

DEVELOPMENTS IN THE BANKING SECTOR

Funding costs rose in the September quarter as a result of the Asian currency turmoil. However, profit growth in the first nine months of the year compared favourably with the same period of 1996. This has provided banks with a cushion against the current more difficult operating environment.

Interest Rate Movements

The Asian currency turmoil added volatility to the Hong Kong interbank market during the third quarter. Average 1-month and 3-month HIBOR rose by 102 and 94 basis points to 7.01% and 7.02%. This followed corresponding increases of 63 and 56 basis points in the June quarter. In addition, banks continued to bid for time deposits by offering higher deposit rates. Average 1-month and 3-month time deposit rates rose by 92 and 85 basis points to 6.33% and 6.37%, compared with increases of 70 and 64 basis points in the previous quarter.

With the best lending rate remaining unchanged at 8.75%, banks experienced a decline in interest rate spreads. In the quarter, the average spread between the best lending rate and 1-month HIBOR dropped by 102 basis points, and that between 3-month HIBOR by 94 basis points. The spread between the best lending rate and 1-month time deposit rate narrowed by 92 basis points and that between 3-month time deposit rate by 85 basis points. Some major banks announced an increase of 50-75 basis points in their mortgage lending rates during the quarter, indicating a reversal of the price-cutting which had been a feature of the first half of the year.

Balance Sheet Developments

Customer deposits

Total customer deposits grew at a more moderate pace of 1.7% in the September quarter, down from 4.8% in the June quarter. Growth in Hong Kong dollar deposits (adjusted to include foreign currency swap deposits) slowed to 2.1% from the very high growth rate of 8.0% in the last quarter, while that of foreign currency deposits picked up to 1.2% from 0.6%. This was more than accounted for by faster growth in US dollar deposits.

The deceleration in growth of Hong Kong dollar deposits was due to a 8.7% decline in savings

deposits and slower growth in demand deposits (0.1% compared with 5.3%). Nonetheless, Hong Kong dollar time deposits continued to exhibit significant growth of 6.2%, though the pace was somewhat slower than the 8.6% growth in the June quarter. The drop in savings deposits was partly attributable to the higher interest rates for time deposits during the quarter. The use of savings deposits to subscribe for new shares may have also contributed.

Negotiable instruments

Negotiable certificate of deposit (NCD) continued to be a source of medium to long-term funding for the authorised institutions. Total NCDs issued and outstanding grew by 6.4% to HK\$217 billion in the September quarter, following growth of 9.8% in the June quarter. The proportion of floating rate instrument fell to 77% of the NCDs issued (compared to 80% in the June quarter). The proportion of NCDs held by authorised institutions rose further, to 62.5% from 59.7%. Of the NCDs issued by authorised institutions, a notable trend during the first nine months of 1997 was the growing popularity of Hong Kong dollar-denominated NCDs. Their share of total NCDs outstanding increased from 73.0% at end-1996 to 76.5% at end-September 1997, thus extending the maturity of institutions' Hong Kong dollar funding.

Lending

Total loans and advances fell by 0.2% in the September quarter (against an increase of 8.9% in the June quarter). This was mainly due to a 6.1% decline in offshore lending which was attributable to the depreciation of the Yen during the quarter. By contrast, other loans for use in Hong Kong (excluding trade finance) continued to grow by 6.4%, which was somewhat slower than the 7.5% rise in June quarter.

Property and securities-related lending were the main driving forces behind growth in loans for use in Hong Kong. However, the growth in

property lending slowed somewhat compared with the June quarter (7.2% against 10.5%). Within the property sector, growth in residential mortgage loans (excluding loans under Home Ownership Scheme and Private Sector Participation Scheme) remained at about the same rate (9.8%). However, lending for property development and investment grew at a much slower pace (4.3% against 11.8%). This reflected a decline of 1.5% in lending for property development, while lending for property investment rose by 7.7%.

Total property lending as a percentage of loans for use in Hong Kong rose slightly to 43.3% in the September quarter, broken down as follows:

Residential mortgage lending	23.2%
Loans for property investment	13.1%
Loans for property development	7.0%
	43.3%

Reflecting the active trading in the stock market and share subscription activities, growth in loans to stockbrokers surged to 106.2%, compared with a rise of 26.4% in the preceding quarter. In part this was due to the financing of initial public offerings (IPOs) which straddled the end of the quarter. However, growth in loans to non-stock broking companies and individuals for the purchase of shares slowed sharply to 8.3% from 31.4%.

Reflecting stronger demand for loans from private individuals, consumer lending (excluding residential mortgage loans) grew by 7.0% in the September quarter, up from 4.5% in the June quarter. Total credit card receivables continued to grow, but at a decelerating rate (7.4% compared

with 11.8%). For the other major sectors, loans to manufacturing and wholesale and retail trade fell by 3.1% and 2.2% respectively; these followed increases of 3.1% and 6.2% in the previous quarter. Trade financing was virtually unchanged after 6.7% growth in the June quarter.

Loan to deposit ratio

With expansion in Hong Kong dollar loans outpacing growth in Hong Kong dollar deposits, the Hong Kong dollar loan to deposit ratio of the banking sector increased to 112.1% at end-September from 107.6% at end-June. For locally incorporated banks, the ratio increased only slightly to 77.4% at end-September from 77.3% at end-June.

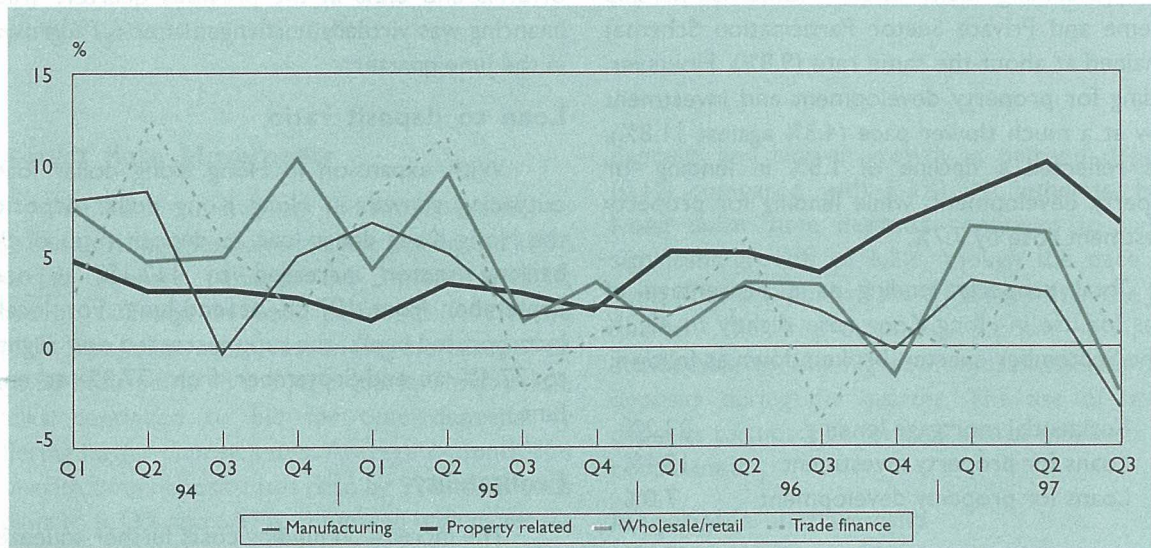
Profitability

The increase in funding costs further squeezed margins in the September quarter. This was evidenced by the reduction in the net interest margin of local banks, to 2.46% (annualised) in the first nine months of 1997 from 2.60% (annualised) in the corresponding period of the previous year.

Nevertheless, profit growth of local banks was sustained over the nine months as a whole by the growth in lending volume, a reduced bad debt charge (only 0.11% of total assets at an annualised rate) and by a lower cost-income ratio (just below 37%). Other operating income (including fees and commissions) was also buoyant. The favourable outcome for the first nine months of the year has provided a good cushion against the more difficult conditions so far in the last quarter. ☎

– 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)				
	Demand	Savings	Time *	Swap	Time @
Sep/96	112.4	335.5	817.0	39.3	856.2
% growth	7.9	2.6	5.1	-7.8	4.4
Dec/96	121.8	366.1	873.7	38.5	912.2
% growth	8.3	9.1	6.9	-1.9	6.5
Mar/97	117.1	355.8	942.1	35.8	977.9
% growth	-3.9	-2.8	7.8	-6.9	7.2
Jun/97	123.2	381.3	1024.5	37.4	1061.9
% growth	5.3	7.2	8.8	4.4	8.6
Sep/97	123.3	348.0	1092.2	35.9	1128.1
% growth	0.1	-8.7	6.6	-4.0	6.2

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

* excludes swap deposits

@ includes swap deposits