1. Summary and overview

Global economic growth generally held up well during the review period, but the disinflation path has been slow and bumpy. This, coupled with the potential for a resurgence in trade tensions which could lead to supply chain disruptions and higher tradable goods inflation, poses a key risk to the global economic and inflation outlook. With signs of labour market cooling down, the US Federal Reserve (Fed) delivered a 50-basis-point rate cut in September, but the pace of future rate cuts remains uncertain as it has to strike a balance between maintaining growth momentum and containing upside risks to inflation.

Hong Kong's exchange rate and interbank market continued to trade in a smooth and orderly manner. Total deposits increased in the first seven months of 2024 while bank credit declined amid weak credit demand. Meanwhile, the residential property market softened after improving somewhat following the policy relaxations announced in late February. Looking ahead, uncertainties over the future path of the US policy rate and geoeconomic fragmentation will continue to pose challenges to the Hong Kong banking sector. Banks should stay vigilant against the impact of these risk factors on the asset quality of their loan portfolios and continue to maintain sufficient provisioning coverage.

The external environment

During the review period, global economic growth generally held up well. In early August, global financial markets suffered from a sell-off amid an unwinding of Japanese yen carry trades and renewed concerns over a US recession, bolstering market expectations of significant monetary easing by the US Fed in 2024. While financial markets have since stabilised and the US Fed subsequently delivered a 50-basis-point rate cut in September, its pace of future rate cuts remains uncertain, as it needs to strike a balance between sustaining growth momentum and containing upside risks to inflation emanating from the stalling of services disinflation and the increased fiscal and trade policy uncertainties in the run-up to the US presidential election in November. Meanwhile, the still-high global interest rates are likely to weigh on the global commercial real estate (CRE) markets. Box 1 assesses the risks of forced property liquidations and credit downgrades of global real estate investment trusts (REITs) amid the CRE market downturn.

In emerging Asia, global market sell-offs in early August have heightened regional currency and equity volatility. However, such volatility has been contained, and the region's financial systems have remained resilient in general. Looking ahead, the region faces risks of weakened corporate debt servicing capacity amid still-high interest rates, as well as geopolitical uncertainties that could disrupt global supply chains and cause price spikes. Over the longer term, the region faces challenges from climate change, and will need to continue its efforts in greening its global value chains (GVCs), given its high participation in GVCs and the contribution of these GVCs to carbon emissions. Box 2 explores how GVCs have the potential to serve as conduits for improving the environmental, social and governance (ESG) practices of firms engaged in them.

In Mainland China, the overall economy grew by 5% year on year in the first half of 2024, keeping pace with the official annual growth target due in part to strengthened policy support. That said, the pace of the economic recovery has remained uneven, with solid external trade on the one hand offset by weak domestic demand and property market activities on the other. The near-term economic outlook still faces multiple challenges, which include insufficient domestic demand and an increasingly complicated geo-strategic environment (e.g. higher tariffs from the US and the European Union). Over the long term, as the economy shifts to high-quality development, the country's economic growth should be supported by the promotion of new quality productive forces and deepening reforms as emphasised at the Third Plenum.

The domestic economy

In Hong Kong, the economy maintained steady growth in the first half of 2024, with real gross domestic product (GDP) posting a year-on-year growth of 2.8% and 3.3% in the first and second quarters respectively. Economic growth was mainly driven by a surge in goods exports, fuelled by an improvement in external demand and an increase in electronics orders amid the ongoing tech cycle recovery. However, imports of travel services recovered at a faster pace than their export counterparts, resulting in a negative contribution of net exports of services to GDP growth. Domestically, private consumption expenditure lost momentum in the face of sluggish consumer sentiment, while investment spending remained under pressure due to tight financial conditions.

Looking ahead, economic growth is expected to remain moderate. Merchandise exports are expected to strengthen further on the back of robust external demand, particularly for electronic goods. Meanwhile, the Government's efforts in promoting mega events, coupled with the supportive tourism policy implemented by the Mainland authorities, will continue to bolster inbound tourism. On the other hand, the retail sector is likely to continue to face headwinds due to shifts in the consumption patterns of residents and inbound tourists, while capital spending may remain subdued amid the still-high interest rate environment.

Given the actual outturn in the first half of the year, the Government has maintained its real GDP growth forecast for 2024 at 2.5%–3.5%. However, the economic outlook is subject to a number of risks and uncertainties, including those related to the US policy rate path, global economic growth prospects, the rising trade tensions, as well as the upcoming US presidential election. To cultivate new growth areas, the Government has dedicated efforts to support research and development (R&D) in recent years. Box 3 analyses how R&D investment could help drive Hong Kong's long-term economic growth.

The labour market remained resilient, with the unemployment rate having stayed low at around 3.0% over the past few months. The size of the labour force increased slightly, although it has not yet returned to its pre-pandemic level. Looking ahead, the ongoing economic recovery may continue to lend support to labour demand, while the Government's various talent attraction and labour importation schemes should help alleviate manpower shortages and rejuvenate the working population.

On the price front, the underlying inflation rate remained modest, staying within the 0.8%–1.2% range in the first eight months of this year. In the near term, local inflation is expected to remain soft as receding external price pressures may help offset the upward pressures on domestic labour costs and housing rentals.

Monetary conditions and capital flows

The Hong Kong dollar (HKD) strengthened between late April and mid-May 2024, mainly supported by dividend-related funding demand. In early August, the HKD strengthened sharply as concerns of a possible US recession and expectations of faster and deeper US Fed rate cuts triggered an unwinding of carry trades and short HKD positions, and remained stable thereafter. As the Convertibility Undertakings have not been triggered since May 2023, the Aggregate Balance of the banking system remained little changed at HK$44.9 billion at the end of August 2024, and the day-to-day and interbank operations and settlement activities among banks have continued to operate in a smooth and orderly manner.

Hong Kong's interbank market also continued to trade in a smooth and orderly manner. Hong Kong Interbank Offered Rates (HIBORs) eased in early April as the seasonal funding demand faded after the end of the first quarter, followed by some tightening amid equity-related and dividend-related funding demand since late April. HIBORs eased again in early August after the dividend peak season. On the retail front, after the US Federal Reserve (Fed) lowered its policy rate in September 2024, many local banks reduced their Best Lending Rates by 25 basis points. Meanwhile, the average lending rate for new mortgages increased slightly from 4.13 to 4.14% between January and July 2024.

Hong Kong's offshore renminbi (CNH) liquidity pool expanded during the first seven months of 2024, with the total outstanding amount of renminbi customer deposits and certificates of deposit increasing to RMB1,185.6 billion at the end of July 2024. Both the amounts of outstanding renminbi loans and renminbi trade settlement continued to grow steadily. The average daily turnover of the renminbi Real Time Gross Settlement (RTGS) system stayed high at RMB3,327.1 billion during the first seven months of 2024.

Looking ahead, the continuing development of Hong Kong's CNH ecosystem will further reinforce Hong Kong's role as the leading CNH business hub. On liquidity, the expansion of the list of eligible collateral for HKMA's renminbi liquidity facility to include onshore renminbi (CNY) bonds issued by the Ministry of Finance and policy banks on the Mainland came into effect on 26 February 2024. Market response has been positive since the implementation, with banks in Hong Kong successfully using onshore bonds to obtain liquidity from the HKMA. On products, the continuous efforts to upgrade and expand the family of Connect schemes between the Mainland and Hong Kong, which include Swap Connect, Stock Connect, Bond Connect, and Cross-boundary Wealth Management Connect, will widen the spectrum of renminbi products and tools available for asset allocation and risk management, facilitating greater two-way traffic between the two markets. As for financial infrastructure, the Central Moneymarkets Unit (CMU) is also undergoing a major overhaul to enhance its operational capacity and product offerings, with the aim of better supporting the growth of renminbi bond issuances and associated custodian services. The Multiple Central Bank Digital Currency Bridge (mBridge) project had reached the Minimum Viable Product (MVP) stage as of June 2024. Further progress has been made to expand the scope of the e-CNY pilot in Hong Kong to facilitate the set up and the use of e-CNY wallets by Hong Kong residents, as well as the top-up of e-CNY wallets through Hong Kong's Faster Payment System (FPS). This can improve cross-border payment and settlement efficiency for commercial and retail users. With these developments, Hong Kong will continue to play a unique role in supporting Mainland's capital account opening, the development of the green finance market, as well as the Guangdong-Hong Kong-Macao Greater Bay Area and the Belt and Road initiatives.

Asset markets

The Hong Kong equity market experienced a notable rebound between April and May 2024 on the back of improved market sentiment. The Hang Seng Index subsequently consolidated, before picking up again in August. The global equity market continued to rally during the review period, despite a sharp decline in early August amid renewed concerns over the US economic outlook and the unwinding of yen carry trades following the interest rate hike by the Bank of Japan (BOJ). Overall, the Hang Seng Index increased by 8.9% from the end of February 2024 to the end of August 2024, while the MSCI World Index rose by 9.7% during the same period.

Yields of the 10-year US Treasury and the Hong Kong dollar 10-year Government Bond fluctuated during the review period, with a notable drop towards the end of July amid market concerns over the US economic outlook. Despite these fluctuations in interest rates, the debt market in Hong Kong continued to exhibit stable growth in the first half of 2024, supported by steady issuances.

Looking ahead, the near-term performance of the local equity market will remain subject to the volatility fueled by uncertainties surrounding the US economic outlook and the forthcoming US presidential election, as well as the potential further unwinding of yen carry trades in global financial markets and persistent geopolitical tensions. Furthermore, market expectations on policy measures by the Mainland authorities to support the Mainland economy will remain key drivers of sentiments in the local equity market. Meanwhile, the near-term prospects of the local debt market will continue to be influenced by the interest rate paths of major advanced economies.

During the review period, several policy initiatives were introduced to foster the development of green and sustainable finance in Hong Kong. These included the extension of the Green and Sustainable Finance Grant Scheme, the publication of the Hong Kong Taxonomy for Sustainable Finance, and a new offering of green bonds under the Government Sustainable Bond Programme (previously known as the Government Green Bond Programme). The latest green bond offering also included the inaugural offering of the 20-year and 30-year renminbi bonds, which helps to extend the offshore renminbi yield curve, further enrich the offshore renminbi product offerings, and promote renminbi internationalisation in an orderly manner.

The residential property market has retreated following a period of stabilisation supported by the policy relaxations announced in late-February 2024. The average monthly housing transaction volume dropped to 3,744 units in June to August, down from its recent peak of 8,551 units in April, as market sentiment faltered from May onwards amid renewed uncertainty surrounding the US policy rate path. With weakened market sentiment and pressure arising from the competitive pricing of new launches by property developers, secondary-market housing prices dropped by 5.7% from May to August, reversing the 2.4% increase recorded in March and April.

Alongside these housing price movements, the estimated number of residential mortgage loans (RMLs) in negative equity increased to 32,073 cases at end-March 2024, followed by a slight decline to 30,288 cases at end-June 2024. These cases were related to bank staff housing loans or RMLs under the Mortgage Insurance Programme (MIP), and their delinquency ratio remained low given the MIP's strict requirements relating to applicants' repayment ability. Furthermore, the macroprudential measures introduced by the HKMA since 2009 have been effective in keeping both the average loan-to-value (LTV) ratio and the average debt-servicing ratio (DSR) for new mortgages in check. This, together with the fact that over half of the private housing units did not carry any outstanding mortgages as of end-2023, indicates that the systemic risks relating to banks' RMLs have been properly managed on various fronts.

The near-term outlook for the residential property market is affected by a number of uncertainties and risks. Specifically, tight financial conditions and the accumulated supply in the primary market are likely to pose further headwinds to the market, although the start of the US Fed's easing cycle, the resilient labour market and the Government's policies to attract businesses and talents may provide some support to housing demand. Over the longer term, the outlook for the housing market will hinge on the supply-demand gap. According to the Government's projections, private housing completions, and thus housing supply in the market, are expected to remain high in the next few years.

In the commercial real estate market, transaction volumes remained subdued, with prices falling further and rentals staying soft across all the segments. The outlook for the market remains challenging in the near term. In particular, sluggish retail sales will continue to weigh on the retail premises segment, while the high vacancy rates, due partly to higher completions in recent years, may exert further pressures on both the capital and rental values of office spaces. That said, the Government's earlier inclusion of commercial real estate as a permissible investment in its new Capital Investment Entrant Scheme (CIES) may offer some support to the market. Meanwhile, the expansion of the Mainland China's Individual Visit Scheme (IVS) and the increased duty-free shopping allowance for Mainland tourists may help stimulate tourists' spending, thereby providing support to retail sales and the retail premises segment.

Banking sector performance

The pre-tax operating profits of retail banks grew moderately by 6.2% year-on-year in the first half of 2024, which improved the return on assets to 1.18% during the review period. The improvement in profits was driven by an increase in income from investments held for trading, which more than offset a decrease in net interest income and increases in total operating expenses and loan impairment charges. Reflecting faster growth in interest expenses than in interest income, the net interest margins of retail banks narrowed mildly in the first half of 2024 compared with the same period in 2023.

Partly reflecting subdued credit demand amid the high interest rate environment, bank credit declined modestly during the review period. On a half-yearly basis, total loans and advances of all authorized institutions (AIs) declined modestly by 1.9% in the first half of 2024, driven by decreases in both domestic loans (comprising loans for use in Hong Kong and trade financing) and loans for use outside Hong Kong. Meanwhile, the classified loan ratio of all AIs increased during the first half of 2024, but remained at a manageable level.

Overall, the Hong Kong banking sector remained robust and resilient, underpinned by strong capital and liquidity positions. The total capital ratio of locally incorporated AIs stood at a high 21.1% at the end of June 2024, well above the international minimum requirement of 8%. The average Liquidity Coverage Ratio of category 1 institutions and the average Liquidity Maintenance Ratio of category 2 institutions were 183.3% and 67.9% respectively in the second quarter of 2024, well above their statutory minimum requirements.

From a medium-term perspective, recent advances in technology and the rising adoption of digital innovations in the banking industry may help enhance banks' fundamentals and performance. Based on a sample of globally listed banks and the use of textual analysis, Box 4 provides some fresh empirical evidence to support the benefits of digital innovations. Notably, banks with a higher degree of digitalisation adoption, as reflected by a textual measure derived from banks' earnings call transcripts, tend to exhibit better performance and improved market valuations than other banks. Notwithstanding the benefits, new challenges and risks will inevitably emerge as technologies continue to evolve. To harness the benefits of innovation in a safe and sustainable manner, it is essential for banks and regulators to collaborate closely to ensure that key risk management principles are upheld appropriately.

Looking ahead, uncertainties over the future path of the US policy rate and geoeconomic fragmentation will continue to pose challenges to the Hong Kong banking sector, with the classified loan ratio expected to edge closer to the long-term historical average of 2%. Banks should stay vigilant against the impacts of these risk factors on the asset quality of their loan portfolios and continue to maintain sufficient provisioning coverage, particularly in view of the impact of the high interest rate environment on the debt servicing ability of corporates.

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