Financial Review

Financial Review

In 2012, the Hong Kong economy faced strong external headwinds amid the recession in the euro area, the slow recovery of the US economy and the negative spillover to Asia, which weighed heavily on Asian production and trade flows. As a result, Hong Kong's total exports of goods showed only moderate growth in the third quarter after two quarters of slowing growth. Exports of services also decelerated in the face of the prevailing external conditions. Domestically, investment spending remained strong on the back of robust private machinery and equipment acquisition, intensive large-scale infrastructure works, and a further surge in private sector building activity. Meanwhile, private consumption expenditure grew steadily amid generally stable job and income conditions. The labour market too held largely stable, though some signs of weakening emerged towards the end of third quarter amid concerns the uncertainty in the external environment would restrain economic growth. The seasonally adjusted unemployment rate stayed at 3.3% in the last quarter. For the year, the Hong Kong economy grew a modest 1.4%.

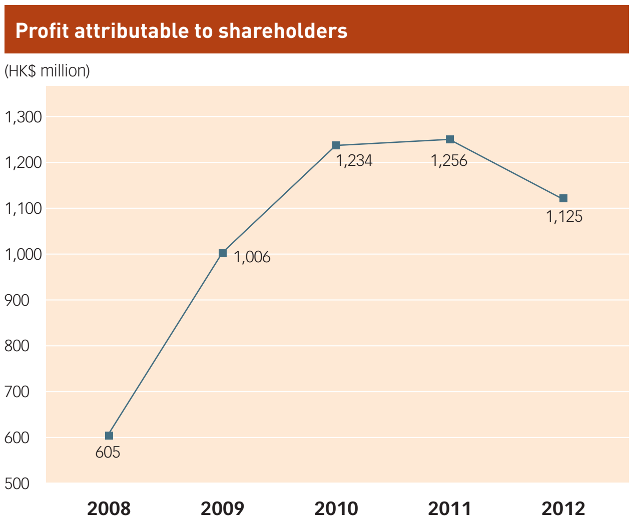
Inflation continued its easing trend in 2012 in tandem with the slow economic growth. The underlying inflation rate fell to 4.1% from 5.3% in 2011. However, pressure from the rental component is likely to increase further amid the gradual pass-through of rising property prices and rentals for fresh leases. Risks to inflation have also increased with additional quantitative easing in the US, through its potential impact on global commodity prices and local property prices. In the property market, the disconnection between housing prices and economic fundamentals appeared to have become more acute. In contrast to moderate income growth, housing prices surged about 25% over the year. The local economy still faces downside risks stemming from external environment, while upside risks to inflation and property prices remain amid loose global monetary conditions.

Income Statement

Financial Performance

Despite the challenging economic environment, the Corporation continued to achieve satisfactory financial results. The profit attributable to shareholders for 2012 was HK$1,125 million, a decrease of HK$131 million or 10.4% compared with 2011 **(Figure 1)**. The return on equity was 12.4% (2011: 15.5%). Against the record financial performance in 2011, the reduced profitability was mainly due to loan portfolio rundown with tightening in net interest spread, reduced contributions from the mortgage insurance business amid a slower housing turnover, and increased costs due to the launch of new policy initiatives such as Special Concessionary Measures under the SME Financing Guarantee Scheme and the Microfinance Scheme. The lower return on equity was also attributable to the relatively low dividend payout to shareholders over the past two years in order to retain capital for new policy initiatives. Amid the decrease in operating income with resources required to support the new policy initiatives, the cost-to-income ratio increased to 15.4 % from 11.8% in 2011. The capital adequacy ratio remains solid at 20.2%, well above the minimum 8% guideline stipulated by the Financial Secretary.

Figure 1



Net Interest Income

The net interest income for the year declined 5% to HK$812 million (2011: HK$855 million), which was attributable mainly to the loan portfolio runoff but partially offset by an increase in cash and investments. The net interest spread fell to 1.4%, from 1.6% in 2011, and the net interest margin dropped to 1.5% from 1.7%.

Net Mortgage Insurance Premiums Earned

In view of the volatile property price movements in 2012, the Government announced successive supply side measures, prudential measures requiring tighter mortgage underwriting criteria and anti-speculative measures with Special Stamp Duty to curb speculation, and the introduction of Buyer's Stamp Duty to alleviate the supply and demand stress in the residential property sector. New mortgage loans drawn down in the residential property market decreased to HK$192 billion from HK$227.8 billion in 2011. New business underwritten under the Mortgage Insurance Programme (MIP) dropped to HK$22 billion from HK$26.3 billion. The net premiums earned after commission expenses decreased to HK$363 million from HK$550 million a year earlier amid slower housing turnover. Taking into account the write-back of provisions for outstanding claims of HK$13 million (2011: a write-back of HK$19 million), the net premiums earned decreased by 33.9% to HK$376 million from HK$569 million.

Other Income

Other income rose 17.2% to HK$232 million (2011: HK$198 million). The net gain on disposal of investments was about HK$97 million (2011: HK$65 million), which was mainly a result of rebalancing and diversifying of the investment portfolio. A dividend income of HK$90 million (2011: HK$65 million) was received from listed investment securities, consisting of ABF Hong Kong Bond Index Fund, ABF Pan Asia Bond Index Fund and a real estate investment trust. The Corporation also recorded an exchange gain of HK$30 million (2011: HK$51 million), primarily due to the revaluation of the approved US dollar and renminbi exposures.

Operating Expenses

The Corporation continued to maintain stringent cost controls to contain expenses and improve operating efficiency. Operating expenses recorded a 14.1% increase year on year to HK$219 million, but this was HK$21 million lower than that of the approved budget. Staff costs rose 9.2% to HK$143 million, attributable mainly to resources required to support the launch of new policy initiatives and enhancements to the Reverse Mortgage Programme. Staff costs accounted for 65.3% of total operating expenses (68.2% in 2011). Premises rentals and related costs increased by HK$12 million to HK$28 million, mainly as a result of additional rental expenses for a new office in Sheung Wan after the expiry of a lease at Two International Finance Centre.

Allowance for Loan Impairment

Asset quality remained strong, with the delinquency ratio staying at 0.03%. Taking into account the development of the residential property market and local economic conditions, a collective assessment for loan impairment of HK$6 million was charged back in 2012, according to the approved prudent provisioning policy. During the year, no loan was written off (2011: Nil) with a recovery of HK$2 million (2011: HK$2 million).

Financial Position

Loan Portfolio

During the year, the Corporation purchased Hong Kong loan assets of about HK$0.9 billion (2011: HK$9.7 billion). After accounting for the prepayments and repayments during the year, the outstanding balance of the Corporation's loan portfolio recorded a normal runoff of HK$8.1 billion, leaving an outstanding balance of HK$25.9 billion.

Investment Securities

The Corporation adopts a prudent, low-risk approach in managing its surplus funds and investment activities in accordance with the Board's investment guidelines. As at 31 December 2012, the total investment portfolio was HK$15 billion (2011: HK$10.6 billion), which included HK$5.8 billion of available-for-sale investments and HK$9.2 billion of held-to-maturity investments. Following the prudent investment guidelines, the Corporation did not directly or indirectly hold any sub-prime investments, special investment vehicles, collateralized debt obligations, high risk European sovereign debt, or debt securities issued by failed institutions in its investment portfolio. In 2012, there was no impairment loss from investments.

Debt Securities Issued

In 2012, the Corporation issued HK$19.1 billion of debt securities under the Medium Term Note Programme. All the non-Hong Kong dollar debts were swapped into Hong Kong dollars or US dollars for hedging purposes. As at 31 December 2012, the total outstanding balance of the debt securities had decreased 11.4% or HK$4.7 billion to HK$36.4 billion from a year earlier. The reduction mainly reflected the low level of loan purchases amid abundant liquidity in the local banking sector.

Key Off-balance Sheet Exposure

Mortgage Insurance

The Corporation operates the MIP on a risk-sharing basis with the approved reinsurers. At the end of 2012, the total risk-in-force was about HK$16.6 billion (2011: HK$16.6 billion), of which HK$2.8 billion (2011: HK$2.5 billion) was ceded to the approved reinsurers. The off-balance sheet risk-in-force exposure borne by the Corporation decreased marginally to HK$13.8 billion, as compared with HK$14.1 billion in 2011. Of this exposure, the excess loss of HK$1.8 billion of risk-in-force was hedged through the excess-of-loss reinsurance arrangement to reinsure the middle layer risk position, while the Corporation retains a portion of the total risks comprising the first-loss and residual risks.

The provision for outstanding claims accounted for 0.31% (2011: 0.37%) of the retained risk-in-force at end of 2012. The delinquency ratio remained healthy at 0.002% (2011: 0%).

Dividend

At the Annual General Meeting held on 15 April 2013, the shareholders, having considered the financial performance and the capital requirements for business development, approved a final dividend of HK$0.375 (2011: HK$0.175) per share, totalling HK$750 million (2011: HK$350 million) and representing a dividend payout ratio of 66.7%.