

DEVELOPMENTS IN THE BANKING SECTOR

The operating environment for the banking sector continued to improve in the first quarter of this year. While total loans shrank further because of continued contraction in Japanese banks' Euroyen lending activities, domestic lending in Hong Kong dollars has started to pick up in line with the recovering economy and banks' increased willingness to lend. The operating profits of local banks for the March quarter showed a notable increase compared with the same period in 1999. The recovery was helped by lower funding costs and an increase in interest-bearing assets, which enabled banks to widen their net interest margin, despite the continuing competition for residential mortgage loans. The general improvement in local banks' asset quality also led to a substantial decline in the aggregate bad debt charge.

Interest Rate Movements

Reflecting stable liquidity conditions, funding costs eased further in the March quarter. For the quarter, the average 1-month HIBOR fell by 13 basis points to 5.56% after dropping by 25 basis points in the December quarter, while the average 3-month HIBOR decreased by 32 basis points to 5.83% against an increase of 4 basis points in the preceding quarter. Time deposit¹ rates also dropped in the March quarter. The average 1-month and 3-month time deposit rates contracted by 26 basis points to 4.17% and 37 basis points to 4.58%, compared with a decrease of 13 basis points and a rise of 17 basis points respectively in the December quarter.

In response to the increase in the US Fed Funds rate, the Hong Kong Association of Banks raised the savings rate twice in the March quarter, each time by 25 basis points. Commercial banks followed these moves and raised the best lending rate (BLR) to 9.00% from 8.50%. With the general reduction in funding costs, interest rate spreads widened in the March quarter. The average spread between BLR and 1-month HIBOR widened by 27 basis points to 3.09% during the quarter and that for 3-month HIBOR, by 47 basis points to 2.81%. The average spread between BLR and the 1-month time deposit rate rose by 40 basis points to 4.47% and that for the 3-month time deposit rate, by 51 basis points to 4.06%.

¹ 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*.

Balance Sheet Developments

Customer Deposits

Having risen by 2.6% in the December quarter, customer deposits grew at a more moderate pace of 0.5% in the March quarter. This reflected a decline of 1.0% in Hong Kong dollar deposits during the quarter, against an increase of 2.8% in the December quarter. On the other hand, foreign currency deposits rose further by 2.3%, the same growth rate as in the preceding quarter. As a result, the proportion of Hong Kong dollar deposits to total customer deposits dropped to 54.6% from 55.4% at end-December.

In the March quarter, Hong Kong dollar demand and savings deposits both displayed slower growth while time deposits fell. The growth in demand and savings deposits moderated to 1.7% and 1.1% respectively, following rises of 6.2% and 9.2% in the December quarter. Meanwhile, time deposits fell by 2.0% in the March quarter, against a rise of 0.3% in the December quarter. The decline was mainly due to time deposits maturing within one month, which contracted by 5.8% after an increase of 6.1% in the preceding quarter. Conversely, time deposits maturing between one to three months rose by 1.5% while those maturing over 3 months rose markedly by 18.3%, compared with declines of 2.7% and 25.3% respectively in the December quarter.

Table I
HK Dollar Deposit Mix

Amount (HK\$ bn)

	Deposits				
	Demand	Savings	Time *	Swap	Time @
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
Mar/00	107.6	456.5	1,152.1	27.4	1,179.6
% growth	1.7	1.1	(1.9)	(3.3)	(2.0)

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

Negotiable Instruments

The outstanding amount of negotiable certificates of deposit (NCDs) rose by 1.7% in the March quarter after falling by 3.9% in the December quarter. Unlike in previous quarters, fixed rate instruments dominated the primary NCD market and accounted for 65.0% of NCDs issued during the quarter, up from 32.8% in the December quarter. Most NCDs issued in the quarter were denominated in Hong Kong dollars and were of longer maturity. This reflected banks' preference to lock-in their funding costs in anticipation of higher interest rates. The market environment also enabled banks to issue paper of longer maturity to reduce their maturity mismatch. The share of NCDs held by authorized institutions increased slightly to 57.9% at end-March 2000 from 57.7% at end-December 1999.

Continuing with the trend noted in the previous quarter, some banks switched their surplus funds, especially those released by the growth in foreign currency deposits and the decline in foreign currency lending, into negotiable debt instruments

(NDIs) in the March quarter. The growth of Hong Kong dollar NDIs held by the banking sector accelerated to 7.0% from 4.5% in the previous quarter and that of foreign currency NDIs to 3.3% from 2.2%. Similarly, Hong Kong dollar NDIs held by local banks grew strongly by 13.5% in the March quarter, compared with an increase of 2.8% in the December quarter. By contrast, foreign currency NDIs held by local banks fell notably by 10.1% following a marked increase of 20.4% in the preceding quarter.

Lending

Loans and advances declined further by 4.0% in the March quarter, having fallen by 1.7% in the December quarter. The acceleration in the decline in loans and advances was mainly due to a greater fall of 12.7% in offshore loans (compared with 2.9% in the December quarter), largely a result of continued contraction in Japanese banks' Euroyen lending activities.

Domestic lending² remained virtually unchanged in the March quarter after a drop of

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

1.2% in the preceding quarter. Within this, Hong Kong dollar loans reversed the downward trend and rose by 1.1% during the quarter. This suggested that domestic loan demand had started to pick up in line with the recovering economy and banks' increased willingness to extend new loans. The growth in Hong Kong dollar loans was however offset by a corresponding drop in foreign currency loans. Lending to most economic sectors exhibited either a slow-down in decline or continued growth in the March quarter. The decline in loans for trade financing moderated to 1.9% from 6.4% in the December quarter and loans for manufacturing to 1.3% from 2.0%. Helped by an increase in retail sales before the Lunar New Year, the decline in loans for wholesale and retail trade also moderated to 0.6% from 5.4% in the preceding quarter. Reflecting the activities in the domestic stock market, loans for stockbrokers continued to grow, but at a slower pace, by 7.4% in the March quarter, compared with

8.3% in the December quarter, while loans for non-stockbroking companies registered a fall of 4.3% after rising by 0.7% in the preceding quarter. Credit card receivables rose further by 4.2%, following an increase of 4.7% in the December quarter.

Property lending recouped some of its previous decline by growing by 0.8% in the March quarter, after falling by 0.1% in the December quarter. This was mainly due to the growth in loans for property development and investment. Loans for property development rose by 3.6% from 0.6% in the December quarter. Loans for property investment also increased by 1.1%, reversing the 0.1%³ drop in the preceding quarter. The amount of residential mortgage loans (excluding loans under Home Ownership Scheme and Private Sector Participation Scheme) was broadly unchanged in the March quarter, after decreasing by 0.3% in the previous quarter.

Chart I
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 and Tenants Purchase Scheme).

3 Revised from a rise of 0.1% due to reporting adjustments.

Loan-to-Deposit Ratio

Owing to the continued increase in customer deposits and the contraction in total loans, the overall loan-to-deposit ratio of the banking sector as a whole dropped further to 84.6% at end-March 2000 from 88.5% at end-December 1999. In contrast, the Hong Kong dollar loan-to-deposit ratio rose to 93.2% from 91.3%, reflecting a drop in Hong Kong dollar deposits but an increase in Hong Kong dollar loans. Local banks recorded a rise in total loans against a decline in customer deposits. As a result, the overall loan-to-deposit ratio rose to 54.3% at end-March 2000 from 52.8% at end-December 1999. Similarly, the Hong Kong dollar loan-to-deposit ratio increased to 72.1% from 68.4%.

While loans overdue for more than three months rose slightly to 5.90% at end-March 2000 from 5.85% at end-December 1999, rescheduled loans fell to 0.96% from 1.11%. As a result, the combined ratio of overdue and rescheduled loans was 6.85% at end-March 2000, down from 6.96% at end-December 1999. Non-accrual loans also recorded a decline, falling to 6.81% from 7.14%.

In line with the decline in the combined ratio of overdue and rescheduled loans and the ratio of non-accrual loans, classified loans (a broader measure of problem loans) to total loans dropped to 9.28% at end-March 2000 from 9.81% at end-December 1999. The ratio of 8.05% for special mention loans was at around the same level as the previous quarter.

Asset Quality

There were further signs of improvement in local banks' asset quality in the March quarter.

The quality of credit card receivables continued to improve in the March quarter. Delinquent accounts (measured as accounts overdue for more than 90 days to total receivables)

Table 2
Asset Quality¹ of All Local Banks

	Mar/99	Jun/99	Sep/99	Dec/99	Mar/00
	as % of total loans				
Pass loans	82.18	81.77	81.48	82.14	82.67
Special mention loans	8.99	8.09	8.19	8.04	8.05
Classified loans²	8.82	10.14	10.33	9.81	9.28
o/w <i>Substandard</i>	3.94	4.80	4.33	3.72	3.43
<i>Doubtful</i>	4.61	5.02	5.56	5.44	5.11
<i>Loss</i>	0.27	0.31	0.44	0.66	0.74
Overdue > 3 months and rescheduled³ loans	6.39	7.01	7.54	6.96	6.85
o/w <i>Overdue > 3 months</i>	5.41	5.92	6.32	5.85	5.90
<i>Rescheduled³ loans</i>	0.98	1.09	1.22	1.11	0.96
Non-accrual loans⁴	-	6.70	7.22	7.14	6.81

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.


dropped to 0.82% at end-March 2000 from 0.92% at end-December 1999. The annualized charge-off ratio in the March quarter was 4.24%, down from 4.83% in the December quarter. The ratio was also lower than the 4.92% level for the full year of 1999.

According to the monthly residential mortgage survey, mortgage loans overdue for more than three months as a percentage of total mortgage loans increased to 1.16% at end-March 2000 from 1.13% at end-December 1999. Despite this increase, the asset quality of the mortgage portfolio remained good when compared with other types of loans.

Profitability

The operating conditions for banks continued to improve in the March quarter. Attributable to an increase in the net interest margin, a significant rise in fee income and a sharp decline in the bad debt charge, operating profits for local banks (in respect of their Hong Kong offices) rose notably compared with the same period last year. Profits were also significantly higher than in the previous quarter.

Reflecting the easing in funding costs and an increase in average interest-bearing assets, the net interest margin rose to 2.40% (annualised) in the March quarter from 2.28% (annualised) in the same period of 1999. Consistent with the improvement in asset quality as noted above, the bad debt charge as a percentage of total average assets fell substantially to 0.19% (annualised) in the March quarter from 0.49% (annualised) in the same period of last year and 0.75% (annualised) in the previous quarter. The reduction in bad debt charge also included the write-back of provisions by some banks to their profit and loss account in the March quarter.

With capital base growing faster than risk assets, the average consolidated capital adequacy ratio of local institutions rose to 18.9% at end-March 2000 from 18.7% at end-December 1999. 

- Prepared by the Banking Policy Division