Economic and Financial Environment

With strong merchandise exports, reviving domestic demand and a boost from the Government's supportive policy measures, the Hong Kong economy resumed positive growth in 2021, reversing the contraction experienced during 2019 and 2020. The labour market also improved, and inflation remained moderate albeit having edged up. While economic recovery is expected to continue after the fifth wave of COVID-19 subsides, its strength and speed are subject to uncertainties and risks, especially those surrounding the pandemic and the path of US monetary policy normalisation.

Economic and Financial Environment

THE ECONOMY IN REVIEW

Real activities

Driven by strong merchandise exports and improving domestic demand, the Hong Kong economy grew by 6.3% in 2021, ending the economic contraction in 2019 and 2020 (Table 1 and Chart 1). Private consumption recovered, thanks to improved labour market conditions and a boost from the Government's Consumption Voucher Scheme[1]. Overall investment spending also rebounded as the business environment and outlook improved[2]. Externally, Hong Kong's exports of goods saw strong growth for the whole year, in part supported by the continued global economic recovery. Export of services recorded modest growth, reflecting active regional trade and cargo flows as well as stronger cross-border business and financial activities. Total imports rose appreciably, mainly because of greater domestic and re-export-induced demand. On a net basis, external trade contributed positively to real gross domestic product (GDP) growth in 2021 (Chart 1) as total exports grew faster than imports.

Table 1 Real GDP growth by expenditure component (period-over-period)

	2021					2020				
(% Period-over-period, unless otherwise specified)	Q1	Q2	Q3	Q4	2021	Q1	Q2	Q3	Q4	2020
Gross Domestic Product	5.8	(1.7)	0.7	0.0	6.3	(5.1)	(1.2)	2.7	0.6	(6.5)
(year-on-year growth)	8.0	7.6	5.4	4.7		(9.3)	(9.4)	(4.1)	(3.6)	
Private consumption expenditure	1.5	1.7	1.2	0.7	5.4	(8.1)	(3.0)	2.1	1.9	(10.5)
Government consumption expenditure	2.7	(0.9)	2.0	0.4	4.6	2.8	2.1	(0.1)	1.3	7.9
Gross domestic fixed capital formation	–	–	–	–	9.8	–	–	–	–	(11.5)
Exports										
Exports of goods	11.2	(1.2)	(0.1)	3.1	18.9	(9.7)	7.3	5.4	3.6	(1.4)
Exports of services	12.6	(5.4)	1.4	(1.3)	1.5	(11.5)	(16.4)	0.2	(2.5)	(34.8)
Imports										
Imports of goods	7.2	1.7	1.0	(0.4)	17.4	(6.2)	3.2	5.3	5.7	(3.2)
Imports of services	2.8	(1.5)	1.7	1.3	1.7	(20.0)	(21.5)	6.9	2.7	(32.2)

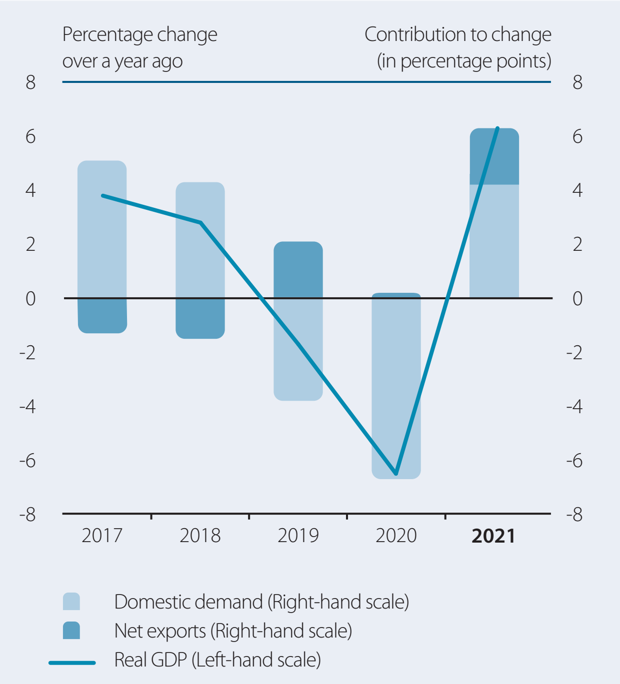
Note: The seasonally-adjusted quarter-on-quarter rates of change in the gross domestic fixed capital formation are not available.
Source: Census and Statistics Department.

1 In response to the lingering pandemic, the Government introduced additional countercyclical fiscal measures in the 2021–22 Budget to support the economy. These measures include the distribution of electronic consumption vouchers worth HK$5,000 to each eligible resident and the Special 100% Loan Guarantee Scheme for unemployed individuals.

2 The HKMA has co-ordinated with the banking sector to extend the Pre-approved Principal Payment Holiday Scheme several times to ease cash-flow pressures of some corporate customers.

Economic and Financial Environment

Chart 1 Real GDP growth by contribution

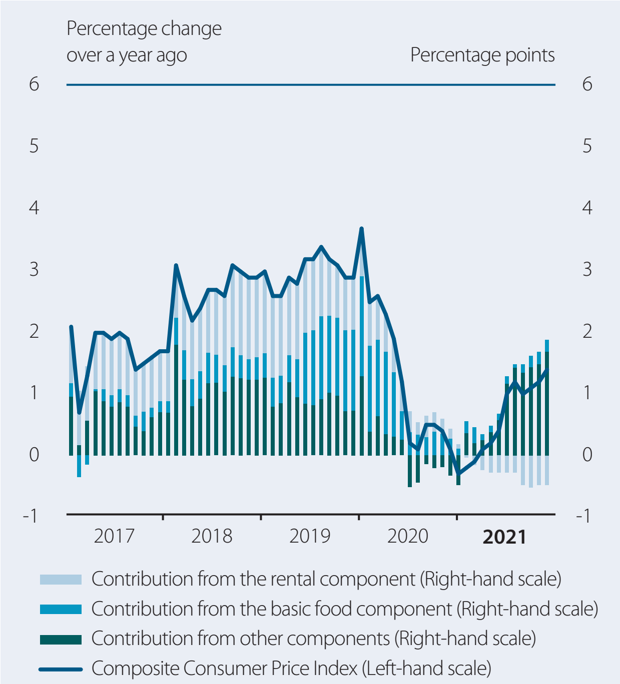


Source: Census and Statistics Department.

Inflation

Inflationary pressures edged up but remained moderate during the year. Netting out the effects of the Government's one-off relief measures, the year-on-year underlying inflation rate[3] picked up gradually to a mild 1.4% in December (Chart 2)[4]. Prices of consumer items such as dining out, transport, clothing and footwear regained upward momentum as local consumption demand improved. Import prices also increased notably alongside bottlenecks in global supply chains and the surge in international energy and commodity prices. By contrast, the housing component was a drag on overall inflation, reflecting the feed-through of the earlier decline in fresh-letting private residential rentals (Chart 2). More broadly, slow growth in nominal wage and commercial rentals helped keep domestic business cost pressures in check. For 2021 as a whole, the underlying and headline inflation rates[5] stayed mild at 0.6% and 1.6% respectively.

Chart 2 Underlying consumer price inflation



Source: Census and Statistics Department.

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3 The underlying inflation rate is the change in Composite Consumer Price Index after netting out the effects of all Government's one-off relief measures.

4 Inclusive of the effects of the Government's relevant one-off relief measures, the headline inflation rate also generally increased from 1.2% in the first quarter to 2.0% in the fourth quarter.

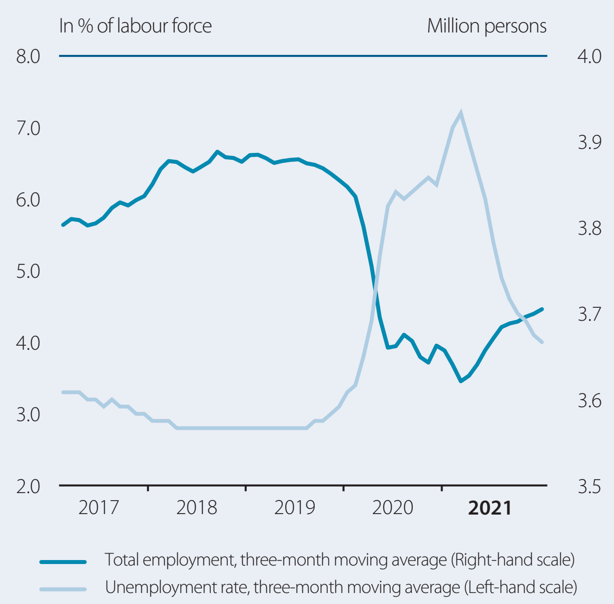
5 Headline inflation rate is the raw inflation figure reported through the Composite Consumer Price Index which is compiled by the Census and Statistics Department.

Economic and Financial Environment

Labour market

Alongside the domestic economic recovery, the labour market improved in 2021. After reaching a 17-year high of 7.2% in February, the unemployment rate declined visibly to 4.0% in December[6] (Chart 3) and the decline was broad based across most economic sectors. Overall labour demand strengthened gradually as reflected by a pick-up in total employment (Chart 3) and private sector vacancies, though they were still below their pre-pandemic peaks. On the other hand, the labour force shrank slightly by 1.3% in December compared with a year earlier, partly due to a modest decline in the labour force participation rate. The year-on-year growth in nominal wage and labour earnings, while moderate, showed signs of acceleration in the first three quarters of 2021, reversing the trend of deceleration during 2019–2020.

Chart 3 Labour market conditions



Source: Census and Statistics Department.

Stock market

The local stock market was broadly sluggish during the year, despite a continued rally in some major overseas equity markets (Chart 4). Extending its rebound in late 2020, the Hang Seng Index rose to a high of 31,085 on 17 February 2021, but market sentiment had turned sharply negative since then owing to a host of factors, including concerns about the new COVID-19 virus variants, potential monetary policy tightening by major central banks and reduced inflows from southbound trading under Stock Connect[7]. The Hang Seng Index closed the year at 23,398, down markedly by 14.1% from a year ago.

Chart 4 Asset prices

Sources: Rating and Valuation Department and Hong Kong Exchanges and Clearing Limited.

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6 The underemployment rate also declined from a peak of 3.9% in February to 1.7% in December 2021.

7 Including Shanghai-Hong Kong Stock Connect and Shenzhen-Hong Kong Stock Connect.

Economic and Financial Environment

Property market

The residential property market regained some upward momentum in the first half of 2021 alongside better economic prospects, but saw some consolidation in the second half amid weakened asset market sentiments (Chart 4). Overall, housing prices and transaction volume still recorded an increase of 3.7% and 24.1% respectively in 2021. Household affordability also became even more stretched, partly reflecting reduced household income. On the other hand, after going through sharp corrections in 2019 and 2020, the non-residential property markets generally improved, with prices and rentals of industrial properties generally rising to their pre-pandemic peaks, whereas those of retail and office spaces remained below their respective peaks.

See *Table B: Major Economic Indicators* on pages 326 to 327 for more details, including their trends during 2017–2021.

OUTLOOK FOR THE ECONOMY

Economic environment

In early 2022, the fifth wave of local COVID-19 infections has exerted pressures on domestic economic activities. In response, the Government introduced the fifth and the sixth rounds of the Anti-epidemic Fund and additional countercyclical measures under the 2022–23 Budget to help support the economy. The HKMA, together with the banking sector, also extended the Pre-approved Principal Payment Holiday Scheme to the end of October 2022.

For 2022 as a whole, economic recovery is expected to continue, albeit at a more moderate pace compared to 2021, partly reflecting the impact of the fifth wave of COVID-19, slower global economic growth, a less favourable base effect and US monetary policy normalisation. The Government forecasts real GDP growth for 2022 to be in the range of 1–2% and the latest growth estimates by international organisations and private sector analysts averaged 1.1%. That said, the strength and pace of the recovery are subject to a host of uncertainties and risks, especially those surrounding the pandemic, the Ukraine situation, and the path of US monetary policy normalisation.

Inflation and the labour market

Alongside rising import prices and pandemic-induced logistics disruptions, inflationary pressures are expected to edge up in the near term, but should stay broadly in check owing to soft rentals and mild local labour cost pressures. Market consensus forecasts a headline inflation rate of 2.4% in 2022, while the Government projects the headline and underlying inflation rates to be 2.1% and 2.0% respectively. The fifth wave of local COVID-19 infections has exerted pressures on the labour market in early 2022, especially for contact-intensive sectors. Further out, labour market conditions will depend on the pandemic developments and the pace of the domestic economic recovery.

PERFORMANCE OF THE BANKING SECTOR

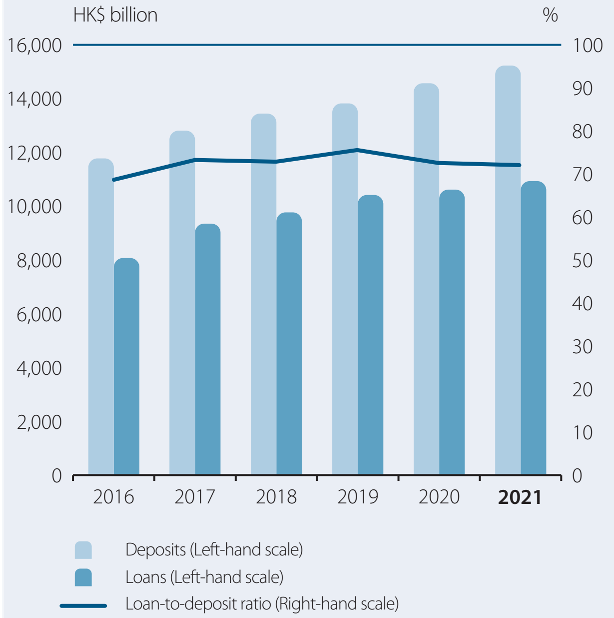
The Hong Kong banking sector continued to be stable in 2021. Total banking assets expanded moderately as both loans and deposits increased. The capital and liquidity positions of the banking sector remained robust. Asset quality stayed at a healthy level by both historical and international standards.

Balance sheet trends

The banking sector's balance sheet grew by 1.9% in 2021. Driven by the economic recovery, total loans recorded a growth of 3.8% during the year, compared with 1.2% in 2020. Among the total, loans for use in Hong Kong grew by 4.4%, loans for use outside Hong Kong grew by 1.1% and trade finance increased by 14.2%. Mainland-related lending expanded by 3.6% in 2021, after remaining largely stable in 2020.

On the liability side, total deposits rose by 4.6% in 2021, compared with 5.4% in 2020. As total deposits increased at a faster pace than total loans, the overall loan-to-deposit ratio edged down to 71.8% at the end of 2021 from 72.3% a year ago (Chart 5).

Chart 5 Loans and deposits of the banking sector



Source: HKMA.

Economic and Financial Environment

Capital adequacy

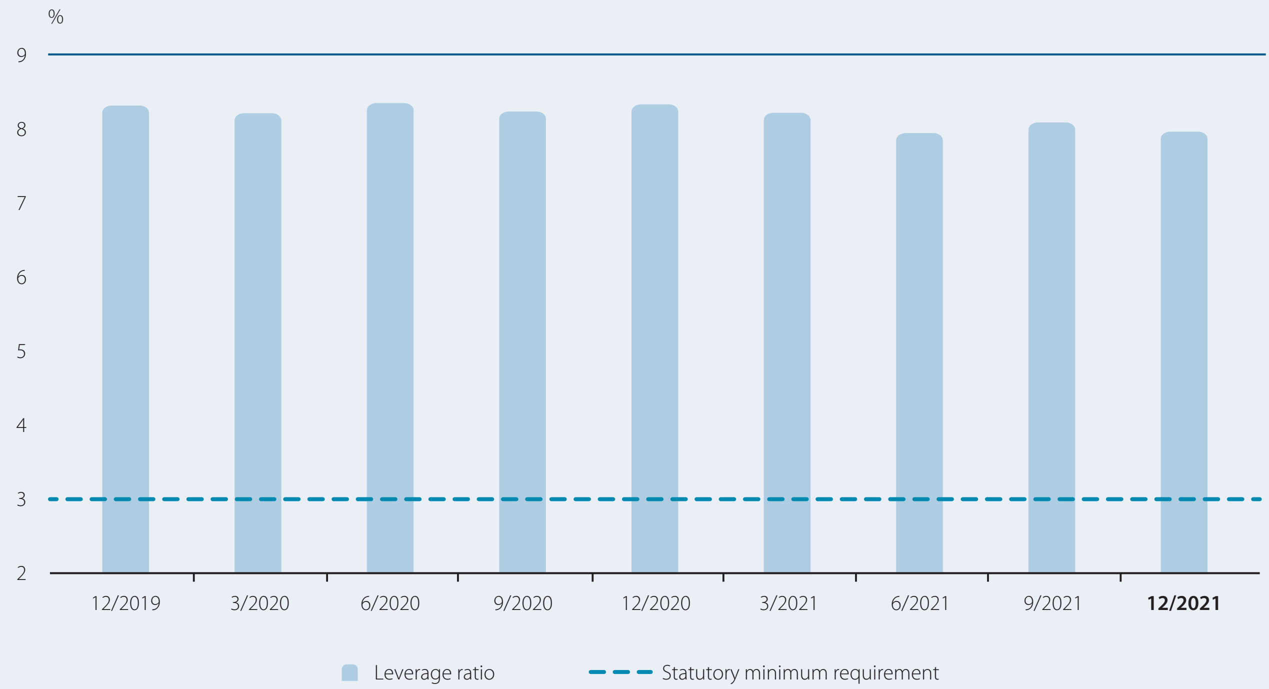
The banking sector remained well capitalised. The consolidated total capital ratio of locally incorporated authorized institutions (AIs) stood at 20.2% at the end of 2021. The Tier 1 capital ratio was 18.2% (Chart 6). Both ratios were well above their respective international minimum requirements of 8% and 6%.

The Basel III leverage ratio was 7.9% at the end of 2021, well above the statutory minimum requirement of 3% (Chart 7).

Chart 6 Consolidated capital ratios of locally incorporated AIs

Source: HKMA.

Chart 7 Consolidated leverage ratio of locally incorporated AIs

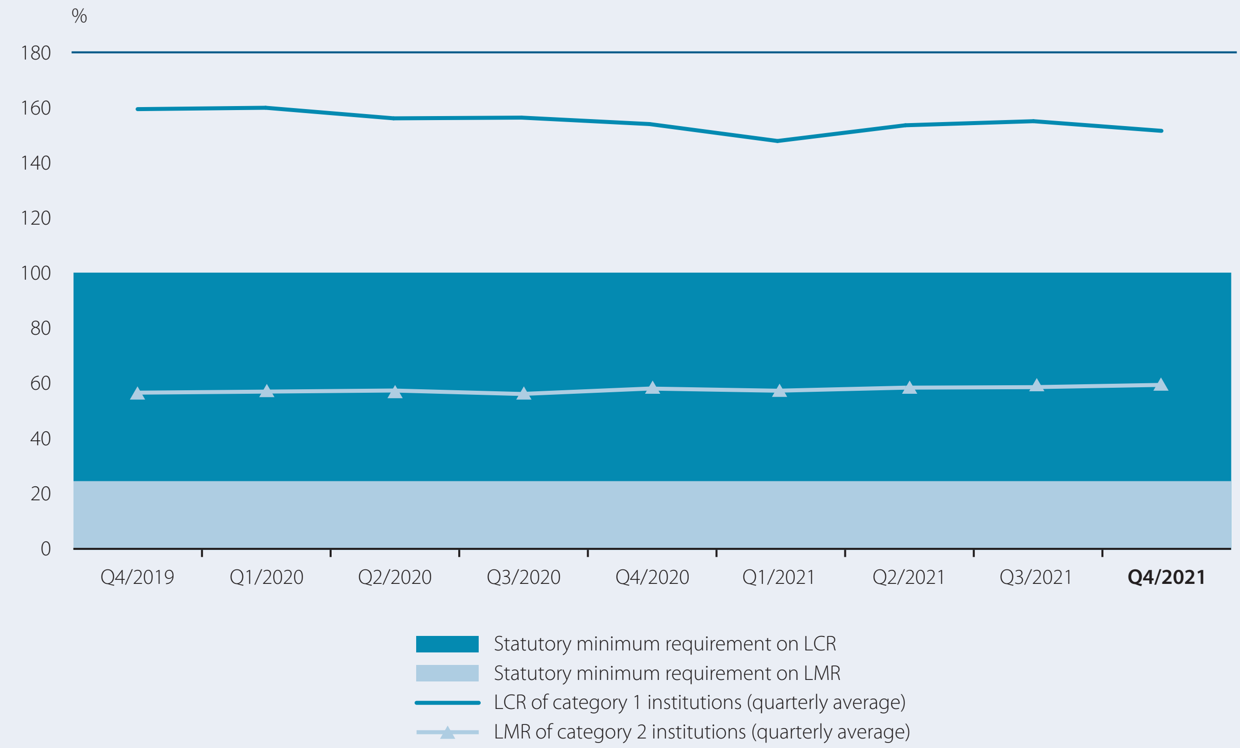


Source: HKMA.

Liquidity

The liquidity position of the banking sector was sound. The quarterly average Liquidity Coverage Ratio (LCR) of category 1 institutions[8] was 151.9% in the fourth quarter of 2021, well above the statutory minimum requirement of 100%. The quarterly average Liquidity Maintenance Ratio (LMR) of category 2 institutions was 59.1%, also well above the statutory minimum requirement of 25% (Chart 8).

Chart 8 Liquidity ratios of designated AIs



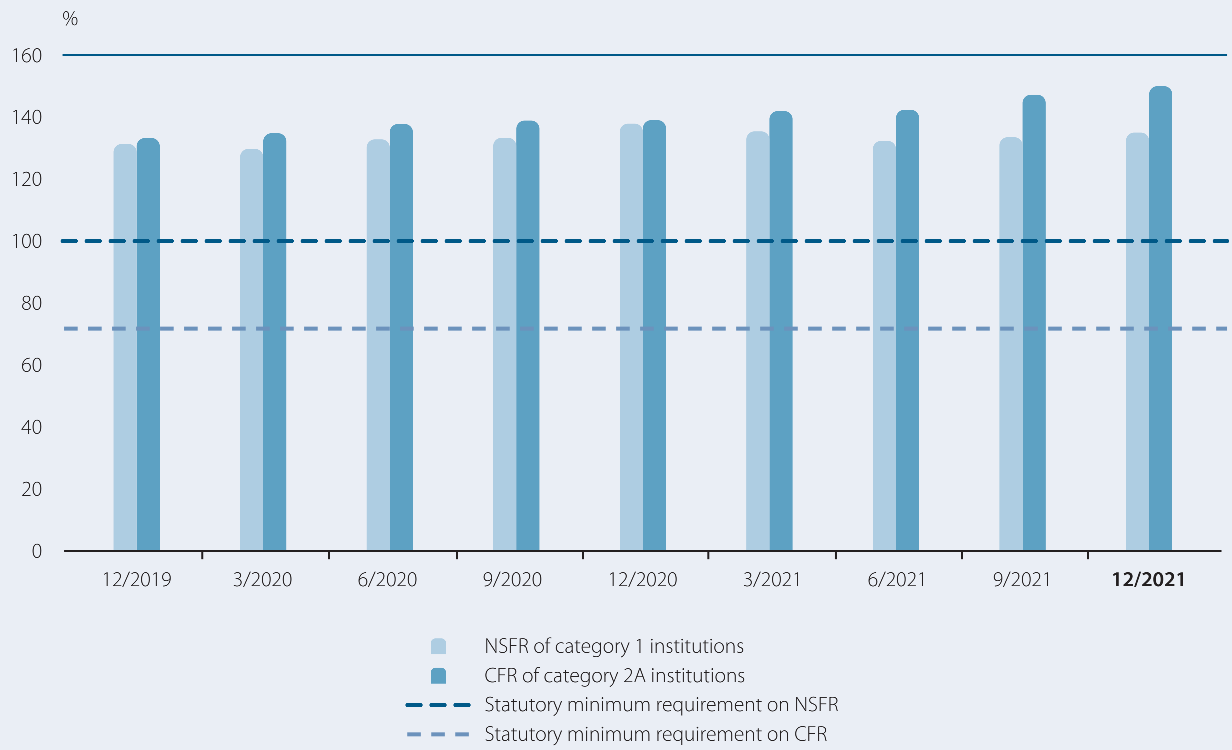
Source: HKMA.

[8] Usually, category 1 institutions are defined as either having significant international exposures or being significant to the general stability of the local banking sector given their size or complexity of business operations. Other AIs are regarded as category 2 institutions.

Economic and Financial Environment

The sources of funding of the banking sector remained stable. The Net Stable Funding Ratio (NSFR) of category 1 institutions was 135.3% at the end of 2021, well above the statutory minimum requirement of 100%. The Core Funding Ratio (CFR) of category 2A institutions[9] was 150.3% at the end of 2021, also well above the statutory minimum requirement of 75% (Chart 9).

Chart 9 Funding ratios of designated AIs



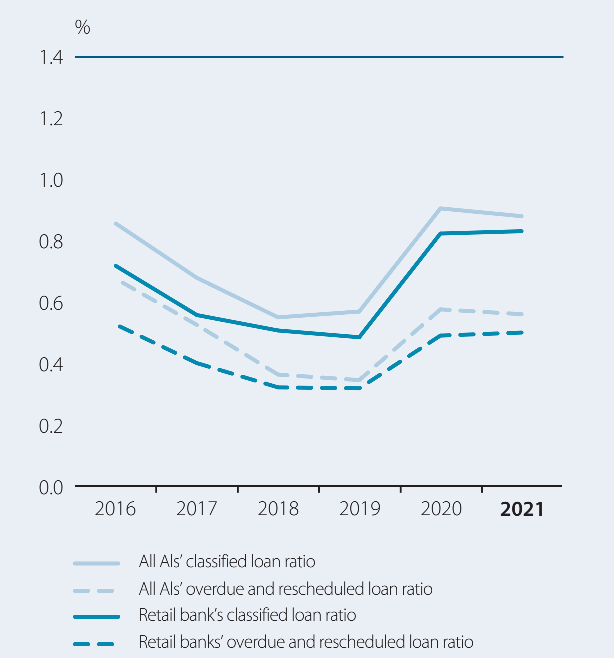
Source: HKMA.

[9] The designation of category 2A institutions are based on the business size and the liquidity risk associated with the institution.

Asset quality

Asset quality remained stable during the year and stayed at a healthy level by both historical and international standards. The classified loan ratio was 0.88% at the end of 2021 as compared to 0.90% at the end of 2020, with the overdue and rescheduled loan ratio edging down to 0.56% from 0.57% during the period (Chart 10). The classified loan ratio for Mainland-related lending was 0.86% at the end of 2021 as compared to 0.96% at the end of 2020. The delinquency ratios of residential mortgage lending and credit card lending remained low at 0.04% and 0.20% respectively (Chart 11). The HKMA will continue to closely monitor the change in the asset quality of the banking sector.

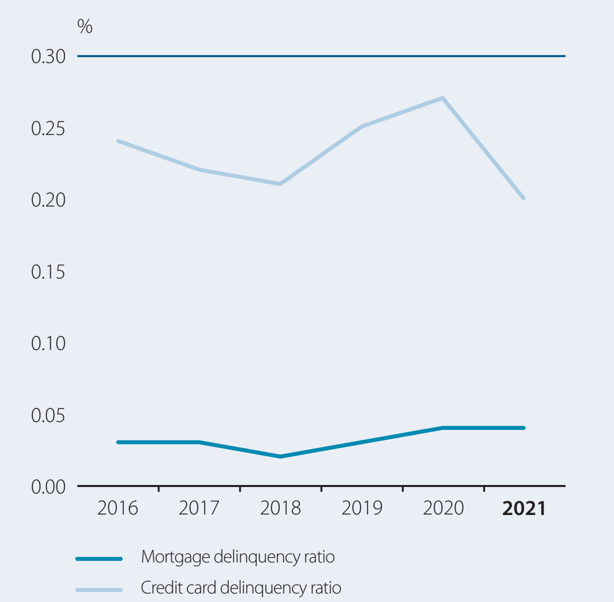
Chart 10 Asset quality of the banking sector



Note: Figures cover Hong Kong offices, overseas branches and major overseas subsidiaries.

Source: HKMA.

Chart 11 Delinquency ratios of residential mortgages and credit card lending



Source: HKMA.

Economic and Financial Environment

Profitability trends

The low interest rate environment continued to weigh on the profitability of the banking sector. The aggregate pre-tax operating profit of retail banks declined by 19.8% in 2021 (Chart 12), mainly attributable to a decrease in net interest income (-13.6%) and an increase in total operating expenses (+7.1%). These were partly offset by an increase in income from fees and commissions (+9.6%) and a drop in loan impairment charges (-25.1%). The net interest margin further narrowed to 0.98% in 2021 from 1.18% in 2020 (Chart 13).

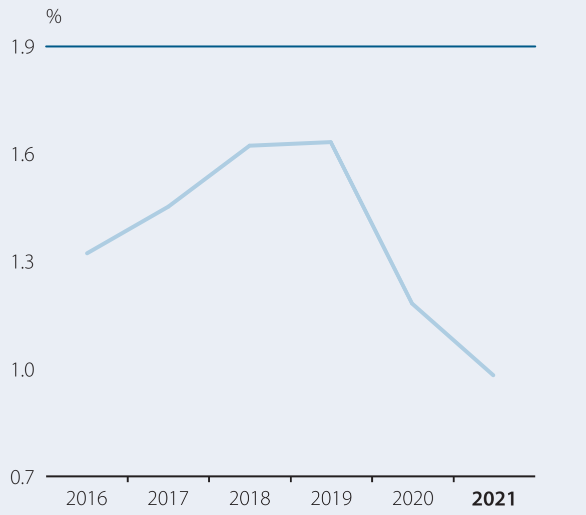
Retail banks' cost-to-income ratio rose to 54.7% in 2021 from 47.0% in 2020 (Chart 14).

More information about the performance and financial positions of all AIs can be found in Tables C, and G to M on pages 328 to 329, and 334 to 342 respectively.

Chart 12 Retail banks' performance

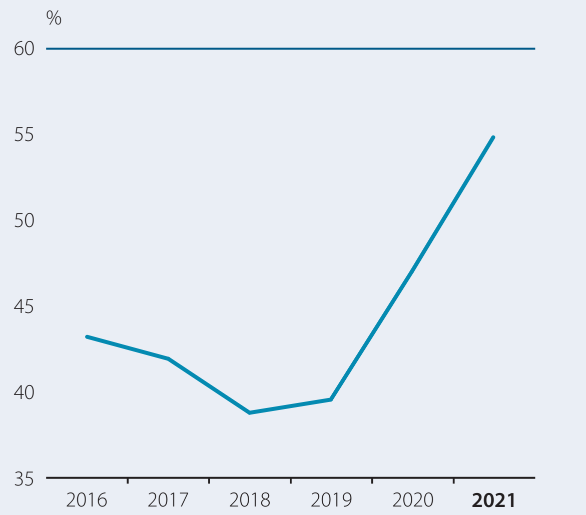
Source: HKMA.

Chart 13 Retail banks' net interest margin



Source: HKMA.

Chart 14 Retail banks' cost-to-income ratio



Source: HKMA.