1. Summary and overview

In the period under review, the global economic environment experienced some turbulence due to heightened uncertainty over US trade policy. Widespread imposition of tariffs and expansionary fiscal policies by the US government have rekindled US inflation concerns, prompting the Federal Reserve (Fed) to adopt a more cautious monetary policy approach. The US tariffs have also brought significant headwinds to Asia-Pacific (APAC) economies, with signs of strain emerging in some of the more externally-exposed segments. Despite these uncertainties, global financial markets have remained buoyant, raising concerns over mispricing of risks and market volatility ahead.

Hong Kong's exchange rate and money markets continued to trade in a smooth and orderly manner. Bank credit reverted to positive growth during the review period while total deposits continued to increase. Furthermore, residential property market activities have improved in the face of easing financial conditions, and housing prices have also shown further signs of stabilisation. Looking ahead, uncertainties over global trade tensions, potential risks arising from fund flow volatility, and the subdued performance of some local economic sectors, will continue to pose challenges to the Hong Kong banking sector. Banks should stay vigilant in assessing the impacts of these risk factors on the asset quality of their loan portfolios.

The global economy is navigating significant trade policy headwinds after the US government introduced reciprocal tariffs in early April. The tariff measures, coupled with expansionary US fiscal policies, have rekindled US inflation concerns and prompted the Fed to adopt a more cautious monetary policy approach. With heightened uncertainty on the one hand, and buoyant global markets on the other, there is the potential for the mispricing of risks and market volatility.

Apart from these macroeconomic risks, cyber risks have become a growing concern for financial stability. The increasing frequency and severity of cyber incidents that affect financial institutions may erode their clients' confidence and trigger abrupt withdrawals of funding. Box 1 analyses the liquidity risks of investment funds resulting from cyber incidents.

Growth in APAC economies remained resilient in the first half of 2025, but signs of strain have emerged in some more externally-exposed segments. The imposition of US tariffs may also impact the region's integrated supply chain networks. Box 2 examines the most recent trends and developments relating to greenfield foreign direct investment into the region and discusses their policy implications.

In Chinese Mainland, economic growth remained solid at 5.3% year on year in the first half of 2025, in line with the official annual growth target of around 5%. In response to the US tariff hikes, the authorities stepped up policy support and prioritised consumption, particularly of services. Merchandise exports performed better than expected due to export front-loading and market diversification. However, the economic outlook continues to face uncertainties and risks, such as potential US tariffs and a weak local housing market.

In Hong Kong, the economy registered robust growth in the first half of 2025, driven by resilience in goods exports as well as improvement in domestic demand. Looking ahead, the widespread imposition of US tariffs is likely to weigh on merchandise exports growth. However, multifaceted supportive measures, coupled with Chinese Mainland's economic stimulus measures, may help boost business sentiment. The outlook is subject to various external risks and uncertainties, especially those related to US trade policies and the pace of the US interest rate cuts.

The Hong Kong dollar (HKD) exchange and money markets continued to trade in a smooth and orderly manner. The HKD firmed in April due to buoyant capital market activities. In early May, amid sharp appreciation of some Asian currencies and continued equity-related demand, the HKD strengthened further and the strong-side Convertibility Undertaking (CU) was triggered four times. Thereafter, Hong Kong Interbank Offered Rates (HIBORs) softened and widened negative HKD-USD interest rate spreads incentivised carry trade activities that weakened the HKD. The weak-side CU was triggered twelve times between late June and mid-August.

While 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. Short-term HIBORs declined in May as liquidity condition eased, and picked up between late June and end-August with the reduction of the Aggregate Balance. The HKMA has continued to closely engage with banks, reminding them not to be concerned about the perceived "stigma effect" of tapping into its liquidity facilities. Box 3 studies the usage of the Discount Window and the stigma effect in Hong Kong from 2018 to 2024.

Looking ahead, heightened uncertainty over the US trade policy and divergences in the monetary policies of major economies may increase fund flow volatility. Nonetheless, with its ample foreign reserves position and robust financial system, Hong Kong is well positioned to withstand the volatilities in fund flows without compromise to its financial stability.

Amid heightened uncertainty over US trade policy, the Hong Kong equity market mirrored global declines in early April before rebounding. Looking ahead, equity market sentiment is expected to remain highly sensitive to US trade policy developments and their potential impact on inflation and monetary policy. In addition, the outlook for Chinese Mainland economy and global fund flows driven by diversifications will be important drivers for the Hong Kong equity market.

The issuance of HKD debt securities grew steadily in the first half of 2025, partly supported by lower issuing costs. Meanwhile, the issuance of offshore Renminbi (CNH) debt securities in Hong Kong slowed down slightly in the first half of 2025, after reaching a peak in 2024. Going forward, investor diversification across asset markets and the moderately loose monetary policy in Chinese Mainland may lend support to CNH debt market development. In addition, the latest expansion of the Southbound Bond Connect investor scope could help increase Hong Kong's attractiveness to bond issuers and global investors.

Residential property market activities have improved amid eased financial conditions, with housing prices showing further signs of stabilisation. In the near term, despite some uncertainties and risks relating to the economic outlook, the Government's ongoing policies to attract businesses and talents should continue to stimulate housing demand. On the other hand, the commercial real estate (CRE) market remained under pressure, with prices and rentals both exhibiting continuous adjustments amid high vacancy rates.

The pre-tax operating profits of retail banks grew by 13.4% year on year in the first half of 2025, boosted by higher incomes from foreign exchange and derivatives operations as well as fees and commissions. Total loans and advances of all authorized institution (AIs) also reverted to positive growth of 2.5% in the first half of 2025, and total deposits continued to increase. While the classified loan ratio continued to face upward pressure during the first 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 continued to be liquid and well capitalised. The average Liquidity Coverage Ratio of category 1 institutions was 172.8% in the second quarter of 2025, well above the statutory minimum requirement of 100%. The total capital ratio of locally incorporated AIs stood at 24.4% at the end of June 2025, well above the international minimum requirement of 8%.

From a medium-term perspective, the growing digitalisation of the financial industry has made financial institutions more dependent on third-party information communication and technology (ICT) providers, potentially exposing them to higher systemic operational risks, as service disruptions of major third-party providers could affect the operations for a large number of financial institutions. Box 4 examines the extent of ICT third-party dependency in the financial industry in the Asia Pacific region, and discusses the potential financial stability implications.

Looking ahead, several downside risk factors will continue to pose challenges to the Hong Kong banking sector, including uncertainties over global trade tensions, potential risks arising from fund flow volatility, and the subdued performance of some local economic sectors. Banks should remain 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