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# 1. Summary and overview

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*While global economic growth has been relatively steady, the world is bracing for more policy and economic outlook uncertainty as the Trump presidency begins in the US. Along with rising trade tensions, the uncertainty surrounding the US interest rate outlook has edged up, as the escalation of tit-for-tat tariff hikes has increased both the upside risk to US inflation and the downside risk to US economic growth. For emerging Asia, these uncertainties are posing significant headwinds to the regional economies and to fund flows.*

*Hong Kong's exchange rate and interbank markets continued to trade in a smooth and orderly manner. Total deposits increased during the review period, while bank credit declined, reflecting subdued credit demand driven in part by the high interest rate environment. Meanwhile, the residential property market was subdued in the third quarter of 2024 before showing signs of stabilisation after the initiation of the interest rate cut cycle in September. Looking ahead, uncertainties surrounding US trade policies and the future path of US interest rates may pose challenges to the Hong Kong banking sector on various fronts. Banks should remain vigilant and carefully assess the potential impacts of these risk factors on the asset quality of their loan portfolios.*

## **The external environment**

US trade policy uncertainty has risen notably under the new US administration. In view of the tariff hikes, the upside risk to the US inflation outlook has increased. Meanwhile, the escalation of tit-for-tat tariff hikes has increased the downside risk to US economic growth. These developments have increased the uncertainty surrounding the pace of the US Federal Reserve (Fed)'s interest rate cuts.

Meanwhile, the artificial intelligence (A.I.) development race has intensified among the major economies, and there are concerns that the increasing adoption of A.I. by investment funds may add to financial market volatilities, as they may be more prone to collective asset sales during times of market stress. Box 1 illustrates our in-house application of generative A.I. (GenA.I.) to examine this issue.

In emerging Asia, increased uncertainty surrounding US trade policy and the pace of the US Fed's interest rate cuts are weighing on the economic outlook for the region. Following the US presidential election in November 2024, Asian currencies have faced downward pressures, prompting several regional central banks to intervene to prevent excessive depreciation. The increased risk of trade conflicts has caused downside risks to the regional economic outlook to edge up, given the region's increased export dependence, reduced fiscal buffers, and constrained scope for regional central banks to cut rates amid concerns over fund flow volatility.

In Mainland China, economic growth picked up in the fourth quarter of 2024, riding on a comprehensive package of policies introduced since September 2024. Front-loaded orders arising from tariff concerns also supported the merchandise exports of Mainland China in the final quarter while the housing market showed

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some signs of stabilisation (Box 2 introduces a novel index developed to track the housing market sentiment, leveraging the HKMA's in-house GenA.I.). For 2024 as a whole, the economy grew by 5%, in line with the official target.

Moving into 2025, the official economic growth target has been set at around 5% for the third consecutive year. However, the economic outlook continues to face multiple challenges and uncertainties which include rising policy uncertainty and trade protectionism (e.g. tariff hikes from the US). In response, the authorities have vowed to adopt a more proactive fiscal policy and a moderately loose monetary policy, strengthen unconventional countercyclical adjustments, support private enterprises and expand domestic demand (especially consumption).

### **The domestic economy**

In Hong Kong, economic growth stayed moderate in the second half of 2024, with real gross domestic product (GDP) increasing by 1.9% and 2.4% year-on-year in the third and fourth quarters respectively. Exports of services improved sequentially as cross-border financial activities improved and inbound tourism continued to recover. Goods exports slowed down compared to the first half of 2024, partly due to a softening economic environment in some major markets. Domestically, investment spending improved during the period despite a fall in the fourth quarter alongside a contraction in building and construction activities. Meanwhile, the changes in residents' consumption patterns persisted as a headwind to private consumption, although the fourth quarter saw initial signs of stabilisation. For 2024 as a whole, real GDP increased by 2.5%, following a growth of 3.2% in 2023.

Looking ahead, the Hong Kong economy is expected to grow further at a moderate pace in 2025. While merchandise exports may be impacted by the intensifying trade conflicts, services exports are expected to benefit from the ongoing recovery of inbound tourism amid the supportive measures from the Mainland authorities and the Government's strenuous efforts to revitalise Hong Kong's tourism sector. Box 3 analyses the potential economic benefits of digitalising trade documents in Hong Kong, which could further consolidate the city's status as an international trading hub by enhancing the efficiency of its trade ecosystem. In addition, Mainland's proactive policies to boost its economy should bolster Hong Kong's business sentiment, thereby strengthening private investment. That said, the shift in residents' consumption patterns may continue to restrain the recovery of private consumption. Against this backdrop, the Government forecasts real GDP growth for the whole of 2025 in the range of 2%–3%, with the growth outlook being subject to a number of risks and uncertainties, including those related to global growth prospects, the US trade policy and the pace of the US Fed's interest rate cuts.

The labour market continued to be resilient, with the unemployment rate remaining low at 3.2% in February 2025. Looking ahead, sustained economic growth is expected to underpin labour demand, although some sectors could be exposed to risks associated with intensifying trade tensions.

Underlying inflation has remained mild over the past few months despite some upward pressure from rising housing rentals. Looking ahead, overall inflation is expected to stay modest as external price pressures are likely to be contained, despite uncertainties surrounding global commodity market developments, mitigating the upward pressure on domestic costs amid continued economic growth.

### **Monetary conditions and capital flows**

The Hong Kong dollar (HKD) strengthened in late September 2024, mainly supported by a surge in local stock market activities following the announcement of a series of economic stimulus measures in Mainland China. The HKD softened in early 2025 but strengthened thereafter amid strong performance of the local stock market. As the Convertibility Undertakings (CUs) have not been triggered since May 2023, the Aggregate Balance of the banking system remained little changed at HK\$44.7 billion at the end of February 2025, 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. Short-term Hong Kong Interbank Offered Rates (HIBORs) tightened temporarily in late September 2024 due to buoyant equity market and quarter-end funding demand, firmed up again amid thinner liquidity ahead of the year-end, and then softened in early 2025 as seasonal liquidity tightness eased. On the retail front, following the US policy rate cuts, many banks reduced their Best Lending Rates three times or by a total of 62.5 basis points from September to December 2024. At the end of the review period, the Best Lending Rates in the market ranged from 5.25%–5.75%. Meanwhile, the average lending rate for new mortgages decreased from 4.14% in July 2024 to 3.51% in January 2025. Banks will decide when and by how much to adjust their lending and savings rates, taking into account factors such as funding supply and demand in the interbank market, the level of interbank rates and their own funding cost structures.

Following the expansion in the first half of 2024, Hong Kong's offshore renminbi (CNH) liquidity pool declined modestly during the review period, with the total outstanding amount of renminbi customer deposits and certificates of deposit

decreasing to RMB1,131.8 billion at the end of January 2025. 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 RMB3,097.5 billion in 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 HKMA's new RMB Trade Financing Liquidity Facility, which was launched in February 2025, will further enhance the liquidity of Hong Kong's CNH market by providing banks with a stable source of relatively lower-cost RMB funds to support trade finance services. 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 RMB products and tools available for asset allocation and risk management, facilitating greater two-way traffic between the two markets. As for financial infrastructure, CMU OmniClear and Hong Kong Exchanges and Clearing Limited (HKEX) signed a Memorandum of Understanding (MOU) in March 2025 to deepen their collaboration in enhancing the post-trade securities infrastructure of Hong Kong's capital markets, and will explore and pursue cooperation in areas such as expanding the use of Mainland bonds as collateral. The HKMA and the People's Bank of China (PBoC) are working closely together to implement the linkage of faster payment systems in the Mainland and Hong Kong (i.e. the Mainland's Internet Banking Payment System (IBPS) and Hong Kong's Faster Payment System (FPS)), supporting broader economic cooperation and exchange between the two places. With these developments, Hong Kong will continue to play a unique role in supporting Mainland's capital account opening, as well as the Guangdong-Hong Kong-Macao Greater Bay Area and the Belt and Road initiatives.

## Asset markets

The Hong Kong equity market rose notably between September and early October 2024, driven by the Mainland's supportive policy measures and the first interest rate cut by the US Fed in more than four years. Although the local equity market softened subsequently, it performed strongly from the middle of January 2025, boosted by the positive market sentiment following China's recent advancements in A.I.. From the end of August 2024 to the end of February 2025, the Hang Seng Index increased by 27.5%, outperforming the MSCI World Index, which rose moderately by 3.9% during the same period.

Despite an interest rate cut by the US Fed in September 2024, the yield of the US 10-year Treasury Notes reversed its downward trend and rose from the middle of September on concerns over rising inflation risks in the US under the new US administration. The yield declined notably in February 2025 as soft economic data sparked concerns over the US economic outlook. The yield of the 10-year HKD Hong Kong Special Administrative Region Government Bonds mirrored the movements of its US counterpart. The average yield of HKD corporate bonds also followed the movements of the yield of the US Treasury Notes of similar maturity, maintaining a narrow yield spread since 2024. Despite volatility in interest rates, new issuances of CNH debt securities in Hong Kong and HKD debt securities continued to grow steadily in 2024.

Looking ahead, developments in the external environment will continue to influence the performance of the local equity market. Changes in fiscal and trade policies under the new US administration may lead to higher uncertainties over inflation risks and thus the future trajectory of interest rates in the US. This could have significant implications for capital flows in the global financial market. Additionally, the potential resurgence of trade tensions and

growing geoeconomic fragmentation could pose downside risks to the global financial market, including Hong Kong's equity market. As for the debt market, the interest rate paths of major advanced economies will continue to influence the issuance of HKD debt securities in the near term. Meanwhile, CNH debt securities issuance in Hong Kong could benefit from a moderately loose monetary policy in Mainland China in 2025.

During the review period, policy initiatives were introduced to foster local debt market developments. These include The Hong Kong Mortgage Corporation Limited's second issuance of infrastructure loan-backed securities, the first CNH bond issuance in Hong Kong by the People's Government of Guangdong Province, and the Digital Bond Grant Scheme, launched by the HKMA, which aims to foster the growth of the digital securities market and promote wider adoption of tokenisation technology in capital market transactions. Furthermore, the official launch of direct linkage between the Central Moneymarkets Unit of Hong Kong and the Central Securities Depository System of Macao in January 2025 will provide a cross-border investment and financing channel, enabling investors from both markets to participate in each other's bond market with greater ease and efficiency.

After a subdued third quarter in 2024, the residential property market regained its footing in the fourth quarter, primarily driven by the initiation of the interest rate cut cycle in September. Notably, average monthly housing transactions increased to 5,033 units in the fourth quarter from 3,408 units in the preceding quarter, while secondary-market housing prices also stabilised and increased mildly in the fourth quarter. For the full year of 2024, the market recorded a significant 23.5% year-on-year increase in total housing transactions to 53,099 units. However, residential property prices declined by 7.1% amid continued adoption of

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competitive pricing strategies by developers in launching new projects. As the market entered 2025, transaction volumes edged down in the first two months of the year, reflecting softened market sentiment amid concerns over a slower pace of the US Fed's interest rate cuts and the holiday effect. In tandem, housing prices also eased down slightly by 1.6% during the same period. Nevertheless, the market turned active in early March following the adjustments to stamp duties for properties at lower values as announced in the 2025–26 Budget.

Taking into account the latest market developments and the stability of the banking system, the HKMA announced further adjustments to the countercyclical macroprudential measures for property mortgage loans on 16 October 2024 with immediate effect. Specifically, the maximum loan-to-value (LTV) ratio and the debt-servicing ratio (DSR) limit have been reverted to the pre-2009 levels before the countercyclical macroprudential measures were first introduced, and standardised at 70% and 50%, respectively, for all properties.

To support stage payment homebuyers who purchased uncompleted residential properties during 2021 to 2023 to complete their transactions, while continuing to ensure the proper risk management of banks' property mortgage lending business, the HKMA also introduced a one-off special scheme on 4 December 2024, under which banks would be allowed to offer mortgage loans with a maximum LTV ratio of 80% and a DSR limit of 60% to eligible homebuyers. Notwithstanding these adjustments, the average LTV ratio and DSR for mortgages remained in check, and the HKMA considered that the Hong Kong banking sector continued to have ample buffers to cope with any challenges arising from a sharp correction in property prices.

The near-term outlook for the residential property market is subject to a host of uncertainties and risks. On one hand, the existing inventories in the primary market, together with increasing uncertainty surrounding the pace of the US Fed's interest rate cuts, may continue to exert downward pressure on housing prices in the near term. On the other hand, the Government's ongoing initiatives to attract businesses and talents should provide some support for housing demand. Over the longer term, the outlook for the residential property market will depend on the supply-demand gap. According to the Government's projections, the private housing supply is expected to remain abundant in the coming years.

The commercial real estate market continued to be sluggish in the second half of 2024, characterised by low transaction volumes and subdued prices and rentals across all segments. The near-term outlook for the market is expected to remain challenging. Specifically, the office segment is likely to continue facing significant headwinds due to the persistently high vacancy rate and the prevalence of remote working. Meanwhile, the retail premises segment may continue to be impacted by shifting consumption patterns among visitors and residents. Nevertheless, the supportive measures introduced by the Mainland authorities to boost Hong Kong's tourism sector and Mainland's economic stimulus measures may provide some relief to the market. Taking into account the high vacancy rates of offices in recent years and the relatively ample supply in the next few years, the Government announced the suspension of commercial site sales in the upcoming fiscal year, as well as the consideration of rezoning some of the commercial sites into residential use and allowing greater flexibility of land use.

## Banking sector performance

The pre-tax operating profits of retail banks grew by 10.9% year-on-year in the second half of 2024, which improved the return on assets to 1.05% compared with 0.99% in the same period of 2023. The improvement was mainly attributable to increases in income from investment held for trading and income from foreign exchange and derivatives operations, as well as a decrease in loan impairment charges. These factors helped offset the decline in net interest income alongside a narrowing of the net interest margin of retail banks.

As credit demand remained subdued amid a still relatively high interest rate environment, total loans and advances of all authorized institutions (AIs) edged down by 0.9% in the second 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 to 1.96% at the end of 2024, hovering around the long-term average of 2%, but the overall asset quality of the banking sector remained manageable.

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 high at 21.8% at the end of 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 178.4% and 67.0% respectively in the fourth quarter of 2024, well above their statutory minimum requirements.

Box 4 introduces a framework that utilises GenA.I. tools to extract useful insights from banks' earnings call transcripts, in a way that can enhance monitoring tools for assessing systemic risks and emerging vulnerabilities in the banking sector. The framework is shown to be capable of identifying key and emerging risks facing the global banking sector. Our latest assessment suggests that geopolitical risks and credit risks are two important risk factors that have attracted increasing attention in the global banking industry at the current juncture. Therefore, a closer monitoring of these areas may be warranted.

Looking ahead, a number of downside factors, including uncertainties surrounding US trade policies and the future path of US interest rates may pose challenges to the Hong Kong banking sector on various fronts. Banks should remain vigilant and carefully assess the potential 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*