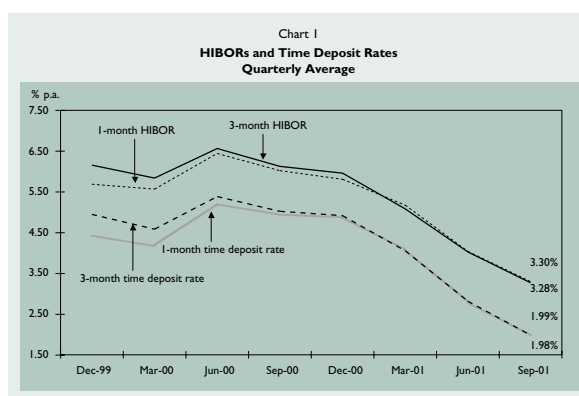


DEVELOPMENTS IN THE BANKING SECTOR

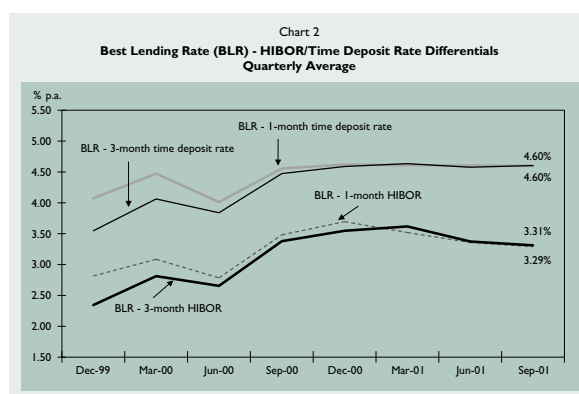
Continuing slowdown in the economy and limited lending opportunities led to a further contraction in domestic lending in the third quarter of the year. With the continued squeeze in lending margins as a result of intense competition among banks, net interest income fell. Operating costs on the other hand rose, leading to an increase in cost-income ratio. As a whole, operating profits of local banks fell modestly in the first three quarters of the year, compared with the same period last year. Helped by a declining interest rate environment which alleviated borrowers' debt burden, local banks' overall asset quality showed a further improvement although the quality of credit card receivables continued to deteriorate.

Interest Rate Movements

Domestic interest rates dropped further in the September quarter. In tandem with the cuts in the US Federal Funds rate, commercial banks lowered their best lending rate (BLR) three times in the September quarter by a total of 100 basis points to 6.00% from 7.00%. HIBOR and time deposit rates¹ also declined. Both average 1-month and 3-month HIBOR contracted by about 74 basis points and the average 1-month and 3-month time deposit rates declined by 80 and 84 basis points respectively (Chart 1).



In the September quarter, the spreads between BLR and HIBOR contracted because the average BLR declined by a larger magnitude than the average HIBOR. The average spread between BLR and 1-month HIBOR narrowed by 7 basis points to 3.29% and that for 3-month HIBOR, by 6 basis points to 3.31%. The average spread between BLR and time deposit rates displayed a different trend. While the spread between BLR and the 1-month time deposit rate remained unchanged at 4.60%, that for the 3-month time deposit rate widened by 2 basis points to 4.60% (Chart 2).



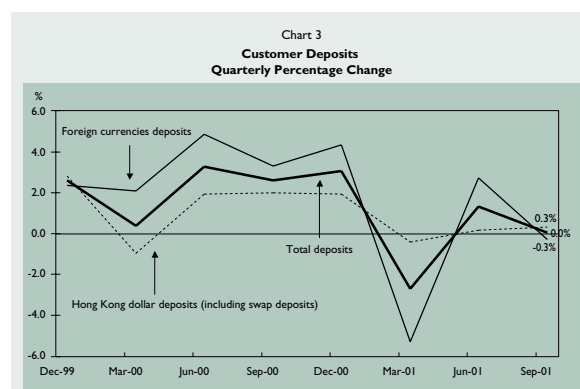
Balance Sheet Developments

Customer Deposits

Having risen by 1.3% in the June quarter, customer deposits remained virtually unchanged 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 September quarter. While Hong Kong dollar deposits increased, foreign currency deposits decreased. Hong Kong dollar deposits grew by 0.3% after rising by 0.2% in the June quarter. Foreign currency deposits declined by 0.3%, against an increase of 2.7% in the preceding quarter (Chart 3). As a result, the proportion of Hong Kong dollar deposits to total deposits edged up slightly to 53.8% at end-September from 53.7% at end-June.



Similar to the June quarter, increases in Hong Kong dollar demand deposits and savings deposits offset a decline in Hong Kong dollar time deposits (including swaps). In the September quarter, demand and savings deposits grew by 5.9% and 4.4%, compared with increases of 0.9% and 8.3% respectively in the June quarter. Time deposits dropped further by 2.0% following a decline of 3.2% in the preceding quarter. The less attractive time deposit rates appeared to have led to a shift of time deposits to saving deposits as consumers chose to hold their funds in a more liquid form. Table I shows the quarterly changes in Hong Kong dollar deposits by type.

Table I
Hong Kong Dollar Deposit Mix

Amount (HK\$ bn)

	Deposits				
	Demand	Savings	Time *	Swap	Time @
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)
Jun/01	106.3	540.8	1,193.1	3.1	1,196.2
% growth	0.9	8.3	(3.1)	(20.4)	(3.2)
Sep/01	112.6	564.8	1,169.0	2.9	1,171.8
% growth	5.9	4.4	(2.0)	(7.5)	(2.0)

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

* excludes swap deposits

@ includes swap deposits

Negotiable Instruments

After an increase of 4.2% in the June quarter, outstanding negotiable certificate of deposits (NCDs) declined slightly by 0.2% in the September quarter. Unlike the preceding quarter, fixed rate instruments dominated the primary NCD market and represented 63.9% of total new issues, up from 45.7% in the preceding quarter. The portion of the outstanding amount of NCDs held by authorized institutions declined to 54.9% at end-September from 58.2% at end-June.

Due to limited lending opportunities, banks continued to turn to holdings of debt securities. This resulted in an acceleration in the growth of negotiable debt instruments (NDIs) held by the banking sector to 6.3% from 4.4% in the preceding quarter (Table 2).

Lending

Despite a more moderate contraction in offshore loans, the faster rate of decline in

domestic lending resulted in a decrease of 3.0% in total loans and advances, following a drop of 2.6% in the June quarter.

The decline in offshore loans slowed to 9.8% from 11.3% in the June quarter. As in previous quarters, the decline mainly reflected further contraction in Japanese banks' Euroyen lending activities. Domestic lending² on the other hand decreased at a faster rate of 1.7%, compared with a drop of 0.4% in the June quarter (Chart 4).

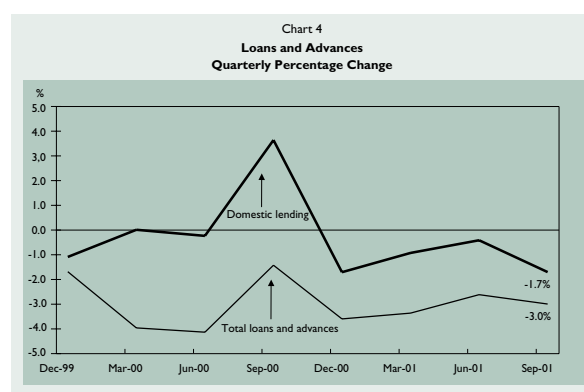


Table 2
NCDs and NDIs

Amount (HK\$ bn)

	All Authorized Institutions			Local Banks			
	Total NCDs outstanding	HK\$	FC	Total	HK\$	FC	Total
Sep/00	186	312	407	719	171	187	358
% growth	(6.1)	7.4	11.7	9.8	6.6	21.4	13.8
Dec/00	178	329	427	756	180	197	377
% growth	(4.3)	5.4	4.9	5.1	5.2	5.3	5.3
Mar/01	173	373	451	824	203	206	409
% growth	(2.7)	13.5	5.6	9.0	12.5	4.7	8.5
Jun/01	180	369	492	861	202	239	440
% growth	4.2	(1.1)	9.0	4.4	(0.7)	16.0	7.7
Sep/01	180	392	522	915	214	255	469
% growth	(0.2)	6.4	6.2	6.3	6.0	6.9	6.5

Note: % growth denotes the quarter-on-quarter growth of NCDs and NDIs.

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

Lending to major economic sectors generally declined in the September quarter (Chart 5). Helped by the respective increases of 1.7% and 0.5% in loans for property investment and residential mortgage loans (excluding loans under the Home Ownership Scheme, the Private Sector Participation Scheme and the Tenants Purchase Scheme) which partly offset the marked decline of 9.4% in loans for property development, the overall decline in property lending moderated to 0.6% from 1.3% in the preceding quarter (Chart 6).

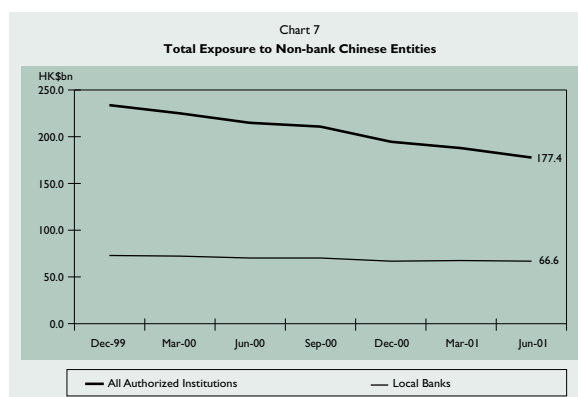
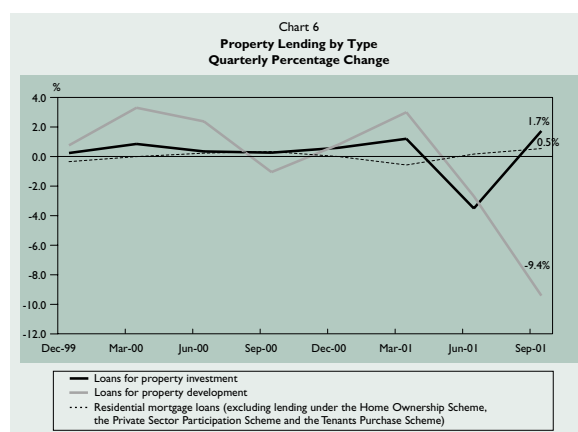
Loans to electricity, gas and telecommunications sector grew by 4.1% after falling for three consecutive quarters. Within this, aggregate lending to the telecommunications sector³ dropped by 4.6% to HK\$46.20 billion from HK\$48.45 billion at end-June, and represented 2.4% of the banking sector's total domestic lending at end-September, down from 2.5% at end-June.

Credit card receivables continued to rise, by 3.3% following an increase of 5.4% in the June quarter.

China Exposures

Total outstanding exposure of the banking sector to non-bank Chinese entities amounted to HK\$177.4 billion at end-June (2.7% of the sector's total assets), down by 5.5% from HK\$187.7 billion at end-March (Chart 7). The reduction was mainly due to loan repayments and write-offs. The total exposure, spread among 140 institutions (both local and foreign), consisted of on- and off-balance sheet exposures of HK\$150.7 billion and HK\$26.7 billion respectively.

The local banking sector's exposure to non-bank Chinese entities also decreased to HK\$66.6 billion at end-June (2.8% of the sector's total assets) from HK\$67.6 billion at end-March.



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

Loan-to-Deposit Ratio

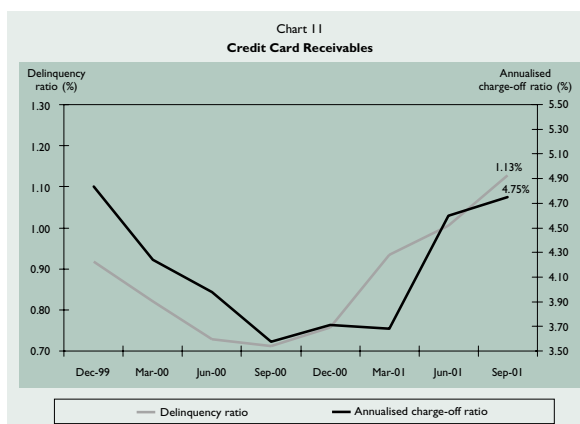
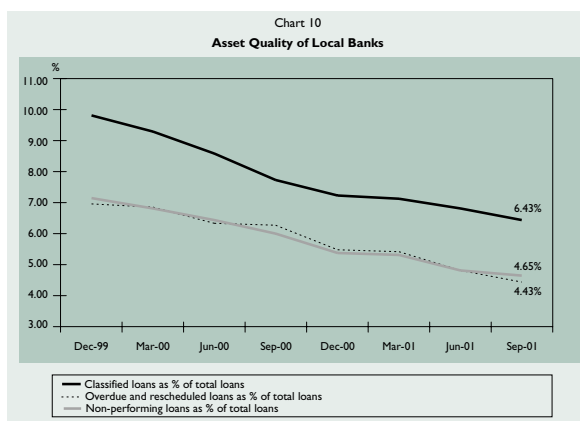
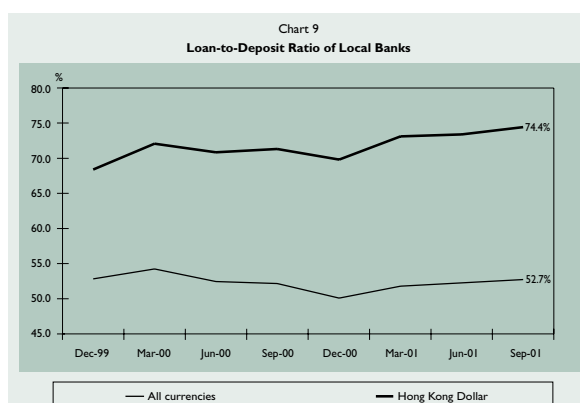
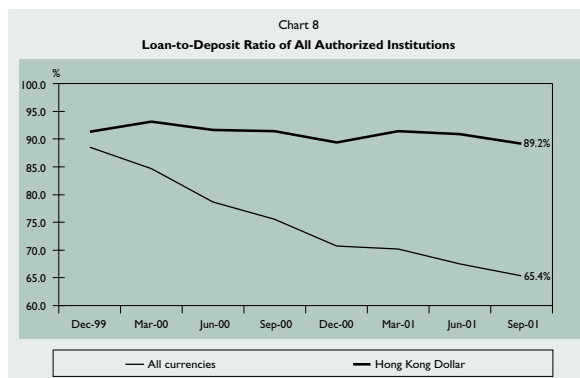
Attributable mainly to the continued decline in total loans, the overall loan-to-deposit ratio of the banking sector fell to 65.4% at end-September from 67.5% at end-June. Similarly, the Hong Kong dollar loan-to-deposit ratio dropped to 89.2% from 90.8% (Chart 8).

The local banks exhibited a different trend. Both the overall and Hong Kong dollar loan-to-deposit ratios of local banks rose to 52.7% and 74.4% at end-September respectively from 52.3% and 73.3%. The increases reflected growth in the local banks' lending in contrast to the decline recorded by the banking sector as a whole (Chart 9).

Asset Quality

Asset quality of local banks improved further due to a decline in problem loans and an increase in total loans. While the ratio of classified loans declined to 6.43% of total loans at end-September from 6.81% at end-June, the ratio of non-performing loans⁴ dropped to 4.65% from 4.82%. The ratio of loans overdue for more than three months and rescheduled loans also dropped to 3.75% and 0.68% from 3.96% and 0.87% respectively. As a result, the combined ratio of overdue and rescheduled loans fell to 4.43% at end-September from 4.82% at end-June (Table 3 and Chart 10).

The quality of credit card receivables however deteriorated further in the September quarter. The delinquency ratio (measured as receivables overdue for more than 90 days as percentage of total receivables) increased to 1.13% at end-September from 1.00% at end-June, while the annualised charge-off ratio increased to 4.75% in the September quarter from 4.60% in the June quarter (Chart 11).



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

Table 3
Asset Quality¹ of All Local Banks

	Sep/00	Dec/00	Mar/01	Jun/01	Sep/01
	as % of total loans				
Pass loans	85.03	86.33	86.59	87.62	88.21
Special mention loans	7.25	6.45	6.29	5.57	5.36
Classified loans (gross)²	7.72	7.22	7.12	6.81	6.43
o/w Substandard	2.58	2.58	2.48	2.69	2.45
Doubtful	4.56	4.17	4.07	3.64	3.44
Loss	0.58	0.47	0.56	0.48	0.55
Classified loans (net)³	4.90	4.85	4.79	4.74	4.41
Overdue > 3 months and rescheduled loans	6.27	5.47	5.41	4.82	4.43
o/w Overdue > 3 months	5.26	4.38	4.47	3.96	3.75
Rescheduled loans	1.02	1.09	0.94	0.87	0.68
Non-performing loans⁴	6.00	5.38	5.31	4.82	4.65

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.

In contrast, there were signs of improvement in banks' residential mortgage loan portfolios. 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 1.28% at end-September from 1.35% at end-June. The fall was partly due to write-offs made by some banks and repayments of loans overdue (Chart 12).

Profitability

The profitability of local banks in respect of their Hong Kong offices fell moderately in the first three quarters of the year, compared with the same period last year. The fall was largely due to an increase in total operating expenses and a decrease in net interest income resulting from the

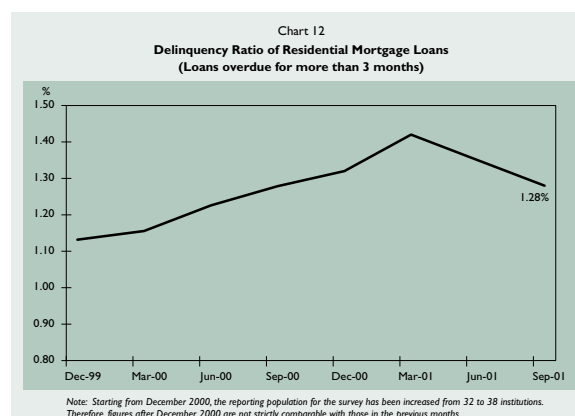


Table 4
Consolidated Capital Adequacy Ratio for all Locally Incorporated Authorized Institutions

(HK\$ mn)

	Sep-00	Dec-00	Mar-01	Jun-01	Sep-01
Total capital base after deductions ¹	261,552	259,314	265,518	267,320	278,264
o/w core capital	219,578	215,085	219,712	222,316	228,249
Total risk-weighted exposures	1,401,147	1,455,703	1,453,517	1,488,771	1,519,178
Capital adequacy ratio	18.7%	17.8%	18.3%	18.0%	18.3%


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

continued squeeze in lending margins. The latter was only partly offset by a rise in income from fees and commissions. Consequently, the cost-income ratio rose to 39.4% in the first nine months of the year from 36.0% in same period last year.

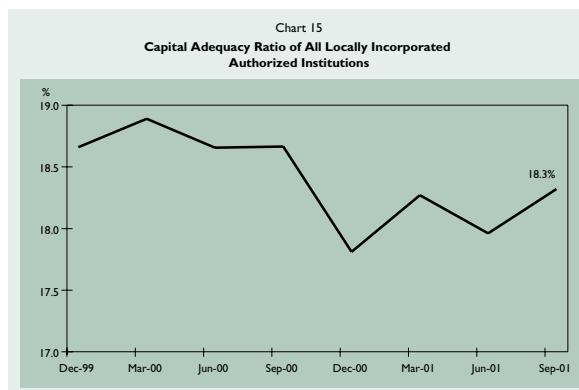
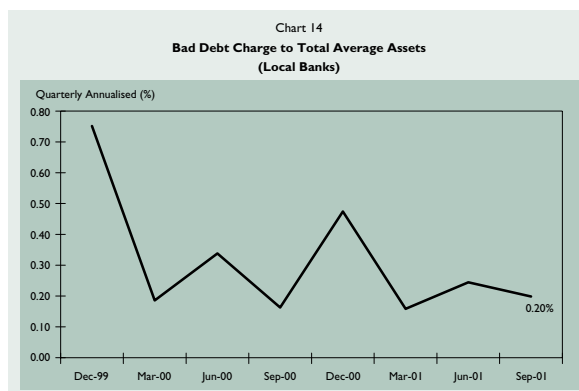
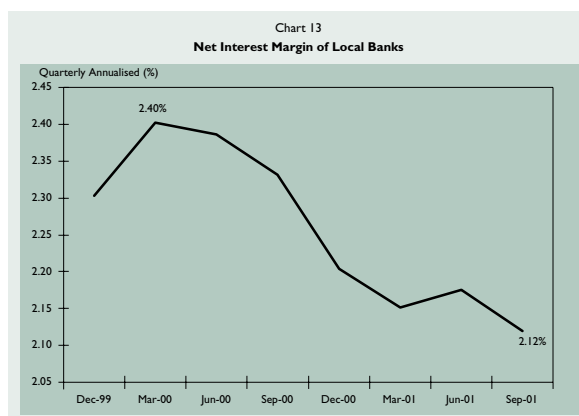
For the first three quarters of the year, the annualised net interest margin (NIM) fell to 2.15% from 2.37% in the same period last year (Chart 13).

In line with the continuing improvement in asset quality as measured by the various ratios, bad debt provisions fell in the first three quarters compared with the same period of last year. As a percentage of average total assets, the annualised bad debt charge fell to 0.20% from 0.23% (Chart 14).

The capital strength of local incorporated authorized institutions remained strong. The average consolidated capital adequacy ratio of all locally incorporated authorized institutions rose to 18.3% at end-September from 18.0% at end-June (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(%)

	Sep-00	Jun-01	Sep-01
Interest rate movements (Quarterly average)			
1-month HIBOR	6.02	4.04	3.30
3-month HIBOR	6.12	4.02	3.28
BLR and 1-month HIBOR spread	3.48	3.36	3.29
BLR and 3-month HIBOR spread	3.38	3.37	3.31
Balance sheet developments (Quarterly change)			
Total deposits	2.6	1.3	0.0
Hong Kong Dollar	2.0	0.2	0.3
Foreign currency	3.3	2.7	-0.3
Total loans	-1.4	-2.6	-3.0
Domestic lending	3.6	-0.4	-1.7
Offshore lending	-16.6	-11.3	-9.8
Negotiable instruments			
Negotiable debt certificates issued	-6.1	4.2	-0.2
Other negotiable debt instruments held	9.8	4.4	6.3
Asset quality²			
Bad debt charge to average total assets ³	0.23	0.20	0.20
As % of total loans			
Pass loans	85.03	87.62	88.21
Special mention loans	7.25	5.57	5.36
Classified loans (gross) ⁴	7.72	6.81	6.43
Classified loans (net) ⁵	4.90	4.74	4.41
Overdue > 3 months and rescheduled loans	6.27	4.82	4.43
Non-performing loans ⁶	6.00	4.82	4.65
Delinquency ratio of residential mortgage loans ⁷	1.28	1.35	1.28
Credit card receivables ⁸			
Delinquency ratio	0.71	1.00	1.13
Charge-off ratio	3.57	4.60	4.75
Profitability^{3,9}			
Net interest margin	2.37	2.16	2.15
Cost income ratio	36.0	38.3	39.4
Capital adequacy ratio¹⁰	18.7	18.0	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. Starting from December 2000, the reporting population for the survey has been increased from 32 to 38 institutions. Therefore, figures after December 2000 are not strictly comparable with those in the previous months.
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 authorized institutions.