Average funding costs increased during the September quarter, resulting in a contraction of the average interest rate spread. Growth in total customer deposits rebounded. This combined with a decelerated growth in total loans resulted in an improvement in the loan-to-deposit ratio. Despite the squeeze in margins, profitability of the banking sector remained solid.

Interest rate movements

Average funding costs picked up during the September quarter, while the best lending rate and savings rate remained unchanged at the levels of 8.5% and 3.75% respectively. This caused a contraction of the average interest rate spread.

The increase in the average funding rates was evident in both the interbank and retail deposit markets. Average 1-month and 3-month HIBOR increased from 5.21% to 5.34% and 5.36% to 5.56% respectively. A similar trend was seen in the average 1-month and 3-month time deposit rates, which rose from 4.55% to 4.69% and 4.72% to 4.91% respectively.

In line with the movement of the average funding rates, the average spread between the best lending rate and 1-month HIBOR decreased by 13 basis point (b.p.) to 3.16%; that between best lending rate and 3-month HIBOR decreased by 20 b.p. to 2.94%. Meanwhile, the average spread between the best lending rate and 1-month time deposit rate fell by 14 b.p. to 3.81% and that between best lending rate and 3-month time deposit rate fell by 19 b.p. to 3.59%.

Apart from the movement in funding costs, the re-emergence of competition in the mortgage market may also affect the margins of the banking sector with some institutions offering more favourable mortgage rates to attract new businesses. In addition, the impact of refinancing activities arising from the reduced rates offered in the first half peaked in the September quarter but has since become more subdued.

Balance sheet development

Customer deposits

Total customer deposits grew by 1.8% in the September quarter (compared with an increase of 0.9% in the June quarter). This was mainly attributable to the strong growth in HK dollar deposits (adjusted to include foreign currency swap deposits) which rose by 4.2% (compared with 2.9% in the June quarter). In sharp contrast, foreign currency deposits continued to fall by 1.2% after decreasing by 1.4% in the June quarter. The latter was caused by a fall in the non-US dollar foreign currency deposits of 2.2% (compared with an increase of 0.2% in the previous quarter) due partly to exchange rate effects. US dollar deposits remained virtually unchanged (compared with a decrease of 3.0% in the previous quarter).

The robust growth in Hong Kong dollar deposits was underpinned by the notable increase in demand deposits by 7.9% and savings deposits by 2.6%. This reflected the increased demand for transaction money in the light of the buoyant stock and property markets during the quarter. Moreover, time deposits grew by 4.4%, due partly to the increase in deposit rates noted above.

Negotiable instruments

Growth in the issue of negotiable certificates of deposit (NCDs) moderated slightly compared with previous quarters, but nevertheless remained strong at 5.2%. The total amount of NCDs outstanding stood at $159 bn as at end September. As in previous quarters, the proportion of floating rate instruments remained high and accounted for 80% of the new issues in the quarter (compared with 72% in the last quarter).

Authorised institutions increased their investment in NCDs by 7.7% during the quarter, further increasing the proportion of NCDs held by the sector to 54.2% (compared to 52.3%). Moreover, their holdings of other negotiable instruments increased by 8.0%.

Lending

Growth in total loans and advances slowed to 0.9% in the September quarter compared to 2.3% in the June quarter. This slowdown was mainly attributable to the deceleration of growth in loans for use in Hong Kong, coupled with the continued sluggishness in offshore lending. Other loans for use in Hong Kong (excluding trade finance) grew by a more modest 2.7% following strong growth of 5.0% in the previous quarter. Offshore lending grew by 0.1% (after falling by 0.1% in the June quarter and 4.3% in the March quarter). This was due to a modest recovery in Euroyen activities which more than offset the negative impact of the continued depreciation of the yen against the Hong Kong dollar.

The slower growth in loans for use in Hong Kong was partly due to a slowdown in residential mortgage lending (excluding those under the Home Ownership Scheme and Private Sector Participation Scheme), which grew by 4.1% after a strong rebound of 5.4% in the June quarter. However, lending to property investment and development (excluding civil engineering) sustained its growth momentum, registering an increase of 4.9%. As a result, total property lending as a proportion of loans for use in Hong Kong rose slightly from 40.0% in the June quarter to 40.7% in the September quarter.

Demand for loans to other major sectors remained mixed, with growth in lending to manufacturing and financial concerns decelerating to 1.2% and 1.7% from 3.6% and 4.0% respectively. Consumer lending, excluding residential mortgage loans, also slowed to 3.8% from 5.9%, partly reflecting sluggish growth in credit card receivables and loans to private individuals for business purposes. The sharp fall in lending to stockbrokers reflected the unwinding of positions built up in the wake of share floatations in the June quarter. In contrast, lending to wholesale and retail sectors grew by 3.9%.

Trade financing loans reversed the recent uptrend, declining by 3.9% after growing by 1.8% in the March quarter and 6.9% in the June quarter.

Loan to deposit ratio

As HK dollar loans grew at a slower rate than HK dollar deposits, the Hong Kong dollar loan-to-deposit ratio for the banking sector as a whole improved from 108.2% at end-June to 106.2% as at end-September. The ratio of the locally incorporated banks decreased only slightly from 72.9% at end-June to 72.8% as at end-September.

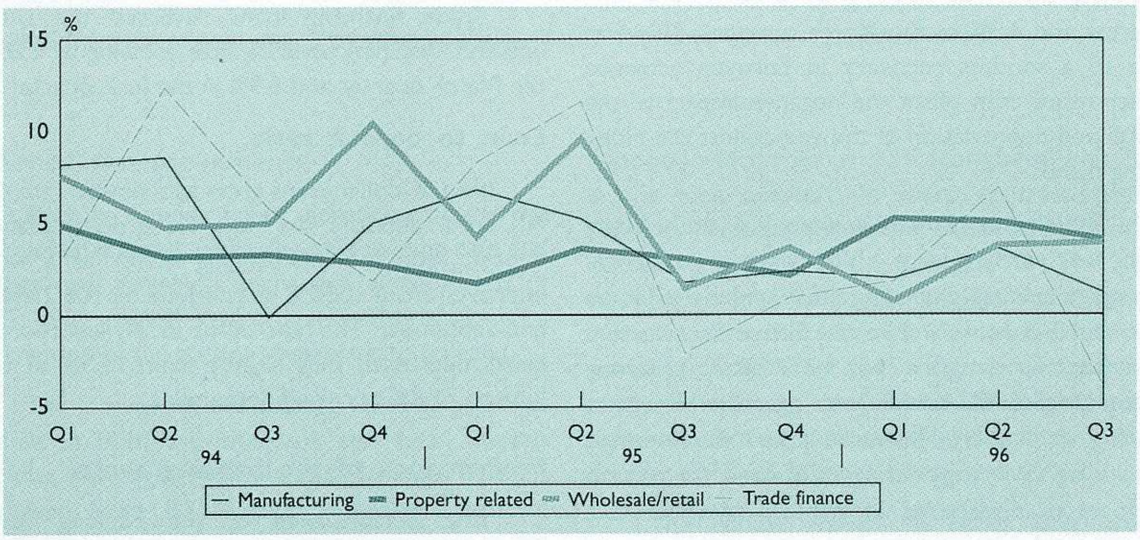
Performance of the banking sector

The performance of the banking sector remained solid in the September quarter, although the growth in operating profits slowed down somewhat after the strong figures recorded in the first half. Net interest margins of the locally incorporated banks for the first nine months of the year declined slightly to 2.60% (annualised) compared with 2.61% in the first half of the year and 2.45% in the first nine months of 1995. Preliminary figures indicate that, as a percentage of average total assets, provisions for bad debts of the local banks improved from 0.16% (annualised) in the first half of the year to 0.13% for the first nine months of the year.

– Prepared by the Banking Policy Department

Chart 1

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).

Table 1:

HK$ Deposit Mix

Amount (HK$ bn)

	Demand	Deposits Savings	Time *	Swap	Time @
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
Sep/96	112.4	335.5	817.0	39.3	856.2
% growth	7.9	2.6	5.1	-7.8	4.4

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