

DEVELOPMENTS IN THE BANKING SECTOR

Preliminary figures showed that the operating profits of local banks in aggregate held up reasonably well for the first half year. This was attributable largely to an increase in other operating income, namely dividend income and fee and commissions, and a further decline in the bad debt charge as asset quality improved. Operating conditions however remained difficult as reflected by intense competition, particularly on residential mortgages and continued sluggish loan demand, thereby leading to a decline in net interest margin. Operating expenses rose, resulting in an increase in cost-income ratio. While the delinquency ratio of residential mortgage loans fell, that of credit card receivables rose, thus calling for closer monitoring in the latter sector.

Interest Rate Movements

In response to the cuts in the US Federal Funds rate, the Hong Kong Association of Banks lowered the savings rate by 50 basis points on 23 April and another 50 basis points on 21 May. Banks followed these moves and reduced their best lending rate (BLR) to 7.00% from 8.00%.

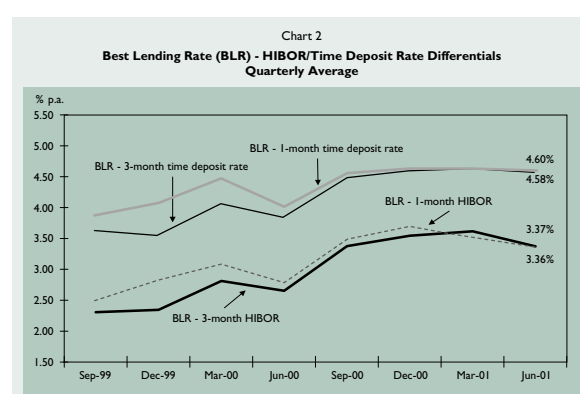
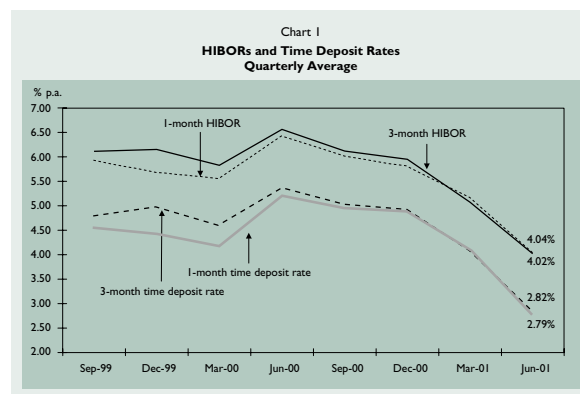
Other domestic interest rates also dropped (Chart 1). The average 1-month HIBOR and 3-month HIBOR fell by 113 basis points and 106 basis points respectively. The average 1-month and 3-month time deposit rates¹ showed a larger decline of 130 and 124 basis points respectively.

Average interest spreads narrowed in the June quarter. The average spread between BLR and 1-month HIBOR narrowed by 16 basis points to 3.36% and that for 3-month HIBOR, by 25 basis points to 3.37%. While the average spread between BLR and 1-month time deposit rate contracted by 1 basis point to 4.60%, that for 3-month time deposit rate declined by 5 basis points to 4.58% (Chart 2).

Balance Sheet Developments

Customer Deposits

In contrast to a decline of 2.7% in the March quarter, customer deposits rose by 1.3% in the



¹ Time deposit rates are period average figures quoted by 10 major banks for deposits of an amount less than HK\$100,000 as reported in the HKMA *Monthly Statistical Bulletin*.

June quarter (Chart 3). The rise was largely due to an increase of 2.7% in foreign currency deposits, compared with a drop of 5.3% in the March quarter. Meanwhile, Hong Kong dollar deposits grew marginally by 0.2% after dropping by 0.4% in the preceding quarter. Reflecting a faster growth in foreign currency deposits than in Hong Kong dollar deposits, the proportion of Hong Kong dollar deposits to total deposits declined to 53.7% from 54.3% at end-March.

The marginal growth in Hong Kong dollar deposits reflected a decline in time deposits (including swaps) which offset increases in demand deposits and savings deposits. The decline in time deposits accelerated to 3.2% in the June quarter from 0.6% in the March quarter. In contrast, demand deposits rose by 0.9%, against a drop of 6.1% in the preceding quarter. Savings deposits grew further by 8.3%, having risen by 1.4% in the March quarter. The faster growth in savings deposits was probably due to the less attractive time deposit rates. Table I shows the quarterly changes in Hong Kong dollar deposits by type.

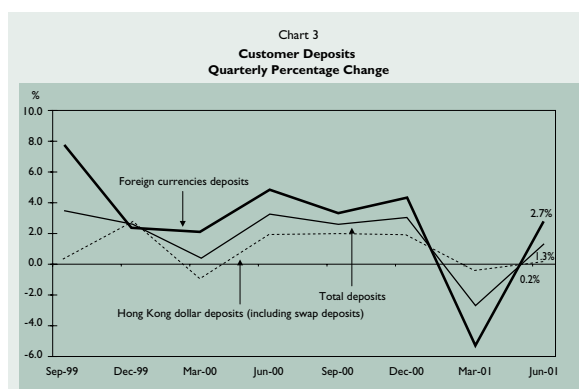


Table I
Hong Kong Dollar Deposit Mix

Amount (HK\$ bn)

	Deposits				
	Demand	Savings	Time *	Swap	Time @
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
Sep/00	104.4	439.0	1,264.8	4.8	1,269.6
% growth	1.5	(1.0)	5.1	(82.6)	3.1
Dec/00	112.2	492.6	1,238.7	4.3	1,243.1
% growth	7.5	12.2	(2.1)	(10.1)	(2.1)
Mar/00	105.4	499.2	1,231.6	3.9	1,235.5
% growth	(6.1)	1.4	(0.6)	(10.3)	(0.6)
Jun/01	106.3	540.8	1,193.1	3.1	1,196.2
% growth	0.9	8.3	(3.1)	(20.4)	(3.2)

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

* excludes swap deposits

@ includes swap deposits

Negotiable Instruments

Against the declines recorded in the previous quarters, negotiable certificate of deposits (NCDs) issued grew in the June quarter. The outstanding amount of NCDs issued grew by 4.2% after a decline of 2.9% in the preceding quarter. As opposed to the previous quarter, floating rate instruments dominated the primary NCD market. Their share represented 54.3% of total new issues, up from 34.1% in the March quarter. The portion of the outstanding amount of NCDs held by authorized institutions declined to 58.0% from 59.4% at end-March 2001.

Banks continued to substitute debt securities for bank loans given limited lending opportunities. Negotiable debt instruments (NDIs) held by the banking sector continued to rise, by 4.4% following an increase of 9.0% in the March quarter (Table 2).

Lending

A slowdown in the rate of decline in both offshore loans and domestic lending contributed to a slower rate of decline in total loans and advances at 2.6%, compared with a drop of 3.4% in the March quarter (Chart 4). Offshore loans fell by

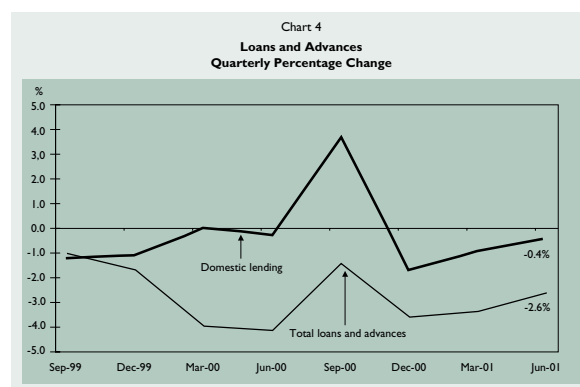


Table 2
NCDs and NDIs

Amount (HK\$ bn)

	All Authorized Institutions			Local Banks			
	Total NCDs outstanding	NDIs held		NDIs held		Total	
		HK\$	FC	Total	HK\$	FC	Total
Jun/00	198	290	365	655	161	154	315
% growth	(2.5)	3.5	9.6	6.8	6.6	29.2	16.6
Sep/00	187	312	407	719	171	187	358
% growth	(5.3)	7.4	11.7	9.8	6.6	21.4	13.8
Dec/00	179	329	427	756	180	197	377
% growth	(4.7)	5.4	4.9	5.1	5.2	5.3	5.3
Mar/01	173	373	451	824	203	206	409
% growth	(2.9)	13.5	5.6	9.0	12.5	4.7	8.5
Jun/01	181	369	492	861	202	239	440
% growth	4.2	(1.1)	9.0	4.4	(0.7)	16.0	7.7

Note: % growth denotes the quarter-on-quarter growth of NCDs and NDIs.

11.3%, having declined by 13.5% in the preceding quarter. This was partly due to a moderation in the contraction in Japanese banks' Euroyen lending activities.

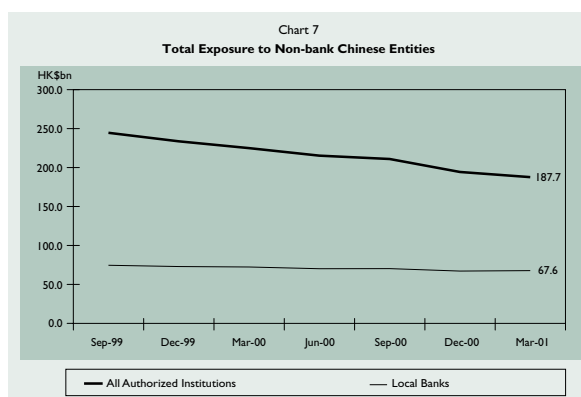
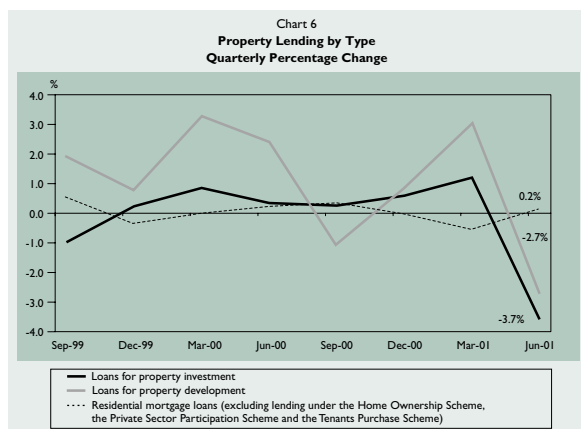
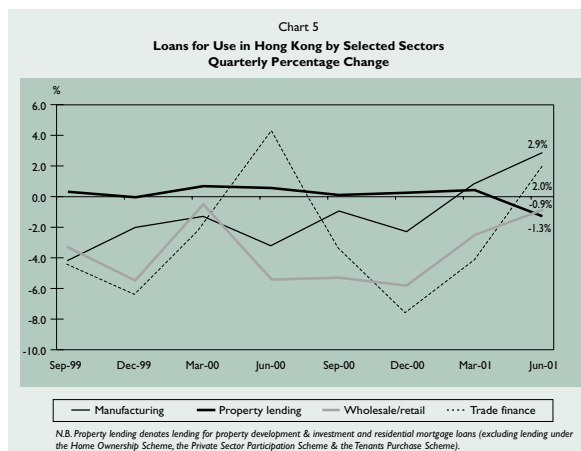
Decline in domestic lending² also moderated, to 0.4% from 0.9% in the preceding quarter. Lending to major economic sectors, other than property lending, either recorded a moderate growth or smaller decline in the June quarter (Chart 5). Property lending contracted by 1.3%, against an increase of 0.4% in the March quarter. Within this, property development and property investment fell by 2.7% and 3.7%, against rises of 3.0%³ and 1.2%⁴ respectively in the March quarter. In contrast, residential mortgage loans (excluding loans under the Home Ownership Scheme and Private Sector Participation Scheme) increased marginally by 0.2% after falling by 0.6% in the preceding quarter (Chart 6).

The decline in loans to the electricity, gas and telecommunications sectors slowed to 1.5% from a notable drop of 13.5% in the March quarter. Aggregate lending to the telecommunications sector⁵ fell modestly by 0.1% to HK\$48.45 billion from HK\$48.48 billion at end-March, and represented 2.5% of the banking sector's total domestic lending, same as in the previous quarter.

Credit card receivables grew by 5.4% in the June quarter, following a previous increase of 0.2%.

China Exposures

Total exposure of the banking sector to non-bank Chinese entities shrank further by HK\$6.6 billion (-3.4%) to HK\$187.7 billion (2.8% of the sector's total assets) at end-March from HK\$194.3 billion at end-December (Chart 7). The reduction was mainly caused by loan repayments and write-offs. The total exposure, consisting of on- and off-balance sheet exposure of HK\$161.7 billion and HK\$26.0 billion respectively, was spread among 147 institutions (both local and foreign).



- Domestic lending comprises trade finance and other loans for use in Hong Kong.
- Revised from 4.3% due to reporting adjustments.
- Revised from 0.7% due to reporting adjustments.
- On-balance sheet lending booked in Hong Kong offices only.

The local banking sector's exposure to non-bank Chinese entities at end-March amounted to HK\$67.6 billion (2.8% of the local banking sector's total assets), rising marginally from HK\$67.0 billion at end-December. The rise was mainly due to more lending to ITICs, red-chip companies and their subsidiaries.

Loan-to-Deposit Ratio

Overall loan-to-deposit ratio of the banking sector dropped to 67.5% at end-June from 70.2% at end-March due to the continued decline in total loans and an increase in customer deposits. Similarly, the Hong Kong dollar loan-to-deposit ratio fell to 90.8% from 91.5% at end-March (Chart 8).

On the contrary, both the overall and Hong Kong dollar loan-to-deposit ratios of local banks rose in the June quarter. The former increased to 52.3% at end-June from 51.8% at end-March and the latter, to 73.4% from 73.1% (Chart 9).

Asset Quality

Asset quality of local banks continued to improve due to a decline in their problem loans and a rise in their total loans (in contrast to the decline in lending by the sector as a whole). Loans overdue for more than three months fell to 3.96% of total loans at end-June from 4.47% at end-March. Together with the decline in the ratio of rescheduled loans to 0.86% from 0.94%, the combined ratio of overdue and rescheduled loans dropped to 4.81% of total loans from 5.41% at end-March. Non-performing loans and classified loans also declined, to 4.82% of total loans from 5.31% and to 6.81% from 7.12% respectively (Table 3 and Chart 10).

The quality of credit card receivables deteriorated in the June quarter. The delinquency ratio (measured as receivables overdue for more than 90 days as a percentage of total receivables) rose to 1.00% at end-June from 0.93% at end-March. The annualised charge-off ratio also rose in the June quarter, to 4.60% from 3.68% in the March quarter (Chart 11).

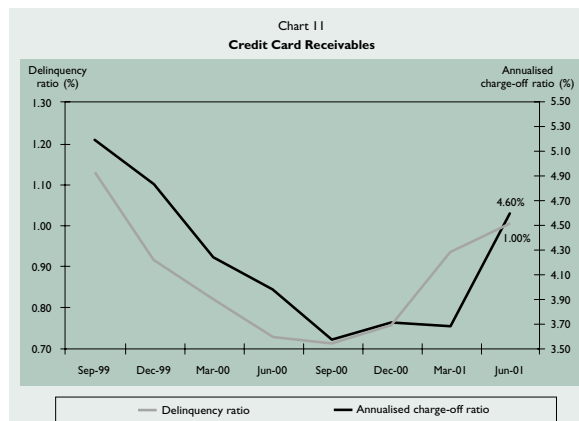
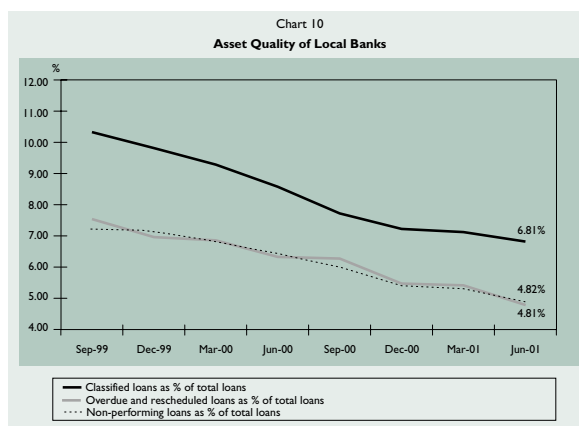
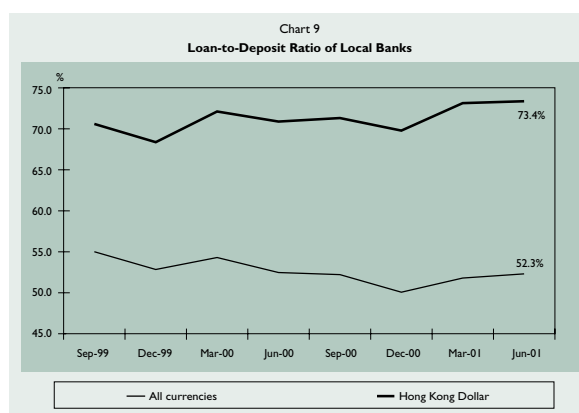
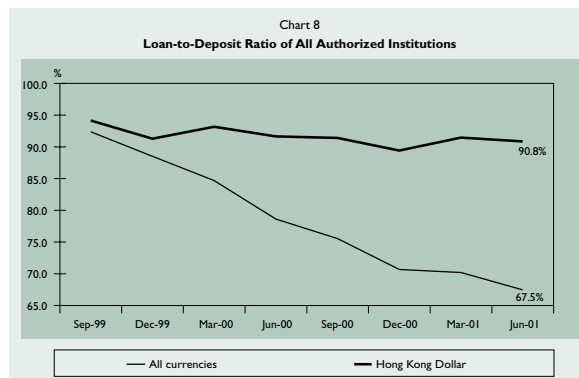


Table 3
Asset Quality¹ of All Local Banks

	Jun/00	Sep/00	Dec/00	Mar/01	Jun/01
	as % of total loans				
Pass Loans	84.07	85.03	86.33	86.59	87.62
Special mention loans	7.36	7.25	6.45	6.29	5.57
Classified loans (gross)²	8.58	7.72	7.22	7.12	6.81
o/w <i>Substandard</i>	3.00	2.58	2.58	2.48	2.69
<i>Doubtful</i>	5.01	4.56	4.17	4.07	3.64
<i>Loss</i>	0.56	0.58	0.47	0.56	0.48
Classified loans (net)³	5.62	4.90	4.85	4.79	4.74
Overdue > 3 months and rescheduled loans	6.33	6.27	5.47	5.41	4.81
o/w <i>Overdue > 3 months</i>	5.48	5.26	4.38	4.47	3.96
<i>Rescheduled loans</i>	0.85	1.02	1.09	0.94	0.86
Non-performing loans⁴	6.44	6.00	5.38	5.31	4.82

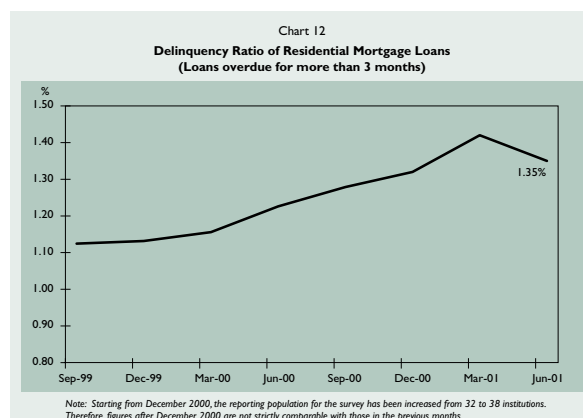
1. Period-end figures relate to Hong Kong offices and overseas branches.
2. Classified loans are those loans graded as “substandard”, “doubtful” or “loss”.
3. Net of specific provisions.
4. Loans on which interest has been placed in suspense or on which interest accrual has ceased.

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

According to the monthly residential mortgage survey, the delinquency ratio of residential mortgage loans (measured by residential mortgage loans overdue for more than three months as a percentage of the total mortgage portfolio) fell to 1.35% at end-June from 1.42%⁶ at end-March (Chart 12). The drop in the delinquency ratio was due partly to increased write-offs made by some banks at the half-year and partly to increased repayments on loans overdue.

Profitability

According to the statistics reported to the HKMA, aggregate pre-tax operating profits of local banks (in respect of their Hong Kong offices only) were broadly unchanged in the first half of the year compared with the same period of last year, before taking account of bad debt provisions. Despite an



6 Revised from 1.36% due to change in the population of authorized institutions (“Als”) participating in the survey. In view of changes in individual Als’ market share in the residential mortgage lending (RML) business, the Hong Kong Monetary Authority (HKMA) has changed the survey population in order to increase the proportion of total RML business covered by the survey. The new population of 38 Als accounts for about 96% of total RML business, compared with the 92% coverage represented by the former population of 32 Als.

Table 4
Consolidated Capital Adequacy Ratio for all Locally Incorporated Authorized Institutions

(HK\$ mn)

	Jun-00	Sep-00	Dec-00	Mar-01	Jun-01
Total capital base after deductions ¹	256,783	261,522	259,314	265,518	267,410
<i>o/w core capital</i>	214,174	219,578	215,085	219,712	222,405
Total risk-weighted exposures	1,376,313	1,401,147	1,455,703	1,453,551	1,488,726
Capital adequacy ratio	18.7%	18.7%	17.8%	18.3%	18.0%


Note: Total capital base after deductions refers to total core and supplementary capital after deductions as specified under the Third Schedule to the Banking Ordinance.

increase in average interest bearing assets, net interest income declined. This resulted in a fall in the net interest margin (see below). Other operating income also increased due to growth in fees and commissions. The increase in total income was however offset by higher operating expenses, resulting in a deterioration in the cost-income ratio. A continued decline in the bad debt charge as asset quality improved and gains from disposal of securities resulted in an increase of almost 7% in aggregate pre-tax profits.

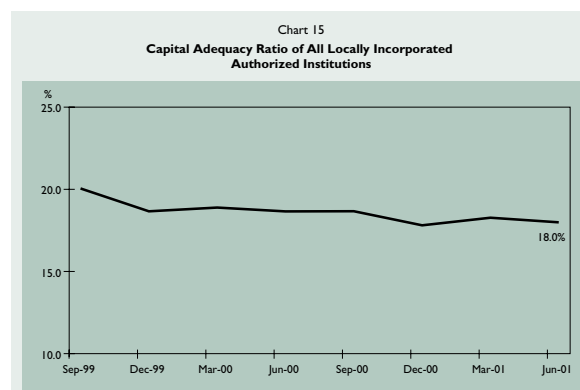
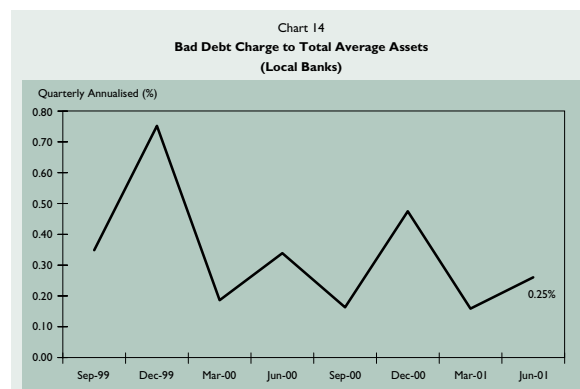
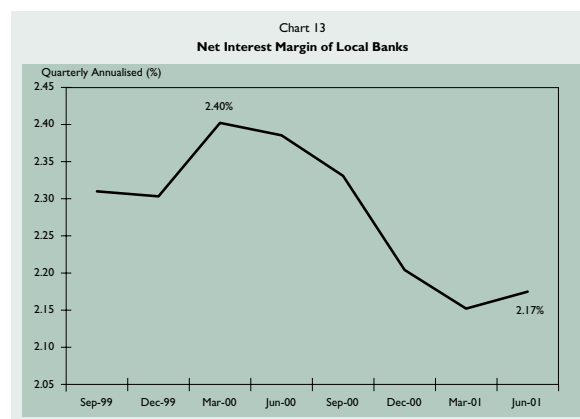
Reflecting the fall in net interest income caused by the continued squeeze in lending margins, the annualised net interest margin (NIM) fell to 2.16% in the first half of the year from 2.39% in the same period last year. Nonetheless, it rose in the June quarter to 2.17% from 2.15% in the previous quarter (Chart 13).

The annualised ratio of the bad debt charge to average total assets fell to 0.20% in the first half of the year from 0.26% in the same period last year. However, it rose to 0.25% in the June quarter from 0.16% in the previous quarter (Chart 14).

Reflecting faster growth in risk assets than in capital base, the average consolidated capital adequacy ratio of all locally incorporated authorized institutions declined slightly to 18.0% at end-June from 18.3% end-March (Table 4 and Chart 15).

A table of key performance indicators of the banking sector is at Annex. 

- Prepared by the Banking Policy Department



Key Performance Indicators of the Banking Sector¹(%)

	Jun-00	Mar-01	Jun-01
Interest rate movements (Quarterly average)			
1-month HIBOR	6.44	5.17	4.04
3-month HIBOR	6.57	5.08	4.02
BLR and 1-month HIBOR spread	2.78	3.52	3.36
BLR and 3-month HIBOR spread	2.65	3.62	3.37
Balance sheet developments (Quarterly change)			
Total deposits	3.3	-2.7	1.3
Hong Kong Dollar	1.9	-0.4	0.2
Foreign currency	4.8	-5.3	2.7
Total loans	-4.1	-3.4	-2.6
Domestic lending	-0.2	-0.9	-0.4
Offshore lending	-14.3	-13.5	-11.3
Negotiable instruments			
Negotiable debt certificates issued	-2.5	-2.9	4.2
Other negotiable debt instruments held	6.8	9.0	4.4
Asset quality²			
Bad debt charge to average total assets ³	0.26	0.16	0.20
As % of total loans			
Pass Loans	84.07	86.59	87.62
Special mention loans	7.36	6.29	5.57
Classified loans (gross) ⁴	8.58	7.12	6.81
Classified loans (net) ⁵	5.62	4.79	4.74
Overdue >3 months and rescheduled loans	6.33	5.41	4.81
Non-performing loans ⁶	6.44	5.31	4.82
Delinquency ratio of residential mortgage loans ⁷	1.23	1.42	1.35
Credit card receivables ⁸			
Delinquency ratio	0.73	0.93	1.00
Charge-off ratio	3.98	3.68	4.60
Profitability^{3,9}			
Net interest margin	2.39	2.15	2.16
Cost income ratio	35.8	40.0	38.4
Capital adequacy ratio¹⁰			
	18.7	18.3	18.0

1. Figures related to Hong Kong office(s) only except where otherwise stated.
2. Period-end figures relate to local banks' Hong Kong office(s) and overseas branches except for the bad debt charge, delinquency ratio of residential mortgage loans, delinquency ratio of credit cards and credit card charge-off ratio.
3. Year-to-date annualised ratio.
4. Classified loans are those loans graded as "substandard", "doubtful" or "loss".
5. Net of specific provisions.
6. Loans on which interest has been placed in suspense or on which interest accrual has ceased.
7. Based on monthly survey on residential mortgage lending. Starting from December 2000, the reporting population for the survey has been increased from 32 to 38 institutions. Therefore, figures after December 2000 are not strictly comparable with those in the previous months.
8. Based on survey on credit card receivables.
9. Figures related to Hong Kong office(s) of local banks.
10. Consolidated ratio for all locally incorporated institutions.