



Summary

The Hong Kong banking sector continued to show growth momentum in the first half of 2014 (1H 2014). The Hong Kong banks in our survey (“the surveyed banks”)¹ delivered sound profit results in 1H 2014 compared to the first half of 2013 (1H 2013), achieving a combined profit before tax growth of 7 percent compared to 1H 2013 (excluding HSBC’s 1H 2013 gain on the sale of Ping An and accounting gain on the reclassification of Industrial Bank Company Limited). Total assets grew by 4 percent, while investments (available-for-sale and trading securities) recorded a growth of 36 percent compared to 31 December 2013.

Notwithstanding the positive profit performance, the results were achieved in a challenging environment, with continued regulatory pressure, tightening margins and uncertainties in the external markets.

Revenue

- *Small improvements in NIM compared to 1H 2013, although low interest rate environment persists*
- *Lower overall growth rate of non-interest income than interest income*
- *Mixed performance in fee and commission income and treasury and trading income*

Net interest income

Overall, the surveyed banks experienced a modest increase in net interest margin (NIM)² in 1H 2014, with average NIM improving by 3 basis points compared to 1H 2013. Though NIM performance was mixed across the surveyed banks, Wing Lung Bank Limited (Wing Lung) recorded the highest increase in NIM of 23 basis points. On the other hand, NIM for The Bank of East Asia, Limited (BEA), DBS Bank (Hong Kong) Limited (DBS), Standard Chartered Bank (Hong Kong) Limited (SCB) and China Construction Bank (Asia) Corporation Limited (CCB (Asia)) decreased compared to 1H 2013 by roughly 5 basis points.

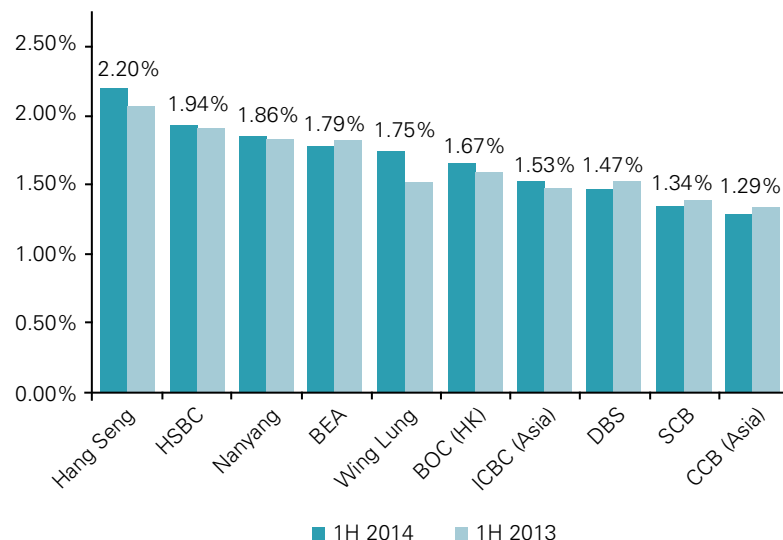
¹ The surveyed banks represent the top 10 locally incorporated licensed banks with the highest total assets among all locally incorporated licensed banks in Hong Kong as at 31 December 2013. These 10 banks also had the highest net profit after tax of all locally incorporated licensed banks in 2013.

² NIM is either quoted from public announcements or financial statements, or calculated based on annualised net interest income and interest-bearing assets or total assets, depending on the availability of information.



NIM for The Hongkong and Shanghai Banking Corporation Limited (HSBC) was broadly flat. However, NIM for Hang Seng Bank Limited (Hang Seng) improved by 13 basis points, mainly because of the improved spread on customer lending, notably term lending offset by narrower deposit spreads in Hong Kong’s competitive deposit market. For HSBC’s Hong Kong operations, NIM dropped from 1.36 percent to 1.21 percent, primarily because of an increase in its surplus deposits deployed in lower yielding assets following the transfer of the Global Private Banking business from HSBC Private Bank (Suisse) SA in late 2013.³ The overall growth in net interest income of the surveyed banks compared to 1H 2013 was 12 percent.

Net interest margin – surveyed banks



Source: Extracted from individual banks’ financial and public statements

³ HSBC 2014 Interim Consolidated Results – Highlights, p. 21, <http://www.hsbc.com/-/media/HSBC-com/InvestorRelationsAssets/interim-results-2014/hbap2014irn-hk-en.pdf>



Non-interest income

Our 31 December 2013 analysis showed a double-digit year-on-year growth in non-interest income for the surveyed banks. Our 1H 2014 survey reveals that non-interest income continues to grow, though at a slower pace. While the performance across the surveyed banks was mixed, the average growth was 7 percent (excluding HSBC's gain on the sale of Ping An and accounting gain on the reclassification of Industrial Bank Company Limited). Growth in non-interest income was mainly attributed to growth in fees and commissions, and trading income. This was driven by the surveyed banks' continued focus on exploring and expanding the cross-selling of products to customers, and also because of general positive market sentiment.

Of the surveyed banks, SCB and CCB (Asia) recorded the highest growth in fee and commission income of 44 percent and 27 percent respectively compared to 1H 2013.

Similarly, for trading activities, the surveyed banks recorded mixed performances. The overall growth in trading income compared to 1H 2013 was 45 percent. HSBC recorded significant growth (107 percent) when aggregating trading activities and items held at fair value through profit or loss, whereas SCB, DBS and Bank of China (Hong Kong) Limited (BOC (HK)) recorded a decrease in trading income of 50 percent, 25 percent and 15 percent respectively compared to 1H 2013. The decrease for SCB, DBS and BOC (HK) was mainly a result of reduced client demand following the renminbi band widening and mark-to-market changes for certain foreign exchange products and equity instruments.⁴ HSBC's increase was mainly due to higher investment returns on assets held by insurance business in Hong Kong, driven by improved equity markets in 1H 2014, as well as the non-recurrence of adverse fair value movements on the Ping An contingent forward sale contract in 1H 2013.⁵

⁴ Standard Chartered PLC – Highlights for the six months ended 30 June 2014, p. 11, http://files.shareholder.com/downloads/STANCHAR/3556954750x0x774125/C684C79E-9AD0-4599-9242-58FF4952CBEA/SC_PL_C_HY_2014_Press_Release_06_August_FINAL.pdf and BOC Hong Kong (Holdings) Limited 2014 Interim Results Announcement 2014, p. 7, http://www.bochk.com/ir/pdf/announcement_2014-08-19a_e.pdf

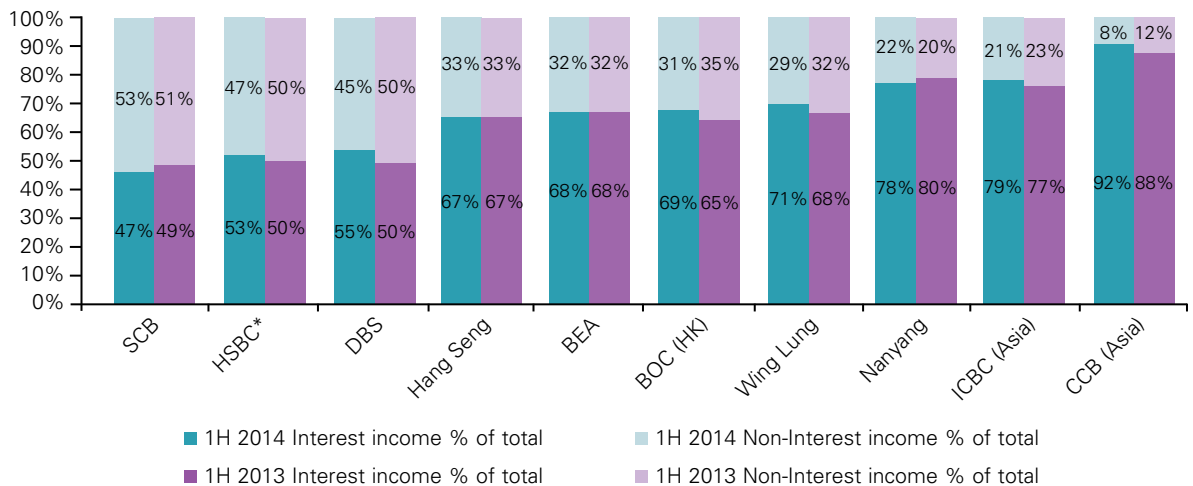
⁵ HSBC 2014 Interim Consolidated Results – Highlights, pp. 13-14, <http://www.hsbc.com/-/media/HSBC-com/InvestorRelationsAssets/interim-results-2014/hbap2014irn-hk-en.pdf>

Income mix

In 1H 2014, the income mix of the surveyed banks varied, with interest income making up between 47 percent and 92 percent of total operating income. The income mix across the surveyed banks reflected a general shift towards interest income during 1H 2014, as we found that the proportion of interest income as a component of total operating income, on an overall basis, increased from 57 percent to 59 percent (excluding HSBC’s 1H 2013 gain on the sale of Ping An and accounting gain on the reclassification of Industrial Bank Company Limited). This was in contrast to 2013, where we saw an increase in the proportion of non-interest income in the total operating income.

Among the surveyed banks, DBS had a comparatively large increase in interest income as a percentage of total operating income compared to 1H 2013. This was mainly as a result of the lower non-interest income in 1H 2014 due to lower foreign exchange trading income and the non-recurrence of net gain on the disposal of non-current assets.

Interest and non-interest income mix – surveyed banks



* HSBC’s 1H 2013 non-interest income excludes the gain from the sale of Ping An and accounting gain on the reclassification of Industrial Bank Company Limited.

Source: Extracted from individual banks’ financial and public statements



Costs

- *Cost discipline remained a key focus for the surveyed banks*
- *Marginal increase in cost-to-income ratio for the surveyed banks in 1H 2014 compared to 1H 2013*

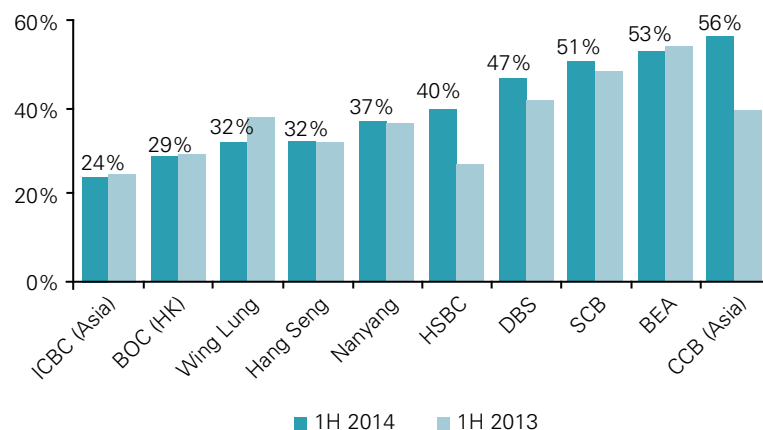
Costs

It is evident that cost discipline remains a key focus for the surveyed banks. The simplification of operating models, greater levels of offshoring, and strategic initiatives to improve productivity will continue to be priorities. Regulatory and compliance costs and increased competition in the sector are expected to continue putting pressure on the cost-to-income ratio.

For the half year, the surveyed banks recorded a marginal increase in the average cost-to-income ratio from 39 percent to 41 percent (excluding the effect of HSBC's 1H 2013 gain on the sale of Ping An and accounting gain on the reclassification of Industrial Bank Company Limited). Our analysis shows that in absolute terms, the growth rate in total operating expenses for the surveyed banks was stable at 9 percent compared to 1H 2013, however, the total operating income decreased by 10 percent in 1H 2014 (excluding the effect of HSBC's 1H 2013 gain on the sale of Ping An and accounting gain on the reclassification of Industrial Bank Company Limited).

Of the surveyed banks, CCB (Asia) showed the most significant increase in its cost-to-income ratio, from 39 percent in 1H 2013 to 56 percent in 1H 2014. The bank had a 13 percent growth rate in operating expenses in 1H 2014, mainly due to the increase in staff costs by 14 percent and a decrease in total operating income of 21 percent. HSBC's significant increase in cost-to-income ratio from 27 percent in 1H 2013 to 40 percent in 1H 2014 was mainly due to the one-off gain from the sale of its Ping An investment and a gain on the reclassification of Industrial Bank Company Limited in 1H 2013. Excluding the impact of these two gains, HSBC's cost-to-income ratio was 42 percent in 1H 2013.

Cost-to-income ratio – surveyed banks



Source: Extracted from individual banks' financial and public statements

Loans and advances

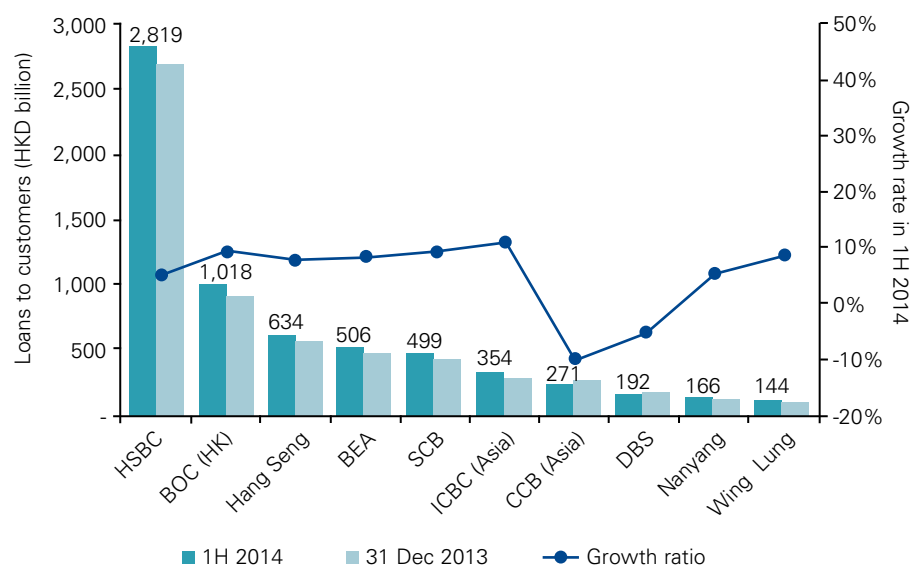
- *Lending growth momentum was subdued*
- *Growth remained strong in trade finance and loans for use outside Hong Kong*
- *Credit quality remained strong, with no observed weaknesses*

Loans and advances

Our 2013 analysis showed that the total loans and advances for the surveyed banks rose at an average of 14 percent year-on-year. During 1H 2014, the growth momentum was 6 percent in aggregate compared to 31 December 2013. We expect the growth rate of total loans and advances in 2014 to be less than in 2013, as the banks tend to have more growth in the first half of the year. While personal lending, commercial and mortgage books reduced by 12 percent, 3 percent and 2 percent respectively, the growth compared to the 2013 year end mainly stemmed from growth in trade finance and loans for use outside Hong Kong, which grew by 17 percent and 16 percent respectively.

Of the surveyed banks, CCB (Asia) and DBS witnessed a fall in their loans and advances balance of 10 percent and 5 percent respectively compared to 31 December 2013, largely due to a reduction in trade bills. On the other hand, Industrial and Commercial Bank of China (Asia) Limited (ICBC (Asia)) recorded 11 percent growth, primarily due to growth in its commercial lending and trade finance portfolios.

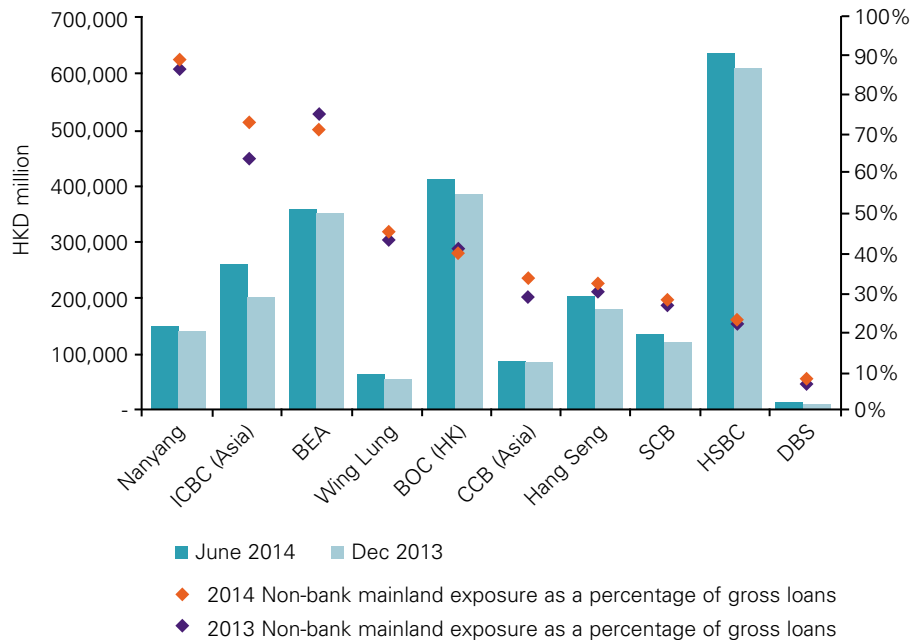
Loans and growth rates – surveyed banks



Source: Extracted from individual banks' financial and public statements

At the end of 1H 2014, although the gross impaired advances to customers for the surveyed banks increased by HKD 2.1 billion compared to 2013, the overall asset quality of the loan portfolio remained healthy, with the impaired loan ratio fairly steady at a low level of 0.40 percent at the end of 1H 2014 compared to 0.38 percent at the end of 2013.

Non-bank mainland exposures – surveyed banks



Source: Extracted from individual banks' financial and public statements

While the mainland China economy sustained its growth momentum, particularly in the second quarter of 2014, the surveyed banks' overall exposure to non-bank mainland China-related business remained stable compared to the 2013 year end. The total exposure witnessed an aggregate growth of 4 percent to HKD 2,337 billion at the end of 1H 2014 compared to the 2013 year end. Our survey indicates that for surveyed banks, while the non-bank mainland exposure as a percentage of gross loans remained fairly stable as at 1H 2014 compared to 31 December 2013, ICBC (Asia) witnessed a growth of 9 percentage points in its non-bank mainland exposures as at 1H 2014 compared to 31 December 2013 due to increased lending to state-owned entities.

HKMA statistics indicate that the total non-bank mainland exposure of all authorised institutions reached HKD 3,936 billion at the end of 1H 2014, from HKD 3,602 billion six months earlier. With increased supervisory focus and potential mainland-related risks, the growth momentum has become more moderate (quarterly growth in 2Q 2013 was 12 percent, while the quarterly growth rate in 2Q 2014 reduced to 3 percent).

List of banks in this article

BEA	The Bank of East Asia, Limited
BOC (HK)	Bank of China (Hong Kong) Limited
CCB (Asia)	China Construction Bank (Asia) Corporation Limited
DBS	DBS Bank (Hong Kong) Limited
Hang Seng	Hang Seng Bank Limited
HSBC	The Hongkong And Shanghai Banking Corporation Limited
ICBC (Asia)	Industrial And Commercial Bank of China (Asia) Limited
Nanyang	Nanyang Commercial Bank, Limited
SCB	Standard Chartered Bank (Hong Kong) Limited
Wing Lung	Wing Lung Bank Limited

Financial Highlights

For the half year ended 30 June 2014

HKD millions	BEA	BOC (HK)	CCB (Asia)	DBS	Hang Seng	HSBC	ICBC (Asia)	Nanyang	SCB	Wing Lung
Income statement										
Net interest income	6,241	14,588	2,125	2,243	9,671	47,187	4,113	2,564	6,815	1,914
Non-interest income	2,961	6,588	188	1,807	4,802	41,348	1,090	721	7,645	782
Operating expenses	4,893	6,092	1,302	1,890	4,640	35,666	1,262	1,209	7,331	858
Loan impairment charges	319	377	93	133	337	1,594	274	281	1,282	63
Profit before tax	4,482	14,830	898	2,027	9,877	59,096	3,723	1,856	6,504	1,878
Net profit after tax	3,632	12,056	702	1,699	8,468	49,904	3,000	1,512	5,747	1,551
Balance sheet										
Total assets	805,349	2,002,475	437,650	313,292	1,195,964	6,765,663	601,784	294,807	1,038,089	246,258
Gross loans and advances to customers ¹	505,570	1,018,136	270,743	192,372	634,413	2,818,972	354,152	166,013	498,628	144,107
Impairment allowances against customer advances	1,151	4,494	605	1,504	1,466	9,593	2,457	1,716	1,729	381
Deposits from customers	559,512	1,442,197	227,039	233,951	860,092	4,420,450	394,506	209,496	798,294	184,103
Total equity	71,210	162,531	42,302	31,984	109,501	555,732	47,865	33,432	60,551	21,418
Other key data/ratios										
Net interest margin ²	1.79%	1.67%	1.29%	1.47%	2.20%	1.94%	1.53%	1.86%	1.34%	1.75%
Liquidity ratio – average	50.2%	39.6%	53.8%	42.5%	34.5%	35.2%	46.6%	51.7%	34.5%	42.3%
Cost efficiency ratio ³	53.2%	28.8%	56.3%	46.7%	32.1%	40.3%	24.3%	36.8%	50.7%	31.8%
Impaired loan ratio ⁴	0.4%	0.3%	0.1%	0.6%	0.2%	0.5%	0.4%	0.6%	0.5%	0.1%
Non-bank mainland exposures	361,296	412,968	92,159	15,647	203,728	637,409	185,296	148,467	139,811	65,404

1 Gross loans and advances to customers include trade bills.

2 Net interest margin is either quoted from public announcements or financial statements, or calculated based on annualised net interest income and interest-bearing assets or total assets, depending on the availability of information.

3 Cost efficiency ratio is calculated as operating expenses divided by operating income.

4 Impaired loan ratio is calculated as gross impaired advances divided by gross advances to customers.

Source: Extracted from individual banks' financial and public statements

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Publication number: HK-FS14-0002

Publication date: November 2014

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