

## DEVELOPMENTS IN THE BANKING SECTOR

*The operating environment for banks remained difficult in the first quarter of this year. Lending volume continued to contract as a result of weak demand for credit, while asset quality showed further deterioration. Although aggregate pre-provisions profits showed some recovery compared with the same period of 1998, this was more than offset by the continuing high bad debt charge.*

### Interest Rate Movements

Domestic interest rates further softened in the March quarter. For the quarter, the average 1-month HIBOR fell by 7 basis points to 5.16% while the average 3-month HIBOR fell by 17 basis points to 5.55%, following the declines of 393 and 385 basis points respectively in the December quarter. Due to improvement in the liquidity of banks in general, time deposit rates decreased more than HIBOR in the March quarter. Average 1-month and 3-month time deposit rates contracted by 32 basis points to 4.77% and 57 basis points to 5.16%, compared with declines of 256 and 258 basis points respectively in the preceding quarter.

In view of the stable market conditions and the easing in interbank liquidity, the Hong Kong Association of Banks cut the savings rate by 25 basis points to 4.0% on 11 January 1999 and commercial banks lowered the best lending rate (BLR) by the same magnitude to 8.75%. The average spread between BLR and 1-month HIBOR dropped to 3.40% from 4.15% during the quarter and that for 3-month HIBOR, to 2.97% from 3.62%. The average spread between BLR and the 1-month time deposit rate declined to 4.01% from 4.51% and that for 3-month time deposit rate to 3.62% from 3.87%.

### Balance Sheet Developments

#### Customer Deposits

Customer deposits remained virtually unchanged in the March quarter after rising 2.7% in the December quarter. HK\$ deposits declined by 0.1%, while foreign currency deposit showed zero growth. Within the latter, US\$ deposits rose by 0.9%, while non-US foreign currency deposits fell by almost the same amount. The proportion of Hong

Kong dollar deposits continued to remain stable at around 57% of total deposits.

In the March quarter, Hong Kong dollar demand and savings deposits fell while time deposits rose. Demand and savings deposits fell by 0.8% and 3.6% respectively, following rises of 8.1% and 33.4% in the preceding quarter. Time deposits, on the other hand, showed an increase of 1.2% in the March quarter compared with a decrease of 5.4% in the December quarter. Time deposits maturing between one and three months declined by 20.1%, having risen by 13.0% in the December quarter. Conversely, time deposits maturing within one month and longer than three months rose by 11.7% and 14.8% respectively, against a decline of 11.9% and 15.9% in the preceding quarter.

### Negotiable Instruments

With improved market sentiment, new issuance of negotiable certificate of deposits (NCDs) resumed after shrinking for three straight quarters. The outstanding amount of NCDs grew by a modest 0.4% to HK\$210.2 mn in the March quarter compared with a 3.9% drop in the December quarter. Reflecting the trend towards lower interest rates, the share of floating rate NCDs fell further to 39.0% of total new issues in the March quarter from 55.1% in the December quarter. The share of NCDs held by authorised institutions remained at around 58.4%.

### Lending

Loans and advances fell for the seventh consecutive quarter, by 7.8% in the March quarter, following a decline of 1.7% in the December quarter. The acceleration in the decline in loans and advances was due mainly to the contraction in offshore loans which dropped by 16.9% after falling

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).

0.2% in the December quarter, largely as a result of contraction in euroyen impact loans.

Domestic lending in Hong Kong<sup>1</sup> dropped by 2.6% in the March quarter, having fallen 2.1% in the December quarter. Within this, loans for trade financing fell by 8.0% following a 9.2% decrease in the previous quarter. Lending to most sectors continued to decline, albeit at a slower pace. Loans for manufacturing declined by 3.1% in the March quarter after falling by 5.3% in the December quarter. Reflecting the weak retail sector, loans for wholesale & retail trade continued to contract by 4.2% in the March quarter, having fallen by 4.9% in the previous quarter. With the rebound in the stock market and improvement in

market sentiment, lending to stockbrokers surged by 15.2% in the March quarter against a decline of 30.6% in the preceding quarter. In consumer lending, credit card receivables contracted by 2.9% following a rise of 5.0% in the December quarter and loans to individuals for other private purposes decreased by 1.6% after falling by 6.3% in the December quarter.

Property lending fell by 0.6% in the March quarter, against a revised 0.3%<sup>2</sup> increase in the December quarter. The fall was mainly due to the continued decline in loans for property development and investment and the slowdown in the growth of residential mortgage loans. Loans for property development decreased by 4.4%

<sup>1</sup> Domestic lending in Hong Kong comprises trade finance and other loans for use in Hong Kong.

<sup>2</sup> Revised from a decline of 0.1% to adjust for re-classification effect.

compared with a 5.0% decline in the preceding quarter and the decline in loans for property investment accelerated to 1.9% from 1.1%. Growth in residential mortgage loans (excluding loans under Home Ownership Scheme and Private Sector Participation Scheme) slowed to 1.0% in the March quarter from 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 47.6% from 46.7%.

### Loan-to-Deposit Ratio

Resulting from the continued decline in Hong Kong dollar loans which outpaced the fall in Hong Kong dollar deposits, the Hong Kong dollar loan-to-deposit ratio for the banking sector as a whole fell to 99.2% at end-March 1999 from 100.6% at end-December 1998. For local banks, the ratio rose slightly to 72.0% from 71.6%. The overall loan-to-deposit ratio for local banks decreased slightly to 58.2% from 58.9%.

### Asset Quality

In the light of the weak domestic economy and the debt problems of Mainland-related companies, asset quality continued to deteriorate in the March quarter. For local banks, the combined ratio of overdue and rescheduled loans to total loans rose to 6.63% at end-March 1999 from 5.10% at end-December 1998. Within the aggregate, loans overdue for more than three months increased to 5.42% from 4.03% and rescheduled loans, to 1.21% from 1.07%. Classified loans - a broader definition of problem loans which incorporates a more judgmental assessment of loan quality - also rose to 8.82%, compared with a revised 7.33% at end-December 1998.

Reflecting continued strain on personal finances caused by the recession, the quality of credit card receivables deteriorated further. Delinquent accounts (overdue for more than 90 days to total receivables) rose to 1.26% at end-

Table 1  
HK\$ Deposit Mix

Amount ( HK\$ bn)

	Demand	Savings	Deposits Time *	Swap	Time @
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	1,144.3	29.3	1,173.6
% growth	8.1	33.4	(5.2)	(13.7)	(5.4)
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

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

March from 1.16% at end-December while the annualised charge off ratio for the March quarter increased to 4.64% from 4.13% in the December quarter.

Mortgage loans overdue for more than three months as a percent of total mortgage portfolio rose to 1.13% at end-March from 0.84% at end-December. Despite the increase in overdue mortgage loans, the quality of the mortgage portfolio continued to perform better than other types of loans.

### **Profitability**

The wider prime-HIBOR spread was reflected in a recovery in the net interest margin in the March quarter, though it remained lower than a year previously (annualised rate of 2.28% against 2.33%). Despite the reduction in loans, average interest bearing assets rose during the year; and this, together with slower growth in expenses, contributed to a modest rise in pre-provisions operating profits in the March quarter compared with a year ago. However, this was more than outweighed by higher bad debt provisions, producing lower post-provision profits than in the same period of 1998. The outcome for 1999 will largely be determined by provisioning requirements which are likely to remain substantial, in the first half of the year at least. ☹

- Prepared by the Banking Policy Division