1. Summary and overview

In the period under review, the global economy demonstrated resilience, driven by the accelerating artificial intelligence boom and sustained demand for technology products, particularly in the Asia-Pacific (APAC) region. The recovery, however, reflected a pronounced "K-shaped" divergence across households and sectors. Looking ahead, the economic outlook for 2026 remains uncertain. The US and global economies are expected to continue benefiting from structural tailwinds driven by technological innovation, though the A.I. surge has also introduced new risks, including stretched valuations in A.I.-related equities and concerns about the sustainability of heavy capital expenditures. Compounding these challenges are ongoing geopolitical tensions, evolving trade policies, and fiscal sustainability challenges in major advanced economies, all of which contribute to an uncertain outlook.

Hong Kong's exchange rate and money markets continued to trade in a smooth and orderly manner. The local equity market delivered its strongest annual performance in eight years in 2025, reflecting improved investor confidence. The local debt market expanded with the introduction of key policy initiatives and several milestone bond issuances. The residential property market continued to recover, supported by improving market sentiment, robust transaction activity, and further stabilisation in housing prices. Meanwhile, the commercial real estate (CRE) market remained under pressure. In 2025, bank loans recorded positive growth, reversing the decline observed in the previous year. The overall asset quality of the banking sector was manageable, and provisions set aside by banks proved adequate to address potential risks.

The US economy demonstrated resilient growth in 2025, though the underlying development was characterised by a "K-shaped" divergence across households and sectors amid the A.I. boom. Looking ahead, the US economy is poised to continue benefiting from structural tailwinds driven by tech innovation. However, the military conflict in the Middle East could cloud the US inflation outlook and the path of US interest rates. Meanwhile, US trade policy remains highly uncertain, with continued signals of tariffs in pursuit of geoeconomic objectives.

Globally, economic performance has remained stable, though the economic outlook appears bifurcated. On the upside, the A.I. boom continues to be a source of strength for the global trade and financial markets. On the downside, risks persist, spanning trade policy uncertainty, the sustainability of the A.I. boom, evolving geopolitical tensions, and fiscal sustainability challenges in major advanced economies. For corporates, these uncertainties translate into pressure on their financial performance, though operational flexibility can help mitigate this adverse effect as highlighted in Box 1.

APAC economies finished 2025 on a strong note, buoyed by solid growth and vibrant financial markets. This performance was supported by exports diversification, concerted monetary easing and the surge in demand for the region's tech products driven by the A.I. boom. However, the military conflict in the Middle East has heightened the region's vulnerability to higher inflation and slower growth. Meanwhile, the region remains exposed to potential shocks, particularly from the sustainability of the A.I. boom, persistent uncertainty in US and global trade policies, and evolving geopolitical tensions.

In the Chinese Mainland, year-on-year real Gross Domestic Product (GDP) growth moderated in the second half of 2025. Domestic demand growth moderated, although merchandise exports remained resilient. For 2025 as a whole, the economy expanded by 5.0%, in line with the official target. 2026 marks the first year of the 15th Five-Year Plan, which emphasises the development of a modern industrial system, technological self-reliance, the cultivation of new quality productive forces, and the expansion of domestic demand — particularly consumption. The economic outlook for 2026 is cautiously optimistic. While persistent external headwinds and domestic structural challenges, particularly in the property sector and weak consumer confidence, continue to weigh on economic performance, sustained innovation, industrial upgrading, and continued policy support are expected to underpin stable growth.

In Hong Kong, the economy recorded solid growth in the second half of 2025, supported by a sustained recovery in domestic demand and a robust expansion in exports. Looking ahead, the economy is expected to grow at a moderate pace, with goods exports likely to remain strong due to sustained demand for high-tech products fueled by the A.I. boom. On the domestic front, private investment is expected to benefit from improved business sentiment. However, the labour market remains soft, with the labour force participation rate (LFPR) continuing its downward trend – a trend driven not only by population ageing but also by rising educational attainment among youth, as detailed in Box 3. The outlook for the Hong Kong economy is subject to external uncertainties, particularly concerning the ongoing geopolitical tensions, the sustainability of the A.I. boom, evolving global trade policies, as well as the US policy rate path.

The Hong Kong dollar (HKD) exchange and money markets continued to trade in a smooth and orderly manner. The HKD traded on the strong side of the Convertibility Zone initially, before shifting to the weaker side of the Convertibility Zone toward the end of the review period, with the movements largely affected by HKD interbank rates and equity-related demand.

While Hong Kong Interbank Offered Rates (HIBORs) generally track their US dollar (USD) counterparts under the Linked Exchange Rate System, shorter-tenor rates are also influenced by local supply of and demand for HKD funding. In September 2025, short-term HIBORs advanced higher, partly reflecting corporate funding needs by the quarter-end, before easing in October and November amid reduced equity-related demand. Short-term HIBORs firmed up again towards the 2025 year-end on seasonal factors, and then softened in early 2026 as seasonal liquidity pressures eased.

Going forward, heightened geopolitical risks and the military conflict in the Middle East, together with elevated uncertainty over the US trade policy and the sustainability of the A.I. boom, may increase fund flow volatility. Nonetheless, with its ample foreign exchange reserves and robust financial system, Hong Kong is well positioned to withstand the volatilities in fund flows without undermining financial stability.

Global equity markets recorded gains during the review period, though volatility intensified amid concerns over stretched valuations in A.I.-related firms and rising geopolitical tensions. The Hong Kong equity market posted its best annual performance in eight years in 2025. However, uncertainties in the external environment have increased volatility in the Hong Kong equity market during the review period. Despite the headwinds, the Hang Seng Index gained 6.2% from the end of August 2025 to the end of February 2026. Entering March 2026, the military conflict in the Middle East has contributed to heightened volatility across global equity markets, including Hong Kong.

Looking ahead, global market sentiment will hinge on trade policy developments, geopolitical risks, and the trajectory of US interest rates. A potentially prolonged military conflict in the Middle East could dampen investor confidence and increase volatility in oil prices, which could cloud the US inflation outlook and the path of US interest rates. Concerns about the valuations of A.I.-related firms and the sustainability of their heavy capital investment could fuel volatility in the global equity markets. Shifts in global capital flows, stemming from investors' pursuit of diversification amid elevated uncertainties, could also add to market volatility. Particular attention should be paid to risks associated with non-bank financial institutions, particularly private credit. As Box 2 suggests, the deep cross-border linkages between hedge funds and prime brokers could amplify contagion risks during periods of stress. In addition, expectations about the Renminbi (RMB) exchange rate could play a significant role in shaping Hong Kong's equity market dynamics.

The issuance of HKD-denominated debt securities rose by 16.6% year on year in 2025, primarily driven by issuers outside Hong Kong. Issuance of offshore Renminbi (CNH)-denominated debt securities in Hong Kong also expanded during the year. Looking ahead, the strong momentum in HKD debt securities issuance is expected to continue in the near term, while improved market depth could boost demand from both issuers and investors over the longer term. CNH debt securities issuance would be influenced by the movements in USD and RMB interest rates, while rising diversification needs among global investors are expected to support the long-term development of Hong Kong's CNH debt market. During the review period, several policy initiatives were introduced to develop Hong Kong's debt market. Several milestone bond issuances also took place, which solidified Hong Kong's status as a global leader in sustainable finance, Asia's leading international bond issuance hub, and a premier offshore RMB business centre.

The residential property market continued to recover, supported by improving market sentiment, robust transaction activity, and further stabilisation in housing prices. In the near term, although the housing market remains subject to a range of uncertainties, the Government's ongoing efforts to attract talents, investors and students are expected to provide sustained support to housing demand. Meanwhile, the CRE market continued to face headwinds, although Grade A offices have begun to show signs of improvement.

The aggregate pre-tax operating profit of retail banks grew by 1.4% in the second half of 2025, driven by higher net interest income and increased fees and commissions. This growth was partially offset by the decline in income from foreign exchange and derivatives operations. Total loans and advances of all authorized institutions (AIs) edged down by 0.2% in the second half of 2025. Nonetheless, for 2025 as a whole, total loan growth recorded a positive growth of 2.3%, reversing the 2.8% decline recorded in 2024. While the classified loan ratio edged up in the second half of 2025, the overall asset quality of the banking sector was manageable and provisions set aside by banks remained sufficient.

Overall, the Hong Kong banking sector remains liquid and well-capitalised. The average Liquidity Coverage Ratio of category 1 institutions reached 165.6% in the fourth quarter of 2025, well above the statutory minimum requirement of 100%. The total capital ratio of locally incorporated AIs stood at 25.1% at the end of 2025, significantly exceeding the international minimum requirement of 8%.

The HKMA and the banking sector have continued to support small and medium-sized enterprises (SMEs) to cope with the changing business environment. More sufficient and timely financial data can facilitate SMEs in obtaining bank credit. To address this, the HKMA launched Commercial Data Interchange (CDI) in October 2022 as part of its "Fintech 2025" Initiatives. As Box 4 demonstrates, CDI helps improve banks' access to consented SME data for credit assessments, thereby enabling banks to offer more favourable loan terms to SME borrowers.

Looking ahead, several downside risks, including uncertainties surrounding global trade tensions, future US interest rate movement, and subdued performance of certain local sectors, could continue to pose challenges to the Hong Kong banking sector. The recent Middle East conflicts also warrant close monitoring. Although the direct impact on the Hong Kong banking sector should be manageable, given its relatively modest cross-border exposures to the region, a prolonged conflict could disrupt global energy commodity supply chains and potentially weigh on global economic growth. Banks should stay vigilant in assessing the impacts of these risk factors on the asset quality of their loan portfolios.

The Half-yearly Report on Monetary and Financial Stability is prepared by the staff of the Research Department of the Hong Kong Monetary Authority