Transcript of Analyst Briefing for 2021 Annual Results

Question and answer session of analyst briefing

Tian Yafei from Citigroup: BOCHK's net interest margin in the fourth quarter of 2021 remained under pressure, while the market interest rates rebounded in the period, what was the reason? In expectation of US Fed to raise interest rates by 7 times, and assuming 25 basis points for each hike, how will it improve your margin and what is your guidance for 2022? Separately, your asset quality has been very stable, which is in stark contrast to your peers' trends, what is your asset quality outlook for this year?

Chief Financial Officer Liu Chenggang: Our adjusted net interest margin for the fourth quarter of 2021 was 1.06%, down 5 basis points quarter-on-quarter. This was mainly due to the substantial fund inflows in the period, while loan demand was not particularly strong. More excess funds in the short-term diluted margin, though it was moderately positive to net interest income.

Currently, the market is very certain about Fed's interest rate hike due to the highest inflation in the US in 40 years. The major certainty is whether it will raise 25 basis points or 50 basis points each time. Based on the operation of Hong Kong's linked exchange rate system, HIBOR will move up with LIBOR. The timing of Hong Kong dollar interest rate rise will depend on its liquidity. Our current view is HIBOR's rise will lag behind LIBOR's.

The positive impact of interest rate hikes to banks' net interest income and margins will be a gradual process. The boosting effect will depend on a number of external factors, including the frequency and magnitude of US interest rate hikes, how closely HIBOR will move along with LIBOR, the changes of treasury yield curve, etc.. Internally, it also depends on bank-specific factors such as asset-liability structure, as well as currency, product and interest rate mixes.

We have disclosed an interest rate sensitivity analysis in our annual report, which measures the net interest income changes in a period of 12 months as a result of market interest rate curves moving upward by certain basis points. It is just a static analysis based on a simulated scenario, which is therefore provided for rough reference only. Since assumptions can be different between banks, hence the outcomes of the impact analysis will vary. This is on top of the factor of substantial funds inflow mentioned before, which will also create periodic fluctuations.

Between 2016 and 2018, average 1M HIBOR and 1M LIBOR rose by 104 basis points and 152 basis points respectively, while our net interest margin expanded by 25 basis points. Of course, the history may not repeat itself, especially the pace of current US interest rate hikes will be more rapid.

Overall speaking, we will take advantage of interest rate hikes and continue to optimise our asset-liability mix, by increasing the proportions of high-yielding asset and high-margin currency assets, and by improving loan yield. Meanwhile, we will stabilise CASA mix, and better manage time deposit prices and tenors, while controlling interest rate and liquidity risks, so as to strive to achieve a steady rise in net interest margin.

Chief Risk Officer Jiang Xin: Our asset quality remained stable and sound in 2021 with the NPL ratio staying at 0.27% and provision coverage at 229%, both at a better level compared with the market. Our credit cost was 0.12%, down 4 basis points year-on-year.

For the outlook of 2022, as the fifth wave of pandemic broke out in Hong Kong since early this year, which came with tightened COVID prevention and control measures, has put service industries such as tourism, transportation, F&B, and retail under severe pressure. In addition, the continued tensions between China and the US, the geopolitical tensions, and the normalising monetary policies by major central banks, have intensified financial market turbulence and affected economic recovery. In 2022, we will continue to pay attention to the changes of financial conditions of our customers and asset quality, especially in those industries and regions that are seriously affected by the pandemic, and enhance our risk management and control. Overall, we are confident in maintaining our NPL ratio at a better level compared with the market. At the same time, we will timely adjust the macro-economic parameters of the ECL model based on our internal forecasts while taking into account of external professional institutions' forecasts.

We will strictly follow accounting standards, ensure prudent and sufficient provisions, and strive to maintain a relatively stable credit cost.

Gary Lam from HSBC: As you reported some provision release in the stage 1 credit cost in the second half of 2021 and given the ongoing fifth wave of pandemic, will you downgrade your ECL model parameters so that your provisions will increase in 2022? At the same time, your stage 2 provisions increased in the second half of last year, while your Southeast Asian entities' non-performing loans also rose, can you elaborate on the asset quality situation and the outlook for this year? Separately, CE Sun has affirmed the Company's intention to support real economy and stand with the society in tough times. In this context, I noted that Mainland regulators had more discussion on income concession in the form of cutting loan prices, will BOCHK be affected so that the profitability will be undermined?

Chief Risk Officer Jiang Xin: As regard to the change in the stage 1 provisions of our ECL model last year, it did reflect the updating of macro-economic parameters due to an improved economic outlook, which in fact began since the first half of 2021. For 2022, as we reported earlier, due to the resurgence of pandemic and rising geopolitical tensions, economic recovery will be affected. Therefore, we will continue to closely monitor the latest development and base on our judgement on the economic recovery progress as well as the external professional institutions' forecasts, to timely adjust the macro-economic parameters of our ECL model, which may induce changes to our provision charges. However we remain confident in maintaining a stable credit cost for the full year. As for the change in stage 2 provisions, there were two reasons. First, as certain customers under loan moratorium programme extended repayment period for multiple times due to the pandemic impact, we strengthened our asset quality control and specifically increased provision charges as part of our prudent provisioning policy. Secondly, there were other loans downgraded to stage 2 based on customers' own operating conditions or due to the pandemic impact. On geographical distribution, Southeast Asian entities accounted for a certain percentage of it as a result of the pandemic resurgence and heightened geopolitical tensions. For the whole year, we will adhere to our prudent provisioning policy and are confident in keeping a relatively stable credit cost.

Chief Executive Sun Yu: To address your question on loan pricing concession, I would like to highlight that the regulatory environment in Hong Kong is different from that in the Mainland. Banks in both markets are proactively fulfilling their social responsibilities, which are implemented in different ways and methods. BOCHK is a century-old bank with operations in Hong Kong for 105 years. We are also a listed banking group in the city and have been pursuing legal and compliant operations. We always put customers first and undertake social responsibility. For example, since the pandemic outbreak in 2020, we have proactively launched various financial relief initiatives. In response to the fifth wave of pandemic since early this year, we rolled out a new round of support measures and fulfilled our social responsibility as a core part of the ESG strategy.

Nick Lord from Morgan Stanley: BOCHK showed very effective cost control in 2021, what is the expectation of expense growth for 2022? As shown in your annual report, in terms of the impact of 100 basis point parallel shift in yield curve, when we think about that, I guess it is pretty easy with what we do in the Hong Kong dollar but your benefit on the RMB seems to be the opposite so you benefit from a downward shift in RMB interest rate curve. I guess that the environment where we have got is Hong Kong dollar interest rates rising and RMB rates falling, how will that translate into what happens to your net interest margin?

Chief Financial Officer Liu Chenggang: We reported a flat operating expense for 2021 compared with the previous year. In the face of income pressure, we continued to pursue low-carbon and intensive operations, with measures including branch network transformation, streamlined branch expenses and promotion of the use of e-statements, which helped us achieve a stable operating expense. For 2022, we will pursue sustainable high-quality development and allocate resources to meet basic operating needs as well as ensure strategic implementation, while optimising existing cost base to balance growth between expenses and income. In line with our low-carbon operating strategy, we will continue to drive digitalisation and promote the use of e-statements, process optimisation, network transformation and clean-up of inactive credit cards, so as to align our input and output. Through enhancing cost structure and exploring internal resources, we can support the needs of IT and digital development, and maintain our market-leading cost efficiency, with a long-term cost-to-income ratio within 35%.

As to the question on interest rate sensitivity, we have already provided some explanation in the previous question. Regarding our RMB business, it is affected by both onshore and offshore markets. Currently, Mainland’s policy is to maintain reasonably abundant liquidity, stable credit growth and continuous drop in corporate financing cost, while the offshore market could face different conditions which are subject to the influence of the international markets and such factors as politics, pandemic situation, and the movements of US dollar and Hong Kong dollar interest rates. Overall speaking, interest rate rise will benefit our net interest margin. We will also utilise various tools to improve our margin performances across different currencies. At present, net interest margin of our RMB business remains at a better level compared with that of US dollar and Hong Kong dollar. We will continue to leverage our RMB franchise and promote business growth, striving to achieve a steady rise in net interest margin.

Jemmy Huang from JP Morgan: According to the interest rate sensitivity analysis displayed in the latest annual report, your net interest margin reacted positively to US dollar interest rate rise in 2020, but it turned negative in 2021. How does the difference in asset structure lead to such change? Separately, although BOCHK has no business in Russia or eastern Europe, will some of your corporate clients’ business operations be affected by the situation there? Has your current ECL model captured the relevant impact?

Chief Financial Officer Liu Chenggang: Overall speaking, market interest rate rise will provide room for banking industry especially in enhancing asset yields. Our asset deployment will be adjusted across different periods, such as increase of debt securities investments. However, when analysing the impact of interest rate rise on banks' margins, changes in liability structure should also be considered. In particular, our main source of funding is low or no-cost CASA deposit and there are different models to approximate its interest rate sensitivity. Based on the prudent assumptions under regulatory approach, majority of our CASA deposits will be repriced within a year, which means their prices will rise with interest rate, but this scenario will not happen in a real world. In reality, customers will only move part of their CASA deposits to fixed deposits for generating higher returns. And a large part of CASA deposits will not be as sensitive as market rates. The final outcome will depend on the assumptions used, and any change to them will yield distinctively different results. In general, interest rate rises in Hong Kong dollar or US dollar will be positive to us. Meanwhile we will also adjust currency and term structures by using various financial products and instruments, to facilitate steady margin improvement.

Chief Risk Officer Jiang Xin: Since the geopolitical event happened, we have reviewed and examined our business and that of our credit clients. Currently, as our and our clients' business interactions with those regions is trivial, the relevant credit risk is controllable. While the situation continues to evolve, we will pay close attention to its impact on the financial market, ensure the effectiveness of early-warning, prevention and control of risks, and will take appropriate counter measures if further changes are seen.

Hou Dekai from CICC: Loan growth in Hong Kong turned negative year-on-year in this January. Was it because of the pandemic situation or the loan growth strategies of banks? What level of loan growth do you see at the moment? Will it affect your loan growth outlook for the whole year? Separately, as it is expected that the US interest rate rises will impact property prices in Hong Kong, what is your outlook on local residential mortgage demand for this year?

Deputy Chief Executive Wang Bing: In 2021, global economy gradually recovered while Hong Kong reversed the negative GDP growth trend in the previous two years. Overall business environment improved, supporting a local market loan growth of 3.8% from the end of previous year. Attributed to our solid customer base and a diversified business layout, our customer loans grew by 6.8%, outgrowing the system by 3 percentage points with our market share up 0.42 percentage point to 14.18%. We witnessed solid growth in both corporate and personal customer loans. Due to the severe pandemic situation in their markets, our Southeast Asian entities prudently developed business and achieved a loan growth of 2.1% in Hong Kong dollar terms. While continuing to grow customer loans, we attached high importance to the optimisation of loan portfolio and client composition. New loans were mainly underwritten with high-quality local, Mainland and Southeast Asian customers. Our overall asset quality remained better than that of our peers. In addition, we continued to maintain a market-leading position in local residential mortgage business and recorded solid loan growth in 2021. Since the first quarter of this year, we have witnessed a good loan growth momentum. Detailed information will be disclosed in our first quarter results release.

For 2022, uncertainties and downward risk on global economic growth are increasing due to the resurgence of pandemic and geopolitical tensions. We will closely monitor the changes in external environment and conduct potential risk analysis to maintain our forward-looking judgement, which is part of the risk management measures just introduced by our Chief Risk Officer earlier. We believe that with Hong Kong's implementation of pandemic prevention initiatives becoming effective, especially the notable increase in recent vaccination rate, and positive impact of the monetary and fiscal policies around the world, our external environment will gradually improve this year. We will focus on Hong Kong, cross-border GBA, Southeast Asian and other overseas markets. On the premise of ensuring manageable risk, we are confident in beating the market and achieve a mid to high-single digit loan growth for the full year.

Our position is well supported by our loan performance in the first quarter of this year. Although the external macro-environment remained uncertain, China continues to implement proactive fiscal policy and solid monetary policy. It has already launched a combination of tax and fee incentive of RMB2.5 trillion, and continuously increased government investments, so as to stabilise economic growth, which is expected to grow about 5.5% this year, a stable growth on a high base. Locally, the countercyclical support measures of more than HK$170 billion and the employment protection scheme of HK$31 billion launched by the latest Budget of HKSAR Government, will facilitate economic recovery and GDP growth. In terms of market opportunities, the pandemic situation in Southeast Asian countries will gradually improve, with IMF remaining relatively positive on their economic growth estimate.

Specifically, regional cooperation will be strengthened under the Regional Comprehensive Economic Partnership (RCEP). Proactively leveraging its headquarters role, BOCHK will coordinate its Southeast Asian entities, and foster closer collaboration with BOC branches in Tokyo, Seoul, Singapore, Sydney, New Zealand, etc, to drive business development in Hong Kong, Southeast Asian and overseas markets by focusing on regional industry and supply chains, cross-border trade and investment, as well as domestic trade and economic cooperation zones, so as to consolidate its cross-border business advantages. Meanwhile we will fully promote business development in key regions such as GBA, Yangtze River Delta and Beijing-Hebei-Tianjin region. Positioning GBA as the most important part of our cross-border market, we will capitalise on policy opportunities from Shenzhen Pilot Demonstration Area and Qianhai Cooperation Zone, and actively provide financial support to key customers in innovative technology and new service industries. Riding on BOC Group’s advantages, we will strive to participate in Hong Kong’s Northern Metropolis plan, support its construction, and promote its integrated development, by providing financing and financial service solutions to large infrastructure projects and innovative technology companies in the region.

In addition, we will consolidate our RMB franchise. We will step up forward-looking research on RMB policy, and capture opportunities of capital market opening-up. We will widen cooperation in RMB business with central government entities, SOEs, financial institutions, and participants of market interconnectivity. We will match with their RMB financing needs and promote the use of RMB in the offshore market, so as to steadily increase the scale of RMB loans.

Meanwhile, with Hong Kong building itself into a green finance hub, we will capture opportunities of green economies under the carbon peaking and carbon neutrality targets. We will continue to drive the development of low-carbon transformation of key industries including power, oil & petrochemistry, transport & transport equipment, and property, by providing credit support. We will focus on green industries such as energy conservation, environmental protection, new materials, new energy, etc, to provide our clients and their industry chains with diversified green financing products. We will support Hong Kong to build a carbon-trading center, and actively conduct R&D on carbon-related financing, settlement, clearing and custody businesses, to enrich our product system.

Lastly, we will grasp the digital opportunities. We will closely follow national strategies, and strengthen our digital industry research on key areas such as integrated circuit, new display technologies, communication equipment and intelligent hardware, so as to support the growth of industry leading players. In addition, we will proactively develop a service model for innovative tech firms, with focus on high-quality SMEs in key cross-border regions, while ensuring their demand for investment and financing will be met. Together with the technology & innovation investment funds, start-up investment and asset management companies within and outside BOC Group, we will strengthen partnership with Hong Kong Science and Technology Park, to provide financing and investment support to innovative tech firms across Shenzhen and Hong Kong. Therefore, we are highly confident in achieving a mid to high-single digit loan growth this year.

Deputy Chief Executive Kung Yeung Ann Yun Chi： Interest rate is an important element that affects market sentiment and affordability. Overall speaking, property market and mortgage loans will be affected by a combination of many factors. The property market in 2021 did very well in terms of price and volume, as we saw 3.3% increase in price and transaction volume of over 96,000, which grew by 31% compared with a year before. This has led to a 12.4% growth in our mortgage loans, which is faster than the 9.8% growth of the market, allowing us to retain number one position that is also supported by other factors including the extended use of our instant valuation service through API and increased popularity of applications via electronic channels. It was also helped by our introduction of the first green mortgages in the market.

As for property prices, we have seen that during the past 2 years, the market had been affected by various factors. And the price fluctuation has been within 7%. According to government's data up to February this year, residential housing prices had dropped by about 2.9% compared with last year end and about 4% from the historical high which happened last September. But against the end of 2020, there's still an increase of 0.6%. This indicates that the property prices continue to be around the level that is close to historic high range, rather resilient despite the various market conditions.

Looking ahead, it is expected that the local property market will continue to see challenges from the pandemic, geopolitical tensions, Fed’s stepping up pace on monetary policy normalisation and increased volatility in global financial market, etc.. These will trigger risk aversion which will negatively affect prices. At the same time, the market will also benefit from HKSAR Government’s measures to boost economy, its plan to gradually ease pandemic restrictions and increase in maximum property value eligible for Mortgage Insurance Program. In addition, the short-term housing supply continues to be on the tight side. Given also the ample liquidity in the local banking system and the expectation that Hong Kong’s interest rate hike will lag behind that of US, the property market for 2022 is projected to remain stable and the transaction volume is expected to gradually pick up again.

As mortgage has always been one of our strategic businesses, we will continue to improve our products, services and channels including our Home Expert app which connects to a number of service providers in the home buying industry. At the same time, we will continue to enhance our cross-border mortgage services and aim to be customers’ first choice.

Webcast question: Can you elaborate on the asset quality of your Mainland property loans?

Chief Risk Officer Jiang Xin: We always attach high importance to the asset quality of our Mainland property loan portfolio. When developing the business, we will choose quality deals, make prudent assessment and adhere to the strictest standards. We manage concentration risk by arranging and participating in loan syndications. As at the end of 2021, our loan exposures to Mainland property firms amounted to about HK$106.5 billion, accounting for 6.7% of the Group's total loans. According to the standards of "three red lines", loans classified as green line accounted for 82%, while those classified as yellow line accounted for 18%, and no balance in red line. By customer types, loans to SOEs and private enterprises accounted for 77% and 23% respectively. Overall, loans to investment grade customers were 71%. Our corporate customers in Mainland property sector mainly operate in the GBA, as well as tier-1 and tier-2 coastal cities, with market-leading position and business presence across the country. An absolute majority of these customers are of pass grade and they basically maintain normal business interaction with us. There was no overdue loan as at the end of 2021. We will continue to pay close attention to the changes in the property industry policies and the operating status of our customers, follow latest market dynamics and keep close communications with our parent bank, to ensure consistency in our credit strategies. As the market situation is still changing, we will dynamically review loan classification and impairment charges to ensure the accuracy of credit risk ratings and sufficient provisions for our loan portfolio.