Average funding costs continued to decline during the June quarter. Domestic lending picked up on the back of the buoyant property market and a recovery in growth in lending to other economic sectors. These factors were reflected in the solid performance of the banking sector in the first half of 1996 particularly among the locally incorporated banks.

Interest rate movements

The best lending rate and savings rate remained unchanged at 8.5% and 3.75% respectively in the June quarter of 1996. This was despite some easing in average short term market rates as evidenced by the fall in 1-month and 3-month HIBOR from 5.29% to 5.21% and 5.41% to 5.36% respectively. Moreover, 1-month and 3-month time deposit rates also dropped from 4.67% to 4.55% and 4.80% to 4.72% respectively. However, funding costs picked up towards the end of the quarter due partly to market expectations of an increase in US interest rates.

Despite the continued decline in average funding costs, the net impact on margins was more mixed during the quarter. As the average best lending rate decreased at a slower rate than the 1-month time deposit rate, the average spread between the two rates widened further from 3.92% to 3.95%. In contrast, the corresponding spread between the best lending rate and the 1-month HIBOR decreased from 3.30% to 3.29%.

Average spreads for the first half of 1996 widened significantly compared with the first half of 1995, producing a positive impact on profitability during this year (see below). The differential between the best lending rate and 1-month time deposits increased by 87 b.p. to 3.94%; that between the best lending rate and 1-month HIBOR increased by 54 b.p. to 3.30%. By contrast, the differential between the best lending rate and the savings rate was unchanged (at 4.75%) between the two periods.

Balance sheet development

Customer deposits

Total customer deposits grew by a more moderate 0.9% in the June quarter (compared with an increase of 2.9% in the March quarter). The growth of HK dollar deposits (adjusted to include foreign currency swap deposits) slowed from 3.8% in the March quarter to 2.9%. Foreign currency deposits fell by 1.4%, partially reversing an increase of 1.8% in the March quarter.

The slow down in the growth of Hong Kong dollar deposits was mainly reflected in more moderate growth in savings deposits (2.2% compared with 6.4%). In contrast, boosted by the increase in property market activities and new share issues, demand deposits grew by 3.4% (compared with 0.5%). Time deposits maintained steady growth of 3.1% (compared with 3.2%).

The decline in foreign currency deposits reflected a fall in US dollar deposits, in particular time deposits, of 3.0%. This was partly due to various special factors. Growth in non-US dollar foreign currency deposits slowed from 3.3% to 0.2%. This in part reflected further depreciation of the yen against the HK dollar.

Negotiable instruments

The market for negotiable certificates of deposit (NCDs) continued to expand steadily during the quarter with the amount outstanding increasing by 6.9% to reach $151 bn as at the end of June. A notable feature of the NCDs issued during the quarter was the increased proportion of floating rate issues which accounted for 72% of new issues in the quarter (compared with 56% in the last quarter).

Corresponding to the growth in NCDs issued, total holding of NCDs by authorised institutions increased significantly by 8.8% during the quarter. As a result, the proportion of outstanding issues held by the banking sector increased to over 52% as at end-June. On the other hand, the sector's holdings of other negotiable instruments decreased by 0.6% during the quarter.

Lending

Total loans and advances recovered in the June quarter to grow by 2.3% (compared with a decrease of 1.0% in the March quarter and an increase of 0.3% in the December quarter). This was on the back of a notable pick-up in total loans for use in Hong Kong from 3.2% to 5.2%. Within this, growth in trade financing loans rebounded to 6.9% (compared with 1.8%). However, as a result of the depreciation of the yen against the HK dollar during the quarter and a further contraction in Euro-yen activities, offshore loans declined by 0.1%.

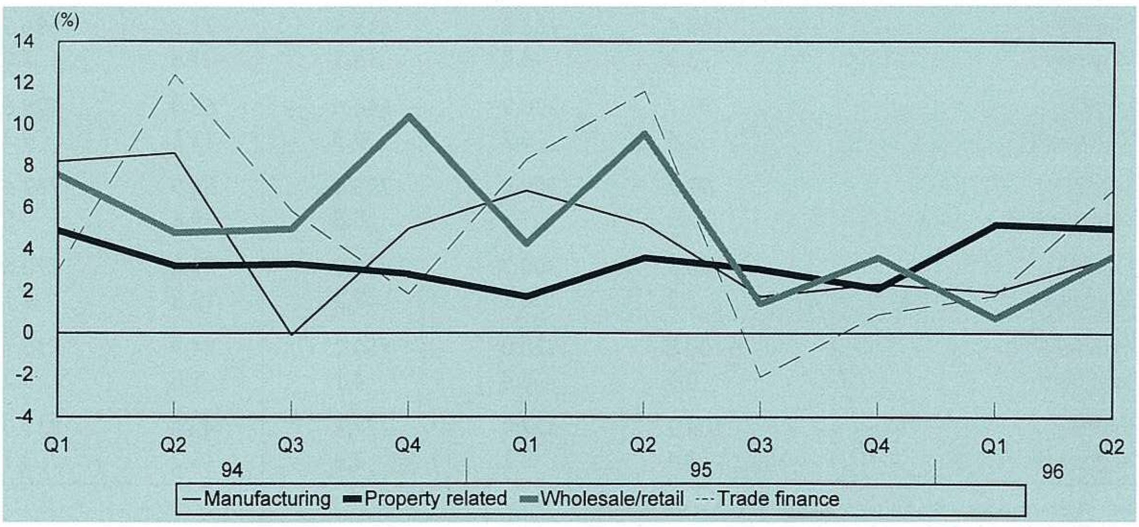
The strong growth in domestic lending was underpinned by the buoyant property market. The demand for residential mortgage loans remained strong though there are signs that the fierce competition for mortgage business among authorised institutions has eased somewhat. Residential mortgage loans for individual customers (excluding those under the Home Ownership Scheme and Private Sector Participation Scheme) grew by 5.4% (compared with 4.6%). This reflected continued revival in primary and secondary residential mortgage market activities. Growth in lending for property development and investment (excluding civil engineering works) moderated somewhat compared to the March quarter, but nevertheless remained strong at 4.9% (compared with 6.5%). As a result, total property lending as a proportion of loans for use in Hong Kong increased slightly from 39.9% to 40.0%.

Other than residential mortgages, consumer lending showed strong recovery, increasing by 6.0% (compared with 2.0%). Within this, credit card receivables rose by 4.8% against 0.7% in the previous quarter. Growth in lending to other economic sectors also picked up. Lending to manufacturing (3.6%), wholesale and retail sector (3.7%) and financial concerns (4.0%) all grew robustly. Boosted by the buoyant stock market and IPO activities during the quarter, share financing loans grew by 11.4%.

Survey on credit card receivables

As losses arising from credit card receivables are a sensitive indicator of deteriorating credit quality, the HKMA recently introduced a monthly survey to collect credit card statistics from 16 authorised institutions who are major players in credit card business.[1] The survey focuses on the size of the market in terms of number and value of accounts and the quality of credit card receivables as measured by the proportion of classified accounts and the charge-off ratio.

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).

(1) The survey covers 16 authorised institutions that book credit card receivables in their own accounts; credit cards issued by subsidiaries of authorised institutions which are not themselves authorised are not captured under this survey.

According to the results of the survey, a 3.0% growth in credit card receivables outstanding was recorded in the five month period from end January 1996 for which the figures are available. As at end-June, delinquent accounts (defined as those accounts which are unpaid for more than 90 days after the due date for payment) accounted for 0.9% of total receivables outstanding of the surveyed institutions. The charge-off ratio (defined as the amount of credit card receivables written off as a percentage of total credit card receivables outstanding) was 2.3% (annualised) during the first half of 1996.(2) While this latter figure is well above the loss experienced in the rest of the loan book, it is lower than the comparable figure in a more mature credit card market such as the United States. Institutions also of course receive a higher return on this type of lending. Notwithstanding these points, competition in the domestic credit card market is likely to intensify, pushing down the rate of return, and institutions will need to take care that this is not accompanied by a sacrifice of prudent lending standards.

Loan to deposit ratio

With the growth in HK dollar loans outstripping that in HK dollar deposits, the HK dollar loan-to-deposit ratio for the banking sector as a whole rose from 105.9% at end-March to 108.2% as at end-June. For locally incorporated banks, the ratio rose from 71.3% at end-March to 72.9% as at end-June.

Performance of the banking sector

Preliminary figures indicate that the banking sector achieved solid growth in profitability in the first half of 1996. This was particularly evident among locally incorporated banks as reflected in the interim results of those which have reported so far. This good performance was mainly supported by an increase in the net interest margin on the back of widening interest rate spreads (as discussed above) and a recovery in domestic lending. The improvement in spreads outweighed the reduced endowment effect (the value of interest free balances) as average funding costs declined. In the

Table 1:
HK$ Deposit Mix

Amount (HK$bn)

	Deposits				
	Demand	Savings	Time*	Swap	Time @
Mar/95	103.4	263.8	615.4	71.2	686.5
% growth	3.3	-4.0	14.5	-31.4	7.0
Jun/95	99.7	278.9	666.6	63.0	729.6
% growth	-3.6	5.7	8.3	-11.5	6.3
Sep/95	97.2	288.8	705.4	56.9	762.4
% growth	-2.5	3.5	5.8	-9.6	4.5
Dec/95	100.3	300.7	720.8	49.8	770.6
% growth	3.2	4.1	2.2	-12.5	1.1
Mar/96	100.8	320.0	750.2	44.9	795.1
% growth	0.5	6.4	4.1	-9.8	3.2
Jun/96	104.2	327.0	777.3	42.6	819.9
% growth	3.4	2.2	3.6	-5.2	3.1

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

(2) The charge-off policies adopted by institutions covered in the survey vary. Typically, however, receivables are written off once they are overdue for over 180 days.

case of the local banks, the net interest margin increased from 2.49% in 1995 to 2.61% (annualised) in the first half of 1996. In addition, local banks benefitted from improvements in dealing profits and in fee income. Operating expenses also rose quite sharply, but this was more than offset by the rise in total income, thus resulting in an improvement in the cost-income ratio.

Nevertheless, the impact of the positive factors discussed above was partly offset by the increase in the bad debt charge. As a percentage of average total assets, provisions for bad debts of the local banks doubled from 0.08% in 1995 to 0.16% (annualised) in the first half of 1996. However, this was from a very low base and therefore was in line with expectations. Indications are that while there has been some deterioration in asset quality this has not been serious so far. Institutions will however need to remain vigilant and the move by a number of them to set aside additional general provisions at the half-year is a sensible precaution.

– Prepared by the Banking Policy Department