

## DEVELOPMENTS IN THE BANKING SECTOR

*Aggregate profits of the local banks from their Hong Kong offices continued to fall in the first half of 1999 compared with the same period of last year, but at a slower pace. Profits rose compared with the second half of 1998, reflecting a decline in bad debt provisions. Although the various ratios of problem loans continued to increase, there were signs of a levelling off in the rate of growth of problem loans in absolute terms.*

### Interest Rate Movements

Domestic interest rates in general softened further in the June quarter. The average 1-month and 3-month HIBOR fell further by 35 and 52 basis points to 5.03% and 5.28% respectively following declines of 7 and 17 basis points respectively in the March quarter. These levels were lower than those before the Asian financial crisis. In line with the decline in HIBOR, average 1-month and 3-month time deposit rates contracted by 52 basis points to 4.25% and 66 basis points to 4.50%, compared with declines of 32 and 57 basis points respectively in the preceding quarter.

In view of the stable market conditions and further improvement in interbank liquidity, the Hong Kong Association of Banks cut the savings rate by 25 basis points on 12 April 1999 and another 25 basis points on 3 May 1999. Commercial banks followed by lowering the best lending rate (BLR) by the same magnitude to 8.25%. The average spread between BLR and 1-month HIBOR dropped to 3.34% in the June quarter from 3.40% in the preceding quarter, but that for 3-month HIBOR rose to 3.09% from 2.97%. Meanwhile, the average spread between BLR and the 1-month time deposit rate increased to 4.12% from 4.01% and that for 3-month time deposit rate to 3.87% from 3.62%.

### Balance Sheet Developments

#### Customer Deposits

Following the flat growth in the March quarter, customer deposits rose by 1.4% in the June quarter. Both Hong Kong dollar and foreign currency deposits exhibited similar growth rates. Hong Kong dollar deposits reversed a decline of

0.1% in the previous quarter and recorded a rise of 1.4% in the June quarter and foreign currency deposits rose by 1.3% after a zero growth. Within foreign currency deposits, non-US\$ deposits grew faster than US\$ deposits. Non-US\$ deposits rose by 1.5% in the June quarter after falling 1.1% in the March quarter whereas US\$ deposits grew further by 1.2% following a 0.9% rise. The proportion of Hong Kong dollar deposits to total customer deposits remained stable at around 57%.

HK\$ savings deposits grew by 7.7% in the June quarter, reversing a decline of 3.6% in the preceding quarter. Demand deposits also grew, albeit at a slower rate of 1.2%, following a decline of 0.8% in the preceding quarter. On the contrary, time deposits fell by 0.7% in the June quarter compared with a 1.2% increase in the March quarter, reflecting the diminished attraction of time deposits and anticipation of an interest rate rise. The fall was mainly concentrated in deposits with maturities longer than one month. Time deposits maturing between one to three months declined further by 6.5% in the June quarter, following a notable drop of 20.1% in the March quarter, while those with maturities longer than three months fell by 10.8% after a strong rise of 14.8%. On the other hand, time deposits maturing within one month rose moderately by 3.8% in the June quarter as compared to a rise of 11.7% in the preceding quarter.

#### Negotiable Instruments

The continued recovery of the stock market and anticipation of an interest rate rise weakened the demand for negotiable certificate of deposits (NCDs). Fewer NCDs were issued in the June quarter. The outstanding amount of NCDs shrank by 2.1% to HK\$205.8 mn, having risen modestly by

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).

0.4% in the preceding quarter. In anticipation of higher money market rates, floating rate instruments dominated the primary NCDs market. The share of floating rate NCDs rose to 73.0% of the total new issues in the June quarter from 39.0% in the March quarter. The share of NCDs held by authorized institutions dropped slightly to 57.4% from 58.4%

#### Lending

Reflecting banks' cautious lending attitude and subdued demand for loans, loans and advances declined for the eighth straight quarter by 5.1% in the June quarter, having fallen 7.8% in the March quarter. Both domestic lending<sup>1</sup> and offshore loans fell. Domestic lending fell further by 3.6% after dropping 2.6% and offshore loans dropped by 8.6%

after declining 16.9% in the March quarter. As in past quarters, the drop in offshore loans was driven by the contraction in the Japanese banks' euroyen impact loans.

Property lending showed a bigger decline of 1.3% in the June quarter compared with a 0.6% drop in the March quarter. The decline was mainly due to the continued fall in loans for property development and loans for property investment, which fell further by 6.0% and 6.2% respectively after dropping by 4.4% and 1.9% in the preceding quarter. In contrast, residential mortgage loans (excluding loans under Home Ownership Scheme and Private Sector Participation Scheme) remained the only area to show sustained growth, rising by 2.4% following a growth of 1.0% in the preceding quarter.

<sup>1</sup> Domestic lending in Hong Kong comprises trade finance and other loans for use in Hong Kong.

Meanwhile, loans to other economic sectors were mixed. The decline in loans for trade financing slowed to 7.3% in the June quarter after falling 8.0% in the March quarter. Loans for manufacturing dropped further by 6.4% after a revised 3.5% decline in the March quarter. Despite some signs of improvement in the retail sector, loans for wholesale & retail trade declined further by 8.1%, having fallen 4.2% in the previous quarter. Reflecting the robust stock market, loans to stockbrokers surged by 72.0% in the June quarter after a rise of 15.5% in the March quarter. Loans to non-stock broking companies and individuals for the purchase of shares also rose, by a notable 24.7%, against a decline of 8.5% in the March quarter. In consumer lending, credit card receivables grew by 3.0% in the June quarter after falling by 2.9% in the March quarter, and loans to individuals for other private purposes increased by 3.0% after falling by 1.6% in the March quarter.

#### Loan-to-Deposit Ratio

Owing to the decline in Hong Kong dollar loans and the increase in Hong Kong dollar deposits, the Hong Kong dollar loan-to-deposit ratio for the banking sector as a whole fell further to 95.4% at end-June from 99.2% at end-March. For local banks, the ratio decreased to 70.3% from 72.0%. The overall loan-to-deposit ratio of local banks was 56.5% at end-June compared with 58.2% at end-March.

#### Asset Quality

There were signs of a slow-down in the rate of growth of the local banks' problem loans in the June quarter. However, the various ratios continued to rise as a percentage of total loans, reflecting in part the lack of overall lending growth. The ratio of loans overdue for more than 3 months as a

Table I  
HK\$ Deposit Mix

Amount (HK\$ bn)

	Demand	Savings	Deposits Time *	Swap	Time @
Mar/98	104.3	362.7	1,049.9	40.2	1,090.1
% growth	(3.0)	7.9	(0.2)	(5.1)	(0.4)
Jun/98	91.0	309.9	1,120.9	35.2	1,156.1
% growth	(12.8)	(14.6)	6.8	(12.4)	6.0
Sep/98	89.8	310.8	1,206.9	33.9	1,240.9
% growth	(1.3)	0.3	7.7	(3.5)	7.3
Dec/98	97.1	414.4	1,144.3	29.3	1,173.6
% growth	8.1	33.4	(5.2)	(13.7)	(5.4)
Mar/99	96.3	399.7	1,157.3	30.2	1,187.5
% growth	(0.8)	(3.6)	1.1	3.0	1.2
Jun/99	97.4	430.6	1,150.0	28.8	1,178.8
% growth	1.2	7.7	(0.6)	(4.5)	(0.7)

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

\* excludes swap deposits

@ includes swap deposits

percentage of total loans increased from 5.41% at end-March to 6.01% at end-June and the ratio of rescheduled loans from 1.21% to 1.45%. The combined ratio of these two items as a percentage of total loans for local banks at end-June was 7.12%, up from 6.39%<sup>2</sup> at end-March. Classified loans, which take account of both qualitative and quantitative factors and are thus a broader measure of problem loans, rose further from 8.82% to 10.05% of total loans. The absolute amount of classified loans rose by almost 14% in the second quarter. However, this represented a slow-down from 19% in the previous quarter and 44% in the last quarter of 1998.

Despite the further deterioration in overall asset quality, signs of improvement began to emerge towards the end of the second quarter in residential mortgage loans. According to the monthly residential mortgage survey, the ratio of mortgage loans overdue for more than three months as a percentage of total mortgage loans remained flat at 1.16% at end-May and declined to 1.14% at end-June — the first fall recorded since the HKMA began to collect the figures in June 1998.


Late in the quarter, there were also tentative signs of improvement in the performance of credit cards. The delinquency ratio for credit cards (i.e. those overdue for more than 90 days) fell in the month of June, though it was slightly higher over the quarter as a whole (from 1.26% at end-March to 1.28% at end-June). Similarly, the annualised charge-off ratio also fell in June to 5.01%, though it also rose over the quarter as a whole (from 4.64%). It is too early to say however whether the improvement in June will be maintained in succeeding months.

### *Profitability*

Profits in the first half of the year continued to fall compared with the same period of last year, but at a more moderate pace. According to the statistics reported to the HKMA, operating profits before tax of local banks in respect of their Hong Kong offices fell by 9.4% in the first half of the year compared with the same period last year. Within this total, a number of banks managed to increase profits. Moreover, when compared with the second half of 1998, pre-tax operating profits increased in aggregate by 20.9% as a result of lower provisions made for bad and doubtful debts.

Compared with the same period of last year, banks saw some recovery in net interest income, as a result of higher average interest bearing assets. Although the net interest margin fell to 2.27% (annualised) in the first half of 1999 from 2.31% (annualised) in the same period last year, it was higher than the 2.20% (annualised) recorded in the second half of last year. Similarly, the bad debt charge as a percentage of total average assets (at 0.62% annualised) was higher than in the first half of 1998, but lower than in the second half (0.83% annualised).

Operating expenses fell compared with both the first and second halves of 1998, taking the aggregate cost-income ratio down to just over 38%.

All local banks continued to be well supported by their capital strength. The average consolidated capital adequacy ratio of all local incorporated institutions rose further to 19.50% at end-June from 19.29% at end-March. 

— Prepared by the Banking Policy Division

<sup>2</sup> After the adjustment for some double counting of total overdue and rescheduled loans of banks.