

DEVELOPMENTS IN THE BANKING SECTOR

Local banks recorded a significant rebound in aggregate operating profits from their Hong Kong offices for the first half of 2000, compared with the same period last year. This was supported by an improvement in net interest margin, a significant rise in fee income and a sharp decline in bad debt charge as banks' asset quality improved further. Despite the improving economic conditions, domestic loan demand did not pick up significantly in the first half of 2000, as reflected by the modest growth in domestic Hong Kong dollar loans.

Interest Rate Movements

Domestic interest rates in general moved upwards in the June quarter, reflecting a tightening in interbank liquidity. Interest rates at the shorter end of the maturity spectrum rose more than those at the longer end. For the quarter as a whole, the average overnight HIBOR increased markedly by 140 basis points whereas the average 12-month HIBOR rose by 31 basis points only. The average 1-month HIBOR and 3-month HIBOR also increased, but to a lesser extent compared with the average overnight HIBOR. They increased by 88 and 73 basis points to 6.44% and 6.57% in the June quarter, as opposed to declines of 13 and 32 basis points respectively in the March quarter. The trend for time deposit rates¹ was similar to that for HIBOR. The average 1-month and 3-month time deposit rates rose by 104 and 80 basis points to 5.21% and 5.38% in the June quarter, against declines of 26 and 37 basis points respectively in the March quarter.

The Hong Kong Association of Banks replicated the increase of 50 basis points in the US Fed Funds rate and raised the savings rate by the same magnitude on 22 May 2000. On the same day, commercial banks also raised the best lending rate (BLR) to 9.50% from 9.00%. Despite the general increase in funding costs, interest rate spreads varied markedly within the maturity spectrum. The average spread between BLR and 1-month HIBOR contracted by 30 basis points to 2.78% and that for 3-month HIBOR by 16 basis points to 2.65%. On the other hand, the average spread between BLR and 12-month HIBOR widened by 27 basis points to 2.19%. The average

spreads between BLR and time deposit rates exhibited a similar trend. The average spread between BLR and 1-month time deposit rate contracted by 46 basis points to 4.01% and that for 3-month time deposit rate by 22 basis points to 3.84%. In contrast, the average spread between BLR and the 12-month time deposit rate widened by 37 basis points to 3.54%.

Balance Sheet Developments

Customer Deposits

Customer deposits rose further by 3.3% in the June quarter after increasing by 0.4% in the March quarter. Hong Kong dollar and foreign currency deposits both increased. Hong Kong dollar deposits reversed a decline of 1.0% in the previous quarter and recorded an increase of 1.9% in the June quarter. Foreign currency deposits went up by 4.8% in the June quarter, following a rise of 2.1% in the March quarter. Within foreign currency deposits, US dollar deposits grew notably by 6.6%, as compared to an increase of 2.4% for non-US dollar deposits. Reflecting the faster growth in foreign currency deposits than Hong Kong dollar deposits, the proportion of Hong Kong dollar deposits to total customer deposits fell to 54.0% at end-June from 54.7% at end-March.

Hong Kong dollar demand and savings deposits fell by 4.4% and 2.9% respectively in the June quarter, reversing respective rises of 1.7% and 1.1% in the March quarter. On the contrary, time deposits rose by 4.4%, against a drop of 2.0% in the preceding quarter. As in the March quarter, time deposits maturing within one month fell, by

¹ These are period average figures quoted by 10 major banks for deposit amounts less than HK\$100,000 as reported in the Hong Kong Monetary Authority (HKMA) Monthly Statistical Bulletin.

Table I
Hong Kong Dollar Deposit Mix

Amount (HK\$ bn)

	Deposits				
	Demand	Savings	Time *	Swap	Time @
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)
Sep/99	99.7	413.7	1,170.4	28.8	1,199.1
% growth	2.3	(3.9)	1.8	(0.1)	1.7
Dec/99	105.8	451.7	1,174.8	28.3	1,203.1
% growth	6.2	9.2	0.4	(1.5)	0.3
Mar/00	107.6	456.5	1,152.1	27.4	1,179.6
% growth	1.7	1.1	(1.9)	(3.3)	(2.0)
Jun/00	102.9	443.4	1,203.6	27.7	1,231.3
% growth	(4.4)	(2.9)	4.5	1.0	4.4

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

* excludes swap deposits

@ includes swap deposits

1.7% after decreasing by 5.8% in the March quarter, and those with longer maturities increased. Time deposits maturing between one to three months surged by 16.8% in the June quarter while those maturing over three months grew by 6.3%, compared with rises of 1.5% and 18.3% respectively in the preceding quarter.

Negotiable Instruments

Issuance of new negotiable certificate of deposits (NCDs) reduced in the June quarter. The outstanding amount of NCDs shrank by 2.5% in the June quarter, against an increase of 1.8% in the March quarter. Floating rate instruments dominated the primary NCD market in anticipation of limited room for further rise in interest rates. Among new issues of NCDs, the share of floating rate NCDs rose significantly to 60.0% in the June quarter from 35.0% in the March quarter. Similar to the previous quarter, most NCDs issued in the June quarter were denominated in Hong Kong dollars, but were of shorter maturity. This reflected banks' reluctance to seek longer-term

funds at a time when interest rates might be peaking. Of the total outstanding amount of NCDs issued, 56.7% were held by authorised institutions at end-June, down slightly from 57.8% at end-March.

Some banks continued to switch their surplus funds into negotiable debt instruments (NDIs). NDIs held by the banking sector as a whole increased by 6.8% in the June quarter, having risen by 5.3% in the March quarter. The increase was mainly driven by foreign currency NDIs which rose markedly by 9.5% in the June quarter, compared with 3.5% in the March quarter. On the other hand, the growth of Hong Kong dollar NDIs moderated to 3.5% in the June quarter from 7.6% in the March quarter. For the first half of 2000, NDIs held by the banking sector as a whole rose by 12.4%, higher than the increase of 10.6% in the second half of 1999.

Local banks' holdings of foreign currency NDIs also grew faster than Hong Kong dollar NDIs in the June quarter. Holdings of foreign currency

NDIs surged by 29.2% in the June quarter, reversing a decline of 9.9% in the March quarter while the growth of Hong Kong dollar NDIs slowed down to 6.6% from 13.5%. Overall, NDIs held by local banks registered strong growth of 16.6% in the June quarter, compared with a modest increase of 1.8% in the preceding quarter.

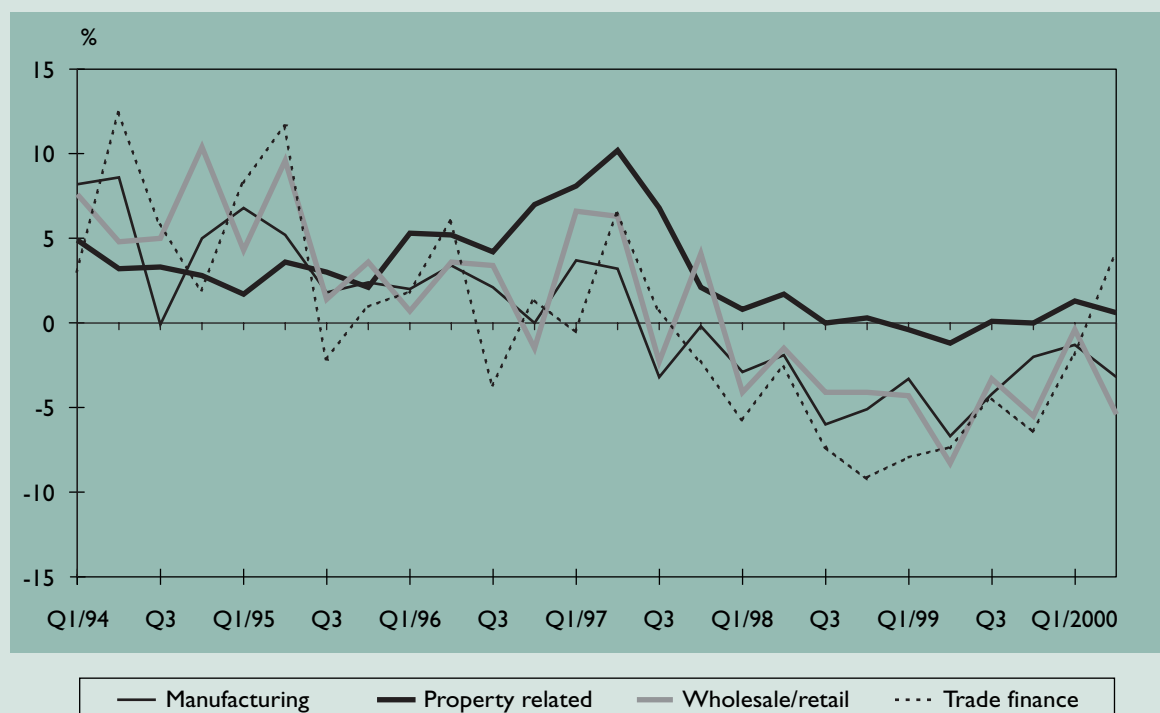
Lending

Loans and advances fell further by 4.1% in the June quarter after a decline of 4.0% in the preceding quarter. This was attributable mainly to the continued decline in offshore loans which fell by 14.3% in the June quarter following a drop of 12.7% in the March quarter. As in the previous quarters, the decline in offshore loans was largely due to the contraction in Japanese banks' Euroyen lending activities.

Domestic lending² fell modestly by 0.2% in the June quarter after recording zero growth in the preceding quarter. The fall was attributable to a 2.2% decline in foreign currency loans. Conversely, domestic lending in Hong Kong dollars increased slightly by 0.2% in the June quarter, after having risen by 1.1% in the March quarter. This indicated that domestic loan demand has still not picked up significantly despite the strong recovery in the local economy.

Loans to various economic sectors exhibited mixed trends. Loans to manufacturing fell at a faster pace of 3.2% in the June quarter, compared with a drop of 1.3% in the March quarter. The decline in loans for wholesale and retail trade also accelerated, to 5.4% from 0.4% in the March quarter. Affected by the uncertain outlook surrounding the domestic stock market, the growth

Chart I
Loans for Use in Hong Kong by Selected Sectors
Quarterly Percentage 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 & Tenants Purchase Scheme).

2 Domestic lending comprises trade finance and other loans for use in Hong Kong.

of loans for stockbrokers slowed down notably to 0.1% in the June quarter from 7.4% in the March quarter while loans for non-stockbroking companies and individuals for the purchase of shares shrank further by 11.7% after falling by 4.3% in the preceding quarter. On the contrary, reflecting a continued improvement in the external trade, loans for trade financing recorded a rise of 4.1% in the June quarter, against a fall of 1.9% in the March quarter. Credit card receivables also registered a strong growth of 8.0%, compared with an increase of 4.2% in the preceding quarter.

Attributable to the lacklustre conditions in the property market, property lending grew modestly by 0.4% in the June quarter, following an increase of 0.7% in the March quarter. Within the breakdown of property lending, the growth in loans for property development and investment moderated to 1.7% and 0.3% in the June quarter, from 3.3% and 0.9% respectively in the March quarter. Residential mortgage loans (excluding loans under Home Ownership Scheme and Private Sector Participation Scheme) rose slightly by 0.1%

in the June quarter after recording a zero growth in the preceding quarter.

Loan-to-Deposit Ratio

The overall loan-to-deposit ratio of the banking sector as a whole dropped further to 78.6% at end-June 2000 from 84.7% at end-March 2000, reflecting the continued drop in loans and rise in customer deposits. The Hong Kong dollar loan-to-deposit ratio also fell, to 91.6% from 93.2% as Hong Kong dollar customer deposits grew faster than Hong Kong dollar loans. In respect of local banks, the overall loan-to-deposit ratio fell to 52.5% at end-June from 54.3% at end-March and the Hong Kong dollar loan-to-deposit ratio fell to 70.9% from 72.1%.

Asset Quality

Local banks' asset quality improved for the third consecutive quarter. Due to the continued decline in the problem loans of local banks and rise in their total loans (in contrast to the decline

Table 2
Asset Quality¹ of All Local Banks

	Jun/99	Sep/99	Dec/99	Mar/00	Jun/00
	as % of total loans				
Pass Loans	81.77	81.48	82.14	82.67	83.98
Special Mention Loans	8.09	8.19	8.04	8.05	7.35
Classified Loans²	10.14	10.33	9.81	9.28	8.67
o/w <i>Substandard</i>	4.80	4.33	3.72	3.43	3.01
<i>Doubtful</i>	5.02	5.56	5.44	5.11	5.09
<i>Loss</i>	0.31	0.44	0.66	0.74	0.57
Overdue > 3 Months and Rescheduled Loans	7.01	7.54	6.96	6.86	6.38
o/w <i>Overdue > 3 months</i>	5.92	6.32	5.85	5.90	5.53
<i>Rescheduled³ loans</i>	1.09	1.22	1.11	0.96	0.85
Non-Accrual Loans³	6.70	7.22	7.14	6.81	6.45

1. Period-end figures relate to Hong Kong offices and overseas branches.

2. Classified loans are those loans graded as "substandard", "doubtful" or "loss".

3. Loans on which interest has been placed in suspense or on which interest accrual has ceased.

Because of rounding, the figures set out in this table may not add up.

recorded by the banking sector as a whole), the various ratios of problem loans as a percentage of total loans fell in the June quarter. The decline in problem loans could also partly be explained by write-offs made by banks prior to the announcement of their interim results and the continued restoration of some restructured loans to performing status.

For local banks as a whole, loans overdue for more than three months fell to 5.53% of total loans at end-June from 5.90% at end-March. Coupled with the fall in rescheduled loans to 0.85% from 0.96%, the combined ratio of overdue and rescheduled loans stood at 6.38% of total loans, down from 6.86% at end-March. Non-accrual loans also registered a fall to 6.45% of total loans from 6.81%. In line with the decline in these ratios, classified loans (a broader measure of problem loans which takes account of both qualitative and quantitative factors) dropped to 8.67% of total loans at end-June from 9.28% at end-March, and the ratio of special mention loans decreased to 7.35% from 8.05%.

The improving trend in the quality of credit card receivables persisted in the June quarter. Delinquent accounts (measured as accounts overdue for more than 90 days to total receivables) fell to 0.73% at end-June from 0.82% at end-March. The annualised charge-off ratio fell to 3.98% in the June quarter from 4.24% in the March quarter.

In contrast to the overall improvement in asset quality, the delinquency ratio of residential mortgage loans continued to increase in the June quarter. According to the monthly residential mortgage lending survey, residential mortgage loans overdue for more than three months as a percentage of total mortgage portfolio rose to 1.23% at end-June from 1.16% at end-March. The increase in the delinquency ratio, which nonetheless remains at a low level, reflected in part the weak market sentiment that prevailed after the disappointing land auction results in April 2000.

Profitability

Supported by an increase in net interest margin, a significant rise in fee income and a sharp decline in the bad debt charge, banks registered a

strong rebound in profits in the first half of the year compared with the same period last year. According to the statistics reported to the HKMA, the pre-tax operating profits of local banks in respect of their Hong Kong offices surged by more than 50% in the first half of the year compared with the same period in 1999, and returned to the pre-crisis level. These profits also exceeded those recorded in the second half of 1999 by 22.2%.

Despite the continued decline in lending margins, the net interest margin (annualised) rose to 2.39% in the first half of 2000 from 2.27% in the same period of 1999. The bad debt charge, a major factor affecting banks' profitability during the Asian crisis, reduced significantly by 57.8% in the first half of 2000 compared with the same period last year. The reduction in the charge was attributable to the general improvement in banks' asset quality mentioned earlier. As a percentage of total average assets, the aggregate bad debt charge declined to 0.25% (annualised) in the first half of 2000 from 0.64% (annualised) in the same period in 1999. ☒

- Prepared by the Banking Policy Division