

DEVELOPMENTS IN THE BANKING SECTOR

The profitability of local banks grew strongly in 2000 as the domestic economy and operating conditions improved. This strong growth was due primarily to increased net interest and fee income and a significant drop in the bad debt charge resulting from improvement in banks' asset quality. Reflecting ample liquidity in the market, average funding costs continued to ease in the December quarter. However, domestic loan demand remained weak and domestic lending shrank despite recovery in the economy. In line with the improvement in overall asset quality, the delinquency ratio of residential mortgage loans dropped in December.

Interest Rate Movements

Reflecting ample liquidity in the banking sector, funding costs eased further in the December quarter. The average 1-month HIBOR and 3-month HIBOR declined further by 21 and 17 basis points to 5.80% and 5.95%, having fallen by 42 and 44 basis points respectively in the September quarter. Time deposit rates¹ also dropped but by a lesser extent compared with the equivalent HIBORs. The average 1-month and 3-month time deposit rates decreased by 6 and 12 basis points to 4.88% and 4.91%, compared with declines of 27 and 35 basis points respectively in the preceding quarter.

Interest spreads widened in the December quarter due to the easing in funding costs while the best lending rate (BLR) remained unchanged at 9.50%. The average spread between BLR and 1-month HIBOR widened by 21 basis points to 3.70% and that for 3-month HIBOR by 17 basis points to 3.55%. The average spread between BLR and the 1-month time deposit rate widened by 6 basis points to 4.62% and that for the 3-month time deposit rate by 12 basis points to 4.59%.

Balance Sheet Developments

Customer Deposits

After rising by 7.6% in 1999, customer deposits grew further by 9.6% in 2000. In the

December quarter, customer deposits rose by 3.0% following an increase of 2.6% in the September quarter. Both Hong Kong dollar and foreign currency deposits increased. Hong Kong dollar deposits increased by 1.9%, having risen by 2.0% in the September quarter. The growth of foreign currency deposits accelerated to 4.3% from 3.3%. Within the currency breakdown, US dollar deposits continued to grow strongly, by 7.5% after an increase of 7.9% in the preceding quarter, while the decline in non-US dollar deposits slowed to 1.1% from 3.5%. Reflecting the continued faster growth in foreign currency deposits compared to Hong Kong dollar deposits, the proportion of Hong Kong dollar deposits to total deposits declined to 53.1% at end-December from 53.6% at end-September.

Reversing a decline of 1.0% in the September quarter, Hong Kong dollar savings deposits increased by 12.2% in the December quarter. Demand deposits also grew markedly by 7.5%, compared with a rise of 1.5% in the preceding quarter. Due possibly to the less attractive time deposit rates, time deposits fell by 2.1%, against an increase of 3.1% in the September quarter. The fall was more pronounced in deposits with longer maturity. Time deposits maturing over 3 months declined notably by 9.8% while time deposits with "within one month" maturity and "between one to three months" maturity fell by 1.0% and 2.3% respectively.

¹ These are period average figures quoted by 10 major banks for deposit amounts less than HK\$100,000 as reported in the HKMA *Monthly Statistical Bulletin*.

Table I
HK\$ Deposit Mix

Amount (HK\$ bn)

	Deposits				
	Demand	Savings	Time *	Swap	Time @
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)
Jun/00	102.9	443.4	1,203.6	27.7	1,231.3
% growth	(4.4)	(2.9)	4.5	1.0	4.4
Sep/00	104.4	439.0	1,264.8	4.8	1,269.6
% growth	1.5	(1.0)	5.1	(82.6)	3.1
Dec/00	112.2	492.6	1,238.7	4.3	1,243.0
% growth	7.5	12.2	(2.1)	(10.4)	(2.1)

Notes: % growth denotes the quarter-on-quarter growth of the deposits

* excludes swap deposits

@ includes swap deposits

Negotiable Instruments

Reflecting sluggish demand and continued redemption of negotiable certificate of deposits (NCDs), the outstanding amount of NCDs shrank further by 4.8% in the December quarter following a decline of 5.3% in the September quarter. Of the NCDs issued, most were denominated in Hong Kong dollars. As in the previous two quarters, floating rate instruments continued to dominate the primary NCD market. The share of floating rate NCDs to total new issues increased to 80.5% from 68.7% in the September quarter. The share of outstanding amount of NCDs held by authorized institutions went up slightly to 58.6% at end-December from 58.2% at end-September.

In view of limited lending opportunities and the growth in deposits, some banks continued to switch their surplus funds into negotiable debt instruments (NDIs) in the December quarter.

Nevertheless, the growth of NDIs slowed compared with the September quarter. NDIs held by the banking sector grew by 5.1%, moderating from 9.8% in the preceding quarter. Similarly, the growth of NDIs held by local banks decelerated to 5.2% from 13.8%.

Lending

Loans and advances fell by 12.5% in 2000 after a drop of 14.9% in 1999. In the December quarter, loans and advances decreased by 3.6% following a decline of 1.4% in the September quarter. Both domestic lending² and offshore loans declined. Domestic lending declined by 1.8%, against an increase of 3.8% in the preceding quarter. Owing to a slower rate of decline in the Japanese banks' euroyen lending activities, the decline in offshore loans moderated to 10.3% from 17.0%.

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

Amid subdued property market conditions, property lending rose modestly by 0.7% in the December quarter, against a decline of 0.3% in the September quarter. The rise was attributable to an increase in loans for both property development and investment. Loans for property development increased by 3.7%, as opposed to a decline of 4.0% in the previous quarter and loans for property investment rose further by 0.6% after rising by 0.3%. Meanwhile, residential mortgage loans (excluding loans under Home Ownership Scheme and Private Sector Participation Scheme) remained virtually unchanged after rising by 0.3%.

Lending to other economic sectors fell in the December quarter. Loans to the manufacturing sector shrank further by 2.3% after contracting by 1.6% in the September quarter. The decline in loans for trade financing also accelerated, to 9.6%

from 0.8%, due partly to the moderation in export growth in the December quarter. Reflecting the lacklustre performance of retail sales, loans to the wholesale and retail sectors also decreased by 5.7% following the previous fall of 4.9%. Along with the correction in the domestic stock market, loans to stockbrokers and non-stockbroking companies declined by 16.2% and 27.0%, against increases of 68.7% and 21.9%³ respectively. In contrast, credit card advances expanded by 9.0%, having risen by 6.4% in the preceding quarter.

Following a significant increase of 180.5%⁴ in the September quarter, loans to the electricity, gas and telecommunications sectors fell by 7.5% in the December quarter. In order to obtain a better understanding of individual institutions' exposure to the telecommunication sector, the HKMA issued a letter to all authorized institutions requesting them

Chart I
Loans for Use in Hong Kong by Selected Sectors
Quarterly Percentage 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 & Tenants Purchase Scheme).

- 3 Revised from 67.5% due to reporting adjustments.
4 Revised from 148.4% due to reporting adjustments.

to provide a separate breakdown for this sector starting from December 2000. According to the results of the first report, aggregate lending to the telecommunications sector at end-December amounted to HK\$57,811 million⁵, which represented 2.9% of the banking sector's total domestic lending.

Loan-to-Deposit Ratio

For the banking sector as a whole, the overall loan-to-deposit ratio declined further to 70.7% at end-December from 75.5% at end-September and the Hong Kong dollar loan-to-deposit ratio also fell to 89.4% from 91.4% respectively. This reflected a further decline in total loans and continued increase in customer deposits in all currencies including Hong Kong dollar. Similarly, the loan-to-deposit ratios of local banks also declined. The overall loan-to-deposit ratio of local banks fell to 50.1% at end-December from 52.2% at end-September and

that of the Hong Kong dollar loan-to-deposit ratio, to 69.8% from 71.3%.

Asset Quality

The asset quality of local banks continued to improve in the December quarter, in part influenced by write-offs made by banks before the financial year-end. Due to the continued decline in local banks' problem loans and the rise in their total loans, all ratios of problem loans (with the exception of rescheduled loans) as a percentage of total loans fell in the December quarter. The increase in rescheduled loans was largely attributable to the completion of the restructuring of Guangdong Enterprises Group. Loans overdue for more than three months declined to 4.49% at end-December from 5.26% at end-September. Coupled with the increase in rescheduled loans to 1.09% from 1.02%, the combined ratio of overdue and rescheduled loans stood at 5.59% at end-

Table 2
Asset Quality¹ of All Local Banks

	Dec/99	Mar/00	Jun/00	Sep/00	Dec/00
	as % of total loans				
Pass Loans	82.14	82.67	84.25	85.03	86.21
Special Mention Loans	8.04	8.05	7.37	7.25	6.52
Classified Loans (Gross)²	9.81	9.28	8.38	7.72	7.27
o/w Substandard	3.72	3.43	3.00	2.58	2.59
Doubtful	5.44	5.11	4.82	4.56	4.20
Loss	0.66	0.74	0.56	0.58	0.48
Classified Loans (Net)³	6.59	6.12	5.53	4.90	4.87
Overdue > 3 Months and Rescheduled Loans	6.96	6.86	6.14	6.27	5.59
o/w Overdue > 3 months	5.85	5.90	5.30	5.26	4.49
Rescheduled loans	1.11	0.96	0.84	1.02	1.09
Non-Performing Loans⁴	7.14	6.81	6.24	6.00	5.37

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

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

3. Net of specific provisions.

4. Loans on which interest has been placed in suspense or on which interest accrual has ceased.

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

5 On-balance sheet lending booked in Hong Kong offices only.


December, down from 6.27% at end-September. Non-performing loans also fell, to 5.37% of total loans from 6.00%. In line with the decline in these ratios, classified loans (a broader measure of problem loans which takes account of both qualitative and quantitative factors) dropped to 7.27% of total loans at end-December from 7.72% at end-September.

The quality of credit card receivables deteriorated slightly in the December quarter. Delinquent accounts (measured as receivables overdue for more than 90 days to total receivables) increased to 0.76% at end-December from 0.71% at end-September. The quarterly charge-off ratio (annualised) also rose to 3.72% in the December quarter from 3.57% in the preceding quarter. The increase in the charge-off ratio was largely due to the tightening of some banks' charge-off policy on accounts undergoing bankruptcy petition. The charge-off ratio for 2000, which stood at 3.88%, was lower than that of 4.92% for 1999.

The quality of residential mortgage loans improved in December. According to the monthly residential mortgage survey, the delinquency ratio of residential mortgage loans (measured by residential mortgage loans overdue for more than three months as a percentage of the total mortgage portfolio) fell to 1.26% at end-December from 1.31% at end-November. The fall in the delinquency ratio was largely due to write-offs made by some banks.

Profitability

The aggregate profits of local banks showed strong growth as the economy and operating conditions improved in 2000. Preliminary statistics indicate that pre-tax operating profits of local banks in respect of their Hong Kong offices grew by around 30% in 2000, compared with 15.2% in the preceding year. The strong growth was mainly attributable to a significant drop in the bad debt charge and increases in net interest and fee income.

Reflecting the slim lending margins arising from keen competition for business, in particular for residential mortgage loans, the annualised net interest margin (NIM) dropped further in the December quarter⁶. Nonetheless, the NIM for 2000 as a whole widened, indicating that the squeeze in lending margins was offset by lower funding costs. In line with the general improvement in asset quality, the bad debt charge reduced by about 50% in 2000 after showing little change in 1999. 

- Prepared by the Banking Policy Department

6 This is based on preliminary estimates since the relevant figures are still being finalised.