

*Domestic loan growth was more buoyant in the first quarter, while growth in Hong Kong dollar deposits slowed. As a result, the Hong Kong dollar loan to deposit ratio increased significantly. Interest rates hardened somewhat during the quarter, resulting in a slight narrowing of the net interest margin of the locally incorporated banks. Growth in profits was however favourably influenced by a decline in the bad debt charge.*

### Interest Rate Movements

Funding costs of the banking sector began to firm in February 1997, following the slight softening in the last quarter of 1996. In line with the increase of 25 basis points in the US Fed Funds rate, the Hong Kong Association of Banks raised the savings rate from 3.75% to 4.00% on 27 March. The best lending rate was also adjusted upward from 8.50% to 8.75%. During the first quarter as a whole, however, the average 1-month HIBOR and 3-month HIBOR increased only modestly by 2 basis points to 5.36% and 5.52% respectively. Average time deposit rates also increased. For example, average rates for 1-month and 3-month time deposits rose to 4.71% and 4.88%, compared with 4.66% and 4.81% in the preceding quarter.

Since the best lending rate remained at 8.50% for all but the last few days of the quarter, the increase in average funding costs resulted in slight decreases in average spreads between the best lending rate and time deposits. For example, the spread for 1-month time deposits fell by 4 basis points and that for 3-month time deposits by 6 basis points. However, the corresponding spread between the best lending rate and HIBOR narrowed by only 1 basis point.

### Balance Sheet Developments

#### Customer deposits

Total customer deposits grew at a more moderate rate of 2.8%, compared with 4.2% in the December quarter. The slowdown was mainly attributable to the deceleration of growth in HK dollar deposits (adjusted to include foreign currency swap deposits) from 7.4% to 3.6%. In contrast, foreign currency deposits grew at a faster rate of 1.7%, compared with 0.3% in the previous quarter. Within this category of deposits, non-US dollar foreign currency deposits rose sharply by 5.3% (compared with a decrease of 0.8%) while US

dollar deposits fell by 1.9% (compared with an increase of 1.3%). The robust recovery of non-US dollar foreign currency deposits in the quarter was partly due to an increase in deposits from overseas subsidiaries of some banks. This helped outweigh the effect of the decline in US dollar deposits.

Reversing the strong growth recorded in the December quarter, Hong Kong dollar savings and demand deposits decreased by 2.8% and 3.9% respectively (compared with the previous growth of 9.1% and 8.3% respectively). This was somewhat expected as the growth in the preceding quarter was to a certain extent due to year-end factors. Hong Kong dollar time deposits on the other hand continued to record strong growth of 7.2%, compared with 6.5% in the December quarter. The growth was particularly pronounced in the deposits fixed for more than 1 month, apparently due to higher time deposit rates offered by the banks for this longer term funding.

#### Negotiable instruments

The issue of negotiable certificates of deposit (NCDs) remains a popular means for raising funds, although the flow of new issues slowed during the March quarter. Total NCDs issued and outstanding grew by a more moderate 3.7% to reach \$186 bn (compared to 13.2% growth in the December quarter). The proportion of NCDs held by authorised institutions remained stable, at around 58%.

#### Lending

Total loans and advances grew more slowly by 0.1% in the March quarter (compared with an increase of 2.5% in the December quarter) reflecting a significant decline of 6.9% in offshore lending. The latter was caused by the negative impact of the depreciation of the Japanese yen against the Hong Kong dollar, coupled with a contraction in Euroyen activities. In contrast, loans for use in Hong Kong

(excluding trade finance) recorded stronger growth, rising by 8.8% against 5.0% in the previous quarter.

The more rapid expansion of loans for use in Hong Kong was mainly prompted by the continual buoyant growth in property lending (8.4%) and sharp increases in personal loans, share financing loans and lending to financial concerns (10.0%, 30.3% and 12.5% respectively). While the increase in personal loans was partly driven by tax loans, the growth in share financing loans reflected the sustained buoyancy of the stock market.

The growth in property related lending remained the major driving force for the expansion in domestic lending. Within this sector, lending to property investment and development (excluding civil engineering) rose sharply by 10.1% compared with 7.8% in the December quarter. Residential mortgage lending (excluding loans under the Home Ownership Scheme and Private Sector Participation Scheme) sustained the growth momentum in the March quarter, increasing by 7.0% following the previous rise of 6.5%. However, as a result of relatively faster growth in other major sectors, total property lending as a proportion of loans for use in Hong Kong fell marginally to 41.7%.

Demand for loans to other major sectors also rebounded. For example, loans to the wholesale and retail sector and the manufacturing sector increased by 3.7% and 6.7%, reversing the trend of

negative growth in the preceding quarter. However, demand for trade financing loans remained sluggish, declining by 0.6% after a modest recovery of 1.2% in the previous quarter. Credit card receivables also fell, decreasing by 3.3% following the significant rise of 8.7% in the December quarter.

#### **Loan to deposit ratio**

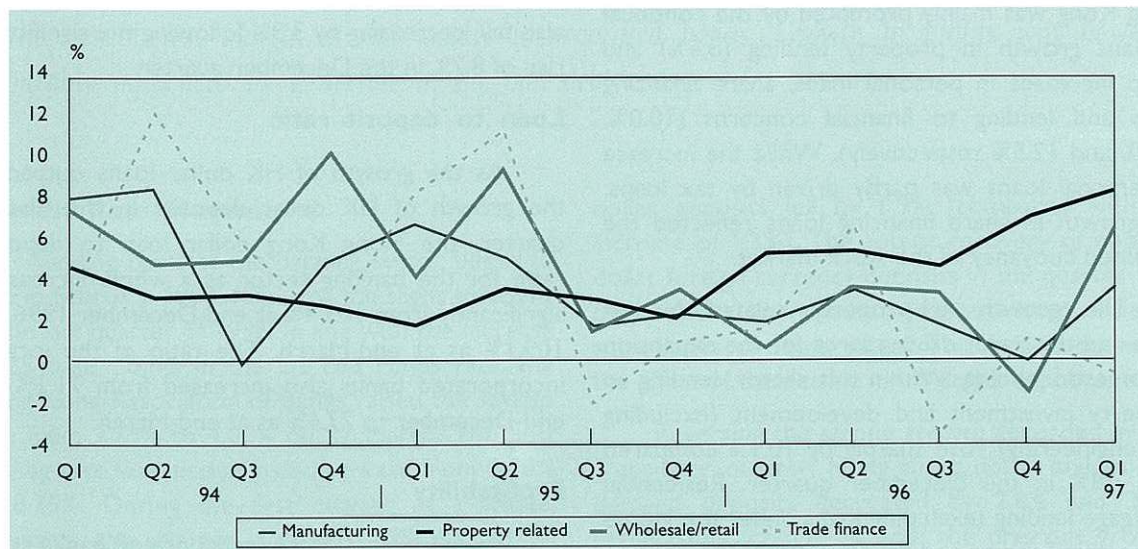
As the growth of HK dollar loans outpaced the growth of HK dollar deposits in the March quarter, the Hong Kong dollar loan to deposit ratio for the banking sector as a whole increased significantly from 103.4% at end-December 1996 to 109.1% as at end-March. The ratio of the locally incorporated banks also increased from 71.1% at end-December to 77.6% as at end-March.

#### **Profitability**

Profits of the locally incorporated banks rose significantly compared with the first quarters of 1996. This reflected growth in domestic lending volume which more than offset a slight narrowing of the net interest margin. The bad debt charge was significantly lower than in both the first quarter of 1996 and the December quarter. As a percentage of total assets, the bad debt charge was 0.09% (annualised) compared with 0.18% for 1996 as a whole. ☺

— 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)

	Deposits				
	Demand	Savings	Time *	Swap	Time @
Mar/96	100.8	320.0	750.2	44.9	795.1
% growth	0.5	6.4	4.1	-9.8	3.2
Jun/96	104.2	327.0	777.3	42.6	819.9
% growth	3.4	2.2	3.6	-5.2	3.1
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

Notes: % growth denotes the quarter-on-quarter growth of the deposits  
\* excludes swap deposits  
@ includes swap deposits