

DEVELOPMENTS IN THE BANKING SECTOR

The main feature of the first quarter's results was the deteriorating quality of credit card receivables, namely as a result of the rising personal bankruptcies. Concerns have been expressed that this might spill over to the mortgage portfolio. Thus far, however, mortgage delinquencies have been contained as the banks have generally been accommodating on rescheduling requests by the borrowers. Overall asset quality, therefore, was largely maintained. The banking sector continues to be well-capitalised and profitable, although operating profits of retail banks fell in the first quarter.

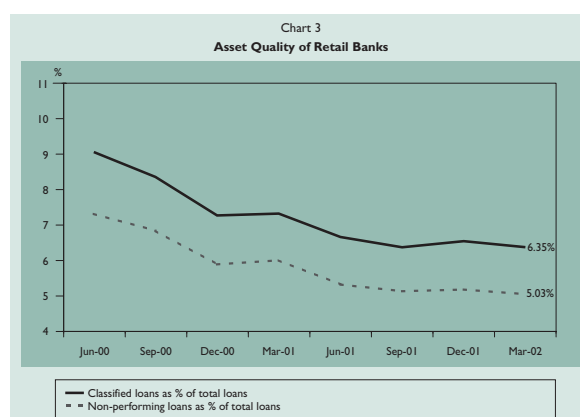
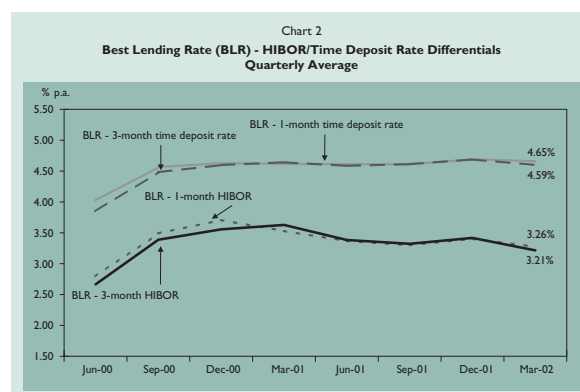
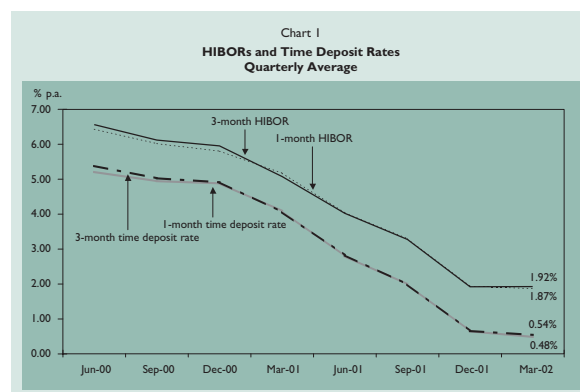
Interest Rate Movements

Domestic interest rates were generally stable in the first quarter. The average one-month time deposit rate contracted by 16 basis points and the one-month HIBOR by 6 basis points. As shown in Chart 1, the average one and three month rates have aligned over the last twelve months given the declining and historically low interest rates, as well as the lack of a need to compete for funds in view of the sluggish demand for borrowing.

The average best lending rate¹ (BLR) dropped by 20 basis points compared to the preceding quarter. Due to the faster decline in average BLR than domestic interest rates, interest spreads narrowed in the first quarter. The average spread between BLR and one-month HIBOR contracted by 13 basis points to 3.26% while that between BLR and one-month time deposit rate declined by 3 basis points to 4.65% (Chart 2).

Asset Quality

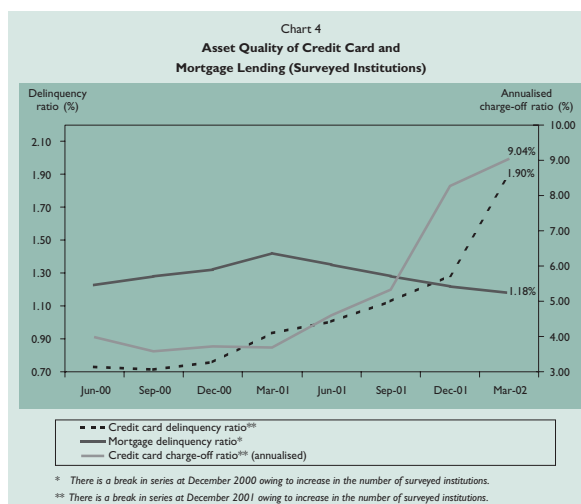
Retail banks' asset quality was largely maintained in the first quarter (Table 1 and Chart 3). While the overdue and rescheduled loan ratio increased slightly to 4.69% from 4.57% in the preceding quarter, the ratios of classified loans and non-performing loans improved to 6.35% and 5.03% from 6.53%^r and 5.16%^r respectively.



¹ Best lending rate refers to the rate quoted by the Hongkong and Shanghai Banking Corporation Limited.

^r Revised figures due to late audit adjustments.

According to the monthly residential mortgage survey, the delinquency ratio of residential mortgage loans continued to improve. The delinquency ratio (measured by the amount overdue for more than three months as a percentage of the total mortgage portfolio) improved further to 1.18% at end-March 2002 from 1.22% at end-December 2001 (Chart 4). The improvement was largely attributable to repayments of overdue loans and the volume of rescheduling requests accommodated by the banks. The rescheduled loan ratio (measured by the ratio of rescheduled mortgage loans to total outstanding mortgage loans) rose to 0.38% from 0.26% at end-December 2001.



The quality of credit card receivables continued to deteriorate in the first quarter. The delinquency ratio rose to 1.90% from 1.28%. The amount charged off in the first quarter was

Table I
Asset Quality¹ of Retail Banks

	Mar-01	Jun-01	Sep-01	Dec-01	Mar-02
	as % of total loans				
Pass loans	86.17	87.61	88.05	88.02 ^r	88.15
Special mention loans	6.52	5.74	5.60	5.45 ^r	5.50
Classified loans (gross)²	7.31	6.65	6.36	6.53 ^r	6.35
o/w <i>Substandard</i>	2.29	2.32	2.05	2.17 ^r	2.03
o/w <i>Doubtful</i>	3.96	3.54	3.34	3.17	2.98
o/w <i>Loss</i>	1.06	0.79	0.97	1.18 ^r	1.34
Classified loans (net)³	4.94	4.66	4.37	4.51 ^r	4.32
Overdue > 3 months and rescheduled loans	6.11	5.36	5.01	4.57	4.69
o/w <i>Overdue > 3 months</i>	5.09	4.43	4.26	3.95 ^r	4.02
o/w <i>Rescheduled loans</i>	1.03	0.93	0.75	0.61	0.66
Non-performing loans⁴	5.99	5.30	5.11	5.16 ^r	5.03

Notes:

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.
- ^r Revised figures due to late audit adjustments.

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

HK\$1.38 billion or 2.26% of average receivables during the quarter. If this rate of charge-off were to be maintained for a full year, the annualised amount of charge-offs would be HK\$5.53 billion or 9.04% of receivables (compared with 8.27% in the preceding quarter) (Chart 4). The continuing deterioration in card quality reflected the further rise in personal bankruptcies. The charge-off ratio was also, however, slightly inflated by the earlier charge-off of accounts (when a bankruptcy petition is presented) by more institutions.

Profitability

Preliminary figures indicate that retail banks' aggregate operating profits before tax (in respect of their Hong Kong offices) fell in the first quarter of 2002, compared with the same period last year. The fall was largely due to an increase in provisions for bad and doubtful debts. Reflecting this, retail banks' annualised ratio of bad debt charge to average total assets rose to 0.33% in the first quarter from 0.21% in the same period last year (Chart 5). Operating income declined due to a combination of factors: a drop in net interest income; losses in investments held for trading arising from unrealised mark-to-market losses; and a fall in income from foreign exchange operations. Total operating expenses also declined by a similar magnitude. This left the cost-income ratio more or less unchanged at around 40.3%.

The annualised net interest margin, however, rose to 2.05% in the first quarter from 2.00% in the same period last year (Chart 6). The rise was due to the faster decline in interest bearing assets than in net interest income.

Capital Adequacy Ratio

The capital position of the locally incorporated authorized institutions remained strong as indicated by the average consolidated capital

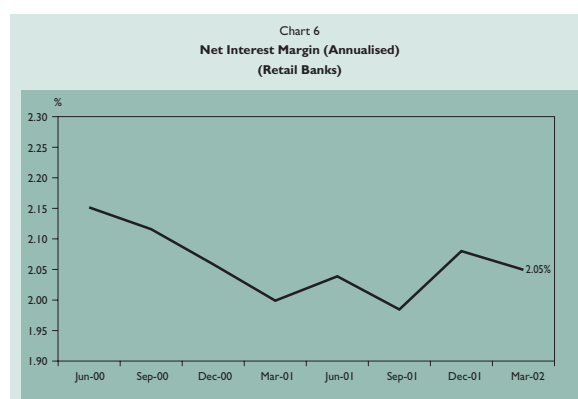
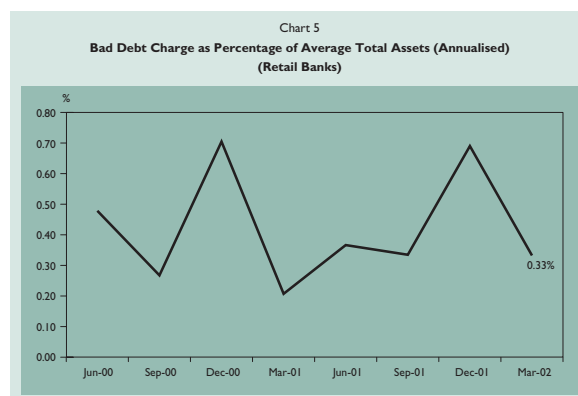


Table 2
Consolidated Capital Adequacy Ratio (All locally incorporated AIs)

(HK\$ mn)

	Mar-01	Jun-01	Sep-01	Dec-01 ^{2,3}	Mar-02
Total capital base after deductions ¹	265,518	267,292	278,215	305,418	307,819
of which core capital	219,712	222,333	228,263	253,250	255,762
Total risk-weighted exposures	1,453,517	1,488,726	1,518,837	1,852,673	1,855,868
Capital adequacy ratio	18.3%	18.0%	18.3%	16.5%	16.6%

Notes:

1. Total capital base after deductions refers to total core and supplementary capital after deductions as specified under the Third Schedule to the Banking Ordinance.
2. Revised figures due to late audit adjustments.
3. There is a break in series at end-December 2001 owing to a change in the reporting population.

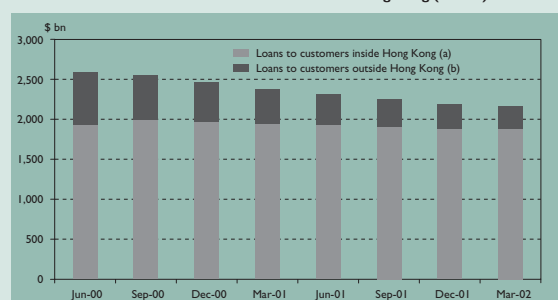
adequacy ratio of all locally incorporated authorized institutions, which stood at 16.6% at end-March (Table 2).

Lending

The decline in the banking sector's total loans to customers moderated to 1.2% from 2.8% in the preceding quarter. Within total loans, loans to customers inside Hong Kong rose marginally by 0.1% after declining for five consecutive quarters (Chart 7). Loans to customers outside Hong Kong, on the other hand, continued to drop, although the decline moderated to 9.6%. As in previous quarters, the decline in loans to customers outside Hong Kong was mainly driven by the continued contraction in Japanese banks' Euroyen lending activities. For the retail banking sector, total loans to customers rose slightly by 0.5%, against a drop of 0.2% in the preceding quarter.

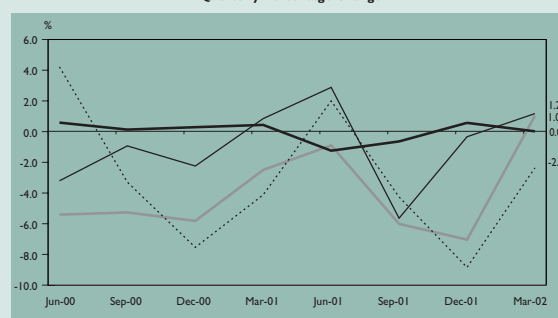
The breakdown of lending by major economic sectors for the banking sector as a whole (Chart 8) indicates that growth in property lending was flat in the first quarter following an increase of 0.6% in the preceding quarter. Within this, loans for property development contracted by 4.1%, against an increase of 5.2% in the preceding quarter. In contrast, loans for property investment increased by 1.3% after decreasing by 1.3%, and residential mortgage loans grew by another 0.4% following an increase of 0.4% in the preceding quarter.

Chart 7
Loans to Customers Inside and Outside Hong Kong (All AIs)



Notes:
(a) Defined as loans for use in Hong Kong plus trade financing loans.
(b) Includes "others" (i.e. unallocated).

Chart 8
Loans for Use in Hong Kong by Selected Sectors
Quarterly Percentage Change



N.B. Property lending denotes lending for property development & investment and residential mortgage loans (excluding lending under the Home Ownership Scheme, the Private Sector Participation Scheme & the Tenants Purchase Scheme).

Loans to the electricity, gas and telecommunications sector declined further by 5.4% following a drop of 16.3% in the preceding quarter. Within this, aggregate lending to the telecommunications sector², which represented 1.61% of the banking sector's total domestic lending at end-March, continued to contract, by 10.0% to HK\$30.3 billion, due mainly to loan repayments made.

The banking sector's total outstanding exposure to non-bank Chinese entities continued its declining trend to stand at HK\$159.8 billion (2.4% of the sector's total assets) as at end-December 2001, down by 5.0% from end-September. The reduction was mainly caused by write-offs and loan repayments.

Customer Deposits

After a marginal increase of 0.3% in the preceding quarter, retail banks' customer deposits dropped by 1.0% in the first quarter. Customer deposits of the banking sector also contracted, by 3.3%, following a decrease of 2.3% in the preceding quarter (Chart 9). The contraction was mainly driven by the 5.9% decline in foreign currency deposits, which can partly be explained by the withdrawals of connected deposits by certain foreign banks. Hong Kong dollar deposits also declined by 1.2%, against a modest growth of 0.1% in the preceding quarter, possibly due to the low interest rate environment. Reflecting the faster decline in foreign currency deposits, the proportion of Hong Kong dollar deposits to total deposits rose to 56.3% at end-March from 55.1% at end-December.

Table 3 shows quarterly changes in Hong Kong dollar deposits by type. Demand deposits declined by 5.0% in the first quarter after growth of 14.0% in the preceding quarter. However, savings deposits grew modestly by 0.5% following an increase of 8.7%. Reflecting the low interest rate on deposits, time deposits fell for the sixth consecutive quarter, by 1.8% in the first quarter.

Negotiable Instruments

Funding through negotiable certificate of deposits (NCDs) picked up slightly by 0.5% in the first quarter, having declined for two consecutive

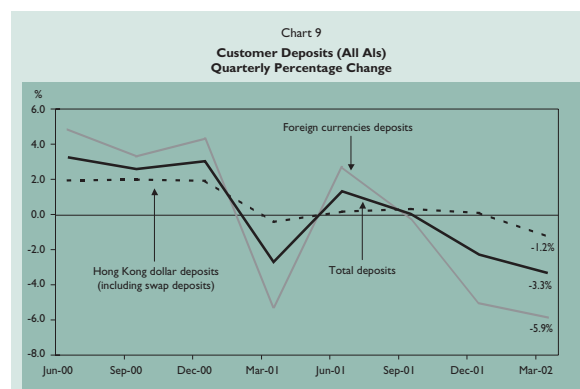


Table 3
Hong Kong Dollar Deposit Mix (All AIs)

Amount (HK\$ bn)

	Deposits		
	Demand	Savings	Time*
Mar-01	105.4	499.2	1,235.5
% growth	(6.1)	1.4	(0.6)
Jun-01	106.3	540.8	1,196.2
% growth	0.9	8.3	(3.2)
Sep-01	112.6	564.8	1,171.8
% growth	5.9	4.4	(2.0)
Dec-01	128.4	613.9	1,108.6
% growth	14.0	8.7	(5.4)
Mar-02	121.9	616.7	1,089.2
% growth	(5.0)	0.5	(1.8)

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

* includes swap deposits.

2 On-balance sheet lending booked in Hong Kong offices only.

Table 4
NCDs and NDIs (All AIs)

Amount (HK\$ bn)

	Total NCDs outstanding	NDIs held		
		HK\$	FC	Total
Mar-01	173	373	451	824
% growth	(2.7)	13.5	5.6	9.0
Jun-01	180	369	492	861
% growth	4.2	(1.1)	9.0	4.4
Sep-01	180	392	522	915
% growth	(0.2)	6.4	6.2	6.3
Dec-01	172	355	553	908
% growth	(4.1)	(9.6)	5.9	(0.8)
Mar-02	173	392	553	946
% growth	0.5	10.7	0.0	4.2


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

quarters. As in the preceding two quarters, fixed rate instruments dominated the primary NCD market, accounting for 55.6% of new issues. The proportion of the outstanding amount of NCDs held by authorized institutions declined to 49.1% at end-March from 50.1% at end-December.

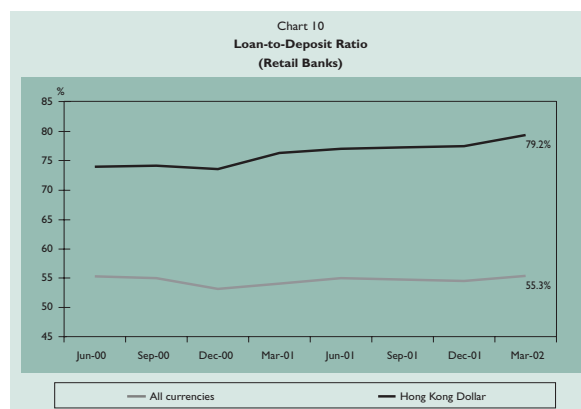
In view of limited lending opportunities, the general trend of banks switching to holdings of negotiable debt instruments (NDIs) continued. NDIs held by the banking sector grew by 4.2%, against a drop of 0.8% in the previous quarter (Table 4). As a percentage of total assets, the portion of NDIs stood at 15.7% at end-March, rising from 14.7% at end-December.

Loan-to-Deposit Ratio

Reflecting an increase in total loans to customers and a decline in customer deposits, the retail banks' overall loan-to-deposit ratio rose to 55.3% at end-March from 54.4% at end-December. Similarly, the retail banks' Hong Kong dollar loan-to-deposit ratio increased, to 79.2% from 77.3% (Chart 10).

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(%)

	Mar-01	Dec-01	Mar-02
Interest rate²			
1-month HIBOR	5.17	1.93	1.87
3-month HIBOR	5.08	1.92	1.92
BLR and 1-month HIBOR spread	3.52	3.39	3.26
BLR and 3-month HIBOR spread	3.62	3.41	3.21
Balance sheet developments³			
All AIs			
Total deposits	-2.7	-2.3	-3.3
Hong Kong Dollar	-0.4	0.1	-1.2
Foreign currency	-5.3	-5.0	-5.9
Total loans	-3.4	-2.8	-1.2
Loans to customers inside Hong Kong ⁴	-0.9	-1.4	0.1
Loans to customers outside Hong Kong ⁵	-13.0	-10.2	-9.6
Negotiable instruments			
Negotiable debt certificates issued	-2.7	-4.1	0.5
Negotiable debt instruments held	9.0	-0.8	4.2
Asset quality⁶			
Retail Banks			
As % of total loans			
Pass loans	86.17	88.02 ^r	88.15
Special mention loans	6.52	5.45 ^r	5.50
Classified loans (gross) ⁷	7.31	6.53 ^r	6.35
Classified loans (net) ⁸	4.94	4.51 ^r	4.32
Overdue > 3 months and rescheduled loans	6.11	4.57	4.69
Non-performing loans ⁹	5.99	5.16 ^r	5.03
Asset quality			
Surveyed Institutions			
Delinquency ratio of residential mortgage loans	1.42	1.22	1.18
Credit card receivables			
Delinquency ratio	0.93	1.28	1.90
Charge-off ratio - quarterly annualised	3.68	8.27	9.04
- year-to-date annualised	3.68	5.47	9.04
Profitability¹⁰			
Retail Banks			
Bad debt charge as % of average total assets	0.21	0.40 ^r	0.33
Net interest margin	2.00	2.03	2.05
Cost income ratio	40.4	43.2 ^r	40.3
Capital adequacy			
All Locally Incorporated AIs			
Capital adequacy ratio (consolidated) ¹¹	18.3	16.5 ^r	16.6

1. Figures related to Hong Kong office(s) only except where otherwise stated.

2. Quarterly average.

3. Quarterly change.

4. Loans for use in Hong Kong plus trade financing loans.

5. Includes "others" (i.e. unallocated).

6. Figures relate to retail banks' Hong Kong office(s) and overseas branches.

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

8. Net of specific provisions.

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

10. Year-to-date annualised.

11. There is a break in series at end-December 2001 owing to a change in the reporting population.

^r Revised figures due to late audit adjustments.