

DEVELOPMENTS IN THE BANKING SECTOR

Operating profits of local banks fell moderately in the first quarter of the year compared with the same period last year. This was mainly due to a contraction in net interest margin amid continuing strong competition for business, together with increases in total operating expenses. Despite successive interest rate cuts, domestic loan demand remained sluggish. As a result of continued improvement in overall asset quality, the aggregate bad debt charge reduced further, albeit at a slower pace.

Interest Rate Movements

In tandem with the cuts in the US Federal Funds rate, the Hong Kong Association of Banks lowered the savings rate by a total of 150 basis points in the March quarter. Banks followed by reducing their best lending rate (BLR) by the same magnitude to 8.00% from 9.50%.

Domestic interest rates continued to move downward (Chart 1). The average 1-month HIBOR and 3-month HIBOR fell by 63 and 87 basis points respectively. Similarly, the average 1-month and 3-month time deposit rates¹ fell by 80 and 85 basis points respectively.

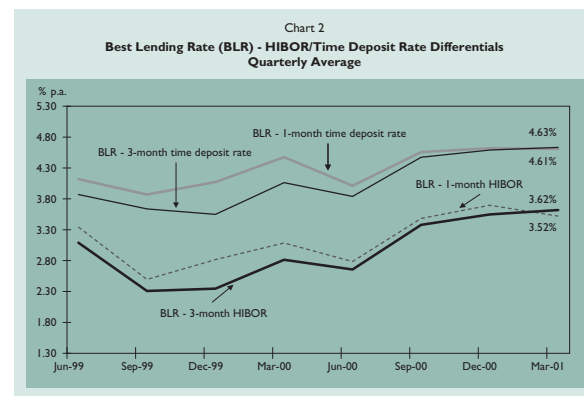
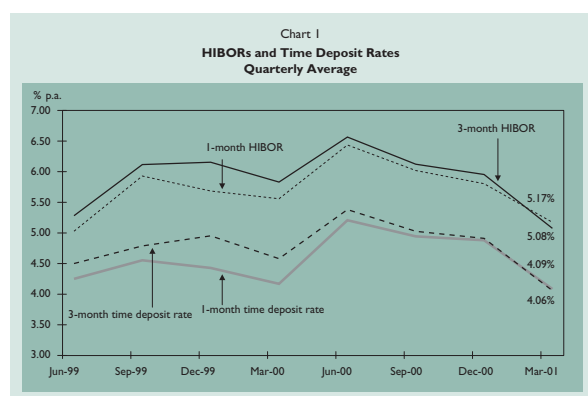
While the spread between BLR and HIBOR with maturity of 3 months and above widened, that

for HIBOR with shorter maturity contracted. The average spread between BLR and 1-month HIBOR contracted by 18 basis points to 3.52%. In contrast, the average spread between BLR and 3-month HIBOR widened by 7 basis points to 3.62%. The average spread between BLR and time deposit rates exhibited a similar trend. The average spread between BLR and 1-month time deposit rates contracted by 1 basis point to 4.61% while that for 3-month time deposit rates widened by 4 basis points to 4.63% (Chart 2).

Balance Sheet Developments

Customer Deposits

Against the rising trend recorded in the previous quarters, customer deposits fell by 2.7% in



¹ Time deposit rates are period average figures quoted by 10 major banks for deposits of an amount less than HK\$100,000 as reported in the HKMA Monthly Statistical Bulletin.

the March quarter (Chart 3). Both foreign currency and Hong Kong dollar deposits fell. While foreign currency deposits contracted by 5.3%, having risen by 4.3% in the December quarter, Hong Kong dollar deposits fell slightly by 0.4%, compared with an increase of 1.9% in the preceding quarter. Attributable to the greater decline in foreign currency deposits than in Hong Kong dollar deposits, the proportion of Hong Kong dollar deposits to total deposits rose to 54.3% from 53.1% at end-December. Table I shows the quarterly changes in Hong Kong dollar deposits by type.

Negotiable Instruments

The downward trend of negotiable certificate of deposits (NCDs) issued continued in the March quarter. The outstanding amount of NCDs issued shrank further by 2.9% following a decline of 4.7% in the December quarter. Unlike the preceding quarters, fixed rate instruments dominated the primary NCD market. The share of fixed rate instruments represented 65.9% of total new issues, up markedly from 19.5% in the previous quarter.

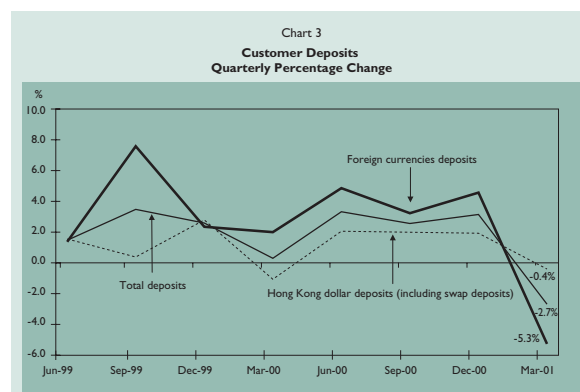


Table I
Hong Kong Dollar Deposit Mix

Amount (HK\$ bn)

	Deposits				
	Demand	Savings	Time *	Swap	Time @
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	1,243.1
% growth	7.5	12.2	(2.1)	(10.1)	(2.1)
Mar/01	105.4	499.2	1,231.6	3.9	1,235.5
% growth	(6.1)	1.4	(0.6)	(10.3)	(0.6)

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

* excludes swap deposits

@ includes swap deposits

The share of the outstanding amount of NCDs held by authorized institutions rose to 59.4% from 58.5% at end-December 2000.

Banks continued to increase their holdings of negotiable debt instruments (NDIs), with holdings increasing by 9.0% after a rise of 5.1% in the December quarter (Table 2).

Lending

The rate of decline in loans and advances moderated to 3.4% in the March quarter compared with 3.6% in the previous quarter (Chart 4). The decline was mainly driven by a drop of 13.5% in offshore loans, which was largely caused by the continued contraction in Japanese banks' Euroyen lending activities.

Reflecting sluggish loan demand, domestic lending² contracted by 0.9% after falling by 1.7% in the preceding quarter. Lending to major economic

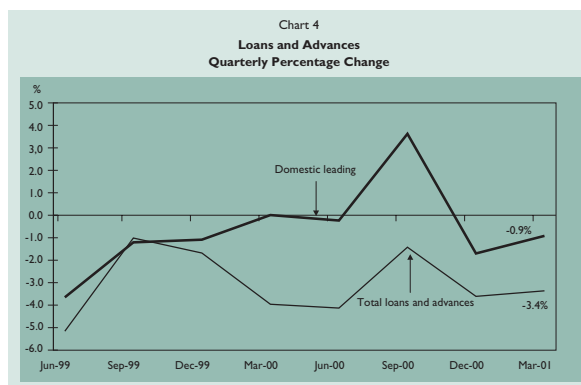


Table 2
NCDs and NDIs

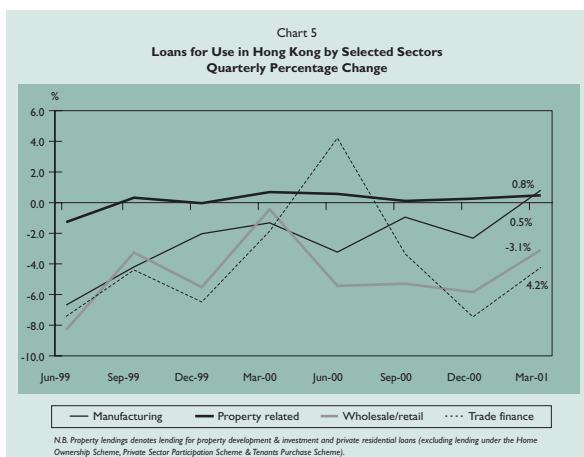
Amount (HK\$ bn)

	All Authorized Institutions				Local Banks		
	Total NCDs outstanding	HK\$	NDIs held FC	Total	HK\$	NDIs held FC	Total
Mar/00	203	281	333	613	151	119	270
% growth	1.8	7.6	3.5	5.3	13.5	(9.9)	1.8
Jun/00	198	290	365	655	161	154	315
% growth	(2.5)	3.5	9.6	6.8	6.6	29.2	16.6
Sep/00	187	312	407	719	171	187	358
% growth	(5.3)	7.4	11.7	9.8	6.6	21.4	13.8
Dec/00	179	329	427	756	180	197	377
% growth	(4.7)	5.4	4.9	5.1	5.2	5.3	5.3
Mar/01	173	373	451	824	203	206	409
% growth	(2.9)	13.5	5.6	9.0	12.5	4.7	8.5

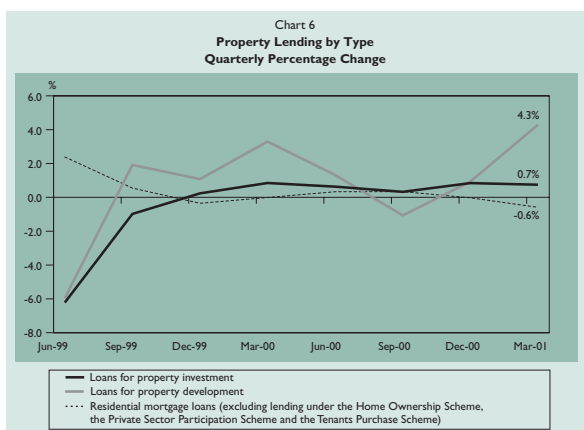
Note: % growth denotes the quarter-on-quarter growth of the deposits

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

sectors showed either a smaller decline or moderate growth in the March quarter (Chart 5). Due to



lacklustre conditions in the property market, residential mortgage loans (excluding loans under the Home Ownership Scheme and Private Sector Participation Scheme) declined by 0.6% after remaining flat in the preceding quarter (Chart 6). In

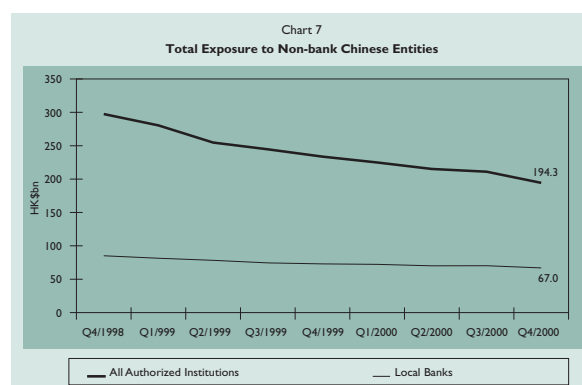


contrast, growth in loans for property development and property investment accelerated to 4.3% and 0.7% respectively, compared with increases of 0.8% and 0.6% in the December quarter. As a result, total property lending rose by 0.5% following growth of 0.3% in the preceding quarter.

Following a decline of 7.5% in the December quarter, loans to the electricity, gas and telecommunications sectors contracted further by 13.2%, with loans to the telecommunications sector³ declining by 16.2% to HK\$48.48 billion from HK\$57.81 billion. Aggregate lending to the telecommunications sector represented 2.5% of the banking sector's total domestic lending, down from 2.9%.

China Exposures

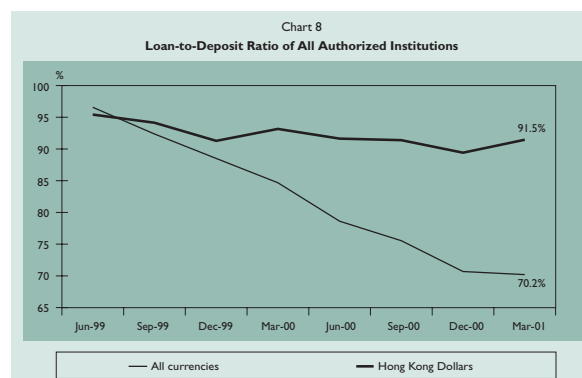
Total exposure of the banking sector to non-bank Chinese entities at end-December 2000 (Chart 7) amounted to HK\$194.3 billion (2.9% of the sector's total assets), down by 7.9% (HK\$16.7 billion) from HK\$211.0 billion at end-September 2000. The reduction was mainly caused by write-offs and loan repayments. The total exposure, consisting of on-and off-balance sheet exposure of HK\$166.9 billion and HK\$27.4 billion respectively, was spread among 151 institutions (both local and foreign).



The local banking sector's exposure to non-bank Chinese entities at end-December 2000 amounted to HK\$67.0 billion (2.8% of the sector's total assets), a reduction of HK\$3.2 billion from the position at end-September.

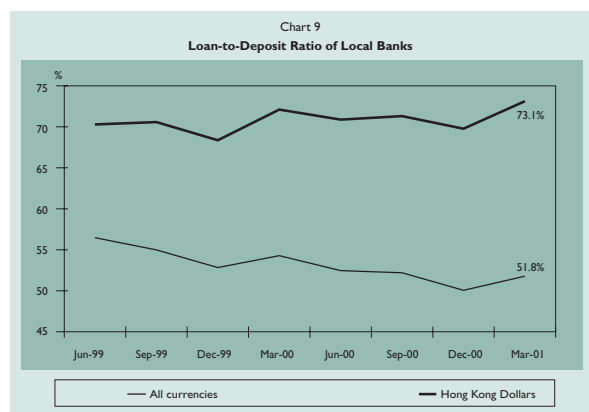
Loan-to-Deposit Ratio

Owing to a faster rate of decline in total loans than in customer deposits, the overall loan-to-deposit ratio of the banking sector declined further to 70.2% at end-March from 70.7% at end-December. In contrast, the Hong Kong dollar loan-to-deposit ratio rose to 91.5% from 89.4% due to an increase in Hong Kong dollar loans and decrease in Hong Kong dollar deposits (Chart 8).



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

Both the overall and Hong Kong dollar loan-to-deposit ratios of local banks rose, to 51.8% and 73.1% at end-March from 50.1% and 69.8% at end-December respectively (Chart 9).



Asset Quality

The improving trend of local banks' asset quality continued. The ratio of overdue and rescheduled loans declined further to 5.41% at

end-March from 5.48% at end-December. Within this, loans overdue for more than three months rose to 4.47% of total loans from 4.39%, while rescheduled loans declined to 0.94% from 1.09%. Non-performing loans also fell, to 5.31% at end-March from 5.38% at end-December. Classified loans fell to 7.12% of total loans at end-March from 7.23% at end-December (Table 3 and Chart 10).

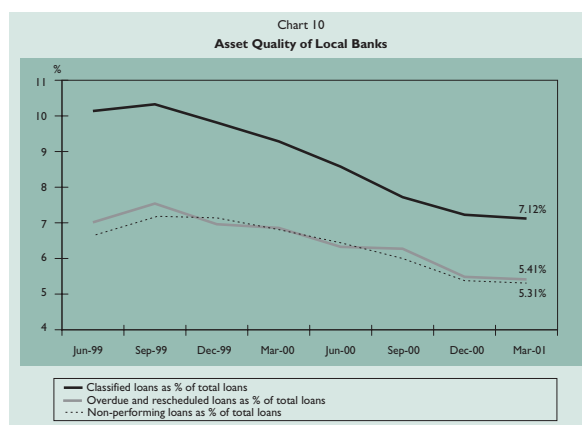


Table 3
Asset Quality¹ of All Local Banks

	Mar/00	Jun/00	Sep/00	Dec/00	Mar/01
	as % of total loans				
Pass Loans	82.67	84.07	85.03	86.30	86.60
Special mention loans	8.05	7.36	7.25	6.48	6.28
Classified loans (gross)²	9.28	8.58	7.72	7.23	7.12
o/w <i>Substandard</i>	3.43	3.00	2.58	2.58	2.48
o/w <i>Doubtful</i>	5.11	5.01	4.56	4.17	4.07
o/w <i>Loss</i>	0.74	0.56	0.58	0.47	0.56
Classified loans (net)³	6.12	5.62	4.90	4.86	4.79
Overdue > 3 months and rescheduled loans	6.86	6.33	6.27	5.48	5.41
o/w <i>Overdue > 3 months</i>	5.90	5.48	5.26	4.39	4.47
o/w <i>Rescheduled loans</i>	0.96	0.85	1.02	1.09	0.94
Non-performing loans⁴	6.81	6.44	6.00	5.38	5.31

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

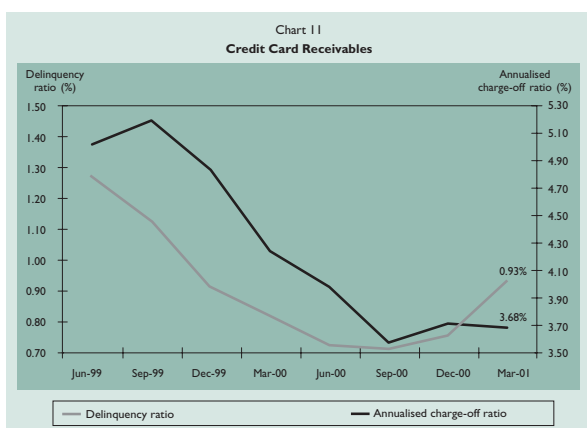
2. Classified loans are those loans graded as "substandard", "doubtful" or "loss".

3. Net of specific provisions.

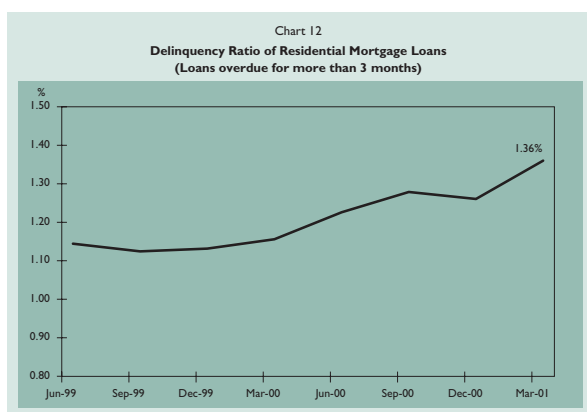
4. Loans on which interest has been placed in suspense or on which interest accrual has ceased.

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

The performance of credit card receivables in the March quarter was mixed. While the delinquency ratio (measured as receivables overdue for more than 90 days as a percentage of total receivables) rose to 0.93% at end-March from 0.76% at end-December, the annualised charge-off ratio in the March quarter fell, to 3.68% from 3.71% in the December quarter (Chart 11).

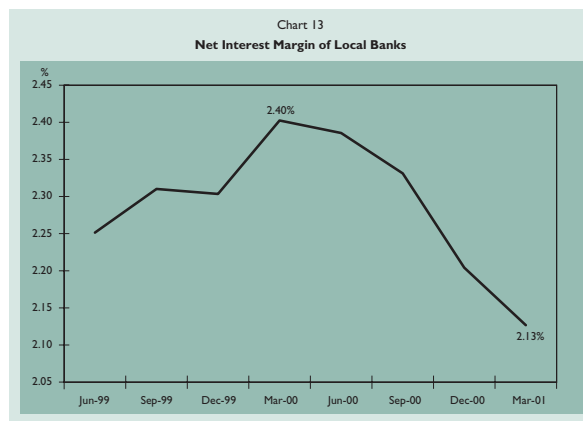


The quality of residential mortgage loans deteriorated in the March quarter. According to the monthly residential mortgage survey, the delinquency ratio of residential mortgage loans (measured by residential mortgage loans overdue for more than three months as a percentage of the total mortgage portfolio) increased to 1.36% at end-March from 1.26% at end-December (Chart 12).



Profitability

Preliminary statistics indicate that pre-tax operating profits of local banks in respect of their Hong Kong offices fell moderately in the first quarter of the year compared with the same period last year. This fall was mainly due to a decline in net interest income and an increase in total operating expenses, primarily staff costs. The former reflected the continued squeeze in lending margins arising from the keen competition for business, in particular for residential mortgage loans. The annualised net interest margin of local banks fell to 2.13% in the March quarter from 2.40% in the same period last year and 2.20% in the preceding quarter (Chart 13).



In line with the improving trend in overall asset quality, the bad debt charge continued to decline. The annualised ratio of bad debt charge to average total assets fell to 0.16% in the March quarter from 0.19% in the same period last year (Chart 14).

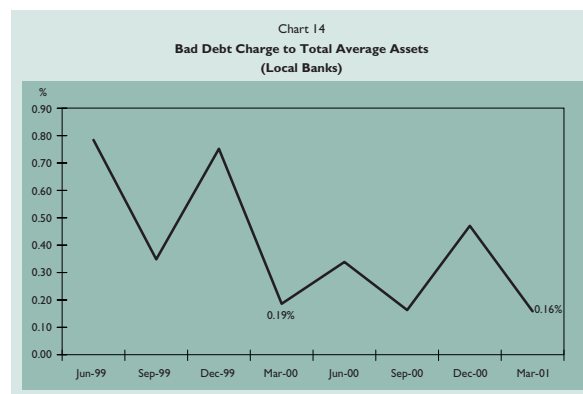


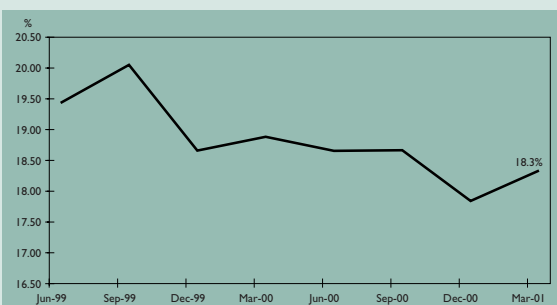
Table 4
Consolidated Capital Adequacy Ratio for all Locally Incorporated Authorized Institutions

(HK\$ mn)


	Mar-00	Jun-00	Sep-00	Dec-00	Mar-01
Total capital base after deductions ¹	255,448	256,755	261,524	259,721	266,490
o/w core capital	212,548	214,146	219,550	215,518	220,684
Total risk-weighted exposures	1,352,766	1,376,307	1,401,141	1,455,706	1,453,542
Capital adequacy ratio	18.9%	18.7%	18.7%	17.8%	18.3%

Note: 1. Total capital base after deductions refers to total core and supplementary capital after deductions as specified under the Third Schedule to the Banking Ordinance.

Chart 15
Capital Adequacy Ratio of All Locally Incorporated Authorized Institutions



The capital strength of local authorized institutions remained strong. The average consolidated capital adequacy ratio (CAR) of all locally incorporated institutions rose to 18.3% at end-March 2001 from 17.8% at end-December 2000 (Table 4 and Chart 15).

A table of key performance indicators of the banking sector is at Annex. 

- Prepared by the Banking Policy Department

Key Performance Indicators of the Banking Sector¹(%)

	Mar-00	Dec-00	Mar-01
Interest rate movements (Quarterly average)			
1-month HIBOR	5.56	5.80	5.17
3-month HIBOR	5.83	5.95	5.08
BLR and 1-month HIBOR spread	3.09	3.70	3.52
BLR and 3-month HIBOR spread	2.81	3.55	3.62
Balance sheet development (Quarterly change)			
Total deposits	0.4	3.0	-2.7
Hong Kong Dollar	-1.0	1.9	-0.4
Foreign currency	2.1	4.3	-5.3
Total loans	-4.0	-3.6	-3.4
Domestic lending	0.0	-1.7	-0.9
Offshore lending	-12.7	-10.8	-13.5
Negotiable instruments			
Negotiable debt certificates issued	1.8	-4.7	-2.9
Other negotiable debt instruments held	5.3	5.1	9.0
Asset quality²			
Bad debt charge to average total assets ³	0.19	0.29	0.16
As % of total loans			
Pass Loans	82.67	86.30	86.60
Special mention loans	8.05	6.48	6.28
Classified loans (gross) ⁴	9.28	7.23	7.12
Classified loans (net) ⁵	6.12	4.86	4.79
Overdue >3 months and rescheduled loans	6.86	5.48	5.41
Non-performing loans ⁶	6.81	5.38	5.31
Delinquency ratio of residential mortgage loans ⁷	1.16	1.26	1.36
Credit card receivables ⁸			
Delinquency ratio	0.82	0.76	0.93
Charge-off ratio ³	4.24	3.88	3.68
Profitability^{3,9}			
Net interest margin	2.40	2.33	2.13
Cost income ratio	35.2	36.4	40.0
Capital adequacy ratio¹⁰	18.9	17.8	18.3

1. Figures related to Hong Kong office(s) only except where otherwise stated.
2. Period-end figures relate to local banks' Hong Kong office(s) and overseas branches except for the bad debt charge, delinquency ratio of residential mortgage loans, delinquency ratio of credit cards and credit card charge-off ratio.
3. Year-to-date annualised ratio.
4. Classified loans are those loans graded as "substandard", "doubtful" or "loss".
5. Net of specific provisions.
6. Loans on which interest has been placed in suspense or on which interest accrual has ceased.
7. Based on monthly survey on residential mortgage lending.
8. Based on survey on credit card receivables.
9. Figures related to Hong Kong office(s) of local banks.
10. Consolidated ratio for all locally incorporated institutions.