

## DEVELOPMENTS IN THE BANKING SECTOR

*Reflecting excess liquidity, average funding costs eased and loan-to-deposit ratios continued to improve during the December quarter. Despite the further shrinkage in customer lending, the decline in domestic lending continued to moderate compared with the first half of the year. Preliminary figures indicate that operating profits of local banks also improved in aggregate, although there were wide variations in performance. The recovery was helped by the increase in interest-bearing assets and some improvement in the net interest margin. The provisional figures for December show signs of improvement in local banks' asset quality, though this was partly influenced by other factors such as write-offs made by banks before the December year-end. While some local banks increased their provisions further in 1999, the bad debt charge as a whole rose only slightly compared with 1998.*

### Interest Rate Movements

Backed by the inflow of funds, there was ample interbank liquidity in the December quarter. Concerns that liquidity would tighten due to Year 2000-related issues proved to be unfounded. This resulted in a general downward movement in interbank interest rates. The average 1-month HIBOR dropped by 25 basis points to 5.68%, against a rise of 90 basis points in the September quarter. The average 3-month HIBOR, in contrast to other interbank interest rates, rose further by 4 basis points to 6.15%, following a rise of 84 basis points in the preceding quarter. The movement of time deposit rates<sup>1</sup> varied in the last quarter of 1999. As a whole, average 3-month and 6-month time deposit rates continued to rise while other time deposit rates with shorter or longer term declined. The average 3-month and 6-month time deposit rates increased by 17 basis points to 4.95% and 4 basis points to 5.04% respectively, compared with rises of 29 and 22 basis points in the September quarter. On the contrary, the average 1-month and 12-month time deposit rates contracted by 13 basis points to 4.43% and 16 basis points to 5.51% respectively, as opposed to rises of 30 basis points and 1 basis point in the preceding quarter.

The Best Lending Rate (BLR) remained unchanged at 8.50% in the December quarter, after rising 25 basis points in August 1999. With the general reduction in interbank rates, average spreads between BLR and HIBOR widened in the December quarter. The average spread between BLR and 1-month HIBOR rose to 2.82% from 2.49% in the September quarter. As the increase in 3-month HIBOR was more than offset by the higher average BLR, the average spread for 3-month HIBOR widened to 2.35% from 2.31%. The average spreads between BLR and time deposit rates also widened, except that for the 3-month time deposit rate which contracted to 3.55% from 3.64% in the preceding quarter. The average spread for the 1-month time deposit rate rose to 4.07% from 3.87%, and that for the 6-month time deposit rate to 3.46% from 3.42%.

### Balance Sheet Developments

#### Customer Deposits

Against a 10.9% increase in 1998, customer deposits grew by 7.6% for the year of 1999. In the December quarter, customer deposits increased by 2.6%, having risen by 3.5% in the September quarter. Within the currency breakdown, Hong

<sup>1</sup> These are period average figures quoted by 10 major banks for deposit amounts less than HK\$100,000 as reported in the Hong Kong Monetary Authority (HKMA) Monthly Statistical Bulletin.

Chart 1  
Loans for Use in Hong Kong by Selected Sectors  
Quarterly % Change



N.B. Property related loans denotes lending for property development & investment (including civil engineering) and private residential loans (including lending under the Home Ownership Scheme & Private Sector Participation Scheme).

Kong dollar deposits increased by 2.8% in the December quarter, following a modest rise of 0.3% in the preceding quarter while the growth of foreign currency deposits moderated to 2.3% from 7.6%. Attributable mainly to the faster growth of Hong Kong dollar deposits than foreign currency deposits in the December quarter, the proportion of Hong Kong dollar deposits to total customer deposits increased to 55.4% from 55.3% at end-September.

Helped by a rebound in Hong Kong dollar savings deposits, the growth of Hong Kong dollar deposits accelerated. Savings deposits increased markedly by 9.2% in the December quarter, against a 3.9% decline in the September quarter. Meanwhile, demand deposits grew faster by 6.2%, compared with a rise of 2.3% in the preceding quarter. On the contrary, the growth of time deposits moderated to 0.3% in the December quarter from 1.7% in the September quarter. Within the maturity spectrum of time deposits,

time deposits maturing within one month increased by 6.1%, after dropping by 4.0% in the preceding quarter. By contrast, time deposits maturing within one to three months reversed a notable rise of 17.1% in the September quarter and registered a decline of 2.7% in the December quarter. Those maturing over three months dropped substantially by 25.3%, compared with a modest decline of 0.2% in the September quarter. The shift from longer-term time deposits to demand and savings deposits in part reflected a rise in transaction demand for money as economic activity and stock market recovered.

The slow-down in the growth of foreign currency deposits owed much to a decline in non-US dollar time deposits, which dropped by 2.2% against strong growth of 11.0% in the preceding quarter. The drop in time deposits led to a decline in non-US dollar deposits of 1.7% in the December quarter, against growth of 9.7% in the September quarter. On the other hand, US dollar

deposits rose further by 5.4% after increasing by 6.1% in the preceding quarter.

#### Negotiable Instruments

The outstanding amount of negotiable certificates of deposit (NCDs) shrank by 3.8%, having risen by 0.8% in the September quarter. The shrinkage reflected increased redemptions, a weakened demand for NCDs which resulted from the continued recovery of the stock market and the anticipation of higher interest rates.

In anticipation of higher money market rates, floating rate instruments continued to dominate the primary NCDs market. The share of floating rate NCDs rose to 67.2% of the total new issues in the December quarter from 60.8% in the September quarter. The share of NCDs held by authorised institutions rose to 57.7% from 56.3% respectively.

Reflecting limited investment opportunities in the domestic market, some banks switched their

Hong Kong dollar surplus funds into foreign currency assets, including negotiable debt instruments (other than NCDs). Negotiable debt instruments (NDIs) held by local banks rose by 10.9% in the December quarter, following an increase of 7.0% in the preceding quarter. The growth came largely from foreign currency NDIs which surged by 20.5%, compared with a rise of 5.7% in the preceding quarter. Meanwhile, Hong Kong dollar NDIs rose by 2.8%, moderating from the previous increase of 8.2%.

In respect of the Hong Kong dollar NDIs held by the banking sector as a whole, the rate of growth slowed to 4.6% in the December quarter compared with 12.4% in the September quarter. The corresponding growth of foreign currency NDIs moderated to 2.2% from 3.4%. For the year of 1999, Hong Kong dollar NDIs held by the banking sector surged by 27.9% and in absolute terms, the amount of increase accounted for slightly more than 70% of the decline in the banking sector's Hong Kong dollar domestic lending. This suggests that some authorised institutions

Table 1  
HK\$ Deposit Mix

Amount (HK\$ bn)

	Deposits				
	Demand	Savings	Time *	Swap	Time @
Sep/98	89.8	310.8	1,206.9	33.9	1,240.9
% growth	(1.3)	0.3	7.7	(3.5)	7.3
Dec/98	97.1	414.4	1,144.3	29.3	1,173.6
% growth	8.1	33.4	(5.2)	(13.7)	(5.4)
Mar/99	96.3	399.7	1,157.3	30.2	1,187.5
% growth	(0.8)	(3.6)	1.1	3.0	1.2
Jun/99	97.4	430.6	1,150.0	28.8	1,178.8
% growth	1.2	7.7	(0.6)	(4.5)	(0.7)
Sep/99	99.7	413.7	1,170.4	28.8	1,199.1
% growth	2.3	(3.9)	1.8	(0.1)	1.7
Dec/99	105.8	451.7	1,174.8	28.3	1,203.1
% growth	6.2	9.2	0.4	(1.5)	0.3

Notes: % growth denotes the quarter-on-quarter growth of the deposits  
\* excludes swap deposits  
@ includes swap deposits

redeployed part of their surplus funds released by the growth in deposits and the decline in lending into NDIs.

#### Lending

Loans and advances fell by 14.8% in 1999, moderating from a drop of 19.8% in 1998. In the December quarter, loans and advances contracted further by 1.6% after declining by 1.0% in the September quarter. Both domestic lending<sup>2</sup> and offshore loans continued to fall. Domestic lending fell by 1.0% in the December quarter, after dropping 1.1% in the preceding quarter. However, when compared with a fall of 6.2% in the first half of 1999, the decline in domestic lending slowed down considerably in the second half of the year, dropping by 2.2%. Largely influenced by the

contraction in Japanese banks' euroyen lending activities, offshore loans showed a greater decline of 3.1%, compared with a drop of 0.5% in the preceding quarter.

With the subdued property market conditions, property lending fell by 0.1% in the December quarter, against a rise of 0.3% in the September quarter. This fall owed much to a decline in residential mortgage loans<sup>3</sup>. The outstanding amount of residential mortgage loans fell by 0.3% in the December quarter, the first such decline for five years. On the contrary, loans for property investment increased by 0.1% - the first increase since the last quarter of 1997. Meanwhile, loans for property development rose by 0.3% in the December quarter, following a rise of 1.9% in the previous quarter.

Table 2  
Asset Quality<sup>1</sup> of All Local Banks

	Dec/98	Mar/99	Jun/99	Sep/99	Dec/99
	as % of total loans				
<b>Pass loans</b>	<b>84.61</b>	<b>82.18</b>	<b>81.77</b>	<b>81.48</b>	<b>82.17</b>
<b>Special mention loans</b>	<b>8.06</b>	<b>8.99</b>	<b>8.09</b>	<b>8.19</b>	<b>8.01</b>
<b>Classified loans<sup>2</sup></b>	<b>7.33</b>	<b>8.82</b>	<b>10.14</b>	<b>10.33</b>	<b>9.83</b>
o/w <i>Substandard</i>	3.18	3.94	4.80	4.33	3.76
<i>Doubtful</i>	3.93	4.61	5.02	5.56	5.42
<i>Loss</i>	0.22	0.27	0.31	0.44	0.65
<b>Overdue &gt; 3 months and rescheduled<sup>3</sup> loans</b>	<b>5.12</b>	<b>6.39</b>	<b>7.01</b>	<b>7.54</b>	<b>6.92</b>
o/w <i>Overdue &gt; 3 months</i>	4.04	5.41	5.92	6.32	5.85
<i>Rescheduled<sup>3</sup> loans</i>	1.08	0.98	1.09	1.22	1.07
<b>Non-accrual loans<sup>4</sup></b>	<b>-</b>	<b>-</b>	<b>6.70</b>	<b>7.22</b>	<b>7.13</b>

1. Period-end figures relate to HK offices and overseas branches.

2. Classified loans are those loans graded as "substandard", "doubtful" or "loss".

3. Effective March 1999, those rescheduled loans which have also been reported under overdue for more than 3 months are excluded.

4. Loans on which interest has been placed in suspense or on which interest accrual has ceased. Not available prior to June 1999.

Because of rounding, the figures set out in this table may not add up.

2 Domestic lending comprises trade finance and other loans for use in Hong Kong.

3 Excluding loans under Home Ownership Scheme and Private Sector Participation Scheme.

Growth in lending to other economic sectors displayed mixed results in the December quarter. Despite the recovery of external trade, loans for trade financing declined by another 6.0% following a drop of 4.4% in the September quarter. The decline in loans for wholesale & retail trade also accelerated to 5.4% from 3.3%, but loans for manufacturing dropped at a slower pace of 2.0%, compared with a decline of 4.2% in the previous quarter. Reflecting the robust domestic stock market, loans to stockbrokers rose by 8.4% in the December quarter, partly reversing a significant drop of 36.4% in the September quarter. Similarly, loans to non-stockbroking companies rose by 0.7%, against a drop of 20.8% in the preceding quarter. Credit card receivables grew by 4.7% after rising by 2.4% in the September quarter.

#### *Loan-to-Deposit Ratio*

As in previous quarters, loan-to-deposit ratios continued to improve. The Hong Kong dollar loan-to-deposit ratio of the banking sector as a whole declined to 91.3% at end-December from 94.1% at end-September, reflecting the continuing growth of Hong Kong dollar deposits and the shrinkage in Hong Kong dollar loans. The overall loan-to-deposit ratio also dropped to 88.6% from 92.4%. Similarly for the local banks as a whole, the Hong Kong dollar and overall loan-to-deposit ratios fell to 68.5% from 70.6% and to 52.9% from 55.0% respectively.

#### *Asset Quality*

After continued deterioration in the first three quarters of 1999, the provisional figures for end-December showed signs of improvement in local banks' asset quality during the last quarter of the year. Various ratios as a percentage of total loans fell in the December quarter as a result of decline in the problem loans of local banks and a rise in their total loans (in contrast to the decline recorded by the banking sector as a whole). It should however be noted that the decline in problem loans was partly influenced by other factors such as write-offs made by banks before the December year-end and the restoration of some restructured loans to performing status. For the local banking sector as a whole, classified loans dropped to 9.83% of total loans at end-December from 10.33% at end-September. Loans overdue for

more than three months also fell, to 5.85% of total loans at end-December from 6.32% at end-September. Along with the reduction in rescheduled loans to 1.07% from 1.22%, the combined ratio of overdue and rescheduled loans stood at 6.92% of total loans at end-December, down from 7.54% at end-September. Similarly, non-accrual loans fell to 7.13% from 7.22%. The ratio of non-accrual loans was higher than that of overdue and rescheduled loans to total loans, reflecting banks' prudent approach in putting loans on non-accrual status when there is a doubt on their collectability.

The asset quality of the mortgage portfolio improved in December due partly to the sale of repossessed properties by some banks. According to the monthly residential mortgage survey, mortgage loans overdue for more than three months as a percentage of total mortgage loans declined to 1.13% at end-December from 1.17% at end-November. However, it was still higher than the 0.84% level at end-December last year.

The performance of credit cards continued to improve. The delinquency ratio for credit cards (i.e. those overdue for more than 90 days) fell from 1.13% at end-September to 0.92% at end-December, a level lower than the 1.16% recorded at end-1998. The annualized charge-off ratio also dropped to 4.92% at end-December from 4.95% at end-September. The ratio was still higher than the 3.14% in 1998.

#### *Profitability*

For the year of 1999, performance of individual banks varied markedly. However, for the 31 local banks as a whole, the preliminary figures suggest that operating profits from Hong Kong offices improved. The recovery was helped by the increase in interest bearing assets and some improvement in the net interest margin. The latter reflected lower funding costs which outweighed the downward pressure on lending margins. In addition, although the bad debt charge remained high by pre-crisis standards, the aggregate figure for 1999 rose only slightly compared with the previous year. This was consistent with the indications of improvement in asset quality mentioned above. ☉

— Prepared by the Banking Policy Division