

# Developments in the Banking Sector

by Banking Supervision Department

## HIGHLIGHTS OF KEY TRENDS

### Banking sector performance

#### Overview

- The Hong Kong banking sector remained sound and resilient, underpinned by strong capital and liquidity buffers. The classified loan ratio increased during the third quarter of 2023, but the asset quality of the banking sector stayed healthy.

#### Profitability

- The aggregate pre-tax operating profit of retail banks increased by 88.8% year on year in the first three quarters of 2023 (Exhibit 1). The improvement in profit was mainly due to an increase in net interest income, coupled with increases in income from investments held for trading, as well as income from foreign exchange and derivatives operations. This was partly offset by an increase in loan impairment charges. Against the backdrop of rising interest rates, the net interest margin of retail banks widened to 1.68% in the first three quarters of 2023, compared with 1.17% during the same period last year (Exhibit 2).

#### Balance sheet trends

- Total loans of the banking sector decreased by 2.2% in the third quarter of 2023 (Exhibit 5). Among the total, loans for use in Hong Kong, loans for use outside Hong Kong and trade finance declined by 1.9%, 2.8% and 2.9%

respectively. Mainland-related lending also decreased by 2.2% during the same period (Exhibit 6).

- Banking deposits remained stable. Total deposits increased by 2.1% in the third quarter of 2023, with US dollar deposits increasing by 4.5% and Hong Kong dollar deposits decreasing by 0.1%. The overall loan-to-deposit ratio decreased to 65.2% at the end of September 2023 from 68.0% a quarter earlier (Exhibit 7).

#### Loan quality, liquidity conditions and capital adequacy

- The classified loan ratio of the banking sector increased to 1.61% at the end of September 2023 from 1.50% a quarter earlier. The classified loan ratio for Mainland-related lending also increased to 2.68% from 2.41% (Exhibit 10). During the same period, the delinquency ratio of credit card lending edged up to 0.28% from 0.26%, while that of residential mortgage loans remained stable at 0.07% (Exhibit 12).
- The banking sector continued to be liquid and well capitalised. The average Liquidity Coverage Ratio of category 1 institutions was 174.5% in the third 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 20.9% at the end of September 2023 (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 AIs<sup>1</sup> increased by 13.9% to HK\$6,952 billion at the end of September 2023 from HK\$6,104 billion a year ago (Exhibit 18). The credit quality of these securities remained high as over 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 9.9% to HK\$143 trillion at the end of June 2023

from HK\$130 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 2023 (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\$8 billion at the end of June 2023.

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

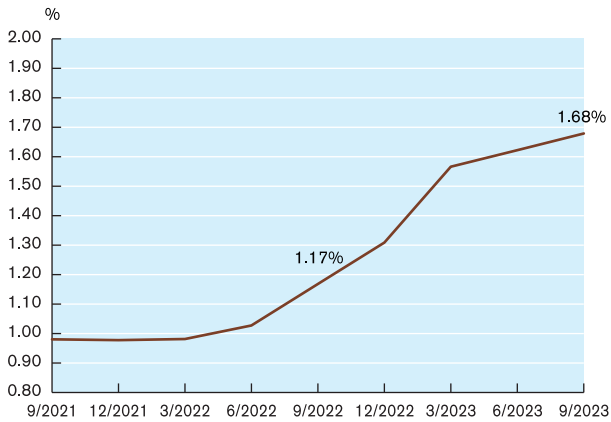
| Key items   | Change of pre-tax operating profit<br>Q1-Q3 2023 vs Q1-Q3 2022 |   |
|---|--|---|
|   | Percentage change  | Contribution to the percentage change in pre-tax operating profit (ppt) |
| Net interest income                                     | +43.7%   | +69.9   |
| Income from investments held for trading*               | +1,231.8%*   | +16.8   |
| Income from foreign exchange and derivatives operations | +41.6%   | +13.7   |
| Loan impairment charges                                 | +27.9%   | -7.2  |
| <b>Pre-tax operating profit</b>                         | <b>+88.8%</b>  |   |

\* In absolute terms, income from investments held for trading rose by HK\$13.6 billion, compared to an increase in overall pre-tax operating profit by HK\$71.9 billion.

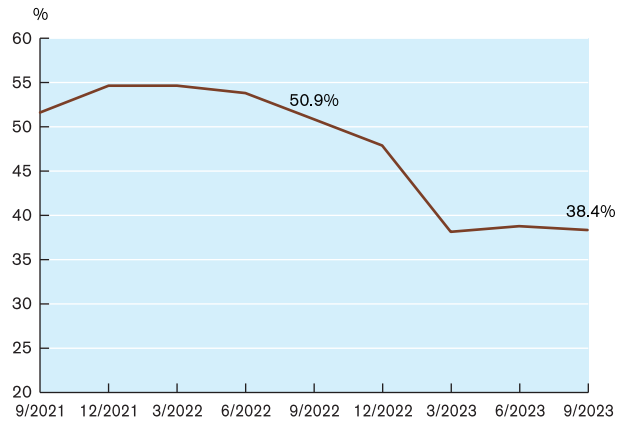
<sup>1</sup> This survey covers all licensed banks and restricted licence banks.

**Exhibit 2**

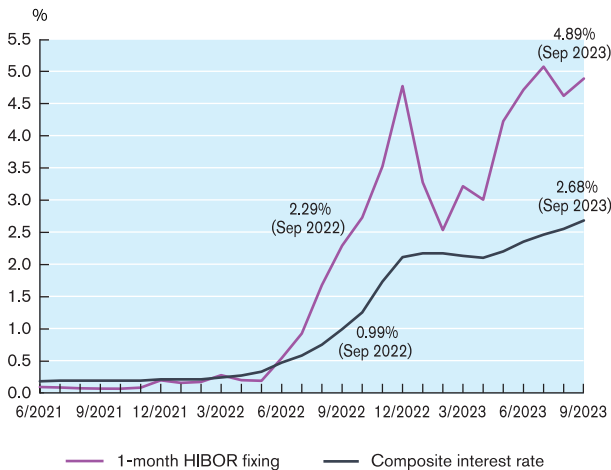
Net interest margin (year-to-date annualised) of retail banks widened in the first three quarters of 2023 compared with the same period last year

**Exhibit 4**

Cost-to-income ratio (year-to-date) of retail banks decreased in the first three quarters of 2023 compared with the same period last year

**Exhibit 3**

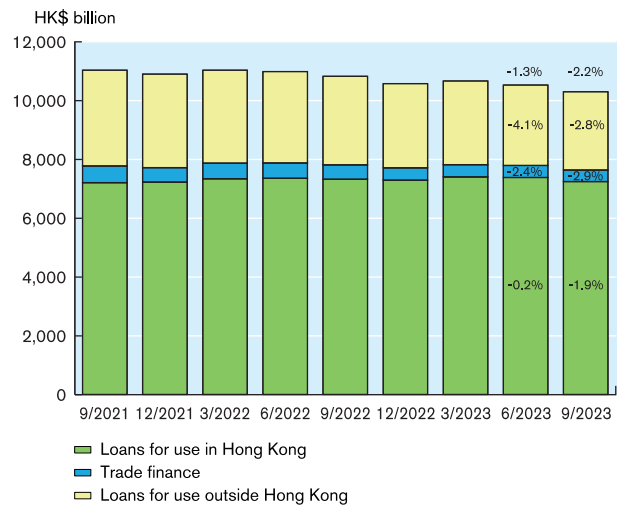
Both the Hong Kong dollar interbank interest rates and composite interest rate trended higher in the third quarter of 2023

**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-rate-sensitive liabilities of retail banks.

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

Total loans decreased by 2.2% in the third quarter of 2023

**Notes:**

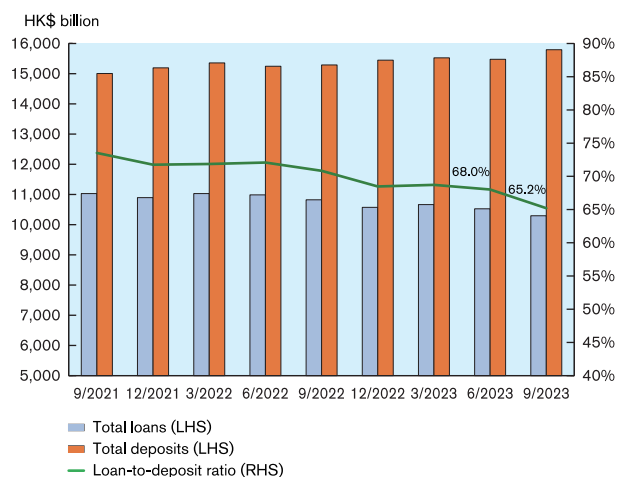
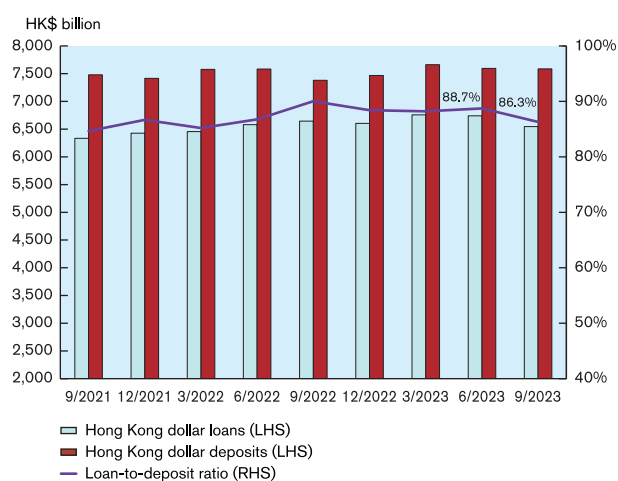
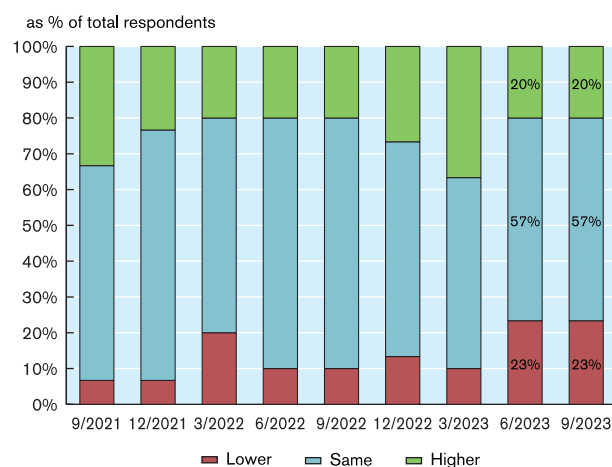
- "Loans for use outside Hong Kong" include "others" (i.e. unallocated).
- Percentage denotes quarter-on-quarter growth rate.

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 2023 were:

| Key items   | Percentage change | Contribution to the percentage change in loans for use in Hong Kong (ppt) |
|---|-------------------|---|
| Financial concerns  | -5.1%             | -0.7  |
| Property lending (including residential mortgage loans and loans for property development and investment) | -0.9%             | -0.4  |
| Manufacturing   | -3.5%             | -0.1  |
| Wholesale and retail trade  | -3.0%             | -0.1  |
| <b>Loans for use in Hong Kong</b>   | <b>-1.9%</b>      |   |

**Exhibit 6****Mainland-related lending**

|  | Jun 2023<br>HK\$bn | Sep 2023<br>HK\$bn |
|--|--------------------|--------------------|
| Mainland-related loans excluding trade finance | 4,108              | 4,025              |
| Trade finance                                  | 281                | 266                |
| <b>Total</b>                                   | <b>4,389</b>       | <b>4,291</b>       |

**Exhibit 7****Total loan-to-deposit ratio decreased in the third quarter of 2023****Exhibit 8****Hong Kong dollar loan-to-deposit ratio edged down in the third quarter of 2023****Exhibit 9****The proportion of respondents to the Hong Kong Monetary Authority Opinion Survey on Credit Conditions Outlook expecting loan demand to be lower in the next three months remained unchanged**

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 2022                             | Dec 2022    | Mar 2023    | Jun 2023    | Sep 2023    |
|---|--------------------------------------|-------------|-------------|-------------|-------------|
|   | <i>% of total loans</i>              |             |             |             |             |
| <b>Special mention loans</b>                                  | <b>1.73</b>                          | <b>2.02</b> | <b>1.98</b> | <b>1.93</b> | <b>1.90</b> |
| <b>Classified loans (gross)</b>                               | <b>1.19</b>                          | <b>1.40</b> | <b>1.46</b> | <b>1.50</b> | <b>1.61</b> |
| of which:   |                                      |             |             |             |             |
| Substandard   | 0.54                                 | 0.64        | 0.55        | 0.55        | 0.54        |
| Doubtful  | 0.56                                 | 0.66        | 0.80        | 0.80        | 0.87        |
| Loss  | 0.09                                 | 0.10        | 0.11        | 0.16        | 0.21        |
| <b>Classified loans (net of specific provisions)</b>          | <b>0.69</b>                          | <b>0.81</b> | <b>0.83</b> | <b>0.84</b> | <b>0.87</b> |
| <b>Overdue &gt; 3 months and rescheduled loans</b>            | <b>0.71</b>                          | <b>0.85</b> | <b>1.00</b> | <b>1.09</b> | <b>1.23</b> |
| of which:   |                                      |             |             |             |             |
| Overdue > 3 months  | 0.58                                 | 0.73        | 0.87        | 0.93        | 1.06        |
| Rescheduled loans   | 0.13                                 | 0.12        | 0.13        | 0.16        | 0.17        |
|   | <i>% of Mainland-related lending</i> |             |             |             |             |
| <b>Classified loans (gross) of Mainland-related lending**</b> | <b>1.80</b>                          | <b>2.26</b> | <b>2.26</b> | <b>2.41</b> | <b>2.68</b> |

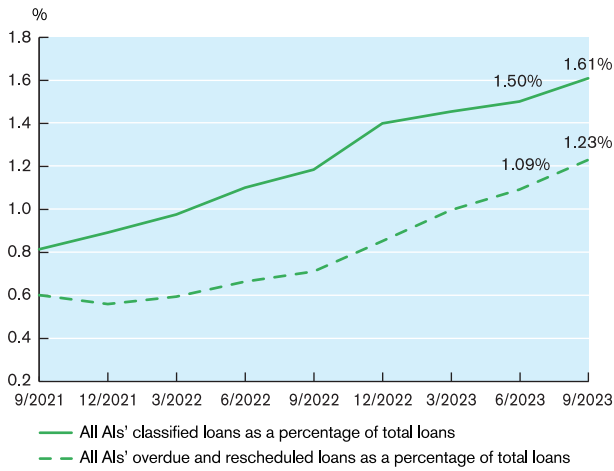
Note: Figures may not add up to total due to rounding.

\* 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**

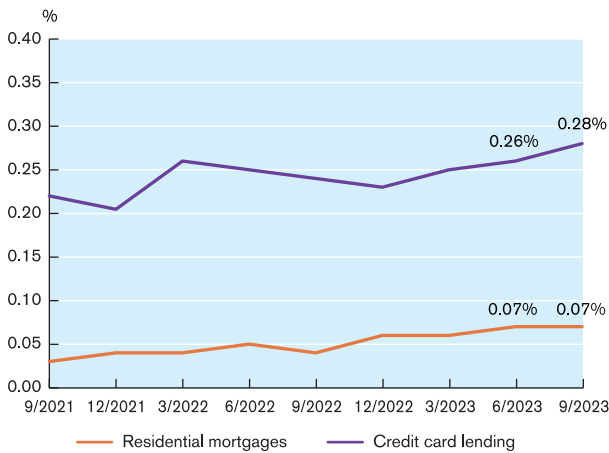
The banking sector's overall asset quality deteriorated in the third quarter of 2023 but remained healthy



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

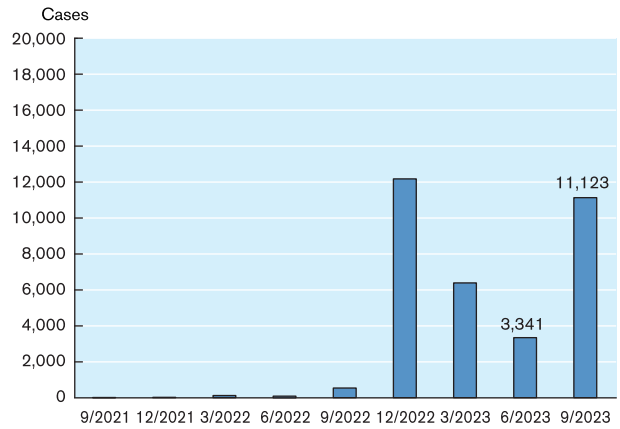
**Exhibit 12**

Delinquency ratio of residential mortgages remained stable while that of credit card lending edged up in the third quarter of 2023



**Exhibit 13**

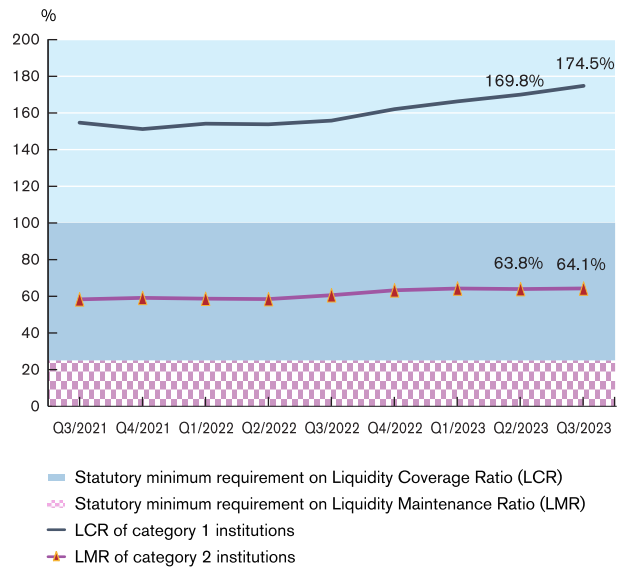
The number of negative equity cases increased in the third quarter of 2023



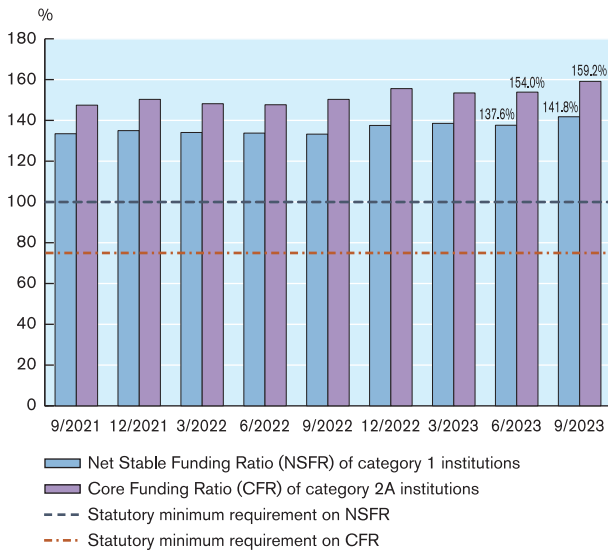
**Liquidity conditions**

**Exhibit 14**

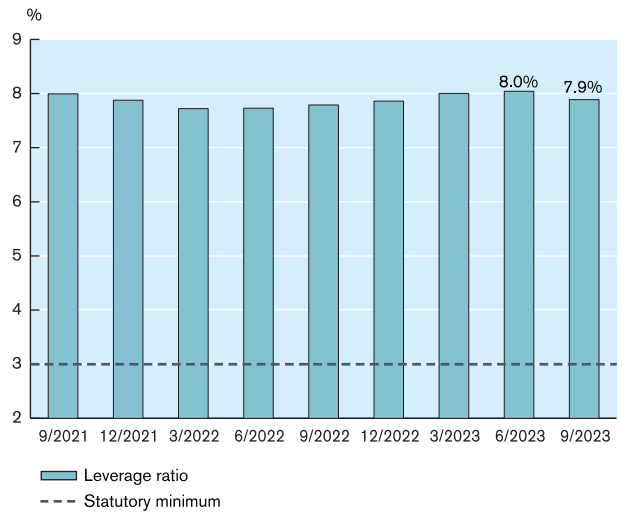
Liquidity positions of AIs have strengthened



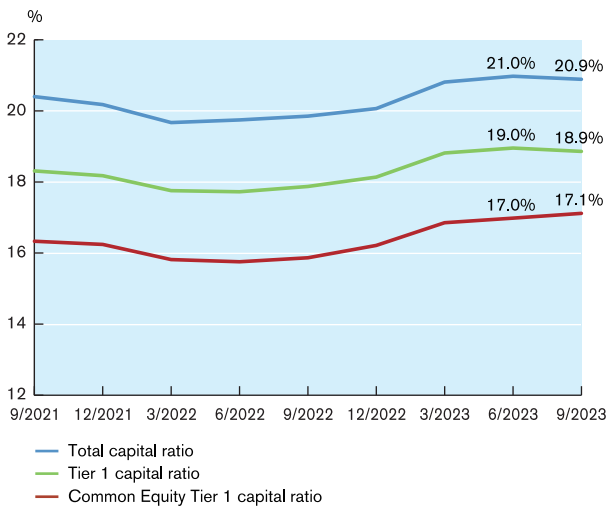
Note: For a category 1 institution, the statutory minimum requirement of the LCR is 100%. A category 2 institution must maintain an LMR of not less than 25% on average in each calendar month.

**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%.

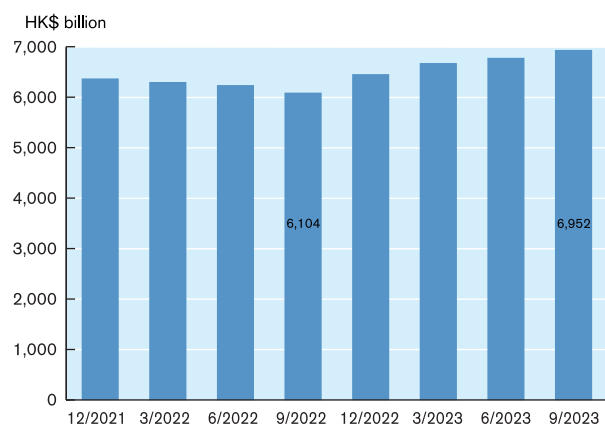
**Capital adequacy****Exhibit 16****Capital positions of locally incorporated AIs remained strong**

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

### Debt securities held<sup>2</sup>

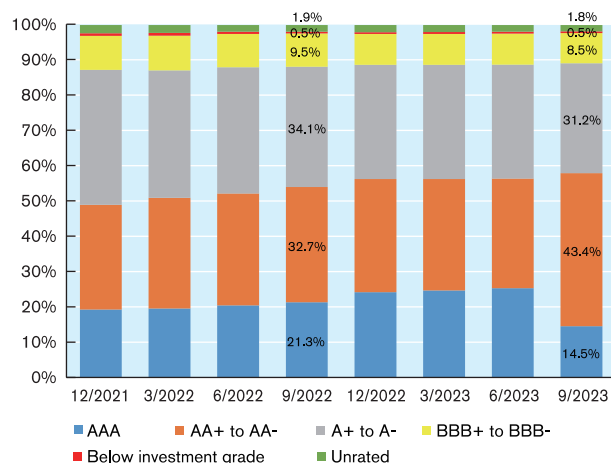
**Exhibit 18**

Surveyed AIs reported an increase 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 2021         | Mar 2022 | Jun 2022 | Sep 2022 | Dec 2022 | Mar 2023 | Jun 2023 | Sep 2023 |
| <b>Part 1: Debt securities other than securitisation products<sup>3</sup></b> |                  |          |          |          |          |          |          |          |
| Governments and international organisations, of which:                        | 49.2%            | 49.6%    | 50.0%    | 50.6%    | 53.0%    | 52.4%    | 53.2%    | 54.0%    |
| Exchange Fund bills and notes   | 19.3%            | 20.7%    | 21.0%    | 22.2%    | 20.7%    | 20.2%    | 19.9%    | 19.6%    |
| US Treasury bills, notes and bonds  | 8.6%             | 8.3%     | 9.2%     | 10.4%    | 13.4%    | 13.4%    | 13.8%    | 14.7%    |
| Public sector entities  | 6.5%             | 6.9%     | 6.7%     | 6.7%     | 6.7%     | 7.7%     | 7.9%     | 7.9%     |
| Banks   | 24.1%            | 23.3%    | 24.0%    | 23.9%    | 23.1%    | 22.9%    | 22.3%    | 21.8%    |
| Corporates  | 13.3%            | 13.3%    | 12.4%    | 12.0%    | 11.0%    | 10.9%    | 10.2%    | 9.9%     |
| Others  | 4.7%             | 4.7%     | 4.7%     | 4.5%     | 4.1%     | 4.0%     | 4.3%     | 4.3%     |
| <b>Part 2: Securitisation products</b>  |                  |          |          |          |          |          |          |          |
| Total securitisation products   | 2.2%             | 2.2%     | 2.3%     | 2.2%     | 2.1%     | 2.1%     | 2.1%     | 2.1%     |

<sup>2</sup> 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.

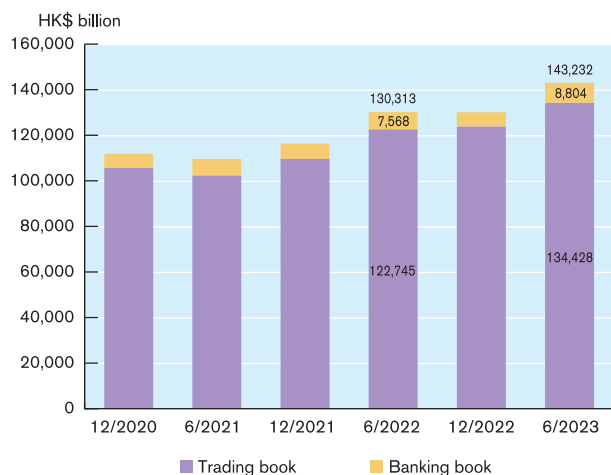
<sup>3</sup> Securitisation products include asset-backed securities, mortgage-backed securities, collateralised debt obligations, notes issued by structured investment vehicles, asset-backed commercial papers, and other similar structured credit products.



## Exposures to Derivatives<sup>4</sup>

### 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 2020 | Jun 2021 | Dec 2021 | Jun 2022 | Dec 2022 | Jun 2023 |
| <b>Derivatives product</b>         |          |          |          |          |          |          |
| <b>Exchange-traded derivatives</b> | 0.6%     | 0.7%     | 0.8%     | 0.8%     | 0.8%     | 0.7%     |
| <b>OTC derivatives</b>             | 99.4%    | 99.3%    | 99.2%    | 99.2%    | 99.2%    | 99.3%    |
| of which:                          |          |          |          |          |          |          |
| Forwards                           | 25.2%    | 26.6%    | 24.5%    | 23.4%    | 22.8%    | 23.2%    |
| Swaps                              | 68.3%    | 66.1%    | 67.5%    | 69.0%    | 70.0%    | 70.6%    |
| Options                            | 3.4%     | 4.1%     | 4.3%     | 4.2%     | 4.0%     | 4.1%     |
| Credit derivatives                 | 0.7%     | 0.6%     | 0.5%     | 0.5%     | 0.5%     | 0.4%     |
| Others                             | 1.9%     | 1.9%     | 2.5%     | 2.1%     | 2.0%     | 1.0%     |

<sup>4</sup> 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.

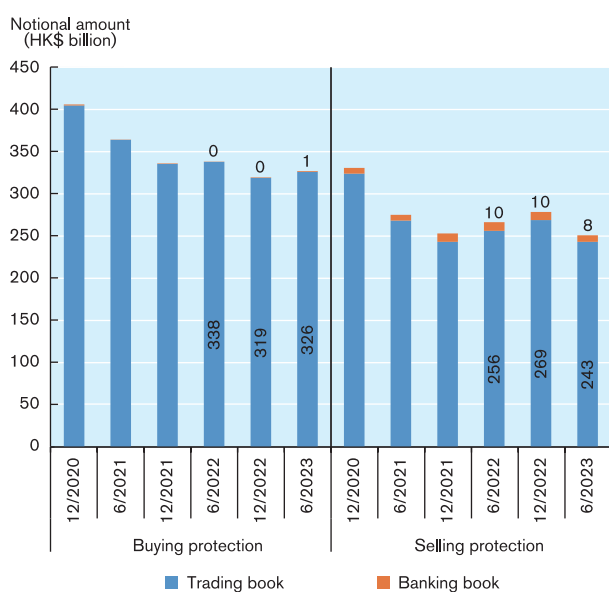
**Exhibit 23**

Derivatives contracts held were predominantly interest rate and foreign exchange contracts

| (% of total)          | All AIs  |          |          |          |          |          |
|-----------------------|----------|----------|----------|----------|----------|----------|
|                       | Dec 2020 | Jun 2021 | Dec 2021 | Jun 2022 | Dec 2022 | Jun 2023 |
| Underlying risk       |          |          |          |          |          |          |
| Interest rate risk    | 47.5%    | 46.6%    | 48.9%    | 49.7%    | 50.1%    | 49.8%    |
| Foreign exchange risk | 50.9%    | 51.7%    | 49.5%    | 49.0%    | 48.7%    | 49.0%    |
| Equity risk           | 0.9%     | 0.9%     | 0.9%     | 0.7%     | 0.7%     | 0.7%     |
| Commodity risk        | 0.1%     | 0.1%     | 0.1%     | 0.1%     | 0.1%     | 0.1%     |
| Credit risk           | 0.7%     | 0.6%     | 0.5%     | 0.5%     | 0.5%     | 0.4%     |
| 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 SECTOR<sup>1</sup> (%)

|   | Sep 2022                            | Jun 2023 | Sep 2023 |
|---|-------------------------------------|----------|----------|
| <b>Interest rates</b>   |                                     |          |          |
| 1-month HIBOR fixing <sup>2</sup> (quarterly average)                                     | 1.63                                | 3.98     | 4.86     |
| 3-month HIBOR fixing (quarterly average)  | 2.42                                | 4.28     | 5.03     |
| BLR <sup>3</sup> and 1-month HIBOR fixing spread (quarterly average)                      | 3.38                                | 1.72     | 0.98     |
| BLR and 3-month HIBOR fixing spread (quarterly average)                                   | 2.59                                | 1.42     | 0.82     |
| Composite interest rate <sup>4</sup>  | 0.99                                | 2.35     | 2.68     |
| <b>Balance sheet developments<sup>5</sup></b>   | <b>All AIs</b>                      |          |          |
| Total deposits  | +0.3                                | -0.3     | +2.1     |
| Hong Kong dollar  | -2.7                                | -0.9     | -0.1     |
| Foreign currency  | +3.3                                | +0.2     | +4.2     |
| Total loans   | -1.5                                | -1.3     | -2.2     |
| Domestic lending <sup>6</sup>   | -0.8                                | -0.4     | -1.9     |
| Loans for use outside Hong Kong <sup>7</sup>  | -3.0                                | -4.1     | -2.8     |
| Negotiable instruments  |                                     |          |          |
| Negotiable certificates of deposit (NCDs) issued  | -3.4                                | -5.4     | -13.1    |
| Negotiable debt instruments held (excluding NCDs)   | -2.8                                | +0.8     | +1.3     |
| <b>Asset quality</b>  |                                     |          |          |
| As a percentage of total loans <sup>8</sup>   |                                     |          |          |
| Pass loans  | 97.08                               | 96.57    | 96.49    |
| Special mention loans   | 1.73                                | 1.93     | 1.90     |
| Classified loans <sup>9</sup> (gross)   | 1.19                                | 1.50     | 1.61     |
| Classified loans (net) <sup>10</sup>  | 0.69                                | 0.84     | 0.87     |
| Overdue > 3 months and rescheduled loans  | 0.71                                | 1.09     | 1.23     |
| Classified loan ratio (gross) of Mainland related lending <sup>11</sup>                   | 1.80                                | 2.41     | 2.68     |
| <b>Liquidity ratios (consolidated)</b>  |                                     |          |          |
| Liquidity Coverage Ratio — applicable to category 1 institutions (quarterly average)      | 155.6                               | 169.8    | 174.5    |
| Liquidity Maintenance Ratio — applicable to category 2 institutions (quarterly average)   | 60.5                                | 63.8     | 64.1     |
| Net Stable Funding Ratio — applicable to category 1 institutions                          | 133.3                               | 137.6    | 141.8    |
| Core Funding Ratio — applicable to category 2A institutions                               | 150.3                               | 154.0    | 159.2    |
| <b>Profitability</b>  | <b>Retail banks</b>                 |          |          |
| Loan impairment charges as a percentage of average total assets (year-to-date annualised) | 0.16                                | 0.14     | 0.20     |
| Net interest margin (year-to-date annualised)   | 1.17                                | 1.62     | 1.68     |
| Cost-to-income ratio (year-to-date)   | 50.9                                | 38.8     | 38.4     |
| <b>Asset quality</b>  | <b>Surveyed institutions</b>        |          |          |
| Delinquency ratio of residential mortgage loans   | 0.04                                | 0.07     | 0.07     |
| Credit card lending   |                                     |          |          |
| Delinquency ratio   | 0.24                                | 0.26     | 0.28     |
| Charge-off ratio — quarterly annualised   | 1.68                                | 1.76     | 1.88     |
| — year-to-date annualised   | 1.59                                | 1.67     | 1.72     |
| <b>Capital adequacy (consolidated)</b>  | <b>All locally incorporated AIs</b> |          |          |
| Common Equity Tier 1 capital ratio  | 15.9                                | 17.0     | 17.1     |
| Tier 1 capital ratio  | 17.9                                | 19.0     | 18.9     |
| Total capital ratio   | 19.9                                | 21.0     | 20.9     |
| Leverage ratio  | 7.8                                 | 8.0      | 7.9      |

## 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.