

DEVELOPMENTS IN THE BANKING SECTOR

Responding to a lower interest rate environment both domestically and externally, the Hong Kong Association of Banks reduced the savings deposit rate four times in the last quarter of 1998. Average margins widened as lower HIBOR and time deposit rates moderated funding costs. The cautious lending policies of banks and subdued loan demand, especially after the Guangdong International Trust and Investment Corporation incident, continued to restrain loan growth. Asset quality worsened further, resulting in higher provisions. As anticipated, profitability of banks in Hong Kong reduced sharply in 1998 as a whole, reflecting the squeeze in interest margins during much of the year and the substantial rise in bad debt provisions. However, banks in Hong Kong will continue to be supported by their strong capital position and are expected to stand up well to the difficulties.

Interest Rate Movements

Funding costs moderated in the December quarter, evidenced by declines in both HIBOR and time deposit rates. The average 1-month and 3-month HIBOR dropped by 393 and 385 basis point (bps) to 5.45% and 5.97%, against rises of 209 and 214bps in the September quarter respectively. In line with the declining trend of interest rates, time deposit rates also fell. The average 1-month and 3-month time deposit rates contracted by 256 and 258bps to 5.09% and 5.73% respectively, compared with rises of 87 and 105bps in the preceding quarter.

In response to the softening in domestic interest rates and the fall in the US Fed Funds rate, the Hong Kong Association of Banks cut the savings deposit rate four times in the December quarter, each time by 0.25%, from 5.25% to 4.25%. Leading banks followed these moves and reduced the best lending rate from 10% to 9%.

With funding costs decreasing at a faster rate than the best lending rate, interest rate spreads widened in the December quarter. The average spread between the best lending rate and 1-month HIBOR widened by 352bps to 4.15% and that for 3-month HIBOR, by 345bps to 3.62%. They were 0.63% and 0.18% respectively in the September quarter. The widening in spread was less marked, however, for the best lending rates and time deposit

rates. The average spread between the best lending rate and 1-month time deposits rate rose by 216bps to 4.51% from 2.35% and that for the 3-month time deposit rate, by 218bps to 3.87% from 1.69%.

Balance Sheet Developments

Customers Deposits

Having risen by 6.1% in the September quarter, customer deposits grew at a more moderate pace of 2.8% in the December quarter. Both Hong Kong dollar and foreign currency deposits exhibited a slower growth. Growth in Hong Kong dollar deposits decelerated to 2.7% in the December quarter from 5.4% in the September quarter, and foreign currency deposits from 7.1% to 2.8%. The share of Hong Kong dollar deposits to total deposits remained stable at around 57%.

The deceleration in growth of Hong Kong dollar deposits was caused by a decline in time deposits. Time deposits fell by 5.3% in the December quarter, against a rise of 7.3% in the September quarter. By contrast, savings deposits rose substantially, by 33.4%, after a mere 0.3% growth in the preceding quarter, while demand deposits increased by 8.1%, against a decline of 1.3%. This was because of the relatively sharp fall in time deposit rates as well as a possible increase in the transaction demand for money as the stock and property markets revived.

Within the maturity spectrum, Hong Kong dollar time deposits maturing within one month fell by 11.7% in the December quarter, after rising 9.6% in the September quarter. By contrast, time deposits maturing within one to three months continued to grow, by 13.0% from 6.2%, while those maturing over three months dropped by 15.9%, as opposed to a rise of 2.0%.

The slowdown in growth of foreign currency deposits owed much to a fall in US deposits, which fell by 0.6% in the December quarter after rising 12.5% in the September quarter. Non-US dollar foreign currency deposits, on the contrary, rose by 7.8% after a modest rise of 0.2%. This rise of non-US foreign currency deposits was partly due to the valuation effect resulting from a stronger Japanese yen.

Negotiable Instruments

The outstanding amount of negotiable certificate of deposits ("NCDs") shrank another 3.9% in the December quarter, to HK\$209 bn. This

followed a decline of 0.7% in the September quarter. New issuance of NCDs was muted by subdued demand as interbank and deposit interest rates declined providing more attractive sources of funding.

Among new issues of NCDs, the share of floating rate paper fell significantly to 55.1% in the December quarter from 77.2% in the September quarter. Demand for such paper receded as the market anticipated interest rates to fall further. Reflecting banks' desire to improve their Hong Kong dollar liquidity, NCDs issued in the December quarter were mostly denominated in Hong Kong dollars. The share of NCDs held by authorised institutions rose to 58.2% from 56.3%.

Lending

Loans and advances fell for the sixth straight quarter, by 1.6% in the December quarter following a decline of 6.5% in the September quarter. This was mainly due to weak domestic lending. Offshore lending, which was a major area of decline in the past quarters continued to drop, but at a much

Chart 1
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).

slower pace of 0.2% in the December quarter, compared with 13.7% in the September quarter.

Domestic loans dropped another 1.7% in the December quarter, having fallen by 1.5% in the September quarter. The continuing cautious lending attitude of banks and subdued loan demand contributed to the decline in loan growth. Lending to most sectors fell. The decline in loans for trade finance accelerated to 8.9% from 7.3% and loans for manufacturing to 6.3% from 6.0%. Reflecting the slackening retail business, loans for wholesale and retail trade contracted by 5.0%, having fallen by 4.1% in the preceding quarter. Despite the rebound in the stock index, loans for stockbrokers declined at a faster pace of 29.7% from 19.8%. Consumer lending (excluding residential mortgage loans) was mixed. Credit card receivables rose by 5.0% after a rise of 2.2% in the September quarter, but loans for other private purposes shrank by 6.1%, after declining by 3.7% in the September quarter.

Property lending fell for the second straight quarter, by 0.1% in the December quarter after a 0.3% fall in the previous quarter. The fall reflected the continued decline in loans for property development and investment. The decline in loans for property development accelerated to 5.8% from 4.1% and that for property investment to 2.3% from 1.1%. Following a rise of 1.4% in the preceding quarter, residential mortgage loans (excluding loans under Home Ownership Scheme and Private Sector Participation Scheme) increased further by 2.6% in the December quarter. Due to the fall in lending to other sectors, property lending as a percentage of loans for use in Hong Kong rose to 46.5% from 46.0%.

Loan-to-Deposit Ratio

With the continued growth in Hong Kong dollar deposits against a decline in Hong Kong dollar loans, the Hong Kong dollar loan-to-deposit ratio of the banking sector fell to 100.6% at end-

Table 1
HK\$ Deposit Mix

Amount (HK\$ bn)

	Deposits				
	Demand	Savings	Time *	Swap	Time @
Sep/97	123.3	348.0	1,092.2	35.9	1,128.1
% growth	0.1	(8.7)	6.6	(4.0)	6.2
Dec/97	107.6	336.1	1,051.7	42.3	1,094.0
% growth	(12.8)	(3.4)	(3.7)	17.9	(3.0)
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	1,145.5	29.3	1,174.8
% growth	8.1	33.4	(5.1)	(13.7)	(5.3)

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

* excludes swap deposits

@ includes swap deposits

December from 104.0% at end-September. The ratio for local banks also declined to 71.6% from 74.8%. The overall loan-to-deposits ratio of local banks dropped to 59.0% from 62.0%.

Reflecting a reduction in risk assets during the year, the consolidated capital adequacy ratio of local institutions rose to 18.6% at end-December 1998 compared with 17.5% at the end of 1997. 🌐

Assets Quality

- Prepared by the Banking Development Division

Asset quality worsened further in the December quarter amid the current economic downturn and the closure of the Guangdong International Trust and Investment Corporation. For local banks, loans overdue for more than three months (as a ratio of total loans) rose to 4.14% at end-December from 3.18% at end-September while rescheduled loans rose to 1.02% from 0.63%. The combined ratio of overdue and rescheduled rose to 5.16% from 3.81%. In line with the increase of overdue and rescheduled loans, classified loans rose to 7.00% at end-December from 4.92% at end-September.

The quality of credit card accounts also deteriorated in the December quarter. Delinquent accounts (measured as accounts overdue for more than 90 days to total receivables) rose to 1.15% at end-1998 from 0.64% at end-1997 and the charge-off ratio rose to 3.14% in 1998 from 2.14% in 1997.

Mortgage loans overdue for more than three months as a percent of total mortgage portfolio rose to 0.84% as at end-December, compared with 0.53% at end-September. This is well below the delinquency ratio on other types of lending, indicating that the quality of the mortgage portfolio has held up relatively well during the recession.

Profitability

As indicated by the recent announcements of the local banks which reported their results so far, profits for 1998 were sharply lower than in 1997. While operating profits suffered to some extent from reduced lending volume and the squeeze on interest margins, the main factor behind the fall in profits was the very substantial increase in bad debt provisions. Further heavy provisions are likely to have to be set aside in the first half of 1999 at least. However, the banks will continue to be supported by their high capital adequacy ratios.