

## DEVELOPMENTS IN THE BANKING SECTOR

*Funding costs rose in the second quarter while the margin on residential mortgage lending continued to fall. This resulted in a narrowing in the net interest margin. Despite this, the profitability of local banks has been sustained by the strong growth in domestic lending prompted by the buoyant property and stock markets and by a decline in the bad debt charge. Preliminary figures for the first half of the year indicate that the underlying profitability of local banks continued to grow at a robust pace. Growth in HK dollar deposits outstripped that of loans in the second quarter, but overall the loan to deposit ratio has deteriorated in the first half of this year.*

### Interest Rate Movements

The best lending rate and savings rate remained unchanged at 8.75% and 4.00% respectively in the June quarter of 1997. However, average short-term market rates and time deposit rates showed significant increases. The average 1-month and 3-month HIBOR rose by 63 and 56 basis points to 5.99% and 6.08% respectively. In contrast, the rates had increased by only 2 basis points in the preceding quarter. With strong competition for time deposits, average time deposit rates picked up even more. For example, the average rates for 1-month and 3-month deposits rose by 70 and 64 basis points to 5.41% and 5.52% respectively, compared with an increase of 5 and 7 basis points in the first quarter.

The rise in funding costs caused average spreads to narrow further. The differential between the best lending rate and 1-month HIBOR decreased by 39 basis points and that for 3-month HIBOR by 32 basis points. The corresponding spread between the best lending rate and the respective time deposit rates contracted even more, by 46 and 40 basis points respectively.

### Balance Sheet Developments

#### Customer deposits

Total customer deposits grew at a faster rate of 4.8% in the June quarter, compared with 3.4% in the March quarter. This was mainly attributable to the strong growth in HK dollar deposits (adjusted to include foreign currency swap deposits) which rose by 8.0%, compared with 3.6% in the previous quarter. Growth in foreign currency deposits however decelerated to 0.6% (compared with 3.1%).

The faster growth in Hong Kong dollar deposits was across the board. More than reversing the decline in the previous quarter, HK dollar demand and savings deposits increased by 5.3% and 7.2% respectively. Time deposits also expanded more rapidly, increasing by 8.6% during the quarter (compared with 7.2% in the March quarter). Growth in such deposits will have been boosted by the more competitive interest rates being offered by banks.

The slower growth in foreign currency deposits was mainly influenced by a sharp decrease in the growth of non-US dollar foreign currency deposits to 1.2% from 6.5%. This was partly due to a fall in deposits from overseas subsidiaries of some banks. US dollar deposits fell marginally by 0.1% (compared with a decline of 0.4% in the preceding quarter).

#### Negotiable instruments

The market for negotiable certificates of deposit (NCDs) expanded at a faster rate during the quarter as authorised institutions sought to raise medium- and long-term funding to finance business expansion and improve their maturity mismatch. The amount of total NCDs issued grew by 9.9% (compared with 3.7%) to reach \$205 bn at end-June. Floating rate instruments continued to dominate the primary market, accounting for 80% of the new issues in the quarter (compared with 64% in the last quarter).

In line with the growth in NCDs issued, the total holding of NCDs by authorised institutions increased by 11.2%, lifting the proportion of NCDs held by the sector to 59.7% at end-June from 57.9% at end-March. On the other hand, the sector's holdings of other negotiable instruments



increased by a more moderate 3.5% (compared with 5.7% in the last quarter).

### Lending

Total loans and advances expanded sharply in the June quarter, increasing by 8.9% against 0.6% in the March quarter. This was on the back of a significant rebound in off-shore lending and the continued robust growth in loans for use in Hong Kong. The former rose by 10.3% due mainly to a revival in Euroyen activities, compared with a decrease of 6.1% in the preceding quarter. Other loans for use in Hong Kong (excluding trade finance) continued to grow at a rapid pace of 7.5%, though somewhat slower than the 8.8% in the March quarter.

Property and securities related lending were the main driving forces behind the expansion in loans for use in Hong Kong. In line with continued buoyancy in the property market, property lending rose by 10.2% in the June quarter, having risen by 8.7% in the March quarter. Within this sector, residential mortgage loans (excluding loans under the Home Ownership Scheme and Private Sector Participation Scheme) rose by 8.8% compared with 7.1% in the March quarter, and lending for property investment and development (excluding civil engineering), rose by 11.8% (against 10.7%). This raised total property lending as a proportion of loans for use in Hong Kong to 42.9% in the June quarter from 41.8% in the March quarter. Reflecting active trading in the stock market, loans to stockbrokers surged by 19.1%, following a rise of 15.1% in the preceding quarter. Loans to non-stock broking companies and individuals for the purchase of shares also grew strongly, by 27.5% (compared with 37.8%).

Stronger credit demand was also evident in trade financing and consumer lending. In the June quarter, trade financing loans increased by 6.7% against a decline of 0.6% in the preceding quarter. Consumer lending (excluding residential mortgage loans) reversed the decrease of 9.9% in the previous quarter to grow by 3.0%. Within this category of lending, the growth in credit card receivables (11.8% against a decline of 3.3%) was particularly pronounced. On the other hand, loans to the manufacturing sector remained subdued,

growing by a modest 1.7% (compared with 3.7%). The growth in loans for wholesale and retail remained stable, rising by 6.2% from 6.6%.

### Loan to deposit ratio

With Hong Kong dollar deposits growing at a faster pace than Hong Kong dollar loans, the Hong Kong dollar loan to deposit ratio for the banking sector as a whole improved to 107.6% at end-June from 109.1% at end-March. The ratio of the locally incorporated banks also improved slightly to 77.3% at end-June from 77.6% at end-March. However, the ratios for both the sector as a whole and for local banks were still higher than the end-1996 figures of 103.4% and 71.1% respectively.

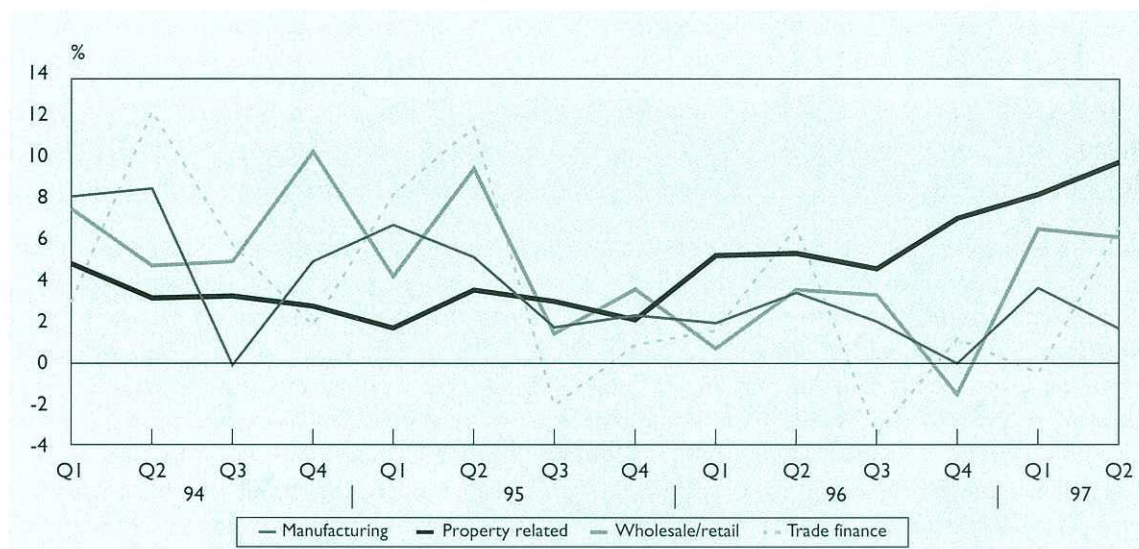
### Profitability

Preliminary interim results indicate that the underlying profitability of the banking sector continued to grow at a robust rate in the first half of 1997. This was particularly evident among locally incorporated banks as reflected in the interim results of those which have reported so far. Operating profits before tax derived from the Hong Kong offices of the local banks rose by around 21% in the first half of the year. This good performance was mainly helped by the strong growth in domestic credit which more than offset the narrowing in interest margins. Reflecting the rise in funding costs in the second quarter and the further narrowing of the margin on residential mortgage lending, the net interest margin of local banks fell to 2.48% (annualised) compared with 2.58% in 1996 as a whole.

Other positive factors contributing to the good performance of the local banks were the further improvement in the cost-income ratio and the decline in the bad debt charge. The cost to income ratio fell to 36.71% in the first half of 1997 from 37.02% in 1996. As a percentage of average total assets, provisions for bad and doubtful debts dropped from 0.18% in 1996 to 0.12% (annualised) in the first half of 1997. In addition, local banks continued to benefit from improvements in dealing profits and in fee income. ❀

- Prepared by the Banking Policy Department

Chart I  
Loans for use in Hong Kong by Selected Sectors  
quarterly % change



N.B. Property related loans denote lending for property development & investment (including civil engineering) and private residential loans (including lending under the Home Ownership Scheme & Private Sector Participation Scheme).

Table I  
HK\$ Deposit Mix

Amount (HK\$bn)

	Deposits				
	Demand	Savings	Time*	Swap	Time@
<b>Jun/96</b>	104.2	327.0	777.3	42.6	819.9
% growth	3.4	2.2	3.6	-5.2	3.1
<b>Sep/96</b>	112.4	335.5	817.0	39.3	856.2
% growth	7.9	2.6	5.1	-7.8	4.4
<b>Dec/96</b>	121.8	366.1	873.7	38.5	912.2
% growth	8.3	9.1	6.9	-1.9	6.5
<b>Mar/97</b>	117.1	355.8	942.1	35.8	977.9
% growth	-3.9	-2.8	7.8	-6.9	7.2
<b>Jun/97</b>	123.2	381.3	1,024.5	37.4	1,061.9
% growth	5.3	7.2	8.8	4.4	8.6

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

\* excludes swap deposits

@ includes swap deposits