

Economic and Financial Environment



Despite a challenging external environment, the Hong Kong economy staged a positive growth in 2023, thanks to the revivals in inbound tourism and domestic demand. The labour market continued to improve alongside the economic recovery, while inflation remained moderate. Asset markets remained soft amid tightened financial conditions and weak market sentiment. Economic activities for 2024 are expected to recover further at a moderate pace, although the outlook is clouded by multiple external uncertainties.

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The economy in review

Real activities

Having navigated through the severe challenges posed by the pandemic in the previous year, the Hong Kong economy grew steadily by 3.2% in 2023 (Table 1 and Chart 1).

Domestically, private consumption recovered notably on the back of improved labour market conditions and various support initiatives introduced by the Government, such as the Consumption Voucher Scheme and a series of promotional campaigns. Despite tightened financial conditions, overall investment expenditure registered significant growth against a low base of comparison from the previous year. Externally, Hong Kong's exports of services rebounded, due mainly to the robust revival of inbound tourism. However, their positive impact on growth was more than offset by the strong recovery in outbound tourism, which was measured as imports of services. On the other hand, exports of goods remained lacklustre amid weak external demand, and put a drag on Hong Kong's gross domestic product (GDP) growth.

Chart 1 Real GDP growth by contribution



Source: Census and Statistics Department

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

(% Period-over-period, unless otherwise specified)	2023					2022				
	Q1	Q2	Q3	Q4	2023	Q1	Q2	Q3	Q4	2022
Gross Domestic Product	4.8	(1.1)	0.2	0.4	3.2	(2.5)	0.4	(2.5)	0.3	(3.7)
(year-on-year growth)	2.9	1.5	4.1	4.3		(4.0)	(1.4)	(4.9)	(4.3)	
Private consumption expenditure	1.2	3.3	(0.7)	(0.6)	7.3	(9.9)	8.2	0.7	2.2	(2.2)
Government consumption expenditure	(3.5)	(4.8)	1.8	1.4	(4.3)	3.8	6.2	(4.0)	2.8	8.0
Gross domestic fixed capital formation	-	-	-	-	10.8	-	-	-	-	(7.4)
Exports										
Exports of goods	0.4	(0.2)	0.1	2.9	(10.3)	(7.3)	(4.9)	(7.3)	(8.4)	(14.0)
Exports of services	14.3	4.3	0.5	2.0	21.2	1.0	(0.9)	(0.0)	3.0	(0.5)
Imports										
Imports of goods	2.3	(1.1)	1.3	1.7	(8.6)	(7.8)	0.3	(9.6)	(7.9)	(13.2)
Imports of services	12.0	6.2	3.2	4.8	26.2	(3.7)	0.7	1.2	5.4	(1.2)

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

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Inflation

Local inflation remained moderate in 2023 as external price pressures gradually eased, while domestic cost pressures remained broadly in check despite rising slightly as the economy recovered (Chart 2)¹. For 2023 as a whole, the underlying and headline inflation rates were 1.7% and 2.1% respectively.

Labour market

Labour market conditions improved further in 2023, with the unemployment rate falling to a decade-low level of 2.8% in July and hovering at a low level for the remaining months of the year² (Chart 3). Both labour demand and labour supply increased, as reflected respectively by the pick-up in total employment (Chart 3) and in the labour force. In view of Hong Kong's manpower shortages, the Government rolled out various labour importation schemes³ and talent attraction initiatives⁴ in 2023. Meanwhile, with tight labour market conditions, the year-on-year growth rates of nominal wages and of labour earnings increased gradually towards their pre-pandemic levels.

Chart 2 Underlying consumer price inflation

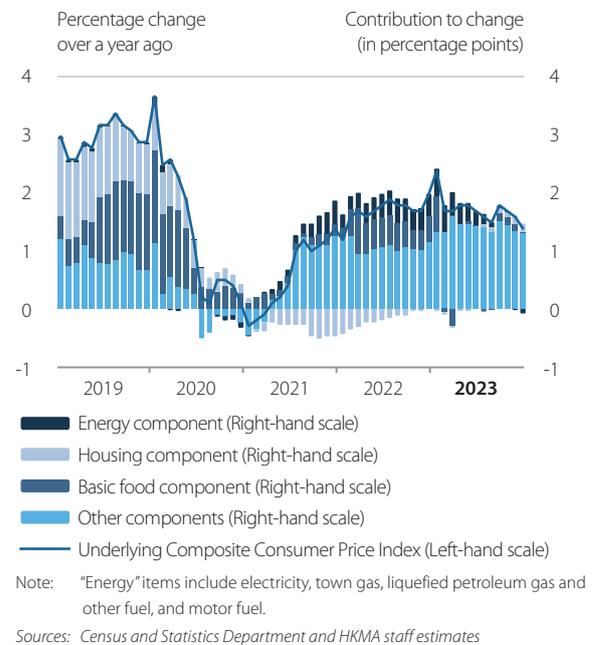
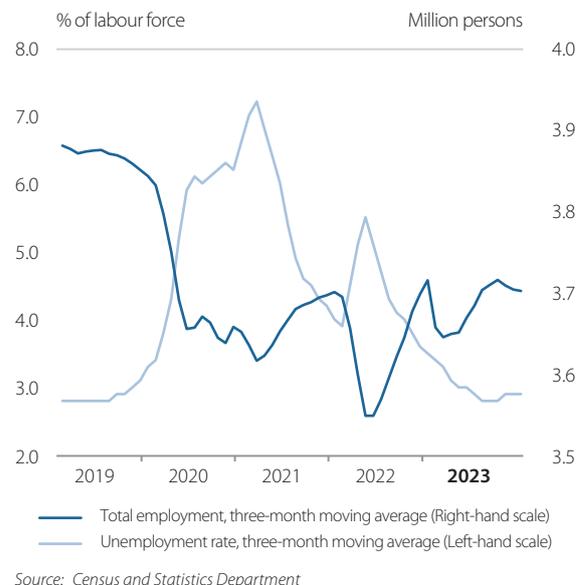


Chart 3 Labour market conditions



¹ Private housing rentals increased by 5.9% in 2023. On the commercial front, rentals increased by 3.7% and 3.1% respectively for private retail premises and flatted factories, while rentals for office spaces decreased by 0.3%. The year-on-year growth rate of nominal payroll increased to 3.6% in 2023 from 2.3% in the previous year.

² The underemployment rate (three-month moving average) also trended down to 1.0% in December 2023 from 1.5% a year earlier.

³ The Government launched sector-specific labour importation schemes for the construction and transport sectors in July, and started accepting applications for the Enhanced Supplementary Labour Scheme covering various other sectors from September.

⁴ In 2023, over 220,000 applications were received under various talent attraction schemes. Of these, over 130,000 applications have been approved, and around 90,000 talents have arrived in Hong Kong.

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Stock market

After stabilising in early 2023, the local stock market turned sluggish in the second half. Extending its rebound in late 2022, the Hang Seng Index rose to a year-high daily close of 22,689 on 27 January 2023. It then retreated and dropped further to low levels by December (Chart 4), reflecting weak market sentiment due to the banking sector problems in the US and Switzerland in March, as well as weaker global economic prospects and tightened financial conditions in the second half. The Hang Seng Index closed the year at 17,047, down notably by 13.8% from the end of 2022, and marking the fourth consecutive year of decline.

Property market

The residential property market experienced a rebound in the first four months of 2023 on the back of the resumption of normalcy in the Mainland and Hong Kong, but softened subsequently alongside rising mortgage rates⁵ and weak market sentiment. Overall, housing prices dropped by 6.9% year on year in 2023, while housing transactions further declined by 4.5% to a record-low of 43,002 units. Housing affordability remained stretched despite improving slightly along with the downward adjustment of housing prices. Similarly, the non-residential property markets continued to face headwinds, with prices of offices, retail premises and flatted factories softened further. The rentals for offices remained under pressure due to high vacancy rates amid the increasing prevalence of work-from-home arrangements and large supply. On the other hand, the rentals for retail premises increased in 2023 with the revival of inbound tourism and the improvement in private consumption.

Chart 4 Asset prices



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

⁵ The effective mortgage interest rates increased from 3.375–3.625% to 4.125% during the year, adding to the repayment burden of mortgage borrowers.

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Outlook for the economy

Economic environment

In 2024, the Hong Kong economy is expected to continue its recovery at a moderate pace. Inbound tourism is set to expand further alongside the continuous improvement in handling capacity and the Government's effort to promote mega events, while local consumption activities should be supported by a steady labour market. The various infrastructure projects to be taken forward by the Government will also lend support to the economy. Meanwhile, Hong Kong's exports of goods will likely stabilise alongside the expected upturn in the global technology cycle. The Government forecasts real GDP to grow steadily by 2.5%–3.5% in 2024⁶. However, the outlook is clouded by multiple risks and uncertainties, including those stemming from the US policy rate path, the pace of technology cycle recovery, the prospects for global economic growth, and evolving geopolitical tensions.

Inflation and the labour market

Local inflation is expected to remain mild in 2024, with softened external price pressures helping to offset the upward pressures on domestic costs amid further economic recovery and rising housing rentals. Market consensus forecasts a headline inflation rate of 2.1% in 2024, while the Government projects the headline and underlying inflation rates to be 2.4% and 1.7% respectively. On the other hand, the labour market is expected to be supported by the ongoing economic recovery, while the various labour importation and talent attraction schemes will continue to help alleviate manpower shortages across different industries.

⁶ Market consensus forecasts a real GDP growth of 2.8% for Hong Kong in 2024.

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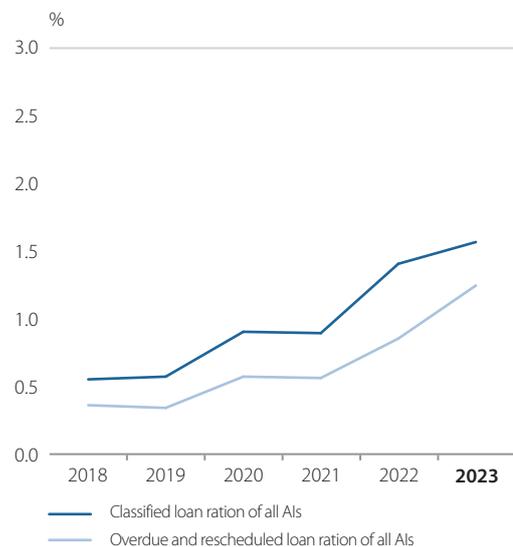
Performance of the banking sector

In 2023, the Hong Kong banking sector faced a number of challenges including a high interest rate environment, heightened volatility in global financial markets caused by the March banking turmoil in the US and Europe, and a slower-than-expected economic recovery in the Mainland and Hong Kong. Despite these multiple headwinds, the Hong Kong banking sector remained sound and continued to be supported by strong capital and liquidity buffers. The asset quality of the banking sector remained healthy despite an increase in the classified loan ratio. The profitability of banks improved notably, driven by higher net interest income.

Asset quality

The classified loan ratio of the banking sector rose to 1.56% at the end of 2023 from 1.40% at the end of 2022, with the overdue and rescheduled loan ratio increasing to 1.24% from 0.85% during the same period (Chart 5). The classified loan ratio for Mainland-related lending also rose to 2.58% at the end of 2023 from 2.26% a year before. The increase in the classified loan ratio was mainly due to downgrades of exposures to Mainland property developers. Nevertheless, the provisions set aside by banks remained sufficient. The provision coverage ratio (i.e. total provisions to classified loans) stood at 75% at the end of 2023. If the market value of collateral held against the classified loans is taken into account, the adjusted provision coverage ratio would reach around 145%. Meanwhile, the delinquency ratios of residential mortgage lending and credit card lending remained low, at 0.08% and 0.30% respectively, at the end of 2023 (Chart 6).

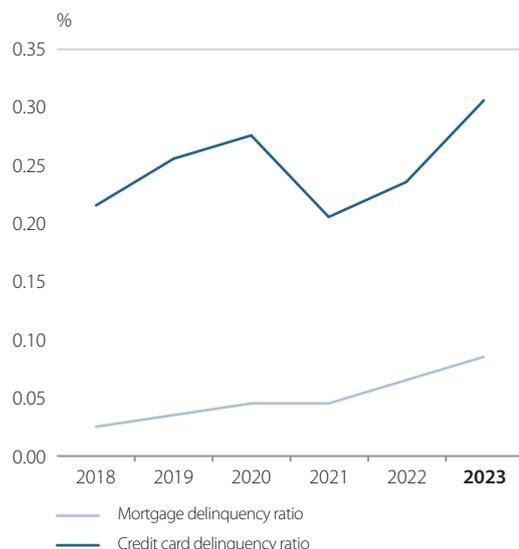
Chart 5 Asset quality of the banking sector



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

Source: HKMA

Chart 6 Delinquency ratios of residential mortgage lending and credit card lending



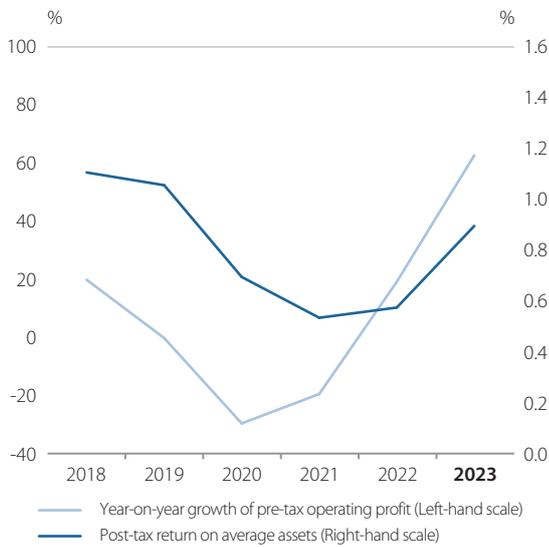
Source: HKMA

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Profitability trends

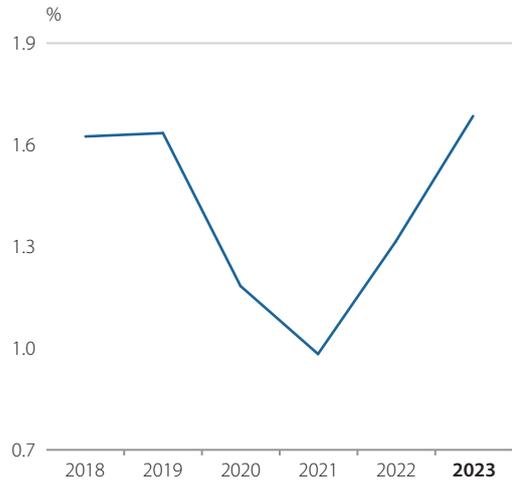
The banking sector recorded notable profit growth in 2023. The aggregate pre-tax operating profit of retail banks increased by 62.1% in the year, while the post-tax return on average assets rose to 0.89% from 0.57% during the same period (Chart 7). The improvement in profit was predominantly the result of an increase in net interest income (+30%), coupled with a significant gain in investments held for trading in 2023 as compared to a mild loss in the previous year. This was partly offset by an increase in loan impairment charges (+28%), as specific provisions were set aside for new classified loans. Against the backdrop of rising interest rates, the net interest margin of retail banks widened to 1.68% in 2023 from 1.31% a year before (Chart 8). Meanwhile, retail banks' cost-to-income ratio fell to 38.8% in 2023 from 48.0% in 2022 (Chart 9).

Chart 7 Retail banks' performance



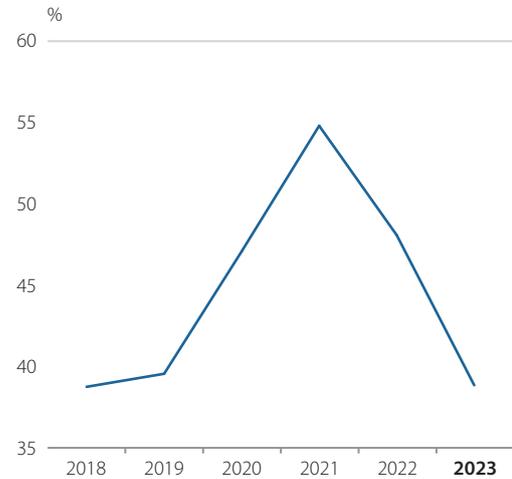
Source: HKMA

Chart 8 Retail banks' net interest margin



Source: HKMA

Chart 9 Retail banks' cost-to-income ratio



Source: HKMA

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Balance sheet trends

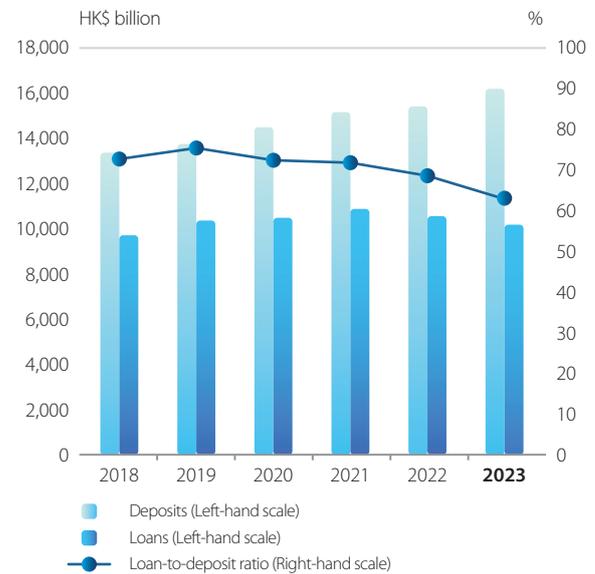
The banking sector's balance sheet grew by 0.9% in 2023, as growths in negotiable debt instruments held (+8.6%) and interbank lending (+4.4%) were mostly offset by a decline in total loans. Given the subdued loan demand amid higher borrowing costs and a weakened global economic outlook, total loans decreased by 3.6% in 2023. Of the total loans, loans for use in Hong Kong remained broadly stable (-0.4%), while loans for use outside Hong Kong and trade finance decreased by 10.4% and 13.1% respectively. Mainland-related lending fell by 6.6% in 2023.

On the liability side, total deposits rose by 5.1% in 2023, compared with a growth of 1.7% in 2022. As total loans declined while total deposits grew, the overall loan-to-deposit ratio decreased to 62.8% at the end of 2023 from 68.5% a year before (Chart 10).

Capital adequacy

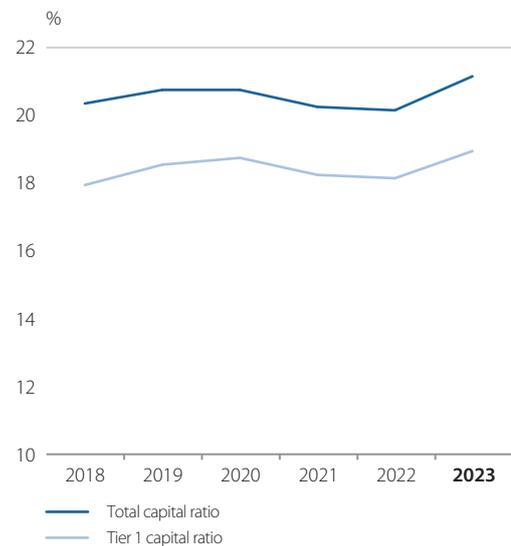
The banking sector remained well capitalised in 2023. The consolidated total capital ratio of locally incorporated authorized institutions (AIs) stood at 21.1% at the end of 2023, compared with 20.1% a year before. The Tier 1 capital ratio was 18.9% (Chart 11). Both ratios were well above their respective international minimum requirements. The Basel III leverage ratio was 7.9% at the end of 2023 (Chart 12).

Chart 10 Loans and deposits of the banking sector



Source: HKMA

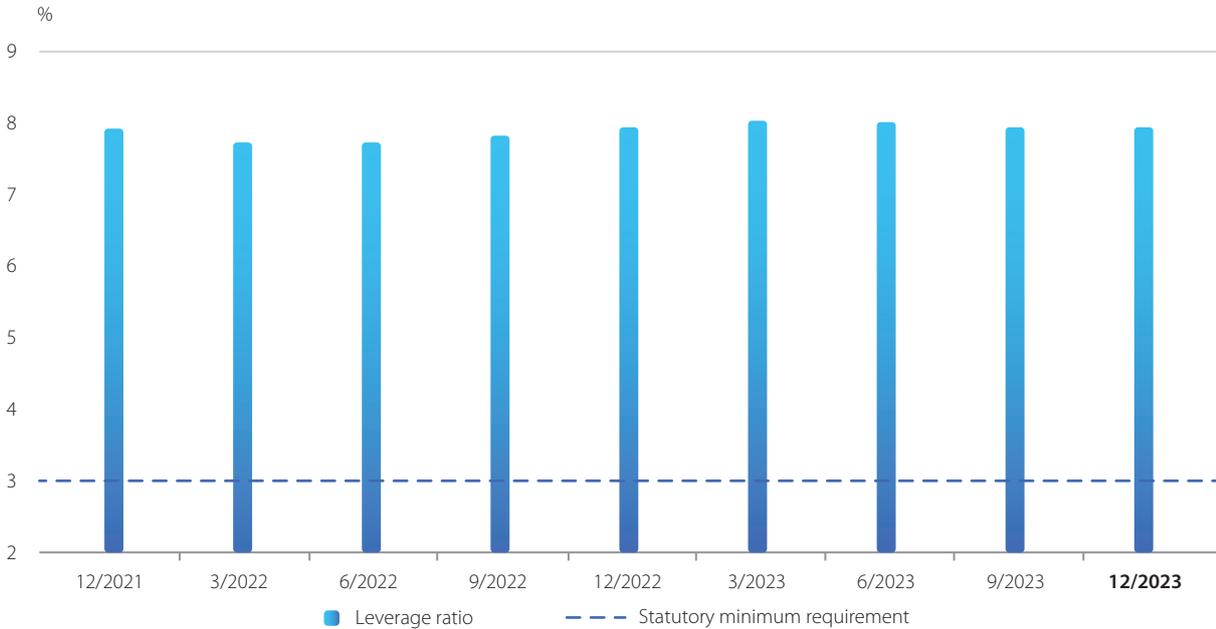
Chart 11 Consolidated capital ratios of locally incorporated AIs



Source: HKMA

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Chart 12 Consolidated leverage ratio of locally incorporated AIs



Source: HKMA

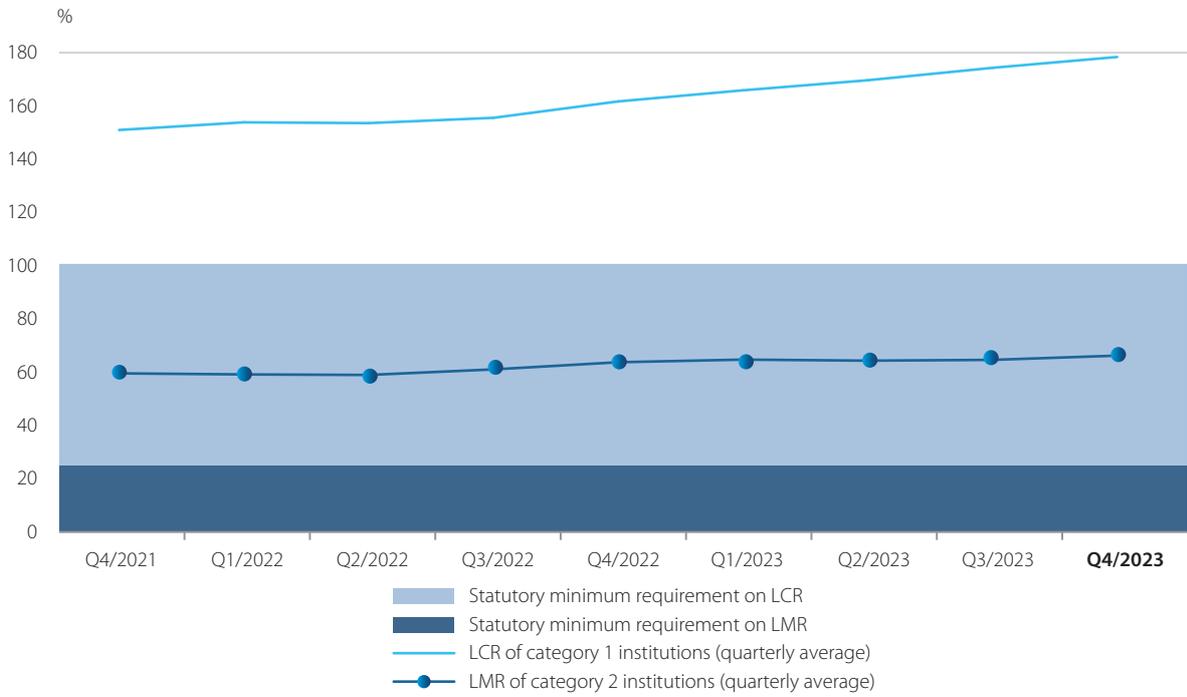
Liquidity conditions

The banking sector continued to maintain a strong liquidity position. The quarterly average Liquidity Coverage Ratio (LCR) of category 1 institutions was 178.6% in the fourth quarter of 2023, and the quarterly average Liquidity Maintenance Ratio (LMR) of category 2 institutions was 65.7% (Chart 13). The main source of funding for the banking

sector continued to be customer deposits. The Net Stable Funding Ratio (NSFR) of category 1 institutions and the Core Funding Ratio (CFR) of category 2A institutions were 144.4% and 169.4% respectively at the end of 2023 (Chart 14). All four ratios were well above the statutory minimum requirements.

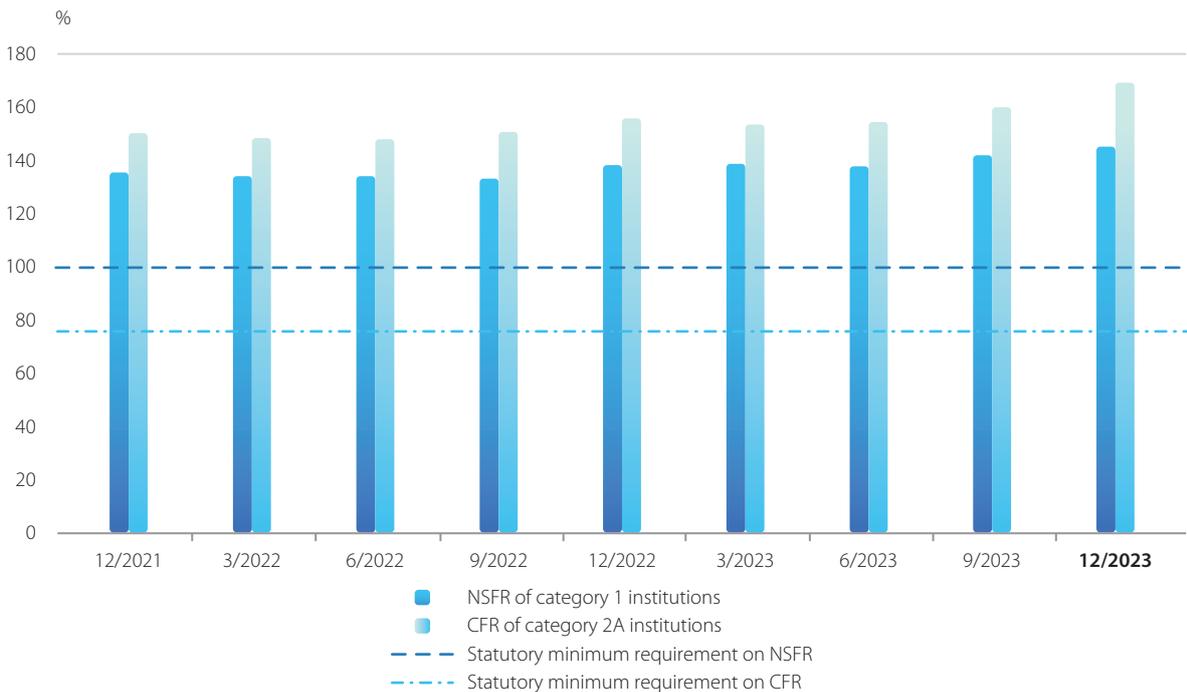
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Chart 13 Liquidity ratios of designated AIs



Source: HKMA

Chart 14 Funding ratios of designated AIs



Source: HKMA