lending also increased to 2.25% from 2.21% (Exhibit 10). During the same period, the delinquency ratio of credit card lending edged up to 0.25% from 0.23%, while that of residential mortgage loans remained stable at 0.06% (Exhibit 12).
- The banking sector continued to be liquid and well capitalised. The average Liquidity Coverage Ratio of category 1 institutions was 166.0% in the first quarter of 2023, well above the statutory minimum requirement of 100% (Exhibit 14). The total capital ratio of locally incorporated authorized institutions (AIs) stood at 20.8% at the end of March 2023 (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 2023 vs Q1 2022	
	Percentage change	Contribution to the percentage change in pre-tax operating profit (ppt)
Net interest income	+58.6%	+92.9
Income from investments held for trading*	+293.0%	+34.6
Loan impairment charges	-55.7%	+14.3
Pre-tax operating profit	+141.3%	

* In absolute terms, income from investments held for trading rose by HK\$8 billion.

Exhibit 2

Net interest margin (year-to-date annualised) of retail banks widened further in the first quarter of 2023

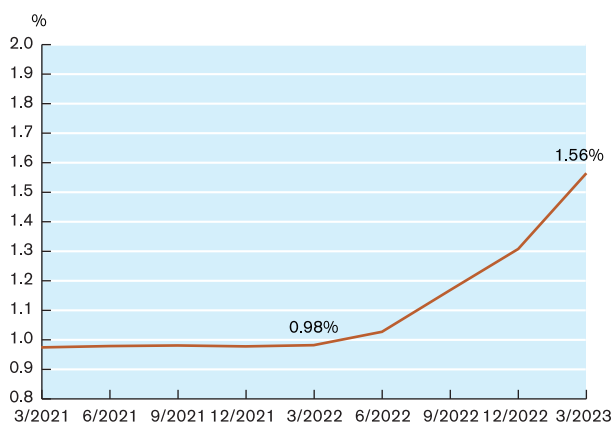
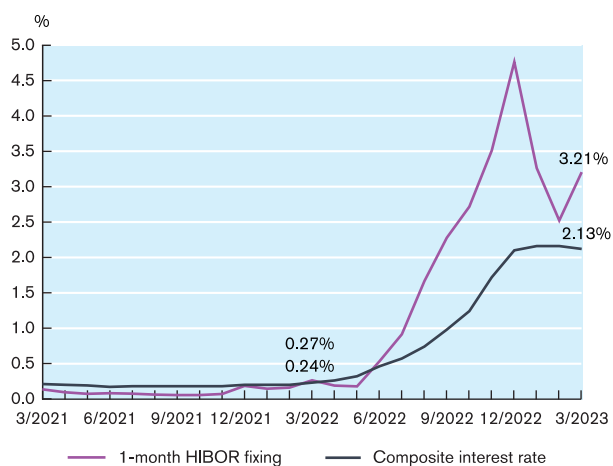


Exhibit 3

Hong Kong dollar interbank interest rates receded from the peak in late 2022 while composite interest rate moved up at a slower pace

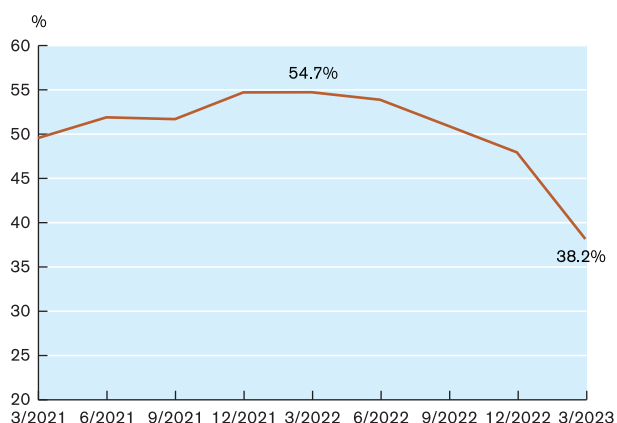


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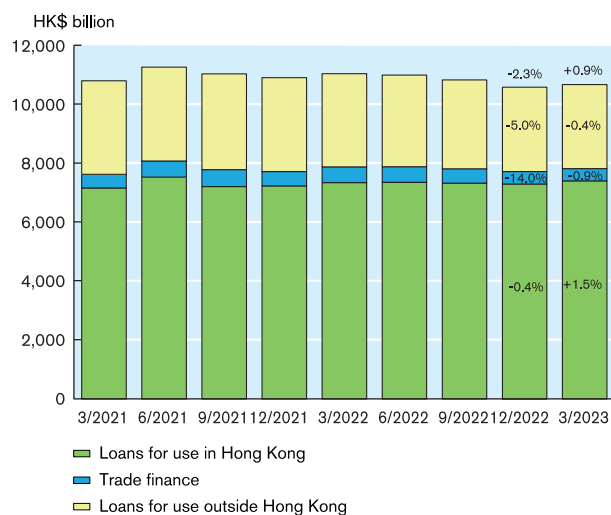
- HIBOR fixing (monthly average) refers to the Hong Kong Interbank Offered Rates released by the Hong Kong Association of Banks.
- The composite interest rate is a weighted average interest rate of all Hong Kong-dollar interest-rate-sensitive liabilities of retail banks.

Exhibit 4

Cost-to-income ratio (year-to-date) of retail banks decreased in the first quarter of 2023

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

Total loans increased by 0.9% in the first quarter of 2023



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 2023 were:

Key items	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)	+1.2%	+0.6
Loans to professionals & private individuals for other private purposes	+2.7%	+0.2
Electricity and gas	+9.8%	+0.2
Loans for use in Hong Kong	+1.5%	

Exhibit 6

Mainland-related lending

	Dec 2022 HK\$ billion	Mar 2023 HK\$ billion
Mainland-related loans excluding trade finance	4,254	4,247
Trade finance	268	303
Total	4,522	4,551

Exhibit 7

Both total loans and total deposits increased in the first quarter of 2023

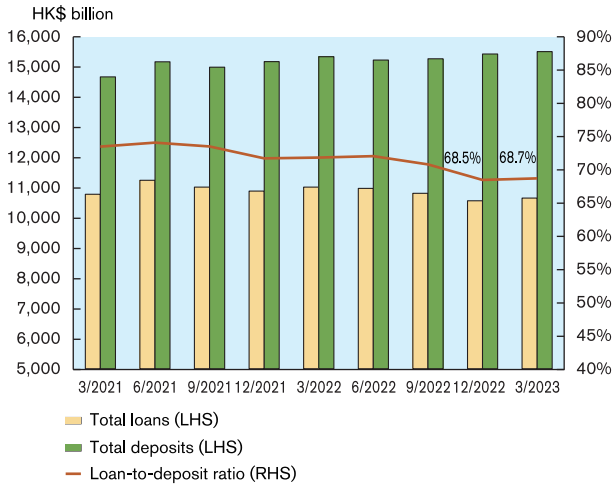


Exhibit 9

A majority of respondents to the Hong Kong Monetary Authority Opinion Survey on Credit Conditions Outlook expected loan demand to remain stable or strengthen in the next three months

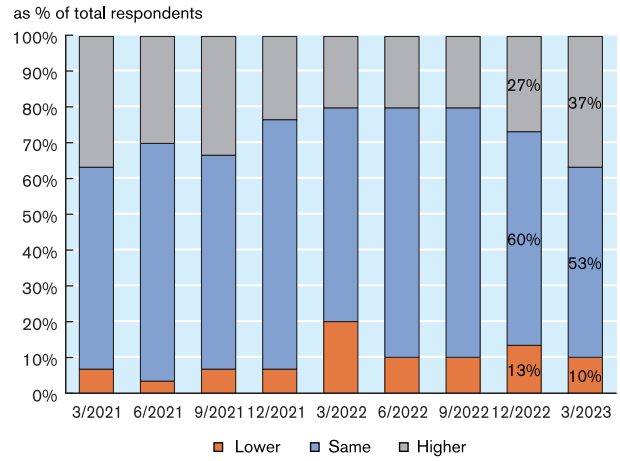
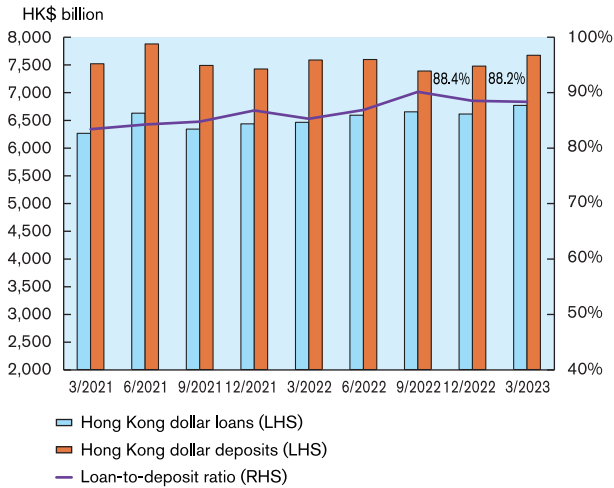


Exhibit 8

Hong Kong dollar loan-to-deposit ratio remained stable in the first quarter of 2023



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 2022	Jun 2022	Sep 2022	Dec 2022	Mar 2023
	<i>% of total loans</i>				
Special mention loans	1.66	1.79	1.73	2.03	1.97
Classified loans (gross)	0.98	1.10	1.19	1.38	1.45
of which:					
Substandard	0.40	0.49	0.54	0.63	0.54
Doubtful	0.50	0.54	0.56	0.66	0.80
Loss	0.08	0.08	0.09	0.10	0.11
Classified loans (net of specific provisions)	0.56	0.63	0.69	0.79	0.83
Overdue > 3 months and rescheduled loans	0.60	0.66	0.71	0.85	0.99
of which:					
Overdue > 3 months	0.46	0.53	0.58	0.73	0.87
Rescheduled loans	0.14	0.13	0.13	0.12	0.13
	<i>% of Mainland-related lending</i>				
Classified loans (gross) of Mainland-related lending**	1.15	1.50	1.80	2.21	2.25

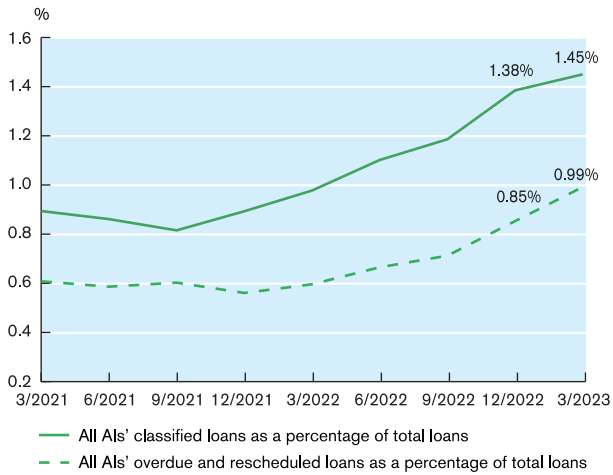
Note: Figures may not add up to total due to rounding.

* 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 2023 but remained healthy



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

Exhibit 12

Delinquency ratio of residential mortgages remained stable while that of credit card lending edged up

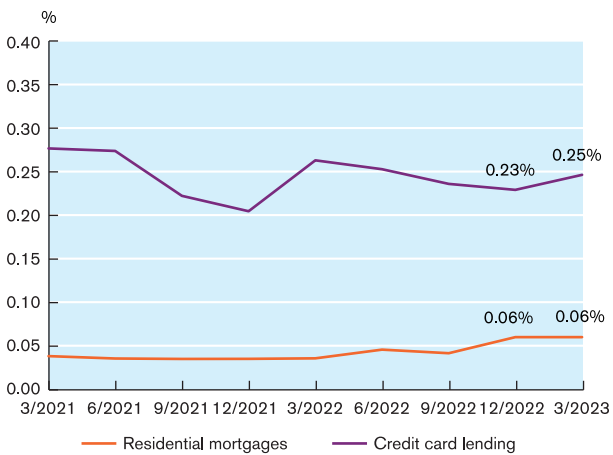
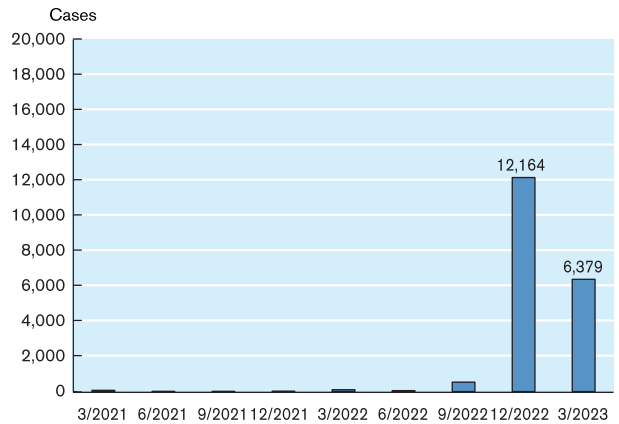


Exhibit 13

The number of negative equity cases* dropped in the first quarter of 2023 after a surge in the fourth quarter of 2022

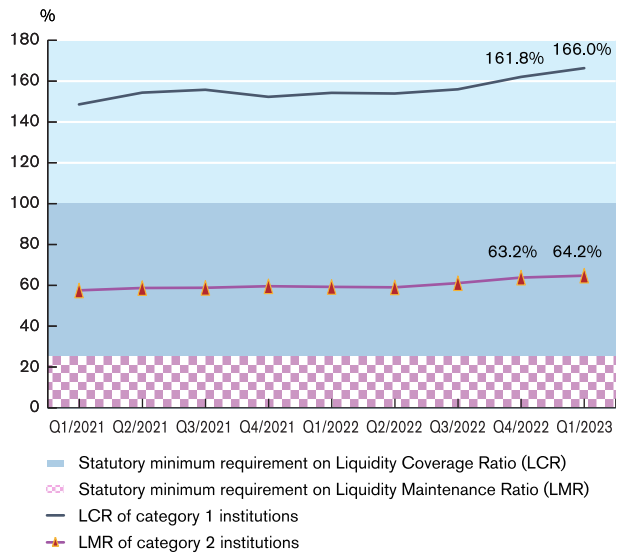


* These cases were related to bank staff housing loans or residential mortgage loans under the mortgage insurance programme, which generally have a higher loan-to-value ratio.

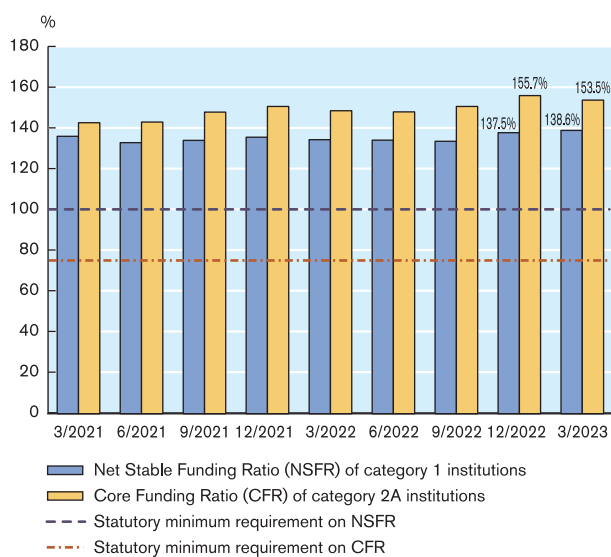
Liquidity conditions

Exhibit 14

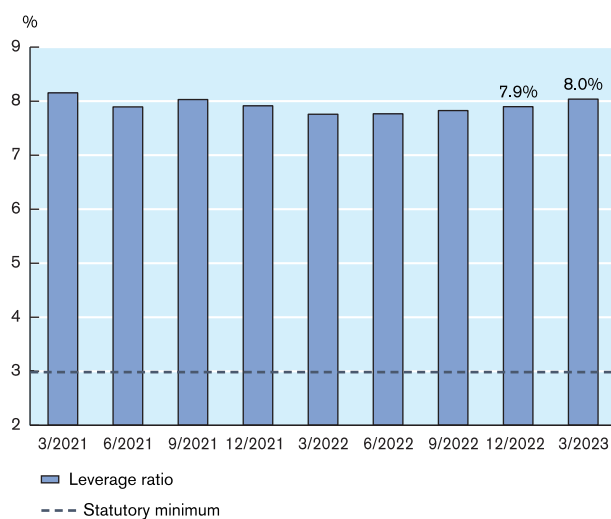
Liquidity positions of AIs have strengthened



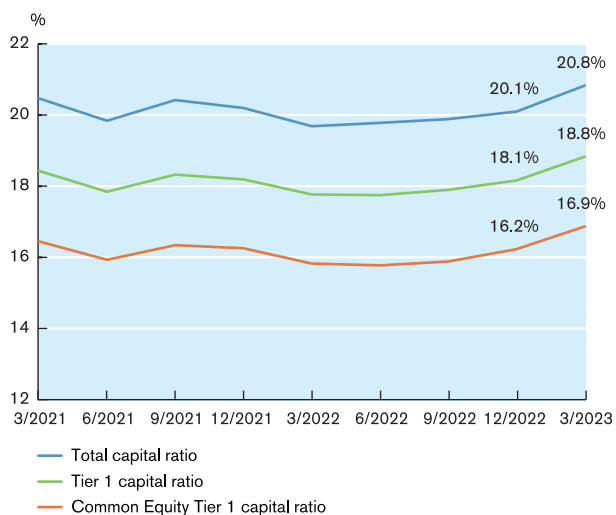
Note: For a category 1 institution, the statutory minimum requirement of the LCR is 100%. A category 2 institution must maintain an LMR of not less than 25% on average in each calendar month.

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**

APPENDIX

KEY PERFORMANCE INDICATORS OF THE BANKING SECTOR¹ (%)

	Mar 2022	Dec 2022	Mar 2023
Interest rates			
1-month HIBOR fixing ² (quarterly average)	0.20	3.67	3.01
3-month HIBOR fixing (quarterly average)	0.41	4.75	3.82
BLR ³ and 1-month HIBOR fixing spread (quarterly average)	4.80	1.65	2.62
BLR and 3-month HIBOR fixing spread (quarterly average)	4.59	0.58	1.81
Composite interest rate ⁴	0.24	2.11	2.13
Balance sheet developments⁵	All AIs		
Total deposits	+1.1	+1.0	+0.5
Hong Kong dollar	+2.2	+1.2	+2.6
Foreign currency	+0.0	+0.9	-1.4
Total loans	+1.2	-2.3	+0.9
Domestic lending ⁶	+2.0	-1.3	+1.4
Loans for use outside Hong Kong ⁷	-0.7	-5.0	-0.4
Negotiable instruments			
Negotiable certificates of deposit (NCDs) issued	-9.7	+9.2	-2.0
Negotiable debt instruments held (excluding NCDs)	-0.5	+3.7	+3.8
Asset quality			
As a percentage of total loans ⁸			
Pass loans	97.37	96.59	96.58
Special mention loans	1.66	2.03	1.97
Classified loans ⁹ (gross)	0.98	1.38	1.45
Classified loans (net) ¹⁰	0.56	0.79	0.83
Overdue > 3 months and rescheduled loans	0.60	0.85	0.99
Classified loan ratio (gross) of Mainland related lending ¹¹	1.15	2.21	2.25
Liquidity ratios (consolidated)			
Liquidity Coverage Ratio — applicable to category 1 institutions (quarterly average)	153.9	161.8	166.0
Liquidity Maintenance Ratio — applicable to category 2 institutions (quarterly average)	58.6	63.2	64.2
Net Stable Funding Ratio — applicable to category 1 institutions	134.1	137.5	138.6
Core Funding Ratio — applicable to category 2A institutions	148.2	155.7	153.5
Profitability	Retail banks		
Loan impairment charges as a percentage of average total assets (year-to-date annualised)	0.13	0.20	0.06
Net interest margin (year-to-date annualised)	0.98	1.31	1.56
Cost-to-income ratio (year-to-date)	54.7	48.0	38.2
Asset quality	Surveyed institutions		
Delinquency ratio of residential mortgage loans	0.04	0.06	0.06
Credit card lending			
Delinquency ratio	0.26	0.23	0.25
Charge-off ratio — quarterly annualised	1.50	1.50	1.60
— year-to-date annualised	1.50	1.49	1.60
Capital adequacy (consolidated)	All locally incorporated AIs		
Common Equity Tier 1 capital ratio	15.8	16.2	16.9
Tier 1 capital ratio	17.8	18.1	18.8
Total capital ratio	19.7	20.1	20.8
Leverage ratio	7.7	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 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.