INTERNATIONAL MONETARY FUND

IMF Country Report No. 25/15

PEOPLE'S REPUBLIC OF CHINA—HONG KONG SPECIAL ADMINISTRATIVE REGION

2024 ARTICLE IV CONSULTATION DISCUSSIONS—PRESS RELEASE; AND STAFF REPORT

January 2025

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of 2024 Article IV consultation with People's Republic of China—Hong Kong Special Administrative Region, the following documents have been released and are included in this package:

- A **Press Release**
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on a lapse-of-time basis, following discussions that ended on November 22, 2024, with the officials of People's Republic of China—Hong Kong Special Administrative Region on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on December 17, 2024.
- An **Informational Annex** prepared by the IMF staff.

The documents listed below have been or will be separately released.

Selected Issues

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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International Monetary Fund
Washington, D.C.

PRESS RELEASE

PR25/006

IMF Executive Board Concludes 2024 Article IV Consultation Discussions with the People's Republic of China—Hong Kong Special Administrative Region

FOR IMMEDIATE RELEASE

Washington, DC – January 23, 2025: The Executive Board of the International Monetary Fund (IMF) concluded on January 14, 2025, the Article IV consultation discussions[1] with the People's Republic of China—Hong Kong Special Administrative Region and considered and endorsed the staff appraisal without a meeting on a lapse-of-time basis.[2]

Hong Kong SAR's economy is on a path of gradual but uneven recovery following three years of recession since 2019. The removal of COVID-related restrictions in early 2023 resulted in a strong rebound in domestic demand and inbound tourism in 2023H1, and decline in unemployment rate to historical lows. However, the recovery has since lost momentum with domestic demand softening amid multiple headwinds, including the high interest rate environment and continued adjustment in the property market. Increased regional competition has also weighed on economic activity by putting pressure on some of the territory's traditional growth engines. The financial system has remained resilient, supported by strong institutional frameworks and substantial capital and liquidity buffers, while the Linked Exchange Rate System continued to function smoothly.

With domestic demand remaining weak, real GDP growth is estimated to have moderated to 2.7 percent in 2024 from 3.3 percent in 2023. Over the medium term, growth is expected to modestly slow to around 2½ percent, driven by demographic headwinds and lower contribution of additional physical capital. The output gap is projected to continue narrow and close by 2029, with inflation projected to rise gradually to around 2½ percent.

The outlook is subject to high uncertainty, with the balance of risks tilted to the downside. Key downside risks include a sharper-than-expected slowdown in Mainland China due to escalation of trade tensions or a deeper and more protracted adjustment in the property market. Tighter-for-longer monetary policy in the U.S., rising geoeconomic fragmentation pressures, and increased regional competition could also weigh on growth. On the upside, a meaningful improvement of consumer and business confidence in Mainland

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. At the request or with the consent of the member, IMF staff may hold separate discussions with respect to territories or constituent parts of a member. These Article IV consultation discussions form a part of the member's Article IV consultation. In such cases, a staff team visits the territory or constituent part, collects economic and financial information, and discusses with officials the territory's or constituent part's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board, which in turn constitutes an integral part of the member's AIV consultation for the relevant cycle.

[2] The Executive Board takes decisions under its lapse-of-time procedure when the Board agrees that a proposal can be considered without convening formal discussions.

China, deeper integration with the Greater Bay Area, increased investment in high value industries, and sustained inflows of skilled workers could support stronger growth.

Executive Board Assessment

In concluding the 2024 Article IV consultation discussions with Hong Kong Special Administrative Region (SAR), Executive directors endorsed staff appraisal as follows:

Hong Kong SAR's economy is recovering gradually after a protracted period of shocks, but emerging and longer-term challenges require close attention. Hong Kong SAR's economic recovery is underway, but momentum has flagged recently amid tight financial conditions, continued adjustment in the property sector, and a challenging environment for SMEs. Moreover, traditional growth drivers like logistics and trade are under pressure from regional competition while the territory's rapid aging and slowing labor force growth pose further challenges. Notwithstanding these developments, the financial system has remained resilient, supported by robust institutional frameworks, ample policy buffers, and a smooth functioning of the LERS. The preliminary assessment for 2024 suggests that Hong Kong SAR's external position is in line with fundamentals and desirable policies.

Growth is projected to moderate gradually over the forecast horizon with risks skewed to the downside. Growth is projected to stand at 2.7 percent in 2025 and decelerate modestly to around 2½ percent over the medium term reflecting rapid population aging and slower capital accumulation. The outlook is subject to a high uncertainty with key downside risks emanating from a sharper-than-expected slowdown in Mainland China due to escalation of trade tensions or a deeper and more protracted adjustment in the property market. Longer-than-expected period of tight monetary policy in the U.S., rising geoeconomic fragmentation pressures, and increased regional competition could also weigh on growth. Financial vulnerabilities in some areas are elevated, but systemic risk in the financial sector is assessed as manageable.

The medium-term fiscal consolidation path is appropriate, but revenue mobilization efforts need to be stepped up to meet aging-related and investment spending needs. The plan to delay the attainment of a balanced budget until FY2027/28 is appropriate given the economic slack and the need to protect social welfare spending. However, given the mounting aging-related expenditure and critical investment plans, adherence to the authorities' balanced budget rule will require a larger and more stable revenue base. This could be achieved by increasing the progressivity of personal income tax, raising excise taxes, and introducing a VAT and taxes on capital gains and dividends. Steps to expand the coverage of social safety nets and increase their adequacy are also needed.

While the banking sector is well-capitalized and profitable, proactive efforts to monitor emerging risks are needed. With local firms seeing weakening debt servicing capacity and rising liquidity risk, supervisors should ensure that bank apply prudent risk management, including in expected loss recognition and provisioning. Policy support to SMEs should be well-calibrated to strike a proper balance between providing necessary support and facilitating an orderly exit of non-viable firms. Prioritization of systemic risk assessments for NBFIs and high-risk activities is needed, augmented with enhanced data collection and stress testing, both at system-wide and sector specific levels. Ensuring that climate risks are integrated into financial institutions' risk management practices will help to support systemic risk surveillance efforts.

Further macroprudential easing should be calibrated carefully, while public housing supply should be further expanded to alleviate affordability pressures. The risks of a sharp and disorderly house price correction and speculative demand have eased, justifying the recent abolition of demand-side management measures and relaxation of macroprudential policies. Further policy easing should be carefully designed to maintain prudent underwriting standards and avoid excessive risk-taking. Continued efforts are needed to expedite the production of public housing and strictly enforce eligibility criteria to reduce social pressures.

Creating a vibrant, well-regulated digital and sustainable finance ecosystem would reinforce the territory's status as an international financial center. Recent efforts to step up the regulation of the fast-evolving intermediation of crypto assets are welcome, and should be part of a comprehensive regulatory strategy that includes a risk-based approach for stablecoin issuers, close cross-sectoral monitoring, and continued supervisory efforts to ensure financial institutions appropriately manage risks. Continued improvements in transparency regarding climate-related risks will strengthen the climate information infrastructure and help position Hong Kong SAR as a global green and sustainable finance hub.

The GBA initiative has the potential to lift growth prospects by creating a new global technology cluster and attracting skilled labor. A critical priority is to mobilize private sector-led R&D, leveraging on the territory's key strengths in finance, its well-regarded academic institutions, and the pro-market legal framework. Encouraging private investment would support Hong Kong SAR's competitiveness and limit potential adverse side effects that could accompany integration, including displacement of some activities. Efforts to attract skilled labor should be continuously monitored to ensure the talent attraction programs meet their objectives. At the same time, steps are needed to raise labor force participation, particularly among older adults and women.

Continued efforts are needed to address long-term challenges posed by climate change. To mitigate the risk of falling short of emissions reduction targets, the authorities should prioritize regional collaboration with Mainland China to develop zero-carbon energy and improve energy efficiency in aging and poorly maintained buildings. Incentivizing energy saving and green transportation with additional forms of carbon pricing mechanisms can also be considered. Finally, continued efforts to bolster infrastructure and enhance resilience against climate-related risks are also important.

Hong Kong SAR—Selected Economic and Financial Indicators, 2019-29

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
						Projections					
NATIONAL ACCOUNTS											
Real GDP (percent change)	-1.7	-6.5	6.5	-3.7	3.3	2.7	2.7	2.6	2.5	2.5	2.4
Private consumption	-0.8	-10.6	5.6	-2.2	7.7	-0.7	0.5	1.0	1.4	1.9	1.9
Government consumption	5.1	7.9	5.9	8.0	-4.3	0.4	-0.5	-0.5	-0.2	0.0	0.3
Gross fixed capital formation	-14.9	-11.1	8.3	-7.4	11.1	3.6	7.7	8.1	3.6	1.5	1.6
Inventories (contribution to growth)	-0.5	1.8	-1.8	-0.9	-0.5	0.2	1.1	0.0	0.0	0.0	0.0
Net exports (contribution to growth)	2.2	0.2	2.8	-1.3	-2.5	2.3	0.0	0.6	1.0	1.0	0.8
Output gap (in percent of potential GDP)	-2.5	-7.3	-2.3	-4.1	-2.5	-2.3	-1.7	-1.1	-0.6	-0.2	0.0
LABOR MARKET											
Employment (percent change)	-0.3	-4.7	-0.6	-1.6	2.7	1.1	1.0	-0.1	-0.2	-0.1	-0.1
Unemployment rate (percent, period average)	2.9	5.8	5.2	4.3	2.9	2.8	2.7	2.7	2.7	2.7	2.7
Real wages (percent change)	0.1	2.5	-0.5	-1.4	1.4	0.9	1.2	1.3	1.3	1.3	1.3
PRICES											
Inflation (percent change)											
Consumer prices	2.9	0.3	1.6	1.9	2.1	1.8	2.3	2.4	2.5	2.5	2.5
GDP deflator	2.0	0.6	0.7	1.7	2.8	2.3	2.3	2.4	2.5	2.4	2.5
GENERAL GOVERNMENT											
Consolidated budget balance (percent of GDP) 1/	-0.6	-9.4	0.0	-6.7	-5.8	-5.2	-3.0	-1.7	0.1	1.3	1.1
Revenue	20.8	21.1	24.2	22.1	18.4	19.4	20.6	21.5	22.0	22.4	22.4
Expenditure	21.4	30.5	24.2	28.9	24.2	24.6	23.6	23.2	21.8	21.1	21.4
Fiscal reserves (as of end-March, percent of GDP)	40.8	34.7	33.4	29.7	24.6	21.3	20.0	19.7	19.7	19.7	19.3
FINANCIAL 2/											
Interest rates (percent, period average)											
Best lending rate	5.1	5.0	5.0	5.1	5.8	5.6	…	…	…	…	…
Three-month HIBOR	2.1	1.1	0.2	2.1	4.6	4.4	…	…	…	…	…
10-year Treasury bond yield	1.6	0.7	1.2	2.8	3.6	3.0	…	…	…	…	…
MACRO-FINANCIAL 2/											
Loans for use in Hong Kong SAR (excl. trade financing)	7.4	2.1	4.3	0.9	-0.4	1.7	…	…	…	…	…
House prices (year-on-year percent change for last quarter)	3.8	0.2	3.7	-13.6	-7.1	-13.0	…	…	…	…	…
Credit-to-GDP gap 3/	21.2	23.9	11.5	3.2	-14.5	-38.9	…	…	…	…	…
EXTERNAL SECTOR											

Merchandise trade (percent change)											
Export value	-4.1	-1.5	26.3	-8.6	-7.8	7.2	1.7	3.1	3.2	3.0	3.0
Import value	-6.5	-3.3	24.3	-7.2	-5.7	3.1	3.0	3.5	3.7	3.7	3.9
Current account balance (percent of GDP)	5.9	7.0	11.8	10.2	9.2	12.0	10.6	10.2	10.0	9.9	9.5
Foreign exchange reserves											
In billions of U.S. dollars (end-of-period)	441	492	497	424	426	439	453	477	503	529	544
In percent of GDP	121	143	135	118	112	109	108	108	108	108	106
Net international investment position (percent of GDP)	432	615	574	492	468	457	446	435	424	413	403
EXCHANGE RATE											
Market rate (HK$/US$, period average)	7.836	7.757	7.773	7.831	7.830	…		…	…	…	…
Real effective rate (period average, 2010=100)	117.7	116.9	111.7	115.8	119.6	…	…	…	…	…	…

Sources: Haver Analytics; BIS; CEIC; HKSAR Census and Statistics Department; and IMF staff estimates.
1/ Before issuance and repayment of government bonds and notes.
2/ Based on loans for use in Hong Kong SAR, excluding trade financing.
3/ Using latest data available for 2024.

INTERNATIONAL MONETARY FUND

PEOPLE'S REPUBLIC OF CHINA—HONG KONG SPECIAL ADMINISTRATIVE REGION

STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION DISCUSSIONS

December 17, 2024

KEY ISSUES

Overview. Hong Kong SAR's economy is on a path of gradual but uneven recovery following a protracted period of shocks. While the unemployment rate has declined to historical lows, employment loss has been sizable and domestic demand has remained weak amid tight financial conditions and property market downturn, both locally and in Mainland China. The territory's integration with Mainland China, including in the context of the Greater Bay Area (GBA) initiative, has significantly increased in recent years, but rising regional competition has put pressure on some of its traditional growth engines, prompting the authorities to pursue new sources of growth, including from innovative, technology-driven sectors.

Outlook and risks. The recovery is projected to continue because of the expected easing of financial conditions and the related pickup in private domestic demand, but rapid aging will weigh on medium-term growth. The outlook is subject to high uncertainty, with key downside risks stemming from a sharper-than-expected slowdown in Mainland China due to internal or external factors. Tighter-for-longer monetary policy in the U.S., the direct impact of rising geoeconomic fragmentation pressures, and increased regional competition could also weigh on growth. Financial vulnerabilities in some areas are elevated, but systemic risk in the financial sector is assessed as manageable.

Policies. Policy priorities include supporting the recovery, managing financial stability risks, and addressing structural challenges to boost the territory's long-term competitiveness:

- **Fiscal policy**. Return to a balanced budget gradually to ensure that public sector support is not withdrawn too fast. Broaden and increase government revenue, including by increasing the progressivity of the tax system, to counter rising aging-related spending pressures and reduce reliance on the property market. Expand the coverage of social safety nets and increase their adequacy.

- **Financial and exchange rate policies**. Closely monitor risks, including from weakening debt service capacity of local and Mainland China borrowers, and non-bank financial institutions. Further strengthen the regulatory and supervisory frameworks to safeguard financial stability, and reinforce Hong Kong SAR's role as an international financial center by creating a vibrant climate and digital finance ecosystem. The Linked Exchange Rate System remains appropriate and should be maintained as an anchor for economic and financial stability.

- **Property market.** Calibrate macroprudential measures to balance adjustment pressures and stability risks in the private real estate market. Continue boosting public housing supply to mitigate affordability pressures.

- **Structural and climate policies.** Continue to encourage talent immigration and increases in labor force participation to counter demographic headwinds. Diversify the sources of growth, including by leveraging on the GBA initiative, focusing on supporting innovation and productivity growth. Improve resilience to climate risks and further reduce carbon emissions by incentivizing energy saving and prioritizing collaboration with Mainland China to increase the use of zero-carbon energy.

Approved By
Thomas Helbling (APD) and Fabian Valencia (SPR)

Discussions took place in Hong Kong SAR and Shenzhen, PRC during November 11-22, 2024. The team comprised Nir Klein (head), Henry Hoyle, Narayanan Raman (all APD), Fozan Fareed (STA) and Sally Chen (resident representative, MCM). Fan Zhang (deputy resident representative, APD) also participated in some of the meetings. The mission met with Financial Secretary Paul Chan, Hong Kong Monetary Authority Chief Executive Eddie Yue, senior officials, and private sector representatives. Steven Lam (OED) joined the official meetings. Phakawa Jeasakul (MCM), Tommy Lee, Alessandra Balestieri, Judee Yanzon (all APD), Atis Lee, Hong Xiao, and Jing Zhou (all Resident Representative's Office) provided support to the mission.

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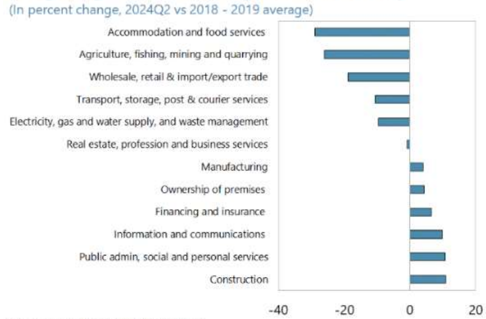
CONTEXT: EMERGING CHALLENGES AMID A CHANGING ENVIRONMENT

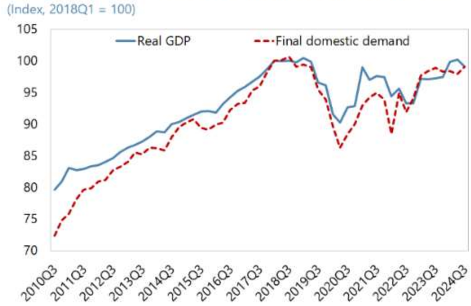
1. Hong Kong SAR economy is recovering gradually after a protracted period of setbacks.[1] The territory's economy experienced a bumpy road in recent years as it endured three years of recession since 2019 amid social unrest, rising U.S.-China tensions, and pandemic-related disruptions. Nevertheless, the financial system has remained stable, supported by strong institutional frameworks, ample policy buffers, and the smooth functioning of the Linked Exchange Rate System (LERS). The removal of COVID-related restrictions in early 2023 resulted in a strong rebound in domestic demand and inbound tourism in 2023H1, but the recovery has faced domestic and external headwinds. At 2024Q3, real GDP (on a seasonally-adjusted basis) remained below its 2019Q1 peak, reflecting subdued domestic demand and uneven recovery across sectors.

Hong Kong SAR: Real GDP by Economic Activity
(In percent change, 2024Q2 vs 2018 - 2019 average)



Sources: Haver Analytics; and IMF staff calculations.

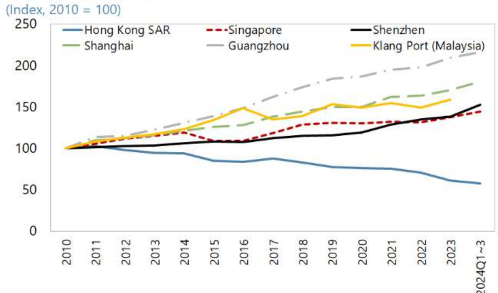
Hong Kong SAR: Real GDP and Final Domestic Demand
(Index, 2018Q1 = 100)



Sources: Haver Analytics; and IMF staff calculations.

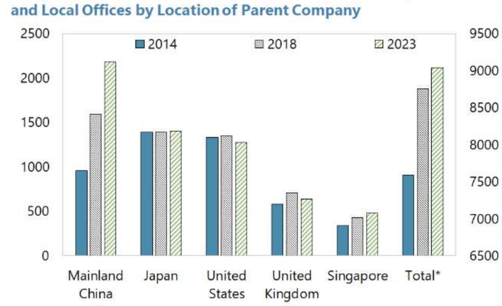
2. Looking ahead, the territory faces several near- and longer-term challenges. Hong Kong SAR's economic integration with Mainland China has significantly increased in recent years, making it more susceptible to Mainland-specific risks, including from the ongoing property market adjustment and rising geoeconomic fragmentation. Moreover, its traditional growth drivers and role as a logistics and trading center remain under pressure due to regional competition while rapid aging and slowing labor force growth also pose challenges.

Port Throughput
(Index, 2010 = 100)



Note: 2024 Q1~3 figures are annualized. Shanghai's 2024 Q1~3 and 2023, Shenzhen's 2024 Q1~3, 2023 and 2015, and Guangzhou's 2023 and 2017 figures are estimates.
Sources: CEIC Data; Port Klang Authority; and IMF staff estimates.

Hong Kong SAR: Number of Regional Headquarters, Regional Offices and Local Offices by Location of Parent Company



Note: Total number of companies represented on RHS.
Sources: Hong Kong SAR authorities.

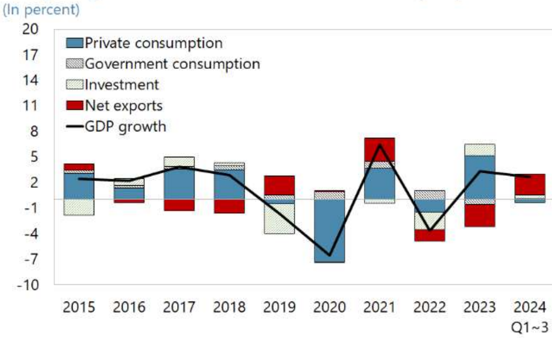
[1] These consultation discussions form part of the Article IV consultation with the People's Republic of China.

3. Recognizing the need to adapt to the changing environment, the government is determined to bolster confidence and pursue high quality development. The authorities are resolute to develop new growth engines to enhance the territory's competitiveness, and have taken steps to attract foreign talents and businesses in high-value technology industries. They also plan to increase economic capacity in various areas—including in climate finance, supply chain management, and aviation—and make their flagship infrastructure project—the *Northern Metropolis*—a hub for innovation and technology to support industries located in the Greater Bay Area (GBA).

RECENT DEVELOPMENTS

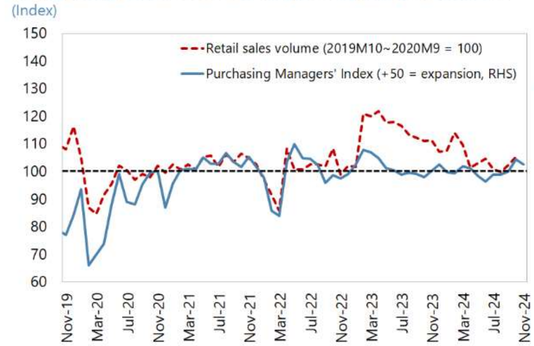
4. Hong Kong SAR's economy rebounded strongly with the post-COVID reopening, but domestic demand has lost momentum over the course of 2023 and 2024. After a contraction of 3.7 percent in 2022, economic activity rebounded and grew by 3.3 percent in 2023 driven by strong private consumption and, to a lesser extent, investment growth. Nevertheless, economic momentum slowed over the year as the initial reopening effects gradually waned. In addition, high interest rates continued to weigh on the property and financial markets while external demand further softened. In the first three quarters of 2024, growth stood at 2.6 percent y/y, driven by a turnaround in net export growth, but domestic demand growth remained subdued at 0.1 percent y/y. High frequency indicators for Q4 point to continued weak domestic demand (Figure 1).

Hong Kong SAR: Contribution to GDP Growth by Expenditure
(In percent)



Note: 2024 Q1~3 data calculated as contribution to growth against 2023Q1~3.
Sources: Haver Analytics; and IMF staff calculations.

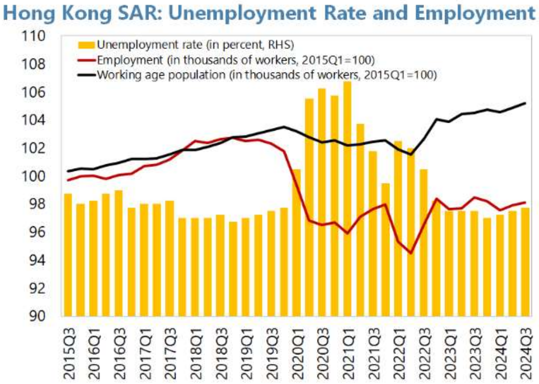
Hong Kong SAR: Selected High Frequency Indicators
(Index)



Sources: Haver Analytics; S&P Global; and IMF staff calculations.

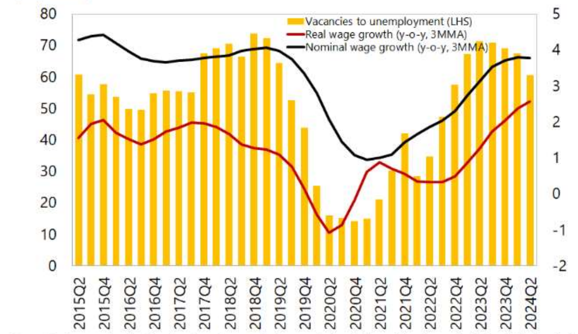
5. Labor market conditions have remained tight albeit with significant employment loss (Box 1). The unemployment rate declined significantly in late 2022 and early 2023 as economic activity rebounded and has remained broadly stable at around 3 percent in recent months. While working age population has fully recovered from the 2022 lows and has broadly returned to the pre-pandemic trend, employment remains well below the 2018-19 levels as labor force participation has declined further, partly reflecting the larger share of older cohorts where the participation rate is lower than for other age groups. Labor shortages have emerged, particularly in construction and segments of the services sector, contributing to higher wage growth.

Hong Kong SAR: Unemployment Rate and Employment



Sources: Haver Analytics; and IMF staff calculations.

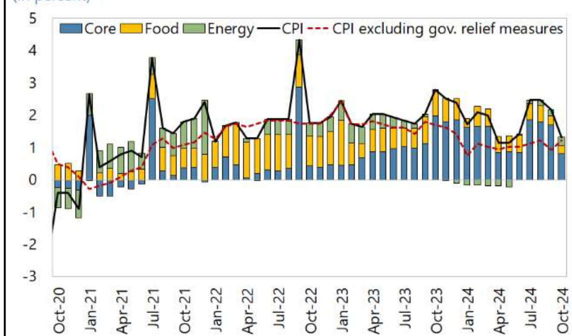
Hong Kong SAR: Vacancies to Unemployment and Wage Growth
(In percent)



Note: Real wage is calculated using the nominal wage index deflated by the underlying inflation index.
Sources: Haver Analytics; and IMF staff calculations.

6. Underlying inflation pressures remain subdued. Headline and core inflation dynamics in the past year have been strongly affected by government one-off relief measures, particularly those related to housing given its large weight in the CPI basket. Netting out the effects of these measures suggests that the underlying inflation moderated significantly from 1.8 percent in September 2023 to 0.8 percent in January 2024 on the back of softer prices of durable goods, energy, and food. In October, underlying inflation stood at 1.2 percent while headline and core prices increased by 1.4 and 1.1 percent (y/y), respectively.

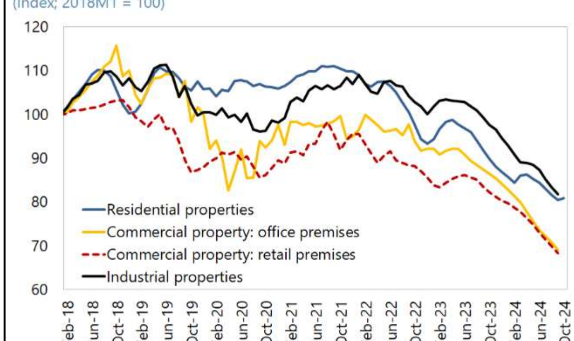
Hong Kong SAR: Contribution to Inflation
(In percent)



Sources: Haver Analytics; and IMF staff calculations.

7. Property market conditions have softened further amid domestic and external headwinds. Albeit a modest uptick in October, residential property prices continued to adjust in 2024 and are now around 27 percent below their 2021 peak. Downward price pressures have largely been driven by rising housing supply, although higher interest rates also played a role. Commercial property saw rising vacancies with prices further declining, reflecting subdued demand from Mainland firms and weaker retail activity on account of shifts in incoming tourists' preferences and increased border crossing of residents to Mainland China. Amid protracted property market weakness, the authorities removed the demand-cooling fiscal measures and relaxed macroprudential measures for property loans (¶35).

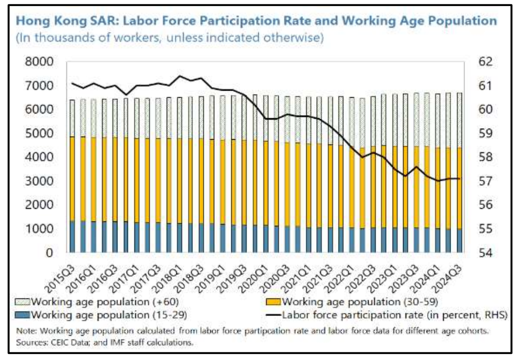
Hong Kong SAR: Residential and Commercial Real Estate Prices
(Index; 2018M1 = 100)



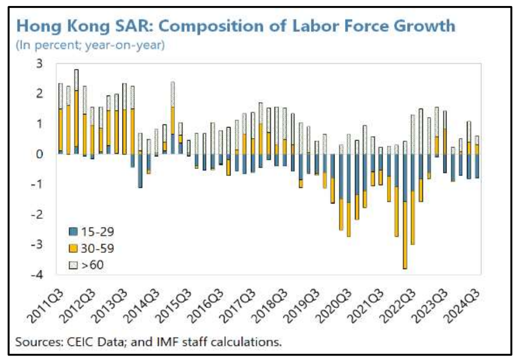
Sources: CEIC; BIS; and IMF staff calculations.

Box 1. Drivers of Labor Market Tightness in Hong Kong SAR[1]

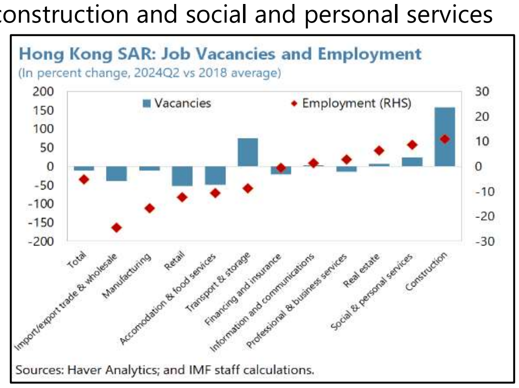
Hong Kong's labor market conditions have tightened significantly as the post-pandemic economic recovery took hold. Following the reopening in early 2023, labor market conditions quickly improved with the unemployment rate falling sharply to around 3 percent and vacancy-to-unemployment ratio—an indication of labor market tightness—increasing to pre-pandemic levels. Nevertheless, overall employment in 2024Q3 remained at around 5 percent below the 2018-19 average, suggesting that exits from the labor force have picked up momentum in recent years. Indeed, the labor force participation rate (LFPR), which has had been stable at around 61 percent until 2018, fell rapidly through the unrest in 2019 and the pandemic period, standing at a historically low level of 57 percent in 2024Q3.



Rapid aging and lower participation of the young have led to a sharp decline in the LFPR in recent years. Following a sharp decline in the pandemic period, the working-age population has started expanding again in recent months. However, the composition has changed: individuals aged 60 and above, where the LFPR is much lower (around 24 percent), now constitute the only group that is growing, given population aging. With Hong Kong's old age dependency ratio (defined as those above 65 years as a proportion of individuals between 15-64) projected to climb from around 30 percent in 2022 to 55 percent by 2045, the ongoing decline in LFPR is expected to continue in the coming years.[2] In addition, a meaningful part of younger population, particularly at the 15-29 cohort, has opted to stay out of the labor force, possibly reflecting limited job opportunities during the pandemic, and a tendency to delay entry into the labor force in pursuit of higher education.



Labor market dynamics vary significantly across sectors as economic recovery remains uneven. Labor demand and employment creation have been particularly strong in construction and social and personal services sectors, with the latter reflecting an increase in education, health, and social work services-related jobs. In contrast, sectors such as trade and wholesale, retail, and accommodation and food services have seen lower employment relative to the 2018 level owing to the sluggish post-pandemic recovery of incoming tourism and possibly a change in the population's spending patterns, including due to deepening integration with the GBA. While employment creation has been low in transport and storage sectors, vacancies have remained high suggesting that labor supply in some occupations remain constrained.



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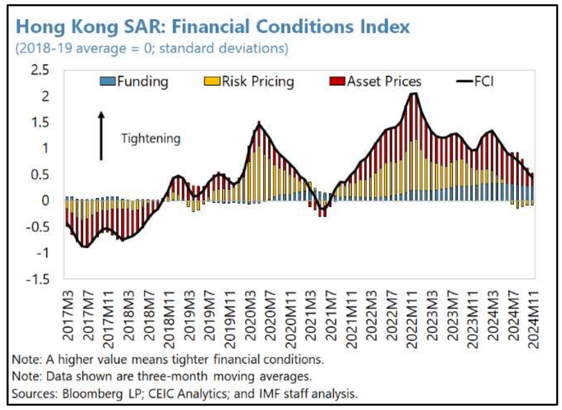
[1] Prepared by Tommy Lee.

[2] Based on the authorities' population projections.

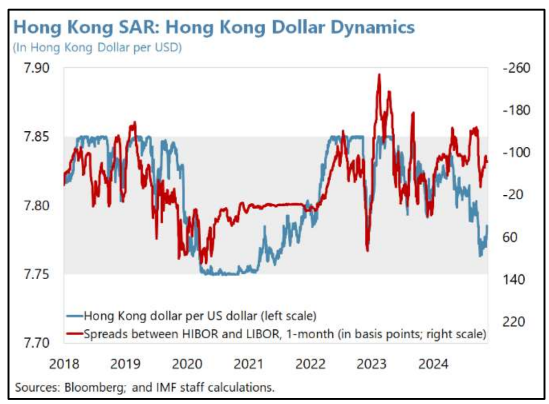
8. Financial market conditions have somewhat eased but remained tight. With more favorable credit spreads and lower risk premia, financial conditions have eased since end-2023, but remained generally tight due to still elevated funding costs, subdued stock and equity prices, and continued adjustment in the property market.

- Following sharp declines in 2022 and 2023, the Hang Seng index has fluctuated at low levels, broadly following developments in Mainland's stock exchanges. Initial Public Offerings (IPOs) in 2024H1 remained well below the levels seen in 2020-2021, and debt issuance has recovered modestly but is still far below average levels in the previous decade. In October 2024, equity prices rose sharply on expectations for Mainland stimulus measures, but partly reversed in the following month and remained well below the 2013-2022 average.



- Bank credit contracted further at the pace of 3 percent y/y in 2024Q3, largely reflecting subdued credit demand amid the high interest rate environment and ongoing adjustment in the property market. Meanwhile, recent credit conditions surveys suggest that lending standards for SMEs also tightened amid weakening profitability and rising default rates in that segment. Loan growth was weak across sectors, with loan-to-deposit ratio further declining to about 58 percent in September 2024 from a peak of 77 percent in March 2020.

9. The LERS continues to function smoothly. Under the currency board arrangement, Hong Kong dollar (HKD) interest rates have increased in 2022-23 in tandem with the U.S. monetary policy tightening. The Hong Kong Interbank Offered Rate (HIBOR) continued to trade in an orderly manner, with fluctuations largely reflecting seasonal demand for HKD funding. The HKD/USD exchange rate remained well within the convertibility zone since May 2023 when the convertibility undertaking was last triggered.[2]



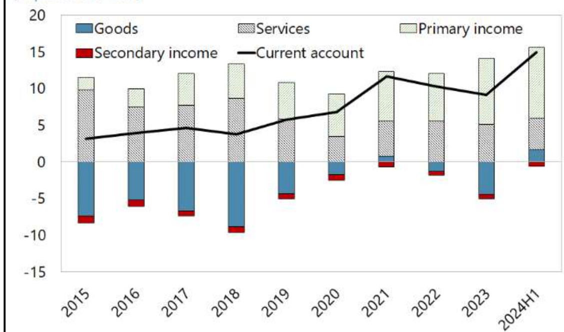
10. The fiscal deficit was wider than expected, largely due to weak property market-related revenue (Figure 2). The fiscal deficit (before bond issuance and repayment) in FY2023/24 stood at 5.8 percent of GDP—higher than the 3.9 percent budget target—largely reflecting the weak housing market conditions and associated shortfall in revenues. Land premium and stamp duty revenue were

[2] Convertibility undertaking refers to the Hong Kong Monetary Authority's (HKMA) conversion of domestic currency into foreign currency and vice versa at a fixed exchange rate.

significantly below initial budget estimates and were partly offset by lower spending as many COVID measures expired. The budget was mainly financed by drawing down fiscal reserves, which remained at an ample level of nearly 25 percent of GDP.

11. The current account (CA) surplus widened significantly in 2024H1 following a decline in 2023. Despite a sizable increase in the primary income balance, the 2023 CA surplus narrowed to 9.2 percent of GDP from 10.2 percent in 2022, owing to weaker demand for goods from Mainland China. The recovery of the services balance stalled due to the lingering pandemic effects, incomplete recovery of tourist arrivals, and weaker demand for logistics and financial services. In 2024H1, the seasonally adjusted CA surplus widened significantly to 15 percent of GDP, driven by higher trade balance and a larger income account surplus. The average real effective exchange rate appreciated by 2.5 percent in the 12 months to October 2024, reflecting in part the RMB weakening against the USD. Based on a preliminary analysis utilizing data available to date, staff assess the external position in 2024 to be broadly in line with the level implied by medium-term fundamentals and desirable policies (ESA, Annex I).[3]

Hong Kong SAR: Current Account
(In percent of GDP)



Sources: Haver Analytics; and IMF staff calculations.

OUTLOOK AND RISKS

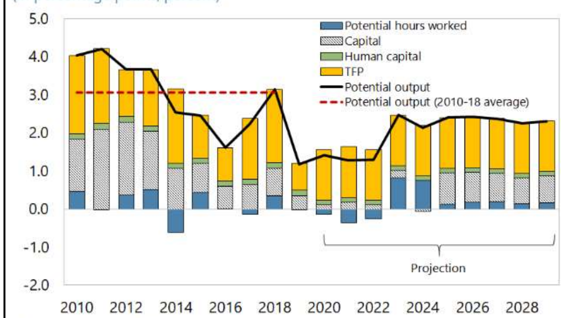
12. Growth is projected to gradually moderate over the forecast horizon. The baseline assumes a gradual monetary policy easing by the Fed in late 2024 and 2025, which is expected to ease financial conditions in Hong Kong SAR and support domestic demand. However, slowing medium-term growth in Mainland China, combined with rapid aging in the domestic economy, likely pose headwinds to growth over the medium term.

- **In 2024**, growth is projected to moderate to 2.7 percent as post-reopening momentum has further waned and the high interest rate environment and strong HKD continue to weigh on domestic activity. **In 2025**, real GDP growth is projected to remain stable as the pickup of domestic demand, supported by the gradual monetary policy easing in the U.S., is projected to be offset by weakening external demand, including from Mainland China. Despite the moderation of GDP growth relative to 2023, it is expected to be above potential growth, resulting in further narrowing of output gap (Text Table 1).

[3] The final assessment for 2024 will be provided in the 2025 External Sector Report.

- **Medium-term growth** is expected to modestly slow and converge to a potential growth of about 2½ percent in 2029. While the contribution of private consumption to growth is projected to increase, it will be more than offset by lower contributions from investment and net exports. On the supply side, demographic headwinds and lower contribution of additional physical capital—reflecting in part lower public investment—are set to keep potential growth below pre-pandemic average.[4] The output gap is projected to continue narrow over the medium term and close by 2029.

Hong Kong SAR: Decomposition of Potential Output Growth
(In percentage points, percent)



Sources: Penn World Tables (PWT); and IMF staff estimates.
Total Factor Productivity (TFP) is calculated as a 5-year moving average from the original estimates in the PWT. Projected TFP for 2020-29 is based on the average TFP growth for 2010-19.

- **Inflation** is projected to gradually increase and stabilize at 2.5 percent in 2027 as the economy continues to recover, housing market stabilizes, and the drag from lower import prices, particularly from Mainland China, dissipates.

- The **CA surplus** is expected increase to around 12 percent of GDP in 2024, reflecting the moderation in export growth in 2024H2. It is projected to decline thereafter modestly amid higher imports but remain high at about 9½ percent of GDP over medium term. This is largely driven by lower goods and income balances, which more than offset the projected improvement in the services surplus due to the continued recovery in incoming tourism and financial services.

Text Table 1. Selected Economic Indicators

	2024	2025	2026	2027	2028	2029
Real GDP growth (%)	2.7	2.7	2.6	2.5	2.5	2.4
Output gap (% of potential GDP)	-2.3	-1.7	-1.1	-0.6	-0.2	0.0
Inflation (% average)	1.8	2.3	2.4	2.5	2.5	2.5
Cyclically adjusted primary balance (% of potential GDP)	-7.0	-3.8	-1.9	0.0	1.3	1.1
Current account (% of GDP)	12.0	10.6	10.2	10.0	9.9	9.5
Public debt (% of GDP)	9.2	11.5	13.3	13.4	12.4	11.4

Sources: Haver Analytics; CEIC Data; and IMF staff projections.

13. The outlook is subject to high uncertainty and risks to growth are tilted to the downside (see Risk Assessment Matrix, Annex II).

- *Downside*. A sharper-than-expected slowdown in Mainland China, due to escalation of trade tensions or a deeper and more protracted adjustment in the property market, would further weaken confidence and adversely affect domestic activity through financial and trade channels. Slowing growth in major economies would weaken external demand for Hong Kong SAR's services and goods, while a longer-than-expected period of tight monetary policy in the U.S. would result in

[4] The potential gains from the Northern Metropolis are likely to materialize over the longer term, beyond the forecast horizon.

more prolonged tight domestic financial conditions, constraining domestic demand and exerting further downward pressure on the local property market. Increasing geoeconomic fragmentation pressures, widening conflict-related economic disruptions, and competition among regional hubs could weigh on the economy and potentially shift some of economic activities outside the territory.

- *Upside*. A meaningful improvement of consumer and business confidence in China—potentially driven by resolute actions to address property market stress and advance pro-market structural reforms—would improve sentiment and increase foreign investment and IPOs in the territory. It would also support external demand, including through increasing inbound tourism. Further improvement in market access to Mainland China, deeper integration with GBA, and increased investment in high value industries could support stronger growth (¶50). Success of the government's talent attraction program would support productivity and innovation and help offset demographic headwinds, thereby raising potential growth.

14. Financial vulnerabilities are elevated in some areas, but systemic risk in the financial sector is assessed as manageable. With stretched housing affordability and inventory pressures elevated, further price adjustment is possible, reducing collateral values and potentially limiting credit availability. Moreover, credit to private nonfinancial corporations (NFCs) and households, although falling modestly, remains high (Table 5), and is largely linked to property. Systemic global financial instability could trigger market dislocations, with cross-border spillovers and adverse macro-financial feedback loops affecting banks and nonbank financial institutions (NBFIs), which may be exposed to risky activities in foreign markets. That said, risks are mitigated by significant capital and liquidity buffers within the financial sector and well-designed regulatory and supervisory frameworks.

Authorities' Views

15. While acknowledging the near-term headwinds to growth, the authorities saw them as largely cyclical and expected them to reverse in the period ahead. With slowing momentum in Q3, the authorities have revised their growth forecast for 2024 to 2.5 percent—the lower bound of their initial growth forecast of 2.5-3.5 percent. Going forward, while noting the challenging business environment, particularly for small businesses and property developers, they saw the headwinds to growth as mostly cyclical, and expected positive spillovers from recent stimulus measures in Mainland China and the monetary policy easing by the Fed on domestic economic activity. They also mentioned that continued labor importation schemes would help address capacity constraints in some sectors and counter the demographic pressures, and noted that the possible easing of the HKD against other currencies in the region would help spur tourist arrivals and reduce consumption leakage to Mainland China. The authorities were confident that increased integration with Mainland China will boost medium-term growth prospects. They agreed that the external position in 2024 remained broadly in line with fundamentals and desirable policies.

16. The authorities concurred that downside risks have increased more recently. They expressed concerns about the potential escalation of trade tensions, which could affect the territory's economy through trade and financial channels. They also agreed that slower-than-expected monetary policy easing in the U.S. could further constrain domestic demand in Hong Kong SAR and dampen the recovery of the property market. While acknowledging the increased regional competition in logistics and trade, the authorities were confident that Hong Kong SAR will continue to act as a super-connector between Mainland China and the rest of the world, and argued that increased synergies with Mainland's industries will lead to efficiency gains and make the territory more competitive.

SUPPORTING THE RECOVERY AND MITIGATING RISKS

A. Fostering a Resilient Recovery and Addressing Aging-Related Spending Pressures

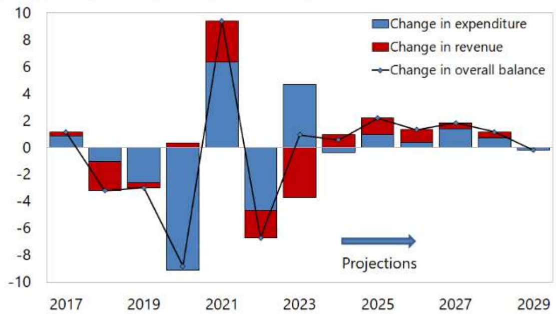
17. The fiscal deficit in FY2024/2025 is projected to remain sizable, narrowing by less than initially budgeted due to continued weakness in land premium revenues. Total public expenditure growth is projected to grow slightly relative to GDP, with continued growth in social welfare, health, and infrastructure spending partially offset by a roughly 80 percent reduction in remaining temporary COVID relief measures (0.3 percent of GDP). The authorities have introduced tax measures, including a second tier to the salaries tax regime for ultra high-income earners[5] and more progressive property tax, while reinstating hotel accommodation tax. As these measures provide only a modest offset to lost revenues, and land premium revenues are tracking far below budget estimates, staff project the overall deficit (before bond issuance and repayment) to remain high, at 5.2 percent of GDP.

18. The authorities' medium-term fiscal stance has also eased. Fiscal consolidation path has become more gradual than previously anticipated, with the return to a balanced budget (before bond issuance and repayment) delayed by two years to FY2027/2028.[6] In staff's view, this is appropriate given the ongoing slack in the economy, and the need to strengthen the adequacy of the social safety net (see below). The envisaged medium-term consolidation path is evenly distributed between revenue and expenditure, driven by a decline of 3 percentage points of GDP in operating expenditure by 2028 and an eventual cyclical rebound in land premium revenues. The projection also incorporates the authorities' plan to phase in a global corporate minimum tax from 2025. Capital spending is set to rise through 2026 due to planned infrastructure projects even as some lower priority infrastructure projects will be put on hold to limit expenditure growth. Government bond issuance is projected to increase by 6 percentage points of GDP by 2029 to fund the bulk of the budget gap and stabilize fiscal reserves as share of annual expenditure. However, the general government debt is expected to remain low, at 11.4 percent of GDP in 2029, and well below the level of fiscal reserves.

[5] The salary tax rate was increased to 16 percent from 15 percent on marginal income above HKD 5 million.

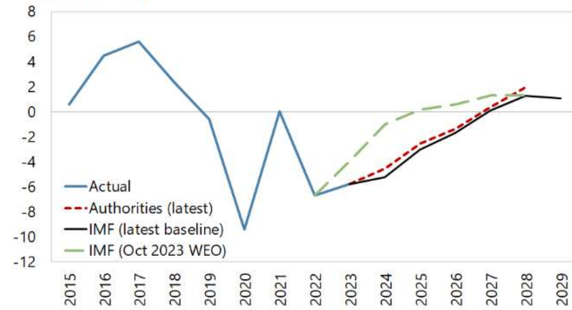
[6] Article 107 of Hong Kong SAR's Basic Law calls for keeping expenditure within the limits of revenue. This allows for fiscal deficits to be offset by fiscal surpluses over the economic cycle.

Hong Kong SAR: Drivers of Changes in Overall Fiscal Balance
(Change from previous year, in percent of GDP)



Sources: CEIC; and IMF staff analysis.
Note: A positive value denotes an increase in revenue and a decrease in expenditure, respectively.

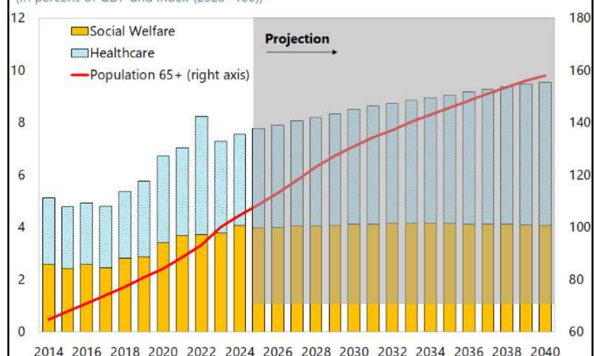
Hong Kong SAR: Overall Fiscal Balance
(In percent of GDP)



Source: Hong Kong SAR authorities; and IMF staff analysis.
Note: Years shown are fiscal years, which begin April 1. The overall balance differs from authorities' definition by excluding the issuance and repayment of government bonds.

19. Spending on social welfare and healthcare has risen rapidly in recent years. This reflects both the rapid aging as well as relatively fast growth in the referenced price index. The authorities' demographic projections suggest that the older population (age 65+) is projected to grow by roughly 25 and 50 percent by 2030 and 2040 from mid-2024, respectively. Based on demographic and inflation projections, staff's baseline foresees healthcare and social safety net spending growing by 1.2 percentage points of GDP by 2030. This expands to 2.3 percentage points of GDP by 2040 (see Selected Issues Paper).

Hong Kong SAR: Recurrent Spending by Segment and Population Growth
(In percent of GDP and index (2023=100))

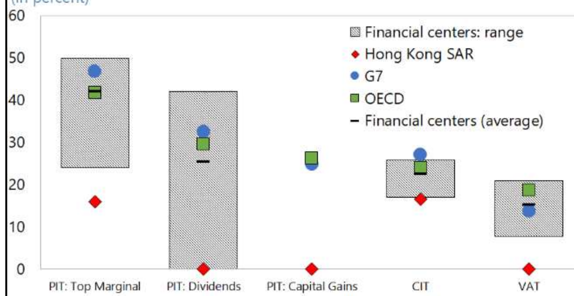


Sources: Hong Kong SAR authorities; and IMF staff analysis.

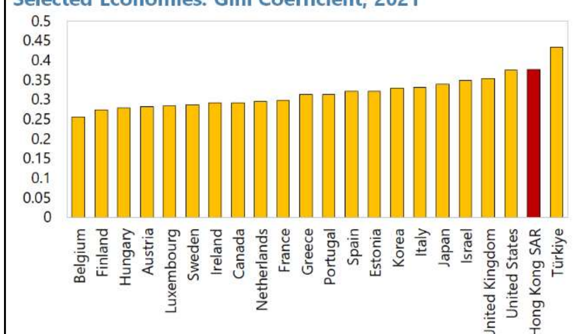
20. Absent additional fiscal measures, aging-related spending pressures and weak land premium revenues will likely limit fiscal space for planned capital spending, undermining growth prospects. Staff assume that operating expenditure can only decline by about 1½ percent of GDP by the end of the forecast period, roughly half of the authorities' projected decline, reflecting the rise in aging-related spending and limits to spending cuts in other areas. The recovery in land premium revenues is also expected to fall short of government budget forecasts, by 0.5 percent of GDP in 2025/2026 and narrowing to 0.2 percent by the end of the decade. Consequently, staff's baseline assumes further scaling back planned infrastructure spending to attain the authorities' plan of closing the deficit by 2027. While fiscal surpluses are expected to remain small in 2028-2029, over the longer term, rising aging-related spending is expected to bring the budget back into deficit, implying that the attainment of the authorities' balanced budget rule will likely be challenging under the current fiscal settings.

21. This budget path faces numerous downside risks that could extend deficits past 2027. Land premium revenues may remain at low levels if the commercial real estate (CRE) adjustment is more protracted than expected. The compression of non-aging operating expenditure may be challenging given ambitious plans to foster high-tech and innovative industries. Larger than anticipated labor force shrinkage, for instance due to difficulty in absorbing skilled labor through the talent immigration scheme, would also weigh on economic growth and therefore tax revenues.

22. Growing pressures on the budget increase the urgency of revenue-boosting tax reforms. Hong Kong SAR's low-tax regime has helped the economy's competitiveness in recent decades, but a transition to a higher and broader tax revenue base is needed to maintain the territory's balanced budget target and underpin the territory's macro-financial resilience. Personal income taxes (PIT) are roughly 3 percent of GDP, compared to an OECD average of 8½ percent, and a relatively small share of overall revenues (see Figure 2). Further increases to the progressivity of personal income taxes PIT with higher rates for top earners—alongside the introduction of taxes on dividends, common in other international financial centers—should be prioritized to provide a higher, more stable source of revenues while helping to reduce inequality (see below). Moreover, increases in excise taxes and introduction of a VAT and taxes on capital gains could provide additional revenues. At the same time, the authorities should continue to wind down remaining one-off COVID relief measures to free up fiscal space.



Sources: OECD, Price WaterHouse Coopers, and IMF staff analysis.
Note: PIT=personal income tax. CIT=corporate income tax. VAT=value-added tax. Financial centers include Belgium, Luxembourg, Netherlands, Singapore, and Switzerland. Data shown are based on 2024 data or latest available, and are averages unless otherwise indicated.



Note: The Gini coefficient of 0 represents perfect income equality, while a coefficient of 1 implies perfect income inequality.
Sources: OECD; and Hong Kong SAR authorities.

23. A broader and more stable revenue base would also help fund stronger social safety nets and growth-enhancing investments. Inequality improved slightly in 2021 relative to 2016 but remains high relative to peers, potentially constraining growth over the medium term. This partially reflects social welfare spending that is low compared to other advanced economies, with pension replacement rates just two-thirds of OECD levels (see Selected Issues Paper). Improving benefits levels for the main social assistance schemes will support an adequate living standard among vulnerable groups and reduce inequality. Stronger protections for the unemployed would increase automatic stabilizers in fiscal policy settings and should include expanded coverage for the unemployed under the Comprehensive Social Security Assistance scheme, establishment of a dedicated unemployment insurance program financed from contributions, and means-tested unemployment assistance for those otherwise not entitled to unemployment insurance. Increased revenues will also provide a sustainable foundation for spending on critical structural initiatives needed to lift potential growth.

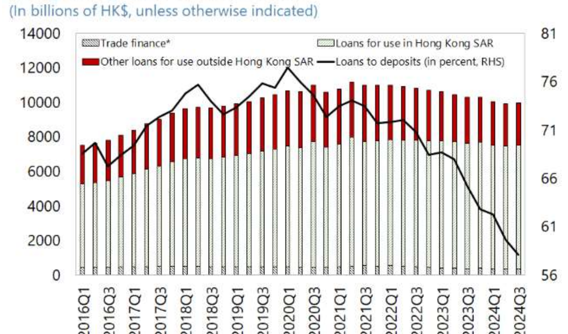
Authorities' Views

24. The authorities reaffirmed plans to gradually close the budget deficits in the coming years. The authorities reiterated their commitment to return to a balanced budget (before bond issuance and repayment) by 2027/28, including by restricting recurrent spending growth and prioritizing public investment. To address rising aging-related expenditure, the government has also initiated reviews of two subsidy schemes, including for the elderly population. The authorities saw limited scope to broaden the tax base for the purpose of increasing revenues at this juncture. They noted concerns that consumption taxes will negatively affect lower income households while taxes on dividends and capital gains could undermine Hong Kong SAR's low and simple tax regime, which they see as a key pillar of its competitiveness. While acknowledging that social safety nets could be further strengthened, the authorities stressed that the government provides significant support to the most vulnerable, including through provision of affordable public rental housing to low-income families who cannot afford private rental accommodation.

B. Safeguarding Financial Stability and Strengthening Oversight

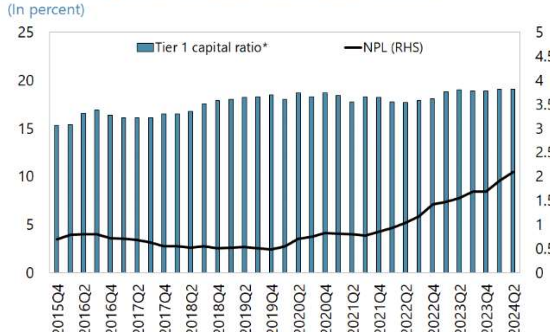
25. Risks to banking sector stability are limited despite the ongoing property market adjustments. Locally incorporated banks are well capitalized and liquid, with the consolidated total capital and liquidity coverage ratios standing at high levels of 21 percent and 183 percent in 2024Q2, respectively. While bank profitability is strong, supported by rising investment income, non-performing loans (NPLs) ratio has crept up to about 2 percent, and impaired credit and loss provisions have increased from low levels, largely from exposures to the Mainland's property developers (Figure 3). Domestic property-related delinquencies remain low despite the decline in real estate (RE) prices and rising share of residential mortgage borrowers with negative equity. Household credit quality is supported by low unemployment and relatively low leverage against the sector's aggregate net worth.[7]

Hong Kong SAR: Credit Growth
(In billions of HK$, unless otherwise indicated)



Note: Trade finance includes loans for financing import, export, and re-export within Hong Kong SAR, as well as for financing merchandise trade outside Hong Kong SAR.
Sources: Haver Analytics; IMF FSI database; and IMF staff calculations.

Hong Kong SAR: Financial Soundness Indicators
(In percent)



Note: Under Basel III, the minimum required tier 1 capital ratio is 6 percent.
Sources: CEIC Data; IMF FSI Database; and IMF staff calculations.

[7] Households' net worth was about 10 times their liabilities as of end-2023. A large part of mortgage borrowers in negative equity are under the Mortgage Insurance Program, which maintains strict requirements regarding the applicants' repayment capacity.

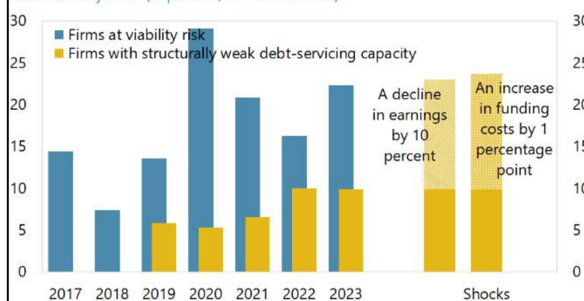
26. Mainland China exposures (MCEs) are well-monitored but nonetheless present elevated risks to lenders. The NPL ratio for Mainland-related lending has more than doubled over two years, to 2.8 percent in 2024Q1, and possible protracted deterioration in Mainland's RE market and local government finances could lead to further worsening of debt-servicing risks and lower recovery values. Heightened credit risk and lower demand for credit contributed to further decline in banks' exposure to Mainland entities to 13.7 percent of total assets in 2023Q4 from about 17 percent in 2019, while supervisory guidance has helped ensure proactive scrutiny and loss recognition for bank loans to Mainland property developers, with stepped up loan-level monitoring for other higher risk MCEs.

27. The debt repayment capacity of local NFCs is also deteriorating, particularly among smaller businesses and in the RE sector, increasing risks to banks. While the share of bank credit for use outside Hong Kong SAR is large, the debt level of local firms is also high and exceeds that of the G20 average and some major advanced economies (Figure 4). Staff's analysis—based on listed companies' data (see Selected Issues Paper)—shows that local firms, particularly small businesses and RE developers, have seen weakening debt servicing capacity and rising liquidity risks:

- **Local RE developers**. This segment has seen rising financial pressures amid the ongoing property downturn, with about one quarter of listed firms making losses in 2023 and 38 percent facing liquidity risk. Staff's analysis shows a substantial share of listed firms could face structural viability risk with modest but sustained declines in earnings. While most risky exposures are overcollateralized, mitigating risks to banks, rising defaults could lead to banks' liquidation of property collateral, reinforcing market adjustment pressures.

Local Hong Kong Non-RE Firms: Debt-Servicing Capacity

Share of risky firms (in percent; in terms of debt)



Note: Firms are at viability risk if their EBIT is less than net interest expense. Firms have structurally weak debt-servicing capacity if they are at viability risk for three consecutive years.
Sources: Capital IQ; WIND; and IMF staff estimates.

- **Small businesses**. About 72 percent of smaller (non-RE) listed firms show structurally weak viability amid increased leverage in recent years, with nearly 40 percent also facing liquidity risk. In response to rising financial stresses in this sector, the authorities have taken numerous measures to support SME financing needs, including by cutting the countercyclical capital buffer (CCyB) ratio (see below), extending two guarantee facilities by two years (to 2026), extending the maximum loan guarantee periods by three years, and re-introducing a principal moratorium for borrowers within the scheme, among other measures.

28. Proactive efforts are warranted to ensure banks' effective monitoring and management of financial vulnerabilities in NFCs. Supervisory authorities should remain vigilant and continue to use the full range of supervisory tools to ensure that banks apply prudent risk management, including in expected credit loss recognition and provisioning. Policy support to small businesses, including the existing credit guarantee, should be well-calibrated to strike a proper balance between providing necessary support and facilitating an orderly exit of non-viable firms. Expanded use of the Commercial

Data Interchange could also help overcome information asymmetry problems and improve financing access for small viable businesses. For MCEs, continued strengthening of the risk surveillance framework with a focus on Mainland's counterparties' vulnerabilities to interconnectedness and macro-financial risks would be important.

29. The HKMA implemented a Positive-Neutral CCyB rate, and subsequently reduced it for the first time since early 2020. The HKMA's decision to introduce a positive-neutral CCyB rate at 1 percent (April 2024) is welcome as it will increase the HKMA's capacity to support lending to the real economy when system-wide risks materialize. More recently, given the challenging business environment for local SMEs, the HKMA reduced the CCyB rate to 0.5 percent as part of a multi-pronged support package for this sector. Going forward, further releases of capital buffers should be reserved for periods of broad-based financial stress.

30. Risks in NBFIs merit continued close monitoring. Private credit funds and other types of risky nonbank financial intermediation have grown in Hong Kong SAR, although their activity appears relatively small compared to other jurisdictions. The authorities should continue to prioritize systemic risk assessments for nonbank financial institutions (NBFI) and market-wide assessments for high-risk activities such as derivatives, repo and securities lending, augmented with enhanced data collection and NBFI stress testing, both at the system-wide and sector-specific levels. The Securities and Futures Commission (SFC) should use its improved data collection framework to directly integrate the monitoring and stress testing of investment funds' liquidity into the supervisory framework, as recommended by the 2021 FSAP.

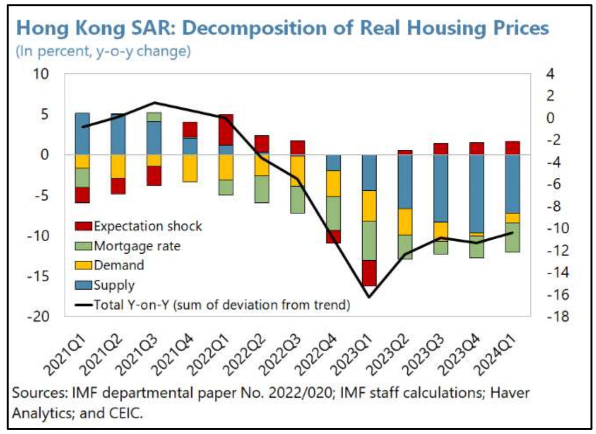
31. The LERS remains an appropriate arrangement for Hong Kong SAR given its highly open economy with its large and globally integrated financial services industry. The territory's robust policy and institutional setup, including transparent mechanism, ample fiscal and foreign reserves, strong regulatory and supervisory frameworks, and a healthy financial system have supported a smooth functioning of the currency board and ensured financial stability amid bouts of global financial volatility. Moreover, its flexible labor and product markets allow a rapid internal adjustment, thus supporting its external competitiveness, even in episodes of large USD swings against other currencies.

Authorities' Views

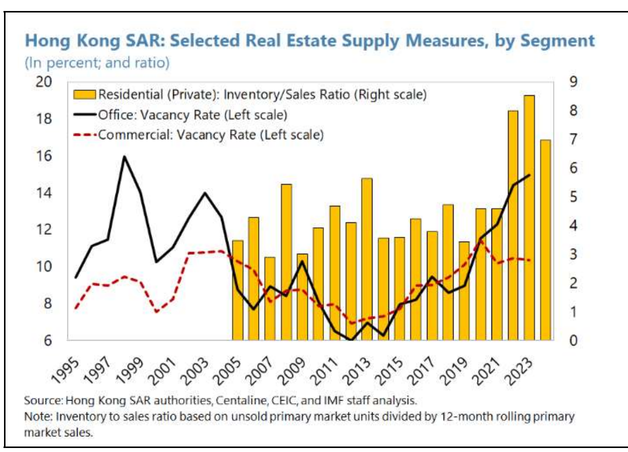
32. The authorities agreed that the weak business environment for developers and small businesses warrants close monitoring but stressed the resilience of the local banking system. Results from the HKMA's latest macro stress testing on retail banks' credit exposure suggest the Hong Kong SAR's banking sector should be able to withstand severe macroeconomic shocks. While CRE loans account for a sizable share of banks' loan portfolios, the authorities were confident that overall risks are well-managed given that exposures are mainly to robust developers with low leverage and large liquidity buffers. To avoid procyclical tightening of credit, the HKMA will continue to encourage banks to ease financing for SMEs and other corporates which are facing cash flow pressure, subject to prudent risk-management principles, and carefully guard against risks, including by maintaining sufficient provisioning coverage. Risks from NBFIs are monitored under existing surveillance frameworks, and could be addressed with macroprudential tools upon identification of associated systemic risks. The HKMA noted that the recent CCyB reduction was guided by negative credit-to-GDP and house price-to-rent gaps and meant to provide a signal to the banks to ease financing to SMEs.

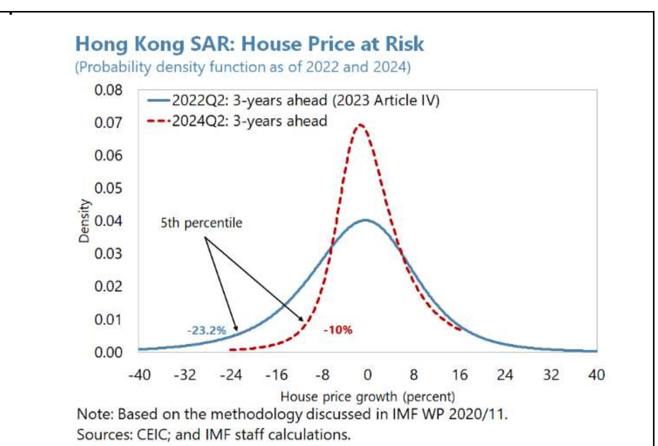
C. Ensuring an Orderly Adjustment in the Property Market

33. Property prices in the private market have continued to decline amid growing supply pressures and elevated borrowing costs. Staff's analysis shows that the decline in house prices has been largely driven by excess supply, although the higher interest rate environment also contributed to lower prices. Subdued demand may also reflect medium-term structural pressures. Recent immigrants have showed a preference for renting over home ownership, which has supported rents and limited the rebound in sale prices. Over the medium term, closer integration with the GBA could also drive some demand towards the lower priced properties on the Mainland's side of the border.



34. House price risks have eased but the market adjustment may continue. According to staff's house price-at-risk analysis,[8] risks of a sharp housing market correction have diminished. The analysis indicates a 5 percent probability that real house prices could drop by another 10 percent over the next three years compared with about 23 percent in mid-2022. Measures of supply, such as inventory-sales ratio in the residential market and vacancy rate in the retail and office market are however still elevated. These market imbalances, along with stretched housing affordability (Box 2), may suggest that the market adjustment has yet to be completed and equilibrium house prices could be lower.





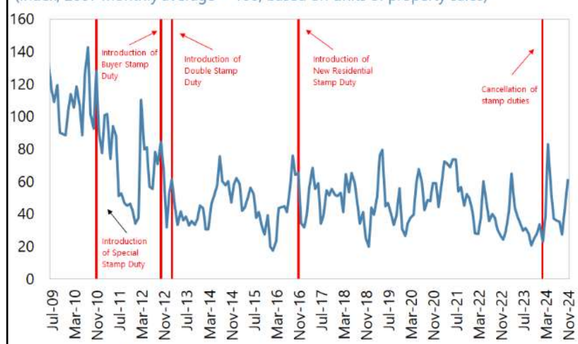
[8] See Adrian et al. (2020) for details on house prices-at-risk assessment.

35. Amid protracted property market weakness, the authorities eased several RE-related tightening measures.

- *Fiscal measures*. These included removing the Special Stamp Duty (SSD) on resale of residential properties, the Buyer's Stamp Duty (BSD) on purchases by nonresidents, and the New Residential Stamp Duty (NRSD) on second homes. The relaxation of these measures helped to drive a sharp, but brief, increase in home sales volumes in 2024Q2.

Hong Kong SAR: Residential Property Transactions

(Index; 2007 monthly average = 100; based on units of property sales)



Sources: CEIC; and IMF staff calculations.

- *Macroprudential policy measures.* Key measures included: (i) raising the maximum LTV ratio for both self-occupied and non-self-use residential properties; (ii) raising the debt servicing ratio limit for non-self-use property loans; (iii) suspending the 200 bps interest rate stress testing requirement for property mortgage lending; and (iv) raising the financing caps for property development projects back to the pre-2017 levels to 60 percent of expected project value. Moreover, the state-backed mortgage insurance program was amended (July 2023) such that the maximum LTV ratios for luxury properties be 10-20 percentage points above the macroprudential limits.[9] Mortgage insurance fees were also significantly reduced.

36. The relaxation of past housing measures is warranted but a cautious approach is needed for further policy easing. Further declines in housing prices would ease the housing affordability problem, reducing strains on the public housing system and enhancing the territory's competitiveness as a destination for international talent and business activities. Nevertheless, lower risks from speculative demand and property price misalignment warrant the removal of most past demand-cooling measures, especially the BSD and NRSD, which were assessed by Fund staff to be capital flow management and macroprudential measures (Annex IV). Further macroprudential policy easing should be carefully designed to maintain prudent underwriting standards and avoid encouraging excessive risk-taking.

Hong Kong SAR: Housing Production

(In thousands of units)

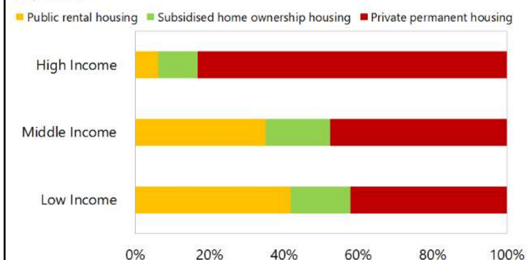
Note: The average public housing target is calculated as the annual average of the rolling 10-year public housing supply target set by the Housing Bureau of Hong Kong SAR.
Sources: CEIC Data; Hong Kong SAR authorities; and IMF staff calculations.

[9] Maximum LTV ratios for eligible self-occupied and non-self-use residential properties were raised by up to 20 percentage points over several rounds of adjustments, and are now at a uniform level of 70 percent. The debt servicing ratio limit for non-self-use residential property lending was lifted from 40 to 50 percent.

37. Increasing public housing supply will be critical to address affordability pressures (Box 2). In contrast to the private housing market which faces excess supply, demand for public housing remains high and production has fallen short of targets. To alleviate the affordability pressures, the authorities plan to significantly expand the public housing supply over the next ten years, including through the Light Public Housing program.[10] Further streamlining statutory and administrative procedures for freeing up land and reducing development costs will help to expedite both public and private housing production and thus mitigate housing affordability pressures.

38. Frequent reviews of eligibility for social housing and its strict enforcement could also alleviate social pressures. About 17 percent of households in the highest income quintile lived in public rental housing or subsidized home ownership housing in 2021, highlighting the need for stringent enforcement of income and asset limits to ensure that public housing resources are allocated to those with genuine needs. Continued reviews of eligibility for social housing, coupled with strict enforcement and measures to combat tenancy abuse, could further alleviate social pressures. The recent introduction of the declaration period of income and asset levels of public rental housing residents to every two years, along with the launch of the Cherish Public Housing Resources Awards Scheme to combat tenancy abuse from 2025, are steps in the right direction.

Hong Kong SAR: Distribution of Households by Income and Housing Type
(In percent)



Source: Population Census 2021
Note: Low, middle, and high-income refer to households in respectively 1st-2nd, 3rd-8th and 9th-10th income deciles.

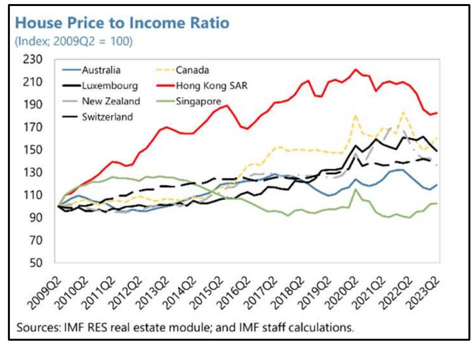
Authorities' Views

39. The adjustment in the residential property market was seen as abating. The authorities noted that the loosening of property sector policies has helped to support the orderly adjustment of the housing market and there are initial signs of stabilization in the residential housing market. They also stressed that continued flows of migrants and further improvement in financial conditions are likely to support housing market demand in the near term. While noting that housing market risks have significantly eased, the authorities will continue to monitor market developments closely and introduce measures that safeguard banking stability as conditions in the property market evolve, with a view to ensuring the steady and healthy development of the market. At the same time, the government will continue to prioritize the production of public housing, including by improving the availability of land supply and reducing red tape. The authorities also plan to increase the availability of public housing by continuing to combat tenancy abuse and conduct regular eligibility reviews to ensure precious public housing resources are allocated to those in genuine need. They also stressed plans to gradually increase the ratio of subsidized sale flats within the new public housing supply to about 40 percent from 30 percent currently.

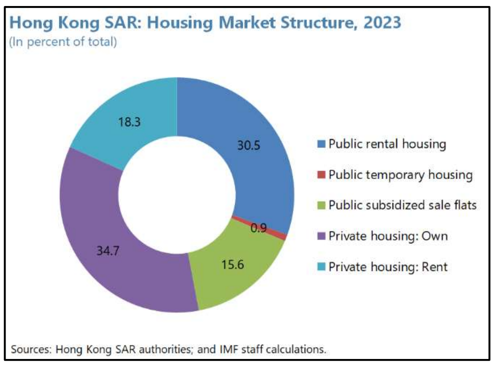
[10] The Light Public Housing project was launched in 2023 and aims to provide housing to those who have been on a waiting list for traditional public rental housing for three years or more, with priority given to families.

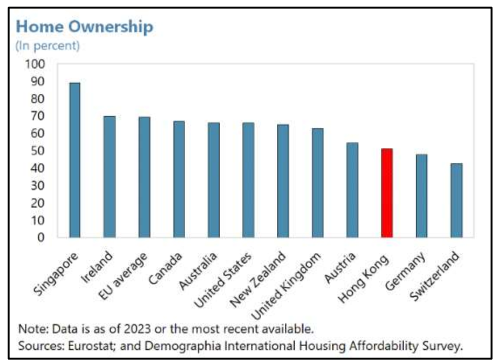
Box 2. Property Market Structure and Housing Affordability[1]

Despite a recent decline in house prices, Hong Kong SAR's property market continues to rank among the world's most unaffordable. The recent decline in house prices has somewhat improved affordability, with the average home prices dropping to 16.7 times the gross annual median household income in 2023 from a peak of 20.8 times in 2019-2020. However, the territory continues to rank among the world's most unaffordable housing markets according to the 2024 Demographia International Housing Affordability Survey.[2]



The distinct divide between public and private housing sectors reflects the territory's unique approach to addressing housing affordability. Public housing plays a critical role, accommodating about 47 percent of the population through rental units and ownership. Home ownership stands at about 50 percent, below many of its peers, with many owners residing in public housing.





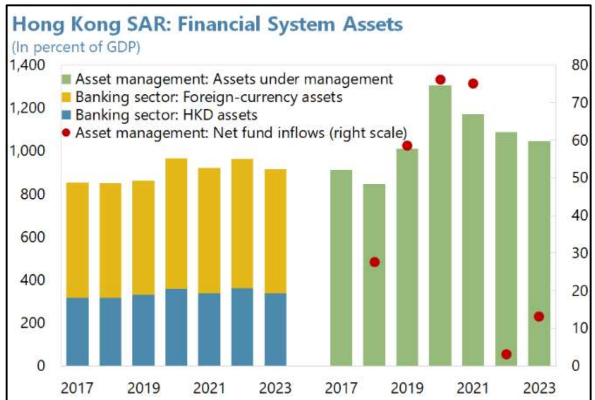
The authorities plan to further expand the supply of public housing to improve affordability. Continued affordability pressures have increased the demand for public housing, and the wait time for public rental housing has significantly increased in recent years, from 1.8 years in 2008 to a peak of 6.1 years in 2022, before declining to 5.5 years in 2024. To alleviate the pressures and further reduce the wait time for public housing, the government in its Long-Term Housing Strategy aims to allocate 70 percent of the planned production (308,000 units) to public housing and has already identified sufficient land, which will mainly come from new development areas and site rezoning.

[1]Prepared by Fozan Fareed.

[2]See IMF WP 2023/247 for a detailed discussion on affordability and cross-country comparisons

REINFORCING THE TERRITORY'S ROLE AS AN INTERNATIONAL FINANCIAL CENTER

40. **Financial services growth in Hong Kong SAR has moderated in recent years, reflecting a multitude of factors**. Banking sector growth and asset management sector inflows have moderated in recent years, lagging the growth seen in regional peers (e.g., Singapore), with local capital markets fundraising at multi-year lows. Cyclical factors such as interest rate differentials, property market adjustment, and weakening financing demand from Mainland China have played an important role in driving this moderation, although other, more structural, elements such as increasing geoeconomic fragmentation pressures and regional competition may have also contributed. Hong Kong SAR's role as a financial gateway for Mainland China—reinforced by the ongoing expansion of the capital market Connect schemes—will underpin its continued relevance as a financial hub (Figure 7), but continued efforts will be needed to maintain its international competitiveness.



Sources: CEIC; Hong Kong SAR authorities; and IMF staff calculations.

A. Creating a Vibrant Digital and Green Finance Ecosystem

41. **Continued efforts to create a vibrant digital finance ecosystem would further boost the territory's status as an international financial hub**. The HKMA has continued to stay in the forefront of experimenting with different forms of digital money. Recent initiatives include the creation of a multi-Central Bank Digital Currency (CBDC) cross-border payment and settlement platform (Project mBridge), which entered minimum viability testing and has welcomed new participants; the launch of Project Ensemble, which will test a wholesale CBDC to facilitate development of the tokenized asset market in Hong Kong SAR; and the initiation of Phase 2 of the e-HKD pilot program, which will explore innovative use cases for new forms of digital money, including settlement of tokenized assets, programmability, and offline payments. Furthermore, a new regulatory sandbox for stablecoin issuers was launched to inform the design of the forthcoming regulatory regime. As the digital finance ecosystem grows in complexity and scale, these market development initiatives must continue to be paired with efforts to enhance resilience against digital and cyber threats.

42. **The authorities have also been proactive in stepping up regulation for the fast-evolving crypto asset ecosystem**. The authorities have taken welcome steps to establish a mandatory licensing system and regulatory requirements for crypto asset services providers in June 2023 to enhance investor protection, and increased criminal penalties for operating unlicensed platforms. Going forward, these efforts should be part of a comprehensive regulatory strategy for crypto assets that includes:

- A risk-based approach for stablecoin issuers to address risks related to macro-financial stability, consumer protection, financial integrity, and regulatory arbitrage.

- Close cross-sectoral monitoring could help enhance the oversight of crypto asset-related activities and support systemic risk surveillance.

- Continued supervisory efforts to ensure that financial institutions appropriately manage credit, liquidity and operational risks related to crypto assets.

43. Advancing the development of a sustainable finance hub could enhance further Hong Kong SAR's competitive position. The authorities have made significant strides in developing a dynamic green and sustainable finance landscape. In 2023, sustainable bond issuance more than doubled, marking the highest growth in the Asia-Pacific region. In May 2024, the Green and Sustainable Finance Grant scheme was extended by three years to 2027, and the Sustainable Finance Taxonomy, which provides a standardized framework for classifying and labelling financial products and investments, was published.[11] Further strengthening the climate information infrastructure in line with international framework and standards—as the authorities plan to do by adopting the IFRS Sustainability Disclosure Standards—would enhance market transparency and support Hong Kong SAR's efforts to position itself as a leading global hub for mobilizing private sector capital for green and sustainable investments. The recently launched Sustainable Finance Action Agenda by HKMA, which encourages banks to enhance transparency on climate-related risks and reach net-zero financed emissions by 2050, is a positive step in this regard.

Sources: Refinitiv; IMF Climate Change Indicators Dashboard; and IMF staff calculations.

44. Ensuring that climate risks are thoroughly integrated into financial institutions' risk management practices will help to support systemic risk surveillance efforts. In recent years, HKMA has put in efforts to enhance banks' capabilities for managing climate risks and incorporated climate risk management into its supervisory framework, while the SFC has set out supervisory expectations for asset managers to incorporate climate risk considerations into their investment strategies and decision-making processes. Going forward, continued efforts to monitor climate-related physical and transition risks, integrate them into systemic risk analysis, and track financial institutions' progress in managing these risks and in transitioning towards carbon neutrality should be a priority.

B. Strengthening AML/CFT

45. Staff welcomes the authorities' actions to enhance the AML/CFT system and encourages ongoing efforts. To mitigate money laundering (ML) risks, trust and company service providers, real

[11] The taxonomy covers 12 economic activities across four sectors. For details, see here.

estate agents, and accountants are now subject to the full range of risk-based AML/CFT supervision. The authorities are also working towards fully implementing risk-based AML/CFT supervision of the legal professionals sector, and have taken several actions to support this, including updating the regulatory framework and issuing guidance to the sector. To prevent the criminal misuse of virtual assets (VAs), all centralized VA trading platforms carrying on business in Hong Kong SAR or actively marketing their services to the Hong Kong SAR public are now subject to licensing requirements, and AML/CFT regulation and supervision. By 2025, the authorities also plan to introduce a regime for licensing and AML/CFT regulation and supervision of issuers of fiat-referenced stablecoins. The authorities are also enhancing their cooperation with international partners to increase the provision of mutual legal assistance and target cross-border ML syndicates. To safeguard the integrity of Hong Kong SAR's financial system further, the authorities should continue robust risk-based supervision of financial and non-financial sectors, and continue strengthening cooperation with international counterparts to identify and combat ML threats posed by foreign proceed-generating crimes.

Authorities' Views

46. The authorities remain dedicated to continuously expanding global connections and enhancing Hong Kong SAR's status as a leading hub for digital and sustainable finance. They have strengthened financial linkages with Mainland China through enhanced Connect schemes, and solidified the territory's role as an offshore RMB center, while also fostering cooperation with ASEAN economies and the Middle East. The government is preparing legislation for the regulatory regime for stablecoin issuers and over-the-counter virtual asset trading platforms, underscoring its ongoing commitment to strengthening the regulatory framework for virtual assets under the "same activity, same risks, same regulation" principle. The authorities noted that they are taking a risk-based approach to virtual assets and intend to introduce regulation for custody for virtual assets in the coming year. The authorities plan to expand the coverage of Hong Kong SAR's Sustainable Finance Taxonomy to include more sectors and activities, including transition activities, which will further help to reduce the risks of green or transition washing. They also emphasized that all financial regulators are proactively addressing climate-related financial risks and are leading efforts to develop climate-related disclosure standards, which will facilitate a smoother transition to a green and sustainable economy.

ENSURING HIGH AND SUSTAINABLE GROWTH

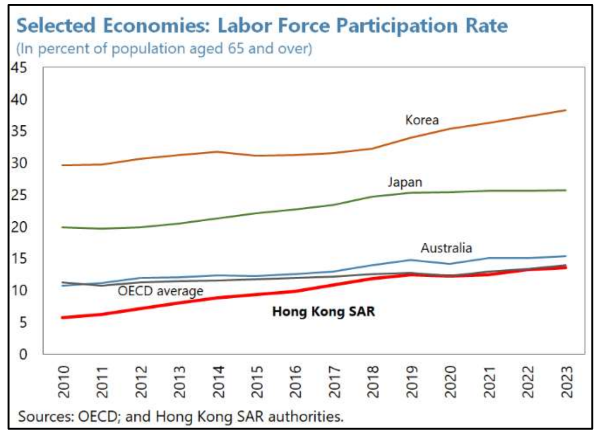
A. Tackling the Impact of Population Aging

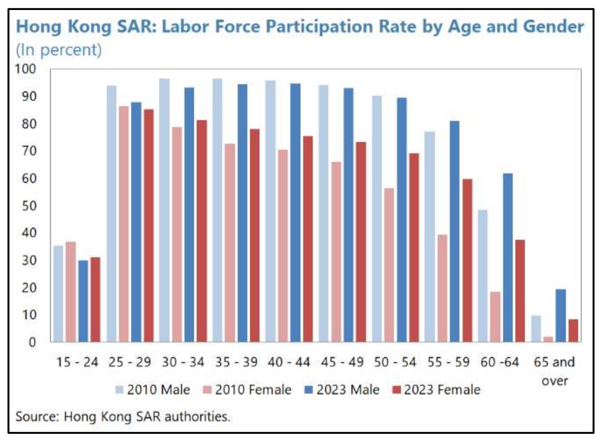
47. Boosting the supply and quality of labor will help to ease aging-related pressures and lift medium-term growth prospects. Specifically, policies should focus on:

- ***Attracting skilled labor***. The government has introduced several schemes to attract and retain talents, including expanding the list of eligible universities under Top Talent Pass Scheme, launching the vocational Professional Admission Schemes, and temporarily exempting non-local full-time postgraduate students from restrictions on taking up part-time job. Consideration is also being given to enhance the Quality Migrant Immigration scheme to attract and retain skilled technical workers, including providing a clearer pathway to permanent residency. These efforts to reverse demographic headwinds through immigration are helpful and should be continuously monitored to ensure the talent attraction programs meet their objectives.

- ***Raising the LFPR, particularly among older population and women***.

  - *Older population*. The increase in the size of the older population, who are much less likely to be active labor force participants, has lowered the overall LFPR (Box 1). While there has been a steady rise in the LFPR in this group, which is now at the OECD average, Hong Kong SAR still lags the rate in regional peers such as Korea and Japan, reflecting several factors including the lower educational attainment of older workers compared to their younger peers and concentration in lower-skilled jobs.[12] Steps to encourage older workers to stay active in the labor force, which could alleviate the demographic shifts, could include measures to encourage retention of older workers, expanded programs to reskill and upskill workers, and adoption of more flexible work arrangements.





  - *Women*. Men and women are actively involved in the labor force at comparable rates in younger ages, but a divergence starts to emerge as childcare and family support commitments rise. Even as female LFPR among older cohorts has increased in recent years, it lags the rate for men by a significant margin. Provision of more affordable childcare and more flexible work arrangements would help support higher female LFPR. In this regard, the authorities' plans to expand childcare centers and extend After School Care Programs for pre-primary children are welcome.

B. Diversifying the Growth Engines

48. Hong Kong SAR's role as a "super connector" to Mainland China has started to diminish as it faces increased regional competition. The territory has prospered in the past decades by serving

[12] See Hong Kong SAR Legislative Council Secretariat (July 2018).

as a bridge for trade and finance services between the Mainland and the rest of the world.[13] However, as the Mainland's economy has continued to open and build capacity, the territory has faced increased competition from other Chinese cities, particularly in areas of logistics and seaborne trade. These structural changes are also playing out in the face of growing importance of other regional hubs, which are competing with the territory for capital and skills.

49. The authorities are adapting to the changing environment, including by intensifying economic ties with Mainland China and diversifying Hong Kong SAR's growth engines. A key element of the authorities' plans is the GBA initiative, which aims at deepening the integration with Macao SAR, and nine Pearl River Delta municipalities. As part of these efforts, the authorities are focusing on developing the *Northern Metropolis*, which will be located across the border with Shenzhen and will aim to support manufacturing and industrial activities on the Mainland, including by making it a hub for innovation and technology.

50. The GBA has the potential to lift Hong Kong SAR's potential growth and address several pressing concerns. Greater integration could bring significant economic opportunities, including by creating a new global technology cluster that will attract leading firms and talents, benefiting from economies of scale. It could also help mitigate the territory's demographic challenges by attracting young migrants to new activities in the area. With R&D spending falling short of global peers,[14] a critical policy priority is to mobilize private sector-led R&D, which will leverage on the territory's key strengths in finance, its well-regarded and established academic institutions, and pro-market legal framework. Encouraging productivity growth and ensuring that business environment remains conducive to private investments would support Hong Kong SAR's competitiveness and limit potential adverse side effects that could accompany the integration, including displacement of some activities.

Authorities' Views

51. The authorities were confident that policies to address demographic headwinds and unlock new sources of growth will bear fruit over the medium term. They emphasized the recent success of talent attraction programs in increasing the territory's population, with new entrants significantly younger than Hong Kong SAR's residents, and noted plans to retain groups prone to dropping out of the labor force through upskilling and retraining, expansion of childcare centers, and enhanced employment programs. The authorities also noted that new growth engines, centered around innovation and regional cooperation in the GBA, are being pursued through public and private investment, and stressed their plan to raise R&D spending to 1.3 percent of GDP over the medium term. They also noted that they are working with their counterparts in Mainland China to facilitate greater mobility of goods, labor, and capital as well as to improve the flow of data. The authorities were

[13] See Cui, G. and Y. Chung, 2022.

[14] At just 1 percent of GDP in 2022, R&D spending significantly lags the OECD average of 3 percent in 2021, or the 2.4 percent recorded for Mainland China in 2022.

confident that the territory will continue to capitalize on its role as a super-connector between Mainland China and the rest of the world, particularly in supporting Chinese investment abroad.

C. Climate Resilience and Transition to a Green and Sustainable Economy

52. Climate change presents an unprecedented long-term challenge to Hong Kong SAR's economy. As a coastal region, the territory faces heightened climate-related physical risks, which can lead to loss of human lives, extensive infrastructure damage, disruptions to supply chains, lower growth, and financial instability.[15] According to the Network for Greening the Financial System's (NGFS) estimates, by 2050, Hong Kong SAR's GDP loss is projected to be 4.8 percent higher if no significant actions are taken at the global level to mitigate climate change relative to an orderly climate transition scenario in which the net-zero emissions objective is achieved by 2050 (see Selected Issues Paper).[16] To address these risks, the authorities have developed a comprehensive strategy—*Climate Action Plan 2050*—which aims at reducing carbon emissions by 50 percent before 2035 (from 2005 levels) and achieve carbon neutrality before 2050, by focusing on four key pillars (Text Table 2). The strategy also emphasizes climate adaptation by strengthening infrastructure, stepping up coastal protection, enhancing flood resilience, promoting climate-resilient urban planning, improving early warning systems for extreme weather events, and fostering the use of nature-based solutions to mitigate urban heat and manage stormwater. In 2021, the government planned to invest about HK$240 billion over the next 15-20 years to support these efforts.

Text Table 2. Climate Action Plan 2050 - Key Targets

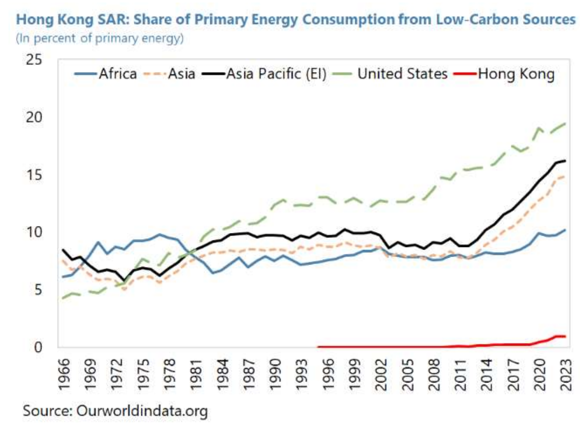
Theme	Targets	Target Year
Carbon neutrality	Achieve carbon neutrality	2050
	50 percent reduction in carbon emissions (from 2005 levels)	2035
1. Net-zero electricity generation	No coal for electricity generation	2035
	Increase the share of renewable energy in the fuel mix for electricity generation to 7.5 to 10 percent	2035
	Increase the share of renewable energy in the fuel mix for electricity generation to 15 percent	2050
	Increase the share of zero-carbon energy to 60 to 70 percent	2035
2. Energy saving and green buildings	30-40 percent reduction in electricity consumption in commercial buildings	2050
	20-30 percent reduction in electricity consumption in residential buildings	2050
	Achieve half of the above energy consumption reductions for commercial and residential buildings	2035
3. Green transport	Cease the new registration of fuel-propelled and hybrid private cars	2035 or earlier
	Take forward measures set in the EV Roadmap to attain zero vehicular emissions	2050
4. Waste reduction	Implement the Waste Blueprint to move away from the reliance on landfills for municipal waste disposal	2035
	Regulation of disposable plastic tableware in phases, reducing plastic at source	2025

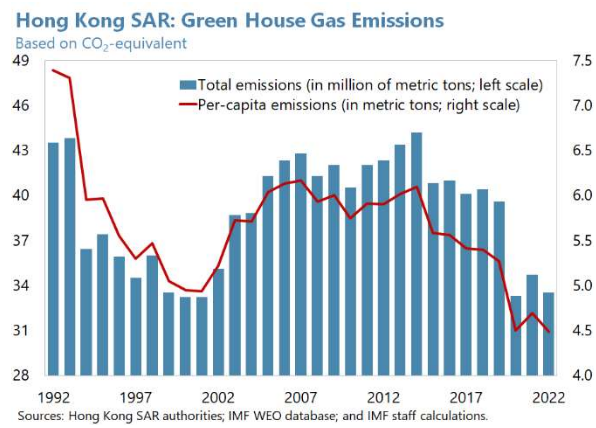
53. While significant progress has been made in reducing greenhouse gas emissions over the past decade, climate mitigation efforts face several challenges. As a services-oriented economy, Hong Kong SAR's per capita carbon emissions are relatively low compared to peers and emissions have been declining as power plants transition from coal to natural gas for electricity production. However, electricity generation remains the primary source of carbon emissions, accounting for about 63 percent of total emissions, and reliance on fossil fuels remains high. Renewable energy accounts for less than 1 percent of the electricity mix, significantly lagging global benchmarks. To mitigate the risk of falling short of emissions reduction targets, more proactive measures are needed, including by prioritizing

[15] The 2021 FSAP noted that physical risks are negatively impacting the equity valuations of the insurance sector. In addition, the HKMA has identified that physical climate risks could also affect housing prices and property transactions with potential implications for financial stability.

[16] NGFS scenarios are global and have no material impact from Hong Kong SAR's emissions. For details, see here.

regional collaboration with Mainland China to develop renewable energy, and improving energy efficiency in many aging, poorly maintained buildings by addressing structural, financial, and legal obstacles for building upgrades. Incentivizing energy saving and green transportation with additional forms of carbon pricing mechanisms, such as mileage-based vehicle taxation scheme, can also be considered.





Authorities' Views

54. The authorities reiterated their commitment to achieving carbon neutrality before 2050. They viewed climate change as a significant long-term challenge and have taken steps to enhance resilience through various mitigation and adaptation strategies. With two-thirds of Hong Kong SAR's carbon emissions originating from electricity generation, they stressed the need to enhance the cooperation with Mainland China in the supply of zero-carbon electricity, while also developing renewable energy sources such as solar energy and exploring wind energy and use of hydrogen. While acknowledging the need to further improve energy efficiency, they did not see an immediate need to introduce additional carbon pricing mechanisms.

STAFF APPRAISAL

55. Hong Kong SAR's economy is recovering gradually after a protracted period of shocks, but emerging and longer-term challenges require close attention. Hong Kong SAR's economic recovery is underway, but momentum has flagged recently amid tight financial conditions, continued adjustment in the property sector, and a challenging environment for SMEs. Moreover, traditional growth drivers like logistics and trade are under pressure from regional competition while the territory's rapid aging and slowing labor force growth pose further challenges. Notwithstanding these developments, the financial system has remained resilient, supported by robust institutional frameworks, ample policy buffers, and a smooth functioning of the LERS. The preliminary assessment for 2024 suggests that Hong Kong SAR's external position is in line with fundamentals and desirable policies.

56. Growth is projected to moderate gradually over the forecast horizon with risks skewed to the downside. Growth is projected to stand at 2.7 percent in 2025 and decelerate modestly to around 2½ percent over the medium term reflecting rapid population aging and slower capital accumulation. The outlook is subject to a high uncertainty with key downside risks emanating from a sharper-than-expected slowdown in Mainland China due to escalation of trade tensions or a deeper and more protracted adjustment in the property market. Longer-than-expected period of tight monetary policy in the U.S., rising geoeconomic fragmentation pressures, and increased regional competition could also weigh on growth. Financial vulnerabilities in some areas are elevated, but systemic risk in the financial sector is assessed as manageable.

57. The medium-term fiscal consolidation path is appropriate, but revenue mobilization efforts need to be stepped up to meet aging-related and investment spending needs. The plan to delay the attainment of a balanced budget until FY2027/28 is appropriate given the economic slack and the need to protect social welfare spending. However, given the mounting aging-related expenditure and critical investment plans, adherence to the authorities' balanced budget rule will require a larger and more stable revenue base. This could be achieved by increasing the progressivity of personal income tax, raising excise taxes, and introducing a VAT and taxes on capital gains and dividends. Steps to expand the coverage of social safety nets and increase their adequacy are also needed.

58. While the banking sector is well-capitalized and profitable, proactive efforts to monitor emerging risks are needed. With local firms seeing weakening debt servicing capacity and rising liquidity risk, supervisors should ensure that bank apply prudent risk management, including in expected loss recognition and provisioning. Policy support to SMEs should be well-calibrated to strike a proper balance between providing necessary support and facilitating an orderly exit of non-viable firms. Prioritization of systemic risk assessments for NBFIs and high-risk activities is needed, augmented with enhanced data collection and stress testing, both at system-wide and sector specific levels. Ensuring that climate risks are integrated into financial institutions' risk management practices will help to support systemic risk surveillance efforts.

59. Further macroprudential easing should be calibrated carefully, while public housing supply should be further expanded to alleviate affordability pressures. The risks of a sharp and disorderly house price correction and speculative demand have eased, justifying the recent abolition of demand-side management measures and relaxation of macroprudential policies. Further policy easing should be carefully designed to maintain prudent underwriting standards and avoid excessive risk-taking. Continued efforts are needed to expedite the production of public housing and strictly enforce eligibility criteria to reduce social pressures.

60. Creating a vibrant, well-regulated digital and sustainable finance ecosystem would reinforce the territory's status as an international financial center. Recent efforts to step up the regulation of the fast-evolving intermediation of crypto assets are welcome, and should be part of a comprehensive regulatory strategy that includes a risk-based approach for stablecoin issuers, close cross-sectoral monitoring, and continued supervisory efforts to ensure financial institutions appropriately manage risks. Continued improvements in transparency regarding climate-related risks will strengthen the climate information infrastructure and help position Hong Kong SAR as a global green and sustainable finance hub.

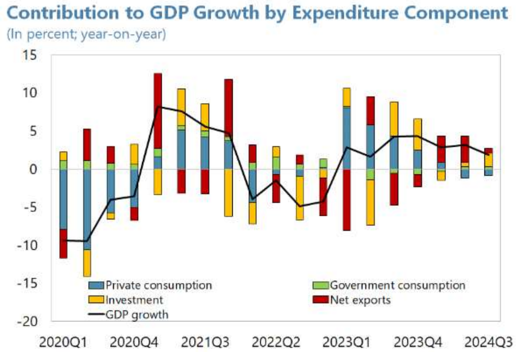
61. The GBA initiative has the potential to lift growth prospects by creating a new global technology cluster and attracting skilled labor. A critical priority is to mobilize private sector-led R&D, leveraging on the territory's key strengths in finance, its well-regarded academic institutions, and the pro-market legal framework. Encouraging private investment would support Hong Kong SAR's competitiveness and limit potential adverse side effects that could accompany integration, including displacement of some activities. Efforts to attract skilled labor should be continuously monitored to ensure the talent attraction programs meet their objectives. At the same time, steps are needed to raise labor force participation, particularly among older adults and women.

62. Continued efforts are needed to address long-term challenges posed by climate change. To mitigate the risk of falling short of emissions reduction targets, the authorities should prioritize regional collaboration with Mainland China to develop zero-carbon energy and improve energy efficiency in aging and poorly maintained buildings. Incentivizing energy saving and green transportation with additional forms of carbon pricing mechanisms can also be considered. Finally, continued efforts to bolster infrastructure and enhance resilience against climate-related risks are also important.

63. It is recommended that the next Article IV consultation discussions with Hong Kong SAR be held on the standard 12-month cycle.

Figure 1. Hong Kong SAR: Recent Developments

Private consumption and investment slowed from H2 2023…



Sources: Haver Analytics; and IMF staff calculations.

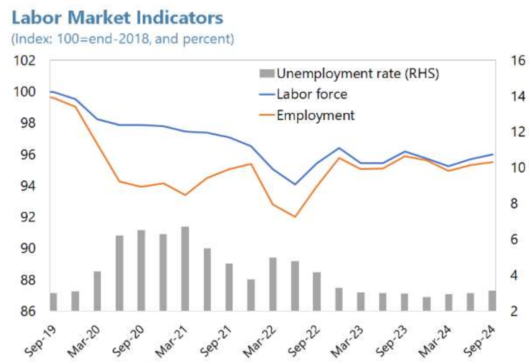
…while high frequency indicators suggest domestic spending remains fragile.

Source: Haver Analytics.

GDP growth so far in 2024 was largely driven by net exports.

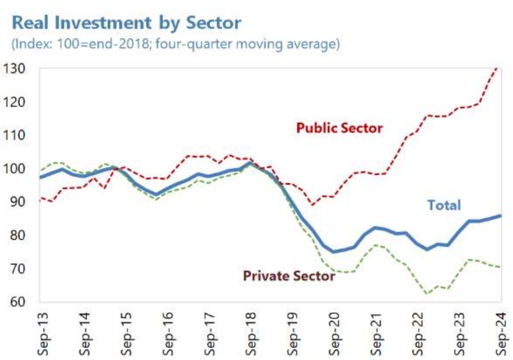
Sources: Haver Analytics; and IMF staff calculations.

The unemployment rate remains at a historically low level, but in large part due to a shrinking labor force.



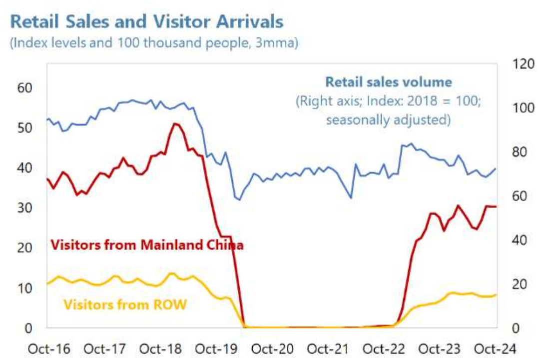
Sources: Haver Analytics, IMF staff calculations.

While public investment picked up strongly, private investment continues to be impacted by high interest rates and ongoing property market adjustment.



Sources: Haver Analytics, IMF staff calculations.

Returning visitors have yet to return to pre-pandemic levels, contributing to the subdued retail activity

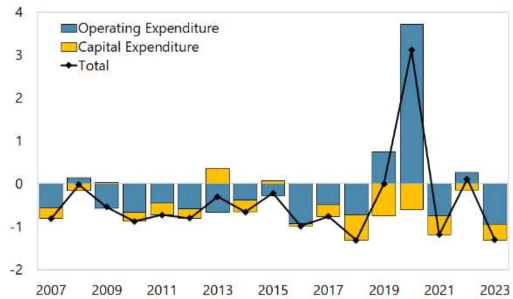


Sources: Haver Analytics; and IMF staff calculations.

Figure 2. Hong Kong SAR: A Modest Improvement in the Fiscal Balance in 2023

Government expenditures were well below budgeted levels in 2023, following significantly weaker revenues…

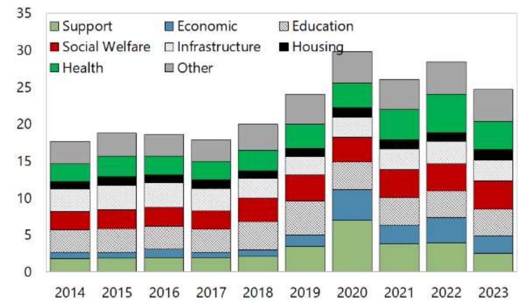
Discrepancy Between Actual and Budgeted Expenditures
(In percent of GDP)



Sources: Hong Kong SAR authorities; and IMF staff calculations.

…With the removal of COVID-related support measures accounting for much of the decline from the previous year

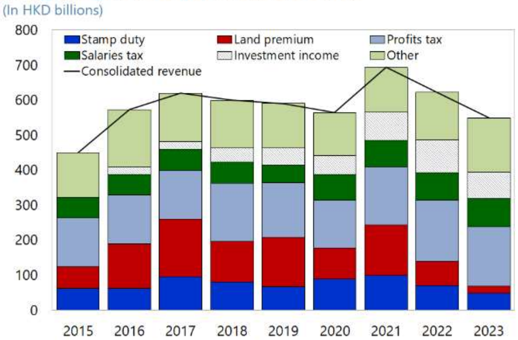
Public Expenditure By Policy Area
(In percent of GDP)



Sources: CEIC and IMF staff calculations.

Overall revenues fell sharply for a second consecutive year…

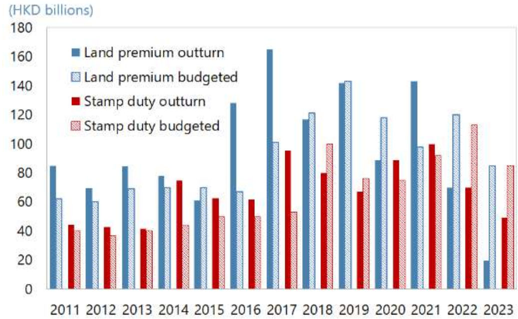
Hong Kong SAR: Major Revenue Sources
(In HKD billions)



Sources: Hong Kong SAR authorities; and CEIC.

…largely driven by lower-than-budgeted land premium and stamp duties

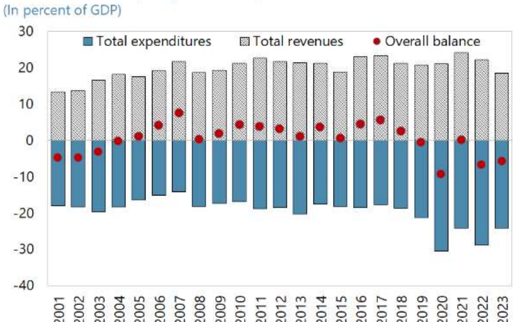
Fiscal Revenues: Real Estate-Related
(HKD billions)



Sources: Hong Kong SAR authorities; CEIC; and IMF staff calculations.

As a result, the fiscal deficit in 2023 closed only modestly from 2022…

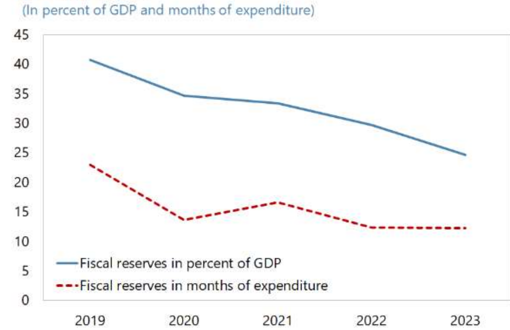
Fiscal Revenues, Expenditure, and Balance
(In percent of GDP)



Sources: CEIC; and IMF staff calculations.

…and fiscal reserves declined further, to around 25 percent of GDP by end-2023.

Fiscal Reserves
(In percent of GDP and months of expenditure)

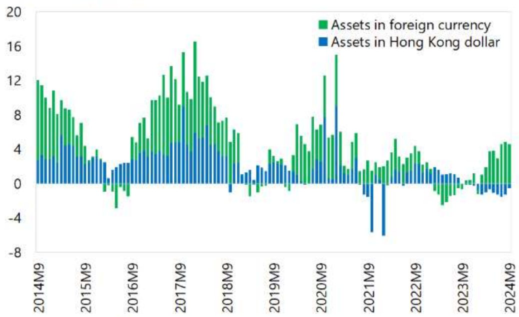


Sources: Hong Kong SAR authorities; and IMF staff calculations.

Figure 3. Hong Kong SAR: The Banking System Remains Strong with Large Buffers

Bank balance sheet growth has slowed significantly from the pre-COVID period.

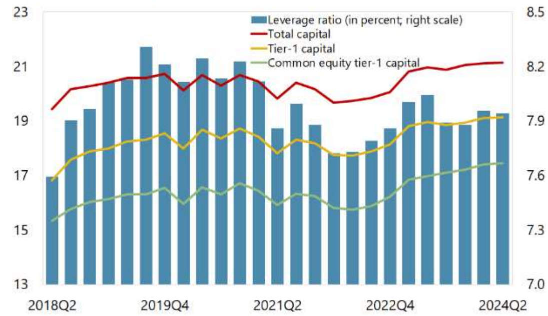
Contribution to Growth of Bank Balance Sheet
(In percentage points)



Sources: CEIC; and IMF staff calculations.

Banks' capital adequacy ratio has remained relatively stable, well above the regulatory requirements.

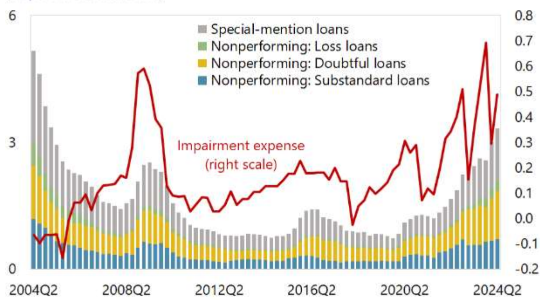
Capital Adequacy and Leverage
(In percent of risk weighted assets)



Sources: Hong Kong SAR authorities; and IMF staff calculations.

Nonperforming and special-mention loans have increased

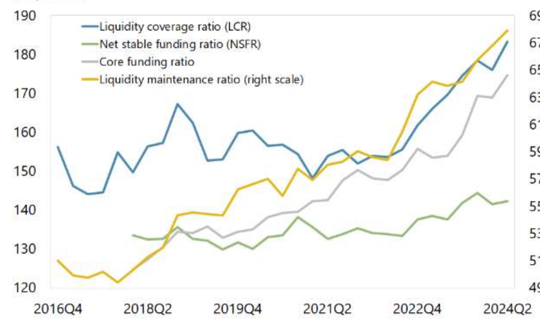
Retail Banks: Problem Loans
(In percent of total loans)



Note: Retail banks refer to banks that offer deposits to retail clients.
Sources: CEIC; and IMF staff calculations.

Banks have plenty of liquidity buffers, underpinned by a relatively stable funding profile.

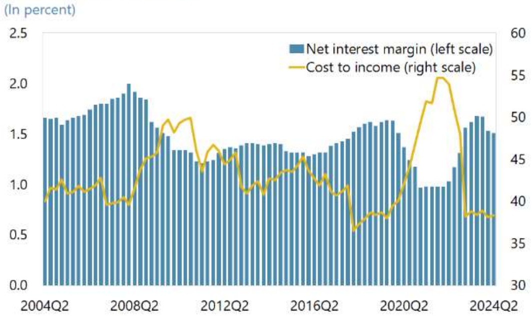
Liquidity Ratios
(In percent)



Sources: Hong Kong SAR authorities; and IMF staff calculations.

Hong Kong SAR banks' net interest margins have rebounded, easing previous earning concerns…

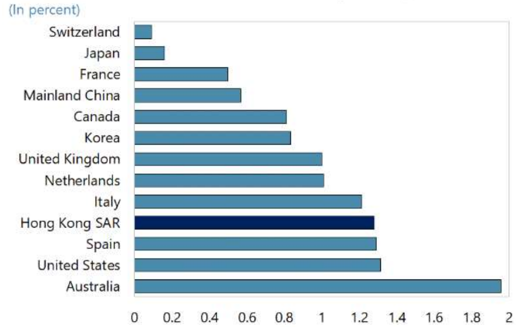
Retail Banks: Earnings
(In percent)



Note: Retail banks refer to banks that offers deposits to retail clients.
Sources: CEIC; and IMF staff calculations.

…and lifting bank profitability relative to other jurisdictions

Selected Economies: Return on Assets, 2024Q2 or Latest
(In percent)

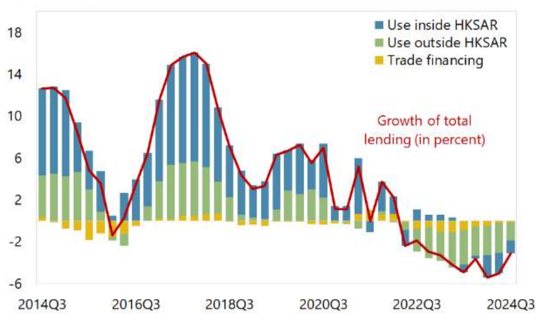


Source: IMF FSI Database.

Figure 4. Hong Kong SAR: Private Sector Indebtedness Remains Elevated

Bank lending growth turned negative, largely driven by a decline of lending for use outside Hong Kong SAR.

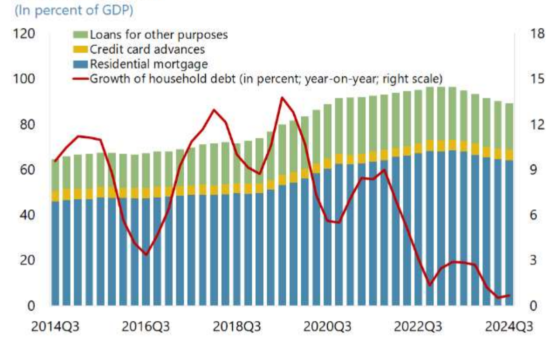
Contribution to Total Bank Lending
(In percentage points; year-on-year)



Sources: CEIC; and IMF staff calculations.

Household debt growth has slowed to nearly zero, and shrunk relative to nominal GDP…

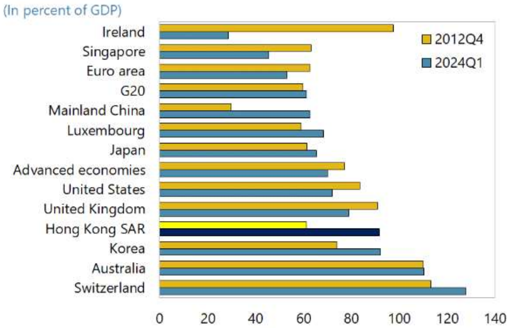
Household Debt
(In percent of GDP)



Sources: CEIC; and IMF staff calculations.

…but Hong Kong SAR households still remain among the most indebted in the world.

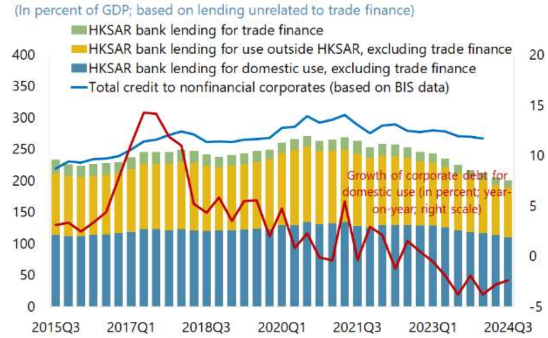
Selected Economies: Household Debt
(In percent of GDP)



Sources: Haver Analytics.

Corporate debt for domestic use is now shrinking, alongside that for use outside HKSAR.

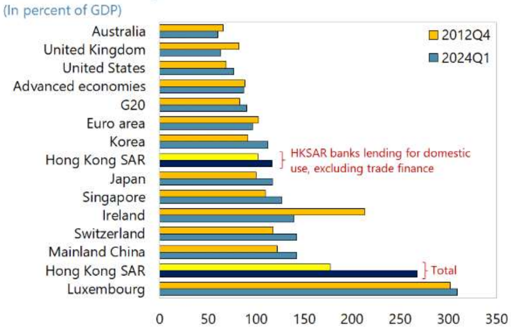
Nonfinancial Corporate Debt
(In percent of GDP; based on lending unrelated to trade finance)



Sources: CEIC; Haver; and IMF staff calculations.

Local debt for domestic use is still higher than in most advanced economies.

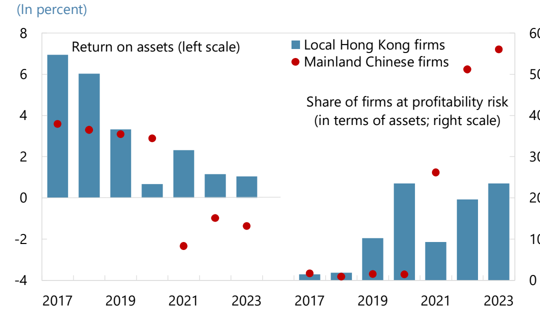
Nonfinancial Corporate Debt
(In percent of GDP)



Sources: Haver Analytics; CEIC; and IMF staff calculations.

Hong Kong SAR's listed Real Estate (RE) firms (both Mainland and local) have seen declining profitability in recent years

Local Hong Kong RE Firms: Profitability
(In percent)



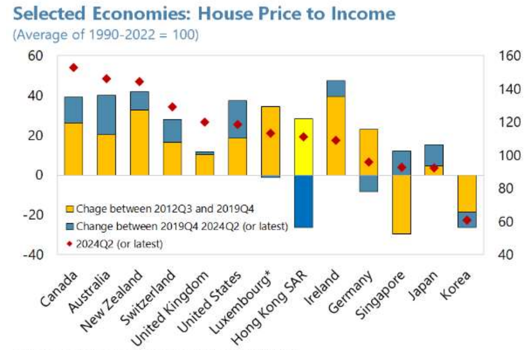
Note: Firms are at profitability risk if their profits are negative.
Sources: Capital IQ; WIND; and IMF staff estimates.

Figure 5. Hong Kong SAR: Housing Market Correction Continues

House prices have fallen since mid-2021, with a few short-lived rebounds after policy easing.

Sources: CEIC; and IMF staff calculations.

Unlike most advanced economies, Hong Kong SAR did not experience a housing market boom during the pandemic.

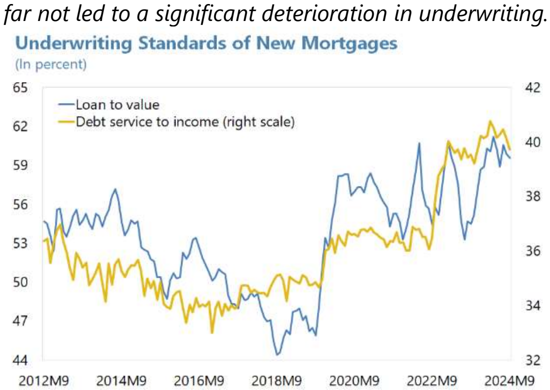


Note: Latest data for Luxumbourgh is from 2023Q4.
Sources: OECD; CEIC; and IMF staff calculations.

Home sales continued to decline, but private residential property construction remains relatively stable.

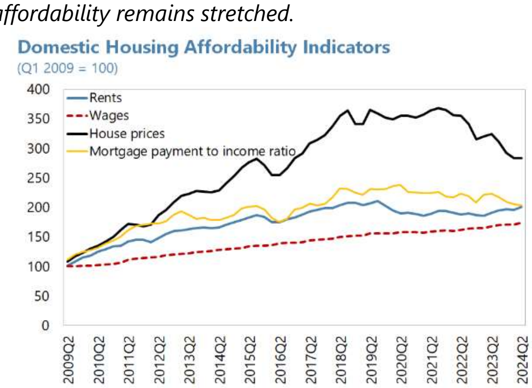
Sources: CEIC; and IMF staff calculations.

The easing of restrictive macroprudential measures has so far not led to a significant deterioration in underwriting.



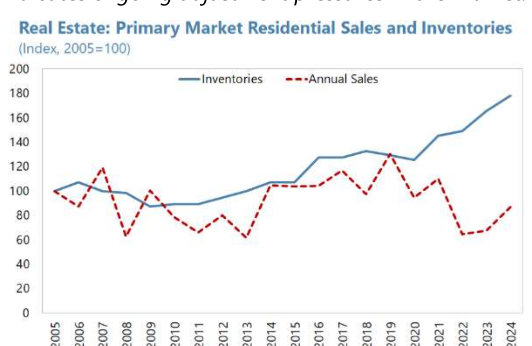
Sources: CEIC; Hong Kong SAR authorities; and IMF staff calculations.

Despite the recent property market adjustment, housing affordability remains stretched.



Sources: Haver Analytics; and IMF staff calcualations.

Declining primary market sales and rising inventories indicates ongoing adjustment pressures in the market.

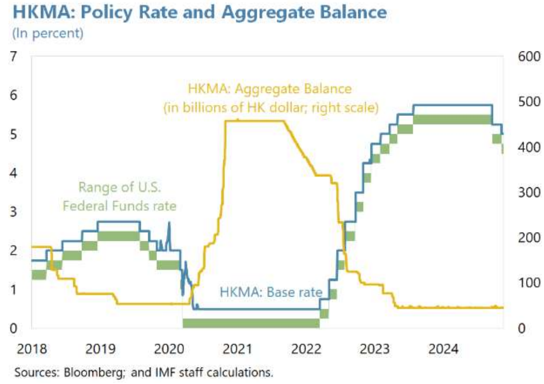


Sources: Hong Kong SAR authorities; CEIC; and IMF staff analysis.
Note: 2024 data is through Q3. Inventories includes unfinished units under construction.

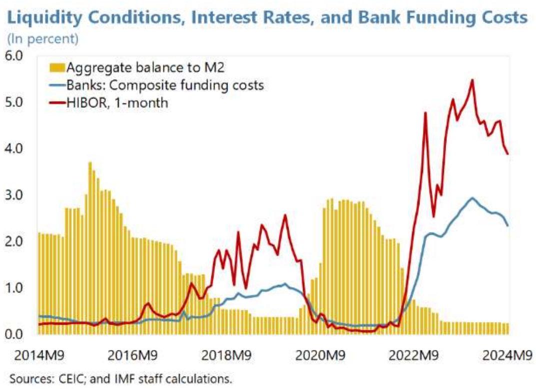
Figure 6. Hong Kong SAR: Linked Exchange Rate System Continues to Function Smoothly

The dynamics of the HKD has been largely driven by the differential between HKD and USD interest rates.

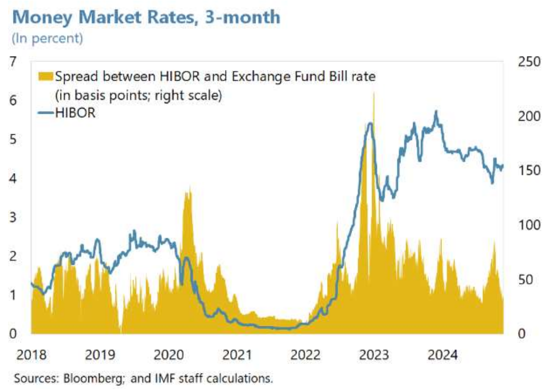
Under the currency peg arrangement, HKD interest rates have largely followed USD interest rates.



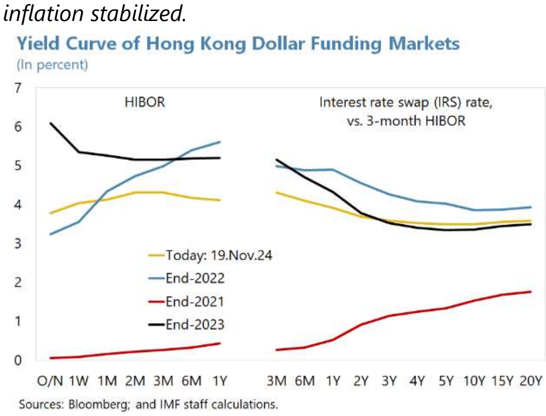
After rising as excess liquidity declined, HKD interest rates stabilized in early 2024 and have started to decline …



… while spreads between bank funding costs and risk-free rates narrowed.



HKD interest rates have declined since end-2022 as U.S. inflation stabilized.



Growth of HKD deposits has remained subdued amid weak economic and capital market (e.g., IPO) activities.

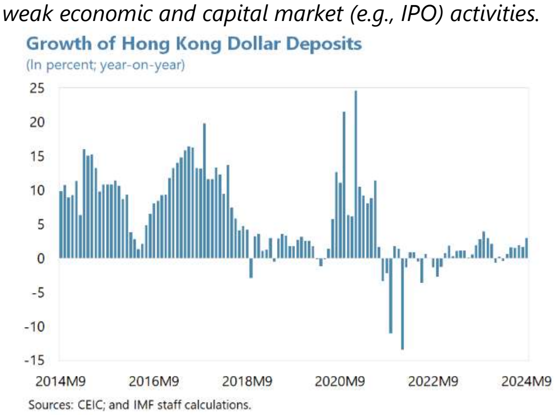
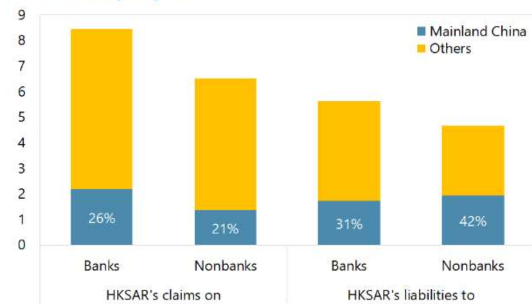


Figure 7. Hong Kong SAR: Financial Linkages with Mainland China Continue to Deepen

Mainland China accounts for a sizeable portion of Hong Kong SAR's external claims and liabilities.

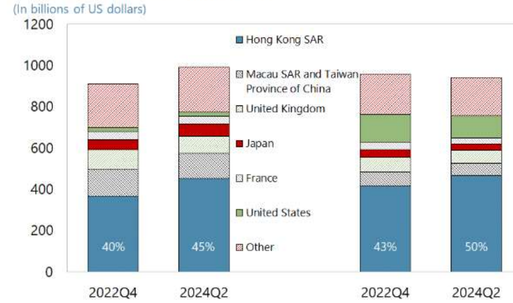
External Claims and Liabilities, June 2024
(In trillion of Hong Kong Dollars)



Sources: CEIC; and IMF staff calculations.

Hong Kong SAR banks play a leading role in intermediating cross-border financing for Mainland China,…

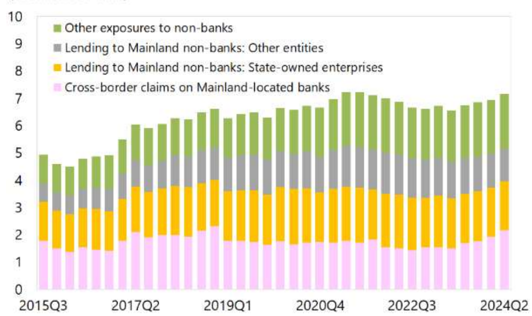
International Banks' Cross-border Position vis-à-vis Chinese Residents, June 2024
(In billions of US dollars)



Sources: BIS; and IMF staff calculations.

…by maintaining lending to Mainland-related non-banks while unwinding some of claims on Mainland banks.

Banking Sector Exposure Related to Mainland China
(In trillions of HKD)



Sources: CEIC; and IMF staff calculations.

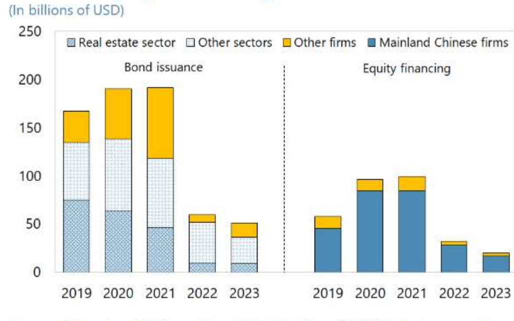
Mainland China is an important funding sources and investment destinations for HKSAR's asset management services.

Asset and Wealth Management Business
(In trillions of Hong Kong Dollars)

Sources: Hong Kong SAR authorities; and IMF staff calculations.

Fund raising activity has declined sharply in Hong Kong SAR since 2021 as deals from Mainland firms dried up.

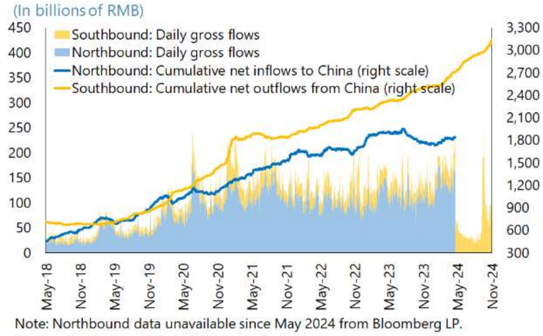
Bond and Equity Fund Raising
(In billions of USD)



Sources: Bloomberg LP; Hong Kong SAR authorities; IMF WEO database; and IMF staff calculations.

The stock connect scheme is the main channel for foreign investors to invest in Mainland equities.

Stock Connect Flows
(In billions of RMB)



Note: Northbound data unavailable since May 2024 from Bloomberg LP.
Sources: Bloomberg LP; and IMF staff calculations.

Table 1. Hong Kong SAR: Selected Economic and Financial Indicators, 2019-29

						Projections					
	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
NATIONAL ACCOUNTS											
Real GDP (percent change)	-1.7	-6.5	6.5	-3.7	3.3	2.7	2.7	2.6	2.5	2.5	2.4
Private consumption	-0.8	-10.6	5.6	-2.2	7.7	-0.7	0.5	1.0	1.4	1.9	1.9
Government consumption	5.1	7.9	5.9	8.0	-4.3	0.4	-0.5	-0.5	-0.2	0.0	0.3
Gross fixed capital formation	-14.9	-11.1	8.3	-7.4	11.1	3.6	7.7	8.1	3.6	1.5	1.6
Inventories (contribution to growth)	-0.5	1.8	-1.8	-0.9	-0.5	0.2	1.1	0.0	0.0	0.0	0.0
Net exports (contribution to growth)	2.2	0.2	2.8	-1.3	-2.5	2.3	0.0	0.6	1.0	1.0	0.8
Output gap (in percent of potential GDP)	-2.5	-7.3	-2.3	-4.1	-2.5	-2.3	-1.7	-1.1	-0.6	-0.2	0.0
LABOR MARKET											
Employment (percent change)	-0.3	-4.7	-0.6	-1.6	2.7	1.1	1.0	-0.1	-0.2	-0.1	-0.1
Unemployment rate (percent, period average)	2.9	5.8	5.2	4.3	2.9	2.8	2.7	2.7	2.7	2.7	2.7
Real wages (percent change)	0.1	2.5	-0.5	-1.4	1.4	0.9	1.2	1.3	1.3	1.3	1.3
PRICES											
Inflation (percent change)											
Consumer prices	2.9	0.3	1.6	1.9	2.1	1.8	2.3	2.4	2.5	2.5	2.5
GDP deflator	2.0	0.6	0.7	1.7	2.8	2.3	2.3	2.4	2.5	2.4	2.5
GENERAL GOVERNMENT											
Consolidated budget balance (percent of GDP) 1/	-0.6	-9.4	0.0	-6.7	-5.8	-5.2	-3.0	-1.7	0.1	1.3	1.1
Revenue	20.8	21.1	24.2	22.1	18.4	19.4	20.6	21.5	22.0	22.4	22.4
Expenditure	21.4	30.5	24.2	28.9	24.2	24.6	23.6	23.2	21.8	21.1	21.4
Fiscal reserves (as of end-March, percent of GDP)	40.8	34.7	33.4	29.7	24.6	21.3	20.0	19.7	19.7	19.7	19.3
FINANCIAL 2/											
Interest rates (percent, period average)											
Best lending rate	5.1	5.0	5.0	5.1	5.8	5.6	...	...	...	...	...
Three-month HIBOR	2.1	1.1	0.2	2.1	4.6	4.4	...	...	...	...	...
10-year Treasury bond yield	1.6	0.7	1.2	2.8	3.6	3.0	...	...	...	...	...
MACRO-FINANCIAL 2/											
Loans for use in Hong Kong SAR (excl. trade financing)	7.4	2.1	4.3	0.9	-0.4	-1.7	...	...	...	...	...
House prices (year-on-year percent change for last quarter)	3.8	0.2	3.7	-13.6	-7.1	-13.0	...	...	...	...	...
Credit-to-GDP gap 3/	21.2	23.9	11.5	3.2	-14.5	-38.9	...	...	...	...	...
EXTERNAL SECTOR											
Merchandise trade (percent change)											
Export value	-4.1	-1.5	26.3	-8.6	-7.8	7.2	1.7	3.1	3.2	3.0	3.0
Import value	-6.5	-3.3	24.3	-7.2	-5.7	3.1	3.0	3.5	3.7	3.7	3.9
Current account balance (percent of GDP)	5.9	7.0	11.8	10.2	9.2	12.0	10.6	10.2	10.0	9.9	9.5
Foreign exchange reserves											
In billions of U.S. dollars (end-of-period)	441	492	497	424	426	439	453	477	503	529	544
In percent of GDP	121	143	135	118	112	109	108	108	108	108	106
Net international investment position (percent of GDP)	432	615	574	492	468	457	446	435	424	413	403
EXCHANGE RATE											
Market rate (HK$/US$, period average)	7.836	7.757	7.773	7.831	7.830	...		...	...	...	...
Real effective rate (period average, 2010=100)	117.7	116.9	111.7	115.8	119.6	...	...	...	...	...	...

Sources: Haver Analytics; BIS,CEIC; HKSAR Census and Statistics Department; and IMF staff estimates.

1/ Before issuance and repayment of government bonds and notes.

2/ Using latest data available.

3/ Based on loans for use in Hong Kong SAR, excluding trade financing.

Table 2. Hong Kong SAR: Balance of Payments, 2019-29

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
						Projections					
					(In billions of U.S. dollars)						
Current account	21.2	24.1	43.7	36.5	34.9	48.3	44.8	45.2	46.3	48.1	48.5
Goods balance	-15.4	-5.3	3.2	-5.2	-16.5	6.5	-1.3	-4.0	-7.9	-12.3	-19.4
Services balance	21.0	12.0	17.4	19.8	19.2	10.1	14.8	18.2	23.5	30.2	38.0
Income balance	15.6	17.5	23.1	21.9	32.1	31.7	31.4	31.0	30.7	30.3	29.9
Capital and financial account	30.1	31.4	45.4	35.5	35.7	48.1	44.9	45.2	46.3	48.1	48.5
Capital account	-0.1	0.0	-1.3	0.2	0.8	-0.1	0.0	0.0	0.0	0.0	0.0
Financial account	30.2	31.4	46.7	35.3	35.0	48.2	44.9	45.2	46.3	48.1	48.5
Net direct investment	-20.5	-34.0	-43.8	-3.5	-8.4	-11.9	-13.8	-13.8	-13.5	-13.2	-13.2
Portfolio investment	27.5	68.1	79.8	40.5	47.7	27.3	26.2	28.4	28.3	30.3	32.4
Financial derivatives	-0.2	-2.4	-5.8	-17.9	-14.3	-7.5	-7.8	-8.3	-8.8	-9.3	-9.8
Other investment	24.5	-34.1	17.6	63.1	20.2	26.5	26.1	14.8	14.8	14.7	23.4
Reserve assets (net change)	-1.1	33.9	-1.2	-46.9	-10.2	13.7	14.2	24.2	25.5	25.7	15.8
Net errors and omissions	9.1	7.3	4.4	-1.3	-0.7	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum item:											
Nominal GDP	363.1	345.0	369.0	358.7	380.8	401.1	421.2	442.5	464.9	488.1	512.3
					(In percent of GDP)						
Current account	5.9	7.0	11.8	10.2	9.2	12.0	10.6	10.2	10.0	9.9	9.5
Goods balance	-4.2	-1.5	0.9	-1.4	-4.3	1.6	-0.3	-0.9	-1.7	-2.5	-3.8
Services balance	5.8	3.5	4.7	5.5	5.1	2.5	3.5	4.1	5.1	6.2	7.4
Income balance	4.3	5.1	6.3	6.1	8.4	7.9	7.4	7.0	6.6	6.2	5.8
Capital and financial account	8.3	9.1	12.3	9.9	9.4	12.0	10.7	10.2	10.0	9.9	9.5
Capital account	0.0	0.0	-0.4	0.0	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	8.3	9.1	12.7	9.9	9.2	12.0	10.6	10.2	10.0	9.9	9.5
Net direct investment	-5.6	-9.9	-11.9	-1.0	-2.2	-3.0	-3.3	-3.1	-2.9	-2.7	-2.6
Portfolio investment	7.6	19.7	21.6	11.3	12.5	6.8	6.2	6.4	6.1	6.2	6.3
Financial derivatives	0.0	-0.7	-1.6	-5.0	-3.7	-1.9	-1.9	-1.9	-1.9	-1.9	-1.9
Other investment	6.7	-9.9	4.8	17.6	5.3	6.6	6.2	3.3	3.2	3.0	4.6
Reserve assets (net change)	-0.3	9.8	-0.3	-13.1	-2.7	3.4	3.4	5.5	5.5	5.3	3.1
Net errors and omissions	2.5	2.1	1.2	-0.4	-0.2	0.0	0.0	0.0	0.0	0.0	0.0

Sources: CEIC and HKSAR Census and Statistics Department; and IMF staff estimates.

Table 3. Hong Kong SAR: Consolidated Government Account, 2019-29 1/

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
						Projections					
	(In percent of GDP, unless stated otherwise)										
Consolidated revenue	20.8	21.1	24.2	22.1	18.4	19.4	20.6	21.5	22.0	22.4	22.4
Operating revenue	15.2	17.2	18.4	18.3	17.0	18.4	18.6	18.9	18.7	18.7	18.7
Capital revenue	5.5	3.9	5.8	3.9	1.4	1.0	2.0	2.6	3.2	3.7	3.7
Taxes	12.4	14.1	14.9	14.4	12.1	14.4	15.1	15.2	15.2	15.2	15.2
Nontax	8.4	7.0	9.3	7.7	6.4	5.0	5.5	6.4	6.8	7.3	7.3
Of which:											
Land premium	5.0	3.3	5.0	2.5	0.7	0.4	1.4	2.3	3.2	3.2	3.2
Investment income	1.7	2.0	2.8	3.3	2.5	2.9	1.8	1.1	1.1	0.9	0.9
Consolidated expenditure	21.4	30.5	24.2	28.9	24.2	24.6	23.6	23.2	21.8	21.1	21.4
Operating expenditure	18.4	26.9	20.6	24.6	20.2	19.4	18.7	18.2	18.2	18.3	18.5
Of which : Personnel related (including pensions)	4.8	5.3	5.0	5.3	5.2	5.1	5.1	5.1	5.1	5.1	5.1
Capital expenditure	3.0	3.6	3.6	4.3	4.0	5.2	4.9	5.1	3.6	2.8	2.8
Of which:											
Interest expenditure	0.0	0.0	0.0	0.0	0.1	0.2	0.3	0.4	0.4	0.4	0.4
Overall balance	-0.6	-9.4	0.0	-6.7	-5.8	-5.2	-3.0	-1.7	0.1	1.3	1.1
Overall balance, authorities' definition 2/	-0.4	-8.7	1.0	-4.4	-3.4	-2.1	-0.3	0.6	0.9	0.9	0.6
Memorandum items:											
Operating balance 3/	-3.1	-9.7	-2.1	-6.3	-3.1	-1.0	-0.1	0.8	0.5	0.4	0.2
Primary balance 4/	-2.3	-11.4	-2.8	-10.0	-8.1	-7.9	-4.5	-2.5	-0.5	0.8	0.6
Cyclically adjusted primary balance (in percent of potential GDP)	-1.3	-7.5	-1.8	-7.8	-7.0	-7.0	-3.8	-1.9	0.0	1.3	1.1
Fiscal impulse 5/	2.3	6.1	-5.7	6.1	-0.9	0.0	-3.2	-1.9	-1.9	-1.3	0.1
Fiscal reserves	40.8	34.7	33.4	29.7	24.6	21.3	20.0	19.7	19.6	19.6	19.3
(Months of spending)	22.9	13.6	16.6	12.4	12.2	10.4	10.2	10.2	10.8	11.1	10.8
Gross general government debt	0.3	1.0	2.0	4.4	6.5	9.2	11.5	13.3	13.4	12.4	11.4
(Including issuance under the Government Bond Program)	3.2	5.5	7.9	11.7	10.9	13.7	16.0	17.7	17.9	16.9	15.8
Assets of the Government Bond Fund 6/	4.3	5.7	7.3	9.4	7.5	7.5	7.5	7.5	7.5	7.5	7.5
Net general government debt 7/	-41.8	-34.9	-32.8	-27.4	-21.2	-15.1	-11.5	-9.4	-9.3	-10.2	-11.0

Sources: Annual Report of the Director of Accounting Services; The Treasury, CEIC; and IMF staff estimates.

1/ Fiscal year begins April 1.

2/ Includes the issuance and repayment of government bonds.

3/ Operating balance, as defined by the authorities, is akin to the current balance.

4/ Overall balance excluding investment income and interest expenditure.

5/ Change in cyclically adjusted primary balance. A positive value corresponds to an expansionary fiscal stance.

6/ The Bond Fund was established in connection with the implementation of the Government Bond Program. The Fund does not form part of the fiscal reserves or government debt and is managed separately from the other Government accounts.

7/ Gross general government debt including issuance under the Government Bond Program minus fiscal reserves and assets of the Government Bond Fund. A negative sign indicates net assets.

Table 4. Hong Kong SAR: Monetary Survey, 2018-24

	2018	2019	2020	2021	2022	2023	Proj. 2024
	(In billions of Hong Kong dollars)						
Net foreign assets	7855	8147	8459	8597	8784	9369	10636
Monetary authorities	3326	3439	3814	3875	3288	3302	3250
Banks	4529	4708	4645	4723	5497	6067	7385
Domestic credit 1/	6320	6787	6932	7227	7291	7263	7074
Other items (net)	174	-188	215	448	462	563	852
M2	14348	14746	15607	16273	16537	17195	18561
Of which:							
Deposits in HKD 2/	6796	6941	7381	7469	7516	7675	7932
Deposits in foreign currencies 2/	7086	7307	7685	8229	8440	8945	10053
Notes and coins in circulation	467	497	541	575	581	575	589
	(Annual percentage change)						
Domestic credit 1/	5.0	7.4	2.1	4.3	0.9	-0.4	-2.6
M2	4.3	2.8	5.8	4.3	1.6	4.0	7.9
	(Contribution to M2 growth, in percent)						
Net foreign assets	2.8	2.0	2.1	0.9	1.1	3.5	7.4
Domestic credit 1/	2.2	3.3	1.0	1.9	0.4	-0.2	-1.1
Other items (net)	-0.6	-2.5	2.7	1.5	0.1	0.6	1.7
	(In percent of GDP)						
Net foreign assets	277.0	286.4	316.1	299.8	312.7	314.2	339.5
Domestic credit 1/	222.9	238.5	259.1	252.0	259.5	243.6	225.8
Other items (net)	6.1	-6.6	8.0	15.6	16.4	18.9	27.2
M2	506.0	518.3	583.3	567.4	588.7	576.7	592.4

Sources: IMF, International Financial Statistics; Haver Analytics, and IMF staff calculations.

1/ Domestic credit measures loans for use in Hong Kong SAR (excluding trade financing).

2/ Includes savings, time, demand deposits, and negotiable certificates of deposits issued by licensed banks.

Table 5. Hong Kong SAR: Financial Soundness Indicators, 2017-24Q2

	2017	2018	2019	2020	2021	2022	2023	2024Q2
Banking sector								
Capital adequacy and leverage								
Total capital to risk-weighted assets	19.1	20.3	20.7	20.7	20.2	20.1	21.1	21.1
Tier-1 capital to risk-weighted assets	16.6	17.9	18.5	18.7	18.2	18.1	18.9	19.1
Common equity tier-1 capital to risk-weighted assets	15.3	16.0	16.5	16.7	16.2	16.2	17.2	17.5
Leverage ratio (per Basel III)	...	8.0	8.2	8.2	7.9	7.9	7.9	7.9
Asset quality								
Nonperforming loans to total loans	0.7	0.5	0.6	0.9	0.9	1.0	1.2	1.5
Profitability and earnings								
Return on assets	1.0	1.0	1.0	0.7	0.6	0.9	1.0	1.3
Return on equity	12.6	13.1	11.7	8.1	6.5	8.1	9.3	12.2
Net interest income to gross income	51.1	56.2	57.1	50.6	48.4	52.4	58.2	51.9
Trading income to gross income	6.2	8.1	9.2	9.1	9.2	9.1	26.3	26.6
Non-interest expense to gross income	45.7	44.7	44.8	49.4	54.7	54.7	43.2	41.5
Liquidity and funding								
Liquid assets to total assets	19.6	20.4	21.3	23.4	23.1	17.8	17.9	17.9
Liquid assets to short-term liabilities	182.2	187.5	176.1	179.9	165.3	163.5	179.5	184.6
Liquidity coverage ratio (per Basel III)	154.8	167.1	159.1	153.6	151.0	161.8	178.5	183.3
Net stable funding ratio (per Basel III)	...	135.6	131.5	138.0	135.0	137.5	144.4	142.3
Loans to deposits	73.0	72.6	75.3	72.3	71.8	68.4	65.1	63.1
Foreign-currency liabilities to total liabilities	59.6	59.5	58.2	59.4	60.5	48.8	49.7	50.3
Selected exposures								
Net open position in foreign exchange to capital	0.5	0.0	-0.2	3.3	0.9	4.6	4.8	4.7
Residential real estate loans to total loans	13.0	13.5	13.8	15.1	15.9	18.7	18.9	19.0
Commercial real estate loans to total loans	6.1	6.1	6.0	6.2	6.1	...	...	...
Mainland-related exposures to total assets	33.1	33.2	31.7	31.4	32.4	29.3	29.3	29.9
Insurance sector: General business								
Profitability								
Net claims to net premiums	54.1	57.5	57.0	50.3	52.1	48.8	51.8	51.8
Expenses to net premiums	37.4	35.4	34.3	33.2	31.6	33.0	33.4	29.9
Reinsurance								
Net premiums to gorss premiums	68.5	65.4	68.0	67.6	67.3	65.3	64.3	64.5
Securities intermediaries sector								
Leverage								
Equity to assets	27.8	32.3	31.4	25.7	31.8	33.3	36.1	34.3
Profitability and earnings								
Return on equity	10.0	10.0	6.2	10.8	13.1	4.5	5.9	3.9
Liquidity and funding								
Liquid assets to short-term liabilities	110.6	125.5	114.7	105.8	126.9	129.9	136.5	131.9
Selected exposures								
Proprietary positions to total assets	10.4	7.3	10.1	11.7	9.0	4.9	5.2	4.5
Nonfinancial sector								
Indebtedness								
Household debt to GDP	71.0	72.7	81.7	91.6	93.1	96.4	93.2	90.2
Corporate debt to GDP								
Total credit	226.9	221.5	233.0	247.8	236.1	230.3	204.6	193.0
Credit for domestic use	121.6	120.7	122.7	130.4	125.1	128.4	118.6	114.1

Sources: CEIC; HKMA; IMF, Financial Soundness Indicators database; SFC; and IMF staff calculations.

Appendix I. External Sector Assessment

Overall Assessment: On a preliminary basis, the external position in 2024 was broadly in line with the level implied by medium-term fundamentals and desirable policies. The CA surplus (in percent of GDP) is estimated to have widened in 2024 as the goods balance increased due to a strong pick-up in external demand. At the same time, the services balance continued its gradual recovery as the positive impact of the lifting of COVID-era restrictions on travel in 2022 was offset by slower growth in key markets, particularly in the case of tourism. The CA surplus is expected to decline moderately over the medium term with the recovery in domestic demand broadly offsetting the impact of improved external conditions. Under the Linked Exchange Rate System (LERS), short-term movements in the REER largely reflect US dollar developments. The credibility of the currency board arrangement has been ensured by a transparent set of rules governing the arrangement, large fiscal and FX reserves, strong financial regulation and supervision, the flexible economy, and a prudent fiscal framework.

Potential Policy Responses: A gradual pace of fiscal consolidation in the near term to secure a balanced recovery, while taking measures to ensure fiscal sustainability over the medium to long term given the rapidly aging population, would help ensure that the external position will remain broadly in line with fundamentals. Maintaining policies that support wage and price flexibility is crucial to preserving competitiveness under the currency board arrangement. Robust and proactive financial supervision and regulation, prudent fiscal management, flexible markets, and the LERS have worked well, and continuation of these policies will help keep the external position broadly in line with fundamentals.

Foreign Asset and Liability Position and Trajectory	**Background.** The net international investment position (NIIP) decreased to 456 percent of GDP in the first 6 months of 2024 from 468 percent of GDP in 2023. This was driven by a decrease in gross assets (by 9 percentage points of GDP), and an increase gross liabilities (2.5 percentage points). Both gross assets and liabilities are high, reflecting Hong Kong SAR's status as an international financial center. Valuation effects in the first half of 2024 were more moderate compared to previous years as the change in the NIIP (-11.5 percentage points of GDP) was only somewhat smaller than the financial account balance (-17.6 percent of GDP). **Assessment.** Vulnerabilities are low given the positive and sizable NIIP and its favorable composition. FX reserves remain large (estimated at 109 percent of GDP at the end of 2024) and direct investments account for a large share of gross assets and liabilities (37 and 55 percent at the end of June 2024, respectively) while only 10.4 percent of gross liabilities are portfolio investments.					
2024 (% GDP)	NIIP: 456 [1]	Gross Assets: 1,611 [1]	Debt Assets[2]: 388 [1]	Gross Liab.: 1,155 [1]	Debt Liab.[2]: 214 [1]	
Current Account	**Background.** The CA surplus is estimated to have widened to 12 percent of GDP in 2024 from 9.2 percent in 2023. This was driven by a substantial increase in the goods balance as external demand strengthened during the year. The recovery in the services balance continued following the lifting of COVID-era restrictions in 2022 but weak demand in Mainland China impacted exports, particularly in tourism. The income balance is estimated to remain large at 7.9 percent of GDP as investment income flows increased the first half of 2024, in part reflecting higher global interest rates. The CA balance is projected to continue to gradually decline over the medium term with the recovery in domestic demand broadly offsetting the impact of improved external conditions. **Assessment.** After adjusting for cyclical and other temporary factors, the CA surplus is estimated to be 12.4 percent of GDP in 2024, compared to the mid-point of the staff assessed range for the norm of 12.6 percent of GDP (11.9 to 13.3 percent of GDP). The IMF staff-assessed CA gap range hence is between -0.9 to 0.5 percent of GDP, with an estimated mid-point of -0.2 percent of GDP. Since Hong Kong SAR is not in the EBA sample, the CA norm was estimated by applying EBA-estimated coefficients to Hong Kong SAR and was adjusted for measurement issues related to the large valuation effects in the NIIP and the discrepancies between stocks and flows.[3]					
2024 (% GDP)	CA: 12.0	Cycl. Adj. CA: 12.4	EBA Norm: --	EBA Gap: --	Staff Adj: --	Staff Gap: -0.2
Real Exchange Rate	**Background.** Under the currency board arrangement, REER dynamics are largely determined by U.S. dollar developments and inflation differentials between the United States and Hong Kong SAR. In the 12 months to October 2024, the average REER appreciated by 2.5 percent, somewhat slower than the 4.3 percent appreciation for the corresponding period a year earlier. **Assessment.** The IMF staff assesses the REER gap, based on the staff-assessed CA gap range, to be around 1 percent (mid-point of the REER gap range of -2.5 to 4.5 percent and based on the average CA-REER elasticity of about 0.2 used in the EBA model).[4]					
Capital and Financial Accounts: Flows	**Background.** As an international financial center, Hong Kong SAR has open capital and financial accounts. The net outflow in non-reserve financial flows increased to 17.6 percent of GDP in the first half of 2024 from 11.8 percent of GDP in 2023, though well below the 22.9 percent recorded in 2022. The increase was driven by net portfolio outflows. The financial account is typically very volatile, reflecting financial conditions in Hong Kong SAR and					

and Policy Measures	Mainland China (transmitted through growing cross-border financial linkages),[5] shifting expectations of U.S. monetary policy, and related arbitraging in the FX and rates markets. **Assessment.** Large financial resources, proactive financial supervision and regulation, and deep and liquid markets should help limit the risks from potentially volatile capital flows. The greater financial exposure to Mainland China could also pose risks to the financial sector through real sector linkages, particularly trade and tourism, credit exposures of the banking sector, and fundraising by Chinese firms in local financial markets. However, Hong Kong SAR's banking system, with its high capital buffers and profitability, is assessed to be broadly resilient to macro-financial shocks.
FX Intervention and Reserves Level	**Background.** The HKD has continued to trade in a smooth and orderly manner within the Convertibility Zone in 2024. The HKMA conducts FX operations as part of the currency board operations. In 2024, no interventions have been reported following USD 6.6 billion sold in 2023.[6] Total reserve assets, which amounted to US$425 billion at end-November 2024 (or 1.7 times the monetary base in October), are projected to remain stable at around 109 percent of GDP at the end of 2024, compared to 112 percent of GDP at the end of 2023. **Assessment.** FX reserves are currently adequate for precautionary purposes and should continue to evolve in line with the automatic adjustment inherent in the currency board system. Despite fiscal deficits since 2020, which are expected to persist through 2026, Hong Kong SAR still holds significant fiscal reserves (about 25 percent of GDP at the end of 2023) built up through strong fiscal discipline in previous years.

[1] Based on the position as of June 2024 and projected nominal GDP for the year. The final assessment for 2024 will be provided in the 2025 External Sector Report.

[2] Includes debt securities, loans, trade credits and other advances.

[3] Hong Kong SAR is not in the EBA sample as it is an outlier along many dimensions of EBA analysis. While it is possible to use EBA-estimated coefficients and apply them to Hong Kong SAR, there are obvious drawbacks. Following this approach, the cyclically adjusted multilaterally consistent CA norm in 2024 was estimated to be about 23.3 percent of GDP. Compared with the CA adjusted for cyclical factors (-0.4 percent of GDP), this implies a CA gap of -10.9 percent. The EBA CA gap is overstated as it does not properly reflect the measurement issues that are relevant for Hong Kong SAR, so two adjustments are made which reduce the CA norm by around 10.7 ppt of GDP to 12.6 percent, based on a staff-assessed norm range. First, a deduction of around 6.1 ppt of GDP (based on a range between 5.4-6.8 ppt) is made to the EBA model's implied contribution of the NIIP position. This is because the positive NIIP contribution in EBA captures average income effects that are less relevant for Hong Kong SAR since the income balance relative to its NIIP is systematically lower than other peer economies, due to a persistently higher share of debt instruments on the asset side than on the liability side. Second, a deduction of around 4.6 ppt of GDP is made to account for a decline in the gold trade balance that does not reflect changes in wealth but rather the increased physical settlement of gold futures contracts resulting from the opening of a Precious Metals Depository (see "People's Republic of China—Hong Kong Special Administrative Region: Selected Issues" (Country Report No. 17/12) for more details).

[4] The range is calculated by applying the average semi-elasticities of Hong Kong SAR and similar economies.

[5] The financial linkages with the Mainland have deepened in recent years with the increase in cross-border bank lending, capital market financing, and the internationalization of the RMB. As of end-September 2024, banking system claims on bank and non-bank entities in Mainland China amounted to 106 percent of GDP, an increase of around 4 pp from end-2023 but still around 16 pp lower than the peak at end-2018.

[6] Based on data on the market activities of the Exchange Fund published by the HKMA. A withdrawal represents a sale of FX while an injection represents a purchase of FX.

Appendix II. Risk Assessment Matrix

Source of Risk	***Likelihood***	***Expected Impact and Policy Advice***
	Conjunctural	
1. Intensification of regional conflict(s). Escalation or spread of the conflict in Gaza and Israel, Russia's war in Ukraine, and/or other regional conflicts or terrorism disrupt trade (e.g., energy, food, tourism, supply chains), remittances, FDI and financial flows, payment systems, and increase refugee flows.	***High***	***High.*** Widening sanctions and conflict-related economic disruptions could create negative spillovers to Hong Kong SAR's highly open and interconnected economy. Macroeconomic policy should step in the event of a strong drag on domestic growth. Hong Kong SAR has fiscal space to increase countercyclical support if needed, with the composition of fiscal stimulus decisively shifting to targeted support for vulnerable and low-income households.
2. Global growth surprises. • ***Slowdown:*** Growth slowdown in major economies, including due to supply disruptions, tight monetary policy, rising corporate bankruptcies, or a deeper-than-envisaged real estate sector contraction, with adverse spillovers through trade and financial channels, triggering sudden stops in some EMDEs.	***Medium***	***High.*** Hong Kong SAR's highly open and interconnected economy is exposed to developments in the U.S. and especially to cyclical economic conditions in Mainland China. Macroeconomic policy should step up if growth falters. Hong Kong SAR has fiscal space to revert to an expansionary stance if needed, with the composition of fiscal stimulus decisively shifting to targeted support for vulnerable and low-income households. Financial stability should be ensured through macro-prudential measures and liquidity provision.
• ***Acceleration:*** Positive supply-side surprises, monetary easing, productivity gains from AI, and/or stronger EMDE performance raise global demand and trade, and ease global financing conditions.	***Low***	***Medium.*** Positive growth spillovers could see an improvement in sentiment, boosting asset prices and investment, supported by higher trade- and tourism-related flows. With domestic and external demand gaining stronger momentum,, fiscal consolidation should be accelerated in light of less need to support the recovery, with spending on addressing the social and aging pressures, public housing shortage, and critical infrastructure gaps prioritized. Macro-prudential measures may need to be tightened to address asset price increases above those justified by fundamentals.
3. Monetary policy calibration. Amid high uncertainty and data surprises, major central banks' stances turn out to be too loose, hindering disinflation, or too tight for longer than warranted, which stifles growth and triggers increased capital-flow and exchange-rate volatility in EMDEs.	***Medium***	***Medium.*** Hong Kong SAR is exposed to U.S. monetary policy through the LERS, though its flexible factor and input markets provide some cushion to any potential miscalibration. In the event policy turns out to be too loose, fiscal consolidation should be accelerated in light of less need to support the recovery, with spending on addressing social and aging pressures, public housing shortage, and critical infrastructure gaps prioritized. Macro-prudential measures may need to be tightened to address asset price increases above those justified by fundamentals. In the event

Source of Risk	***Likelihood***	***Expected Impact and Policy Advice***
		policy is too tight, with an attendant adverse impact on domestic demand, Hong Kong SAR has fiscal space to revert to an expansionary stance if needed, with the composition of fiscal stimulus decisively shifting to targeted support for vulnerable and low-income households.
4. Systemic financial instability. High interest rates and risk premia and asset repricing amid economic slowdowns and elevated policy uncertainty (including from elections) trigger market dislocations, with cross-border spillovers and an adverse macro-financial feedback loop affecting weak banks and NBFIs.	***Medium***	***High.*** A sharp rise in global risk premia compounded by U.S.-China tensions, large capital outflows, large housing market corrections, and a potential shift in market confidence for Hong Kong SAR as a major international financial center could potentially affect the flow of capital and threaten financial stability and growth. Targeted fiscal support should be provided as needed. Financial stability should be ensured through macro-prudential measures and liquidity provision.
	Domestic	
5. Disorderly correction of house prices. A disorderly house price correction could trigger an adverse feedback loop between house prices, debt service ability of households, and lower consumption, with weakening growth leading to a second-round effects on banks' balance sheets.	***Medium-Low***	***High.*** Further relax macroprudential measures and provide targeted fiscal support if needed. Safeguard financial stability and stand ready to provide liquidity through existing facilities. Implement revenue-boosting tax reforms to ensure funding for long-term spending needs.
	Structural	
6. Deepening geoeconomic fragmentation. Broader conflicts, inward-oriented policies, and weakened international cooperation result in a less efficient configuration of trade and FDI, supply disruptions, protectionism, policy uncertainty, technological and payments systems fragmentation, rising shipping and input costs, financial instability, a fracturing of international monetary system, and lower growth.	***High***	***High.*** Escalation in U.S.-China trade tensions or accelerating decoupling in finance, technology, or other key fields between the two countries could create negative spillovers to Hong Kong SAR's economy and financial stability, negatively affecting its growth potential over a longer time horizon. The authorities should provide targeted fiscal stimulus with continued efforts on medium-term reforms and safeguard financial stability through macro-prudential measures and liquidity provision. Further strengthen the regulatory and prudential frameworks to address pockets of vulnerabilities.
7. Cyberthreats. Cyberattacks on physical or digital infrastructure (including digital currency and crypto assets), technical failures, or misuse of AI technologies trigger financial and economic instability.	***High***	***Medium.*** Continue to assess the adequacy of IT risk management practices and pair market development initiatives with efforts to enhance resilience against digital and cyber threats. Coordinate with global financial regulators. Should disruption take place, provide temporary and targeted emergency liquidity support to ensure a functional banking system.

Appendix III. Sovereign Risk and Debt Sustainability Assessment

Appendix III. Figure 1. Hong Kong SAR: Risk of Sovereign Stress

Horizon	Mechanical signal	Final assessment	Comments
Overall	...	Low	The overall risk of sovereign stress is low, reflecting low vulnerability across the near-, medium, and long-term horizons. Hong Kong SAR's debt is negative in net terms, as shown in Table 3.
Near term 1/			
Medium term	Low	Low	Medium-term risks are assessed as low, as the low signal from the GFN module outweighs the risks signalled by the fan chart, which reflect the historical volatility of GDP due to COVID-19.
Fanchart	Low	...	
GFN	Low	...	
Stress test		...	
Long term	...	Low	While long-term risks are low, aging-related expenditures on health and social security will lead to growing financing needs for the HKSAR government.
Sustainability assessment 2/	Not required for surveillance countries	Not required for surveillance countries	
Debt stabilization in the baseline			Yes

DSA Summary Assessment

Commentary: Hong Kong SAR is assessed to be at a low overall risk of sovereign stress and debt is sustainable. Net debt is negative and is expected to remain so during the projection period. While debt to GDP is expected to rise during the forecast period, the projected return to fiscal surpluses in the medium term will help reduce debts. Given the steady rise in fiscal costs from population aging, authorities should undertake revenue-boosting tax reforms to support the attainment of the balanced budget rule over the longer term.

Source: Fund staff.

Note: The risk of sovereign stress is a broader concept than debt sustainability. Unsustainable debt can only be resolved through exceptional measures (such as debt restructuring). In contrast, a sovereign can face stress without its debt necessarily being unsustainable, and there can be various measures—that do not involve a debt restructuring—to remedy such a situation, such as fiscal adjustment and new financing.

1/ The near-term assessment is not applicable in cases where there is a disbursing IMF arrangement. In surveillance-only cases or in cases with precautionary IMF arrangements, the near-term assessment is performed but not published.

2/ A debt sustainability assessment is optional for surveillance-only cases and mandatory in cases where there is a Fund arrangement. The mechanical signal of the debt sustainability assessment is deleted before publication. In surveillance-only cases or cases with IMF arrangements with normal access, the qualifier indicating probability of sustainable debt ("with high probability" or "but not with high probability") is deleted before publication.

Appendix III. Figure 2. Hong Kong SAR: Debt Closure and Disclosures

	CG	GG	NFPS	CPS	Other	Comments
1. Debt coverage in the DSA: 1/	CG	GG	NFPS	CPS	Other	
1a. If central government, are non-central government entities insignificant?					n.a.	

2. Subsectors included in the chosen coverage in (1) above:

					Subsectors captured in the baseline	Inclusion	Comments
CPS	NFPS	GG: expected	CG	1	Budgetary central government	Yes	Fiscal data is for
CPS	NFPS	GG: expected	CG	2	Extra budgetary funds (EBFs)	Yes	Consolidated
CPS	NFPS	GG: expected	CG	3	Social security funds (SSFs)	No	Govt account
CPS	NFPS	GG: expected		4	State governments	No	
CPS	NFPS	GG: expected		5	Local governments	No	
CPS	NFPS			6	Public nonfinancial corporations	No	
CPS				7	Central bank	No	
CPS				8	Other public financial corporations	No	

3. Instrument coverage:	Currency & deposits	Loans	Debt securities	Oth acct. payable 2/	IPSGSs 3/

4. Accounting principles:	Basis of recording		Valuation of debt stock		
	Non-cash basis 4/	Cash basis	Nominal value 5/	Face value 6/	Market value 7/

5. Debt consolidation across sectors:	Consolidated	Non-consolidated

Color code: chosen coverage · Missing from recommended coverage · Not applicable

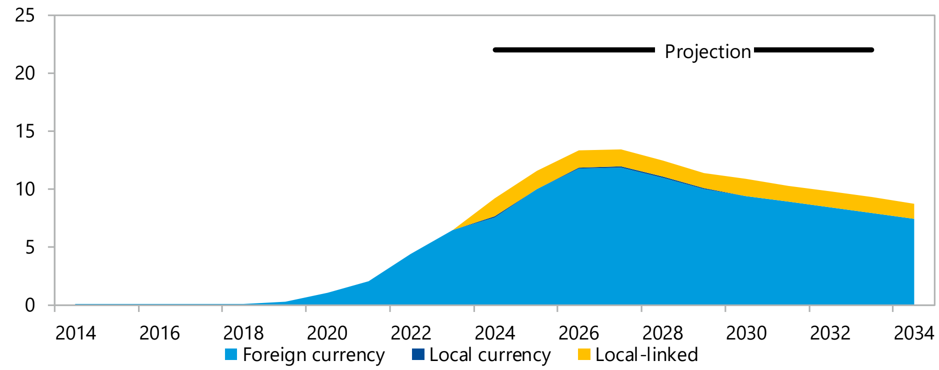
Reporting on Intra-Government Debt Holdings

					Issuer \ Holder	Budget. central govt	Extra-budget. funds	Social security funds	State govt.	Local govt.	Nonfin. pub. corp.	Central bank	Oth. pub. fin corp	Total
CPS	NFPS	GG: expected	CG	1	Budget. central govt									0
CPS	NFPS	GG: expected	CG	2	Extra-budget. funds									0
CPS	NFPS	GG: expected	CG	3	Social security funds									0
CPS	NFPS	GG: expected		4	State govt.									0
CPS	NFPS	GG: expected		5	Local govt.									0
CPS	NFPS			6	Nonfin pub. corp.									0
CPS				7	Central bank									0
CPS				8	Oth. pub. fin. corp									0
					Total	0	0	0	0	0	0	0	0	0

1/ CG=Central government; GG=General government; NFPS=Nonfinancial public sector; PS=Public sector.
2/ Stock of arrears could be used as a proxy in the absence of accrual data on other accounts payable.
3/ Insurance, Pension, and Standardized Guarantee Schemes, typically including government employee pension liabilities.
4/ Includes accrual recording, commitment basis, due for payment, etc.
5/ Nominal value at any moment in time is the amount the debtor owes to the creditor. It reflects the value of the instrument at creation and subsequent economic flows (such as transactions, exchange rate, and other valuation changes other than market price changes, and other volume changes).
6/ The face value of a debt instrument is the undiscounted amount of principal to be paid at (or before) maturity.
7/ Market value of debt instruments is the value as if they were acquired in market transactions on the balance sheet reporting date (reference date). Only traded debt securities have observed market values.

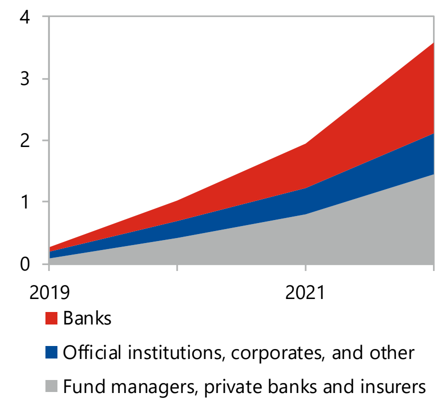
Appendix III. Figure 3. Hong Kong SAR: Public Debt Structure Indicators

Debt by Currency (Percent of GDP)



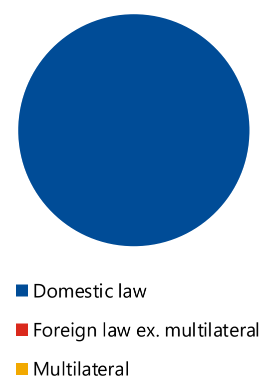
Note: The perimeter shown is general government.

Public Debt by Holder (Percent of GDP)



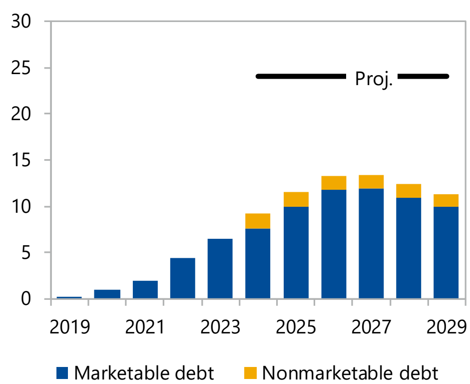
Note: The perimeter shown is general government.

Public Debt by Governing Law, 2023 (percent)



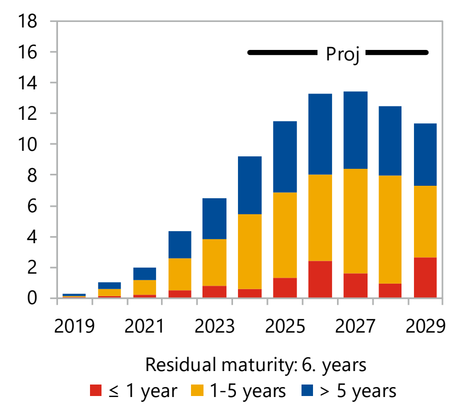
Note: The perimeter shown is general government.

Debt by Instruments (Percent of GDP)



Note: The perimeter shown is general government.

Public Debt by Maturity (Percent of GDP)



Note: The perimeter shown is general government.

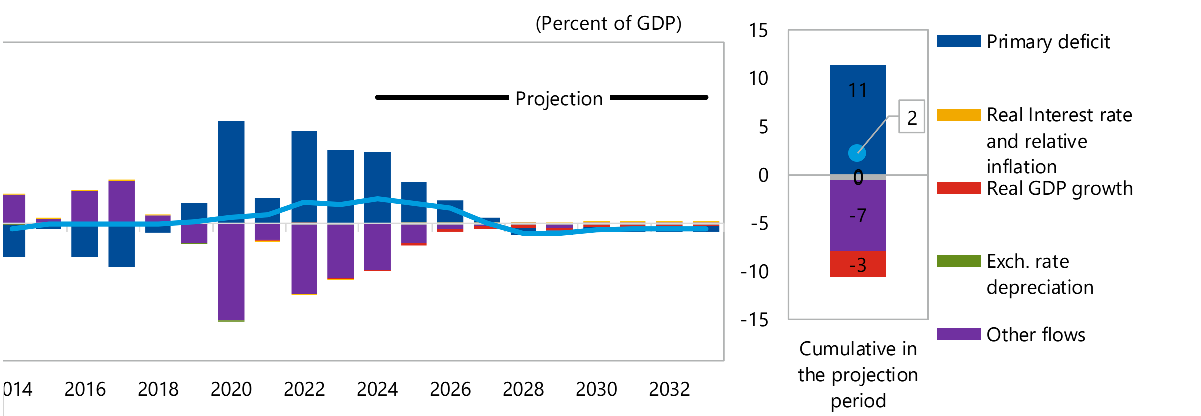
Commentary: The "Public debt by holder" chart represents primary issuance in categories shown in the absence of more detailed information. "Other" category includes central banks, sovereign wealth funds, supranationals, international organisations, official institutions, and corporates.

Appendix III. Figure 4. Hong Kong SAR: Baseline Scenario

(Percent of GDP unless indicated otherwise)

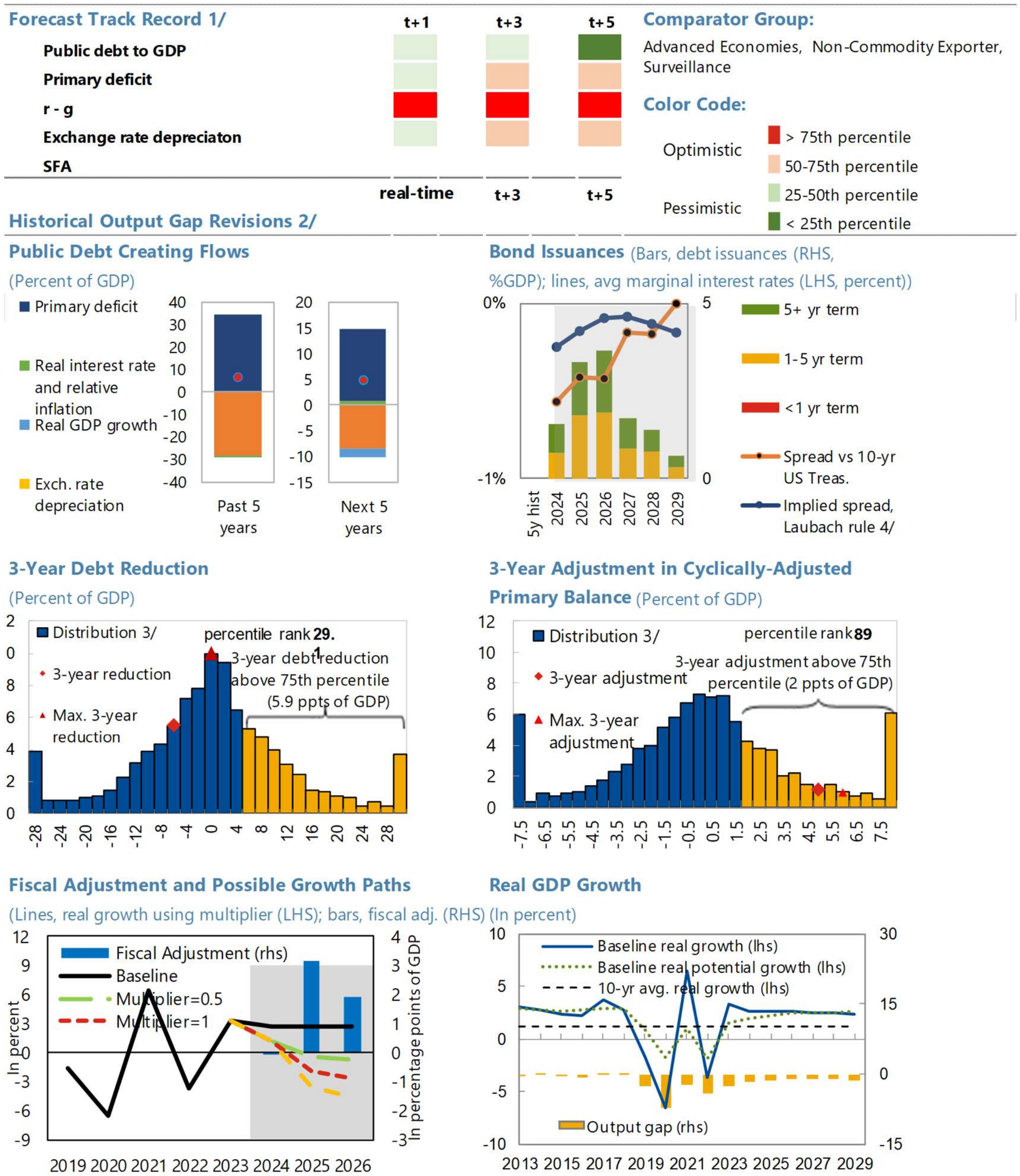
	Actual	Medium-term projection						Extended projection			
	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
Public debt	6.5	9.2	11.5	13.3	13.4	12.4	11.4	10.8	10.3	9.7	9.2
Change in public debt	2.1	2.7	2.3	1.8	0.1	-1.0	-1.1	-0.6	-0.5	-0.5	-0.5
Contribution of identified flows	2.2	2.7	2.3	1.8	0.2	-0.9	-1.0	-0.5	-0.5	-0.5	-0.5
Primary deficit	8.2	7.9	4.5	2.5	0.5	-0.8	-0.5	-0.6	-0.5	-0.5	-0.5
Noninterest revenues	15.9	16.5	18.8	20.4	20.9	21.5	21.5	21.5	21.5	21.5	21.5
Noninterest expenditures	24.1	24.4	23.3	22.9	21.4	20.7	21.0	20.9	21.0	21.0	21.0
Automatic debt dynamics	-0.1	-0.1	-0.1	-0.1	-0.2	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1
Real interest rate and relative inflatio	0.0	0.0	0.1	0.1	0.2	0.2	0.2	0.1	0.1	0.1	0.1
Real interest rate	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Relative inflation	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.0
Real growth rate	-0.1	-0.2	-0.2	-0.3	-0.3	-0.3	-0.3	-0.3	-0.2	-0.2	-0.2
Real exchange rate	0.0	...	...	...	...	...	...	...	...	...	...
Other identified flows	-5.9	-5.0	-2.0	-0.5	-0.2	0.0	-0.4	0.1	0.1	0.1	0.1
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
(minus) Interest Revenues	-2.5	-2.9	-1.8	-1.1	-1.1	-0.9	-0.9	-0.9	-0.9	-0.9	-0.9
Other transactions	-3.4	-2.1	-0.3	0.6	0.9	0.9	0.6	1.1	1.1	1.1	1.1
Contribution of residual	-0.1	0.0	0.0	0.0	-0.1	-0.1	-0.1	0.0	0.0	0.0	0.0
Gross financing needs	5.8	5.3	3.6	3.0	2.3	0.5	0.1	1.6	0.6	0.0	1.5
of which: debt service	0.1	0.3	0.9	1.7	2.9	2.2	1.5	3.1	2.0	1.4	3.0
Local currency	0.0	0.0	0.0	0.1	0.0	0.1	0.0	0.1	0.0	0.1	0.0
Foreign currency	0.1	0.3	0.8	1.6	1.4	2.1	1.5	1.7	2.0	1.3	1.6
Memo:											
Real GDP growth (percent)	3.3	2.7	2.7	2.6	2.5	2.5	2.4	2.4	2.4	2.3	2.3
Inflation (GDP deflator; percent)	2.8	2.3	2.3	2.4	2.5	2.4	2.5	2.5	2.5	2.5	2.5
Nominal GDP growth (percent)	6.1	5.1	5.0	5.1	5.1	5.0	5.0	5.0	4.9	4.9	4.9
Effective interest rate (percent)	3.1	3.0	3.3	3.3	3.4	3.3	3.3	3.3	3.3	3.4	3.4

Contribution to Change in Public Debt



Commentary: Public debt rises due to infrastructure and bond issuance but remains low over the forecast horizon. "Other transactions" includes changes to fiscal reserve asset buffers and investment income. The year 2024 above corresponds with Fiscal Year 2024/2025, as in Table 3.

Appendix III. Figure 5. Hong Kong SAR: Realism of Baseline Assumptions



Commentary: The baseline path through 2029 incorporates rising costs of aging. Relatively low tax revenues to GDP imply space to raise revenues, offsetting downside risks to the fiscal consolidation path.

Source : IMF Staff.

1/ Projections made in the October and April WEO vintage.

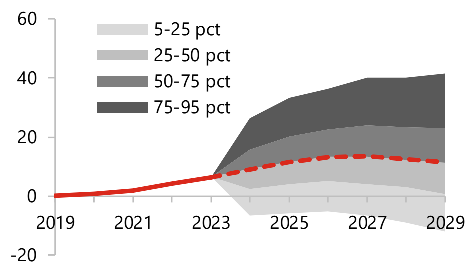
2/ Calculated as the percentile rank of the country's output gap revisions (defined as the difference between real time/period ahead estimates

3/ Data cover annual obervations from 1990 to 2019 for MAC advanced and emerging economies. Percent of sample on vertical axis.

4/ The Laubach (2009) rule is a linear rule assuming bond spreads increase by about 4 bps in response to a 1 ppt increase in the projected debt-to-GDP ratio.

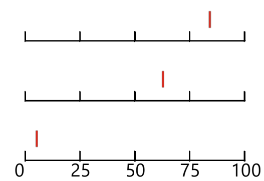
Appendix III. Figure 6. Hong Kong SAR: Medium-Term Risk Assessment

Final Fanchart (Percent of GDP)

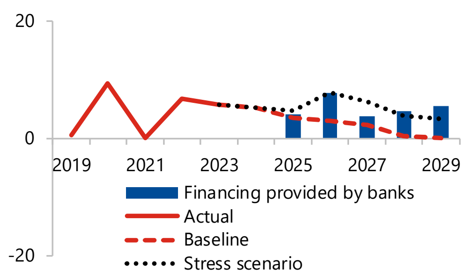


Debt fanchart module

	Value	Contrib 1/	Percentile in peer group 2/
Fanchart width *(percent of GDP)*	53.2	0.8	
Probability of debt non-stabilizaiton *(percent)*	9.5	0.1	
Terminal debt-to-GDP x institutions index	2.0	0.0	
Debt fanchart index (DFI)		0.9	
Risk signal: 3/		Low	

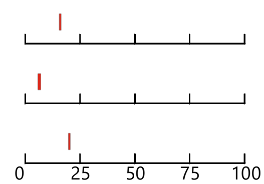


Gross Financing Needs (Percent of GDP)



Gross financing needs (GFN) module

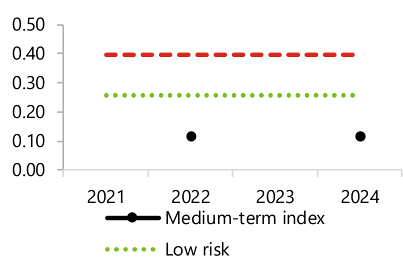
	Value	Contrib 1/	Percentile in peer group 2/
Average baseline GFN *(percent of GDP)*	2.5	0.8	
Initial Banks' claims on the gen. govt *(pct bank assets)*	1.3	0.4	
Chg. In banks' claims in stress *(pct banks' assets)*	1.2	0.4	
GFN financeability index (GFI)		1.7	
Risk signal: 4/		Low	



Triggered stress tests (stress tests not activated in gray)

Banking crisis | Commodity prices | Exchange rate | Contingent liab. | Natural disaster

Medium-Term Index (Index Number)



Medium-term risk analysis

	Value	Value (normalized)	Weight	Contribution
Debt fanchart index	0.9	0.2	0.5	0.1
GFN finaceability index	1.7	0.0	0.5	0.0
Medium-term index		0.1		
Risk signal: 5/		Low		
Final assessment:		Low		

Prob. of missed crisis, 2024-2029, if stress not predicted: 0.0 pct.
Prob. of false alarms, 2024-2029, if stress predicted: 87.5 pct.

Commentary: The relatively large fanchart width reflects the historical volatility of GDP due to the large impact of COVID as well as large variation in the contribution from net exports and inventories.

Source: IMF staff estimates and projections.

1/ See Annex IV of IMF, 2022, Staff Guidance Note on the Sovereign Risk and Debt Sustainability Framework for details on index calculation.
2/ The comparison group is advanced economies, non-commodity exporter, surveillance.
3/ The signal is low risk if the DFI is below 1.13; high risk if the DFI is above 2.08; and otherwise, it is moderate risk.
4/ The signal is low risk if the GFI is below 7.6; high risk if the DFI is above 17.9; and otherwise, it is moderate risk.
5/ The signal is low risk if the GFI is below 0.26; high risk if the DFI is above 0.40; and otherwise, it is moderate risk.

Appendix III. Figure 7. Hong Kong SAR: Triggered Modules

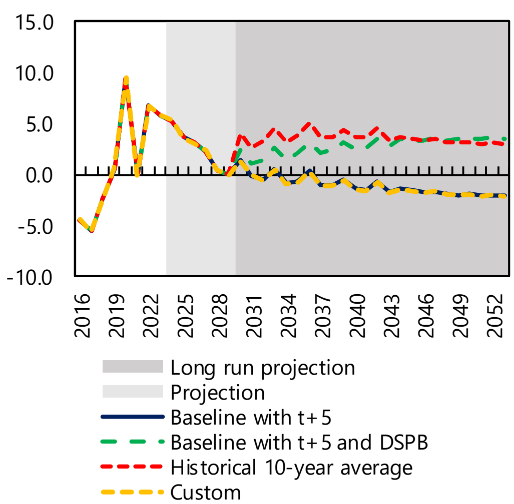
Large amortizations	**Pensions**	Climate change: Adaptation	Natural Resources
	Health	Climate change: Mitigation	

Hong Kong SAR: Long-Term Risk Assessment: Large Amortization Incl. Custom Scenario

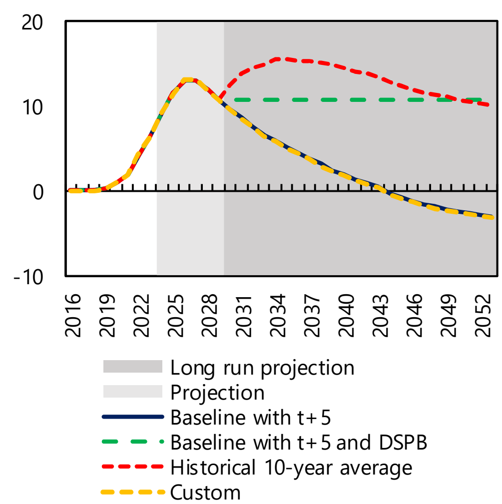
Projection	Variable	Risk Indication
Medium-term extrapolation	GFN-to-GDP ratio	
	Amortization-to-GDP ratio	
	Amortization	
Medium-term extrapolation with debt stabilizing primary balance	GFN-to-GDP ratio	
	Amortization-to-GDP ratio	
	Amortization	
Historical average assumptions	GFN-to-GDP ratio	
	Amortization-to-GDP ratio	
	Amortization	
Overall Risk Indication		

Variable	2029	2033 to 2037 average	Custom Scenario
Real GDP growth	2.4%	2.3%	2.3%
Primary Balance-to-GDP ratio	0.5%	0.5%	0.5%
Real depreciation	-2.5%	-2.5%	-2.5%
Inflation (GDP deflator)	2.5%	2.5%	2.5%

GFN-to-GDP Ratio



Total Public Debt-to-GDP Ratio

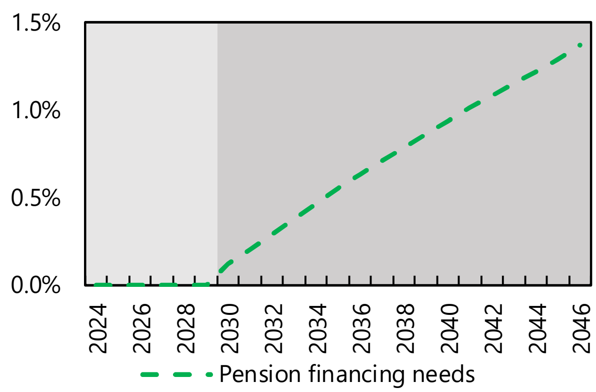


Commentary: Higher risk indications in part reflect low historical average values for amortizations, both relative to GDP and in HKD equivalent. Drivers of the 10-year average scenario are affected by the COVID period, reducing the growth rate and raising the primary deficit.

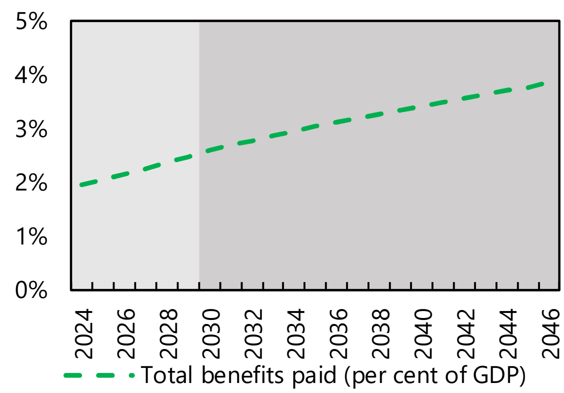
Appendix III. Figure 8. Hong Kong SAR: Demographics: Pensions

Permanent adjustment needed to provide funding for the old-age financial assistance schemes:	**30 years**	**50 years**	**Until 2100**
(pp of GDP per year)	1.4%	2.5%	2.9%

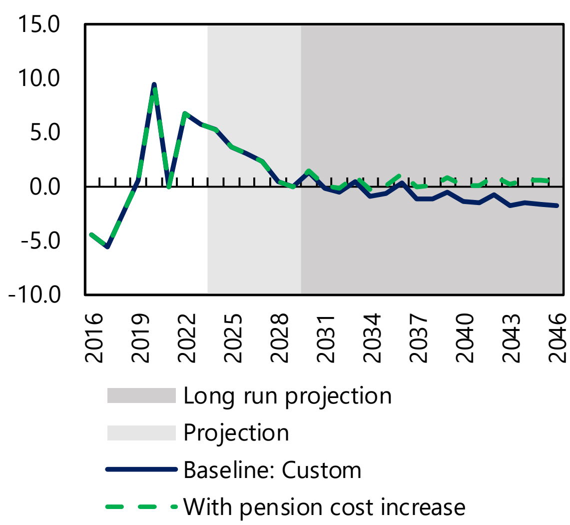
Pension Financing Needs



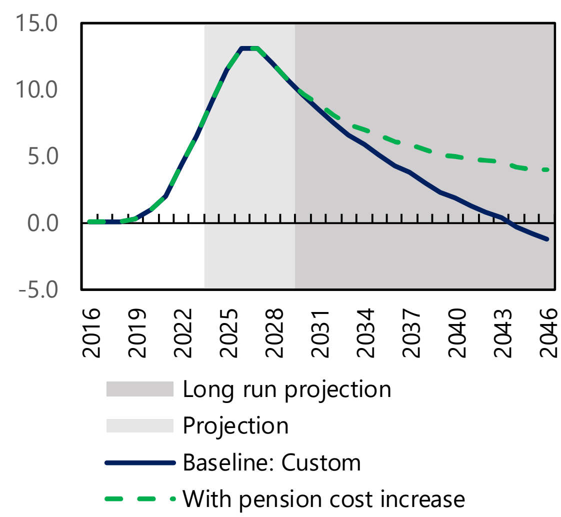
Total Benefits Paid



GFN-to-GDP Ratio

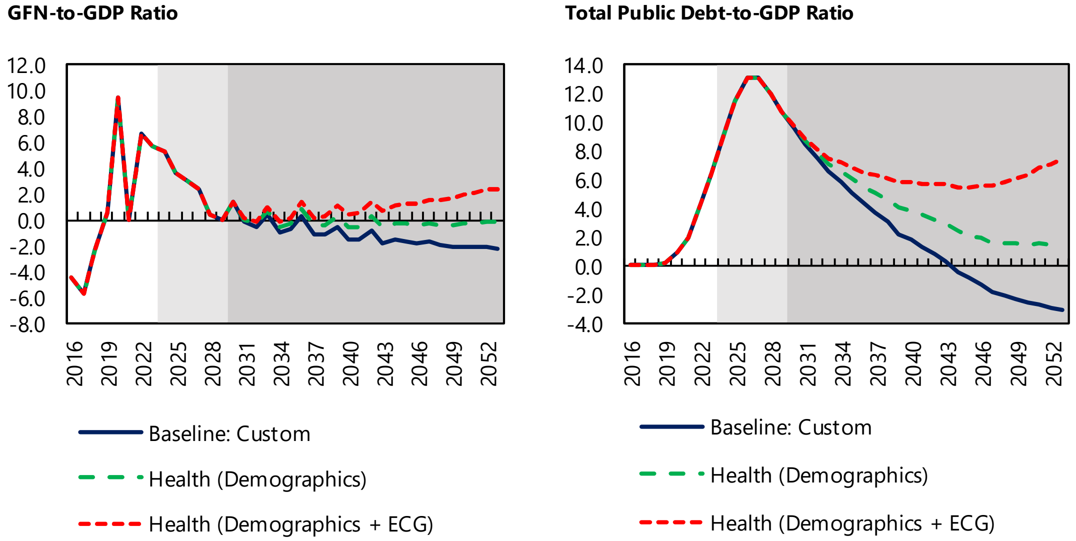


Total Public Debt-to-GDP Ratio



Commentary: Includes only estimated expenditure on the 65+ population under the Social Security Allowance and Comprehensive Social Security Allowance schemes. Financing needs are captured in the baseline through 2029, hence are shown as zero.

Appendix III. Figure 9. Hong Kong SAR: Demographics: Health



Commentary: Follows same methodology and assumptions used in the accompanying Selected Issues Paper on the fiscal implications of aging.

Appendix IV. Implementation of Past IMF Recommendations

Fund Recommendations	Policy Actions
Fiscal policy:	
• The COVID-related increase in the fiscal deficit should be unwound gradually in a growth friendly manner to secure a sustained recovery. • Expanding social safety nets would help enhance the automatic stabilizer role of fiscal policy. • Comprehensive tax reform over the medium term is imperative to provide a stable source of revenues to meet long-term spending needs while ensuring fiscal sustainability.	• The authorities have made the fiscal consolidation path more gradual, with the aim of returning to a balanced budget (before bond issuance and repayment) by two years to FY2027/2028. • The government has enhanced the various cash assistance schemes that are of non-contributory nature, with a notable increase in their recurrent expenditures. • The authorities modestly raised revenues as part of a planned fiscal consolidation, with a new personal income tax tier for high income earners, introduction of a new progressive rating system for rates charged on domestic properties, and re-introduction of the hotel accommodation tax.
Financial sector and housing market policy:	
• Financial relief measures should be phased out to facilitate necessary post-crisis debt restructuring. • The countercyclical capital buffer (CCyB) should be maintained against the backdrop of weak credit growth. Proactive management of risks arising from the stress in Mainland China's real estate sector and the impact of weak economic activity during the pandemic is warranted. • Housing-related macroprudential measures should be maintained and can be recalibrated in the event housing-related stress materializes. Stamp duties need to be adjusted if the systemic risks arising from speculative demand dissipates. • A comprehensive and risk-based regulatory framework related to virtual assets is critical to safeguard financial stability and ensure investor protection. • The authorities should continue their efforts to strengthen the climate information architecture	• An orderly exit from the banking sector's principal payment holiday scheme commenced in July 2023 to facilitate SMEs' gradual return to normal repayment. • The application period of the SME Guarantee schemes has been extended for an additional two years, to end-March 2026. • In 2024Q2, the HKMA announced that the prevailing 1 percent CCyB rate—in place since 2020—would thereafter be considered as the neutral level. In 2024Q3, the CCyB was reduced to 0.5 percent. • Under intensified prudential supervision, impairments and credit loss recognition rose for Mainland-related lending, while Mainland-related lending continued to fall. • In February 2024, the authorities abolished demand-side management measures for residential properties. Macroprudential measures on property-related lending were relaxed. • The authorities established a mandatory licensing system and regulatory requirements for crypto asset services providers in June 2023 to enhance investor protection and increased criminal penalties for operating unlicensed platforms. • In May 2024, HKMA published the Hong Kong Taxonomy for Sustainable Finance, which provides a standardized framework for classifying and labelling financial products and investments.
Structural policies	
• Promoting innovation and digitalization can provide additional growth engines and boost economic resilience amid geoeconomic fragmentation. • Hong Kong SAR should continue to strengthen its competitiveness in attracting human capital.	• The government has introduced funding support for AI development and life and health technology, among other sectors. • The government has introduced or expanded several schemes to attract and retain talents, e.g. the Top Talent Pass Scheme.

Appendix V. Updates on Implementation of FSAP Recommendations[1]

Recommendations	Status
Strengthening Systemic Risk Monitoring	
Continue to monitor Authorized Institutions' concentrated exposures to non-bank mainland China entities, particularly of banking groups with foreign bank branches and subsidiaries. [HKMA]	The HKMA has devoted substantial supervisory resources to banks' non-bank Mainland China exposures, by putting in place rigorous surveillance and analysis framework and conducting regular onsite reviews of banks' systems and practices in the Mainland-related lending business. In light of the heightened credit risk from the property sector in Mainland China in the last few years, the HKMA had stepped up the monitoring of the relevant exposures and conducted deep-dive reviews of some banks' portfolios. So far, the HKMA assesses the risk to be manageable with no particular concentration. Regarding banking groups with foreign bank branches and subsidiaries in Hong Kong SAR, the HKMA has conducted a round of thematic examinations in 2022 on the relevant banking groups' operation in Hong Kong to assess their control with respect to large exposures and credit concentration, as well as any potential signs of regulatory arbitrage. No major deficiencies were identified. The HKMA will continue to carry out supervisory activities on the banking groups concerned in a risk-based manner.
Reassess the need for amending the regulatory perimeter to monitor non-deposit-taking finance companies and leakages to macroprudential policy. [HKSAR Authorities]	The Registrar of Money Lenders conducts annual surveys to monitor the landscape of the licensed money lenders sector. One of the indicators under close watch is the amount of personal loans secured by residential properties for financing the purchase of the properties concerned, which amounted to about $13 billion as at end-2023, 18.8 percent lower than as at end-2022. Furthermore, compared to the amount of loans made by banks for the same purpose in 2023 ($1,980 billion), the portion of loans made by money lenders was not significant (around 0.7 percent). Besides, customer loans of licensed money lenders in 2023 ($165 billion) was 2.2 percent of the customer loans of the banking sector ($7,628 billion) in 2023. The rate was lower than the rate of 2.6 percent in 2022. Based on this, the authorities assessed the systemic risk posed by the licensed money lending sector to the financial system as generally low. Meanwhile, the Government has enhanced regulation of money lenders in recent years. New and revised licensing conditions have been imposed on licensed money lenders since 16 March 2021 requiring them to assess borrower's repayment ability prior to granting unsecured personal loans, and strengthening the regulation over money-lending advertisements and enhancing protection of the information of loan referees. Further, interest rate cap and extortionate rate threshold under the Money Lenders

[1] Prepared by the IMF Staff with information provided by Hong Kong SAR authorities.

Recommendations	Status
	Ordinance (Chapter 163 of the Laws of Hong Kong) were respectively lowered from 60 percent per annum to 48 percent per annum, and from 48 percent per annum to 36 percent per annum since 30 December 2022. The government intends to continue to closely monitor the sector. In co-ordination with the FSTB and other regulatory authorities where necessary, the SFC has been responding proactively to changing markets and new regulatory challenges with a view to (a) identifying, assessing and managing risks in a timely manner; (b) continuing reviewing the effectiveness and relevance of its past regulatory decisions, and (c) determining whether additional measures at the sectoral level are needed, or even to bring in previously unregulated activity into the perimeter of regulation.
Ensure sufficiently forward-looking internal risk models for capital charge for mainland China real estate borrowers with low credit ratings. [HKMA]	In light of the IMF's recommendation, the HKMA has taken further steps to ensure that banks' internal risk models used in determining the capital charge are sufficiently forward looking, including but not limited to that for Mainland real estate borrowers with low credit ratings. In particular, the HKMA conducted a thematic review in 2022 to assess the forward-looking capability of IRB banks' internal risk models. The review focused on examining the extent and effectiveness of the adoption of various model components with forward-looking elements in the internal risk models. The results of the review indicated that the IRB banks' internal risk models were in general sufficiently forward-looking. The HKMA observed that a wide range of forward-looking risk factors, including both quantitative and qualitative ones, were considered in their internal models. In addition, the IRB banks would conduct ad hoc reviews to ensure abrupt changes in borrowers' creditworthiness could be timely reflected in the internal ratings assigned to the borrowers. They also put in place effective model override mechanisms to appraise aspects that might affect borrowers' creditworthiness but were not sufficiently captured by the models' risk factors from a forward-looking perspective. The HKMA has also put in place a framework for ongoing monitoring the performance of internal models adopted by the IRB banks to detect, amongst others, any potential insufficiency in the capital charge that may warrant supervisory follow-up actions with the banks.
Integrate all bank liquidity stress tests, streamline reporting, and enhance monitoring of liquidity position of foreign branches that appear more vulnerable. [HKMA]	**Integrate all bank liquidity stress tests and streamline reporting.** To streamline reporting, the HKMA has revised the relevant return and is consulting the industry on the revisions. The HKMA will integrate the liquidity stress tests upon implementation of the revised return. **Enhance monitoring of liquidity position of foreign branches that appear more vulnerable.** A 3-month supervisory liquidity stress testing (SLST) scenario has been implemented starting from the position of Dec 2021. During

Recommendations	Status
	the initial period of implementation, the results were largely in line with those of FSAP stress tests with a few foreign bank branches being identified as more vulnerable. The HKMA has discussed the stress test results with these banks and requested them to improve their liquidity position as appropriate. No bank failed the 3-month SLST based on the position as of end-March 2024. The HKMA has continued to use the 3-month SLST to monitor banks' liquidity position and plans to take appropriate supervisory actions regarding the stress test results.
Integrate monitoring and stress testing of investment funds' liquidity in the supervisory framework and increase granularity of data collation. [SFC]	The SFC has been requiring fund managers to implement adequate liquidity risk management policies and procedures. In particular, managers of SFC-authorized funds are required to perform ongoing liquidity risk assessment to assess the liquidity profile of their funds' liabilities and assets on a regular basis and perform liquidity stress tests on their funds on an ongoing basis. The SFC reviews compliance during inspections and conducts liquidity stress tests on local-domiciled SFC-authorized funds. The SFC also continues to monitor fund managers' implementation and conducts ad hoc enquiries with specific fund managers for more granular data in response to latest market development. In view of the international regulatory development, starting from 2022, the SFC has expanded the data collection framework to collect more granular data (e.g. detailed breakdown of liquidity profile, credit ratings, currency exposure, etc.) from fund managers for supervisory and monitoring purpose.
Monitor non-mortgage household debt; ensure consistency of risk guidelines among regulators on investment credit to high-net-worth individuals. [HKMA/SFC]	The HKMA has been closely monitoring the trend of household indebtedness regularly, including gathering data and analyzing different components of household debts. To step up monitoring of loans to wealth management customers, the HKMA has introduced a new survey on collateralized lending secured by financial assets in 2022. The HKMA intends to continue to conduct onsite examinations on banks' retail lending business and lending to private banking and wealth management customers. The HKMA has maintained regular and close communications with the SFC in relation to supervisory standards on investment loans to private banking customers with a view to comparing approaches and ensuring consistency. For example, in reviewing the credit risk management of share margin financing, the HKMA had worked closely with SFC to ensure consistency before the revised HKMA guideline on credit risk management of share margin financing was promulgated in October 2021. The SFC has issued guidelines to provide guidance on risk management standards expected of brokers conducting securities margin financing activities. The guidelines, which took effect on 4 October 2019, set out qualitative requirements and quantitative benchmarks for margin lending policies and key risk controls.
Monitor the household debt repayment capacity at a disaggregated level. [HKMA]	The HKMA leverages technology and data analytics for financial analysis and macroprudential surveillance of banking exposure to residential mortgage loans. In particular, the HKMA is using

Recommendations	**Status**
	transaction-level data collected from banks under the Granular Data Reporting initiative to help detect signs of asset quality deterioration pressures, including indicators of debt repayment capacity.
Consider incorporating non-financial corporates in the stress testing framework and communicate the key findings in HKMA's Monetary and Financial Stability Reports. [HKMA]	Shocks to the non-financial corporate sector in Hong Kong have been incorporated into the HKMA's stress testing framework. Please refer to Box 4 of the HKMA's Half-Yearly Monetary and Financial Stability Report (September 2023) for the refined framework. The stress testing results on shocks to the corporate sector, alongside other conventional macroeconomic shocks, will be regularly reported in the HKMA's Half-Yearly Monetary and Financial Stability Report starting from September 2024.
Enhance oversight over banking groups that have both foreign branches and local subsidiaries in HKSAR. [HKMA]	Please refer to the update on the first item (i.e., "Continue to monitor Authorized Institutions' concentrated exposures to non-bank mainland China entities, particularly of banking groups with foreign bank branches and subsidiaries") above. HKMA has strengthened the group-wide supervisions by issuing revised HKMA Supervisory Policy Manual module CS-1 on "Group-wide approach to supervision of locally incorporated AIs" in July 2021 to incorporate the relevant requirements and international standards on the supervision of financial conglomerates, including those with both branches and subsidiaries in Hong Kong.
Heighten monitoring of liquidity risk at the group and entity level for banks that operate with multiple group entities. [HKMA]	The thematic review was completed in October 2022. As noted from the thematic reviews, all reviewed banking groups adhere to supervisory requirements for intragroup liquidity risk management set out in the HKMA's Supervisory Policy Manual module LM-2 on "Sound Systems and Controls for Liquidity Risk Management". Proper monitoring and control mechanisms, such as intragroup liquidity metrics and limits, have been established and adhered to for managing and mitigating the risk of contagion from other group entities.
Stress test banks' large exposures separately from their total loan books. [HKMA]	Stress testing enhancement has been implemented under the HKMA's Top-down solvency stress test framework since Q2 2022.
Macroprudential Policy Framework	
Strengthen the systemic risk monitoring and data collection framework; Continue leveraging analytical expertise of the HKMA/other regulators in CFR/FSC. [HKMA/SFC/IA]	The existing high-level and cross-sectoral setup of the CFR and FSC, with direct oversight by the Financial Secretary and the Secretary for Financial Services and the Treasury, already allows the government to monitor and discuss cross-sectoral issues of regulatory concerns or systemic implications with financial regulators and relevant government agencies.

Recommendations	Status
	The HKMA continues to leverage the enhanced data collection framework to strengthen its systemic risk monitoring. For instance, it has used property market transaction-level data to evaluate the effects of policy loosening on the use of banks' mortgages for commercial real estate transactions. Using the transaction-level loan data collected under its Granular Data Reporting initiative, the HKMA has also applied machine learning techniques to assess credit risks in banks' corporate and residential mortgage loans, and to identify the factors affecting the size of bank loans to the small-to-medium-sized enterprises. These analyses can be found in (i) the June 2022 issue of the HKMA's Quarterly Bulletin; (ii) Box 3 of the September 2022 issue of the HKMA's Monetary and Financial Stability Report; and Box 2 of the September 2023 issue of the same Report. Besides, the HKMA continues to implement its monitoring framework for Hong Kong SAR's financial and monetary stability with input from different data sources (trade repository data, granular data on bank loans, textual analysis) which will be expanded as and when needed. To help detect signs of asset quality deterioration pressures in Hong Kong banks' exposures to corporates, automated dashboards are developed for monitoring credit quality of loans and borrowers. Discussion with other regulators is also held from time to time to assess possible cross-sectoral matters with financial and monetary stability implications. On the insurance front, the IA continues to enhance the supervisory review process by including "outward risk" as part of the qualitative risk assessment in the annual Company Review Cycle. Criteria, indicators and thresholds for the risk assessment will be developed. In addition, the IA has been working on enhancing its macroprudential supervisory tools including implementing a new risk dashboard to identify and monitor systemic risks from a macro perspective.
Enhance data collection of intersectoral claims with a focus on claims of the nonbank financial institutions to better gauge the importance of intersectoral linkages. [HKMA/SFC/IA]	The authorities note that the non-bank financial sector, including non-bank lending, is already covered in their monitoring. The government and the financial regulators will consider further measures to enhance monitoring of financial systemic risks and the need to expand the macroprudential regulatory regime to cover non-bank financial institutions ("NBFIs") as necessary having regard to any systemic risks identified. On the insurance front, sector-wide monitoring data set is being collected from authorized insurers on an annual basis. The data collection template covers, amongst others, the intersectoral linkages (i.e., inter-connectedness) with other financial institutions of an authorized insurer.
Enhance communication through a comprehensive and dedicated financial stability report. [FSTB]	Monthly Reports of the FSC are submitted to the Financial Secretary's Office to strengthen communication and co-ordination.

Recommendations	Status
Financial Sector Supervision	
Update legislation to reflect HKMA's de facto operational independence in the law; in the interim, consider specifying circumstances where Chief Executive may give directions to Monetary Authority. [HKMA]	Section 10 of Banking Ordinance (BO) reserves a right to the Chief Executive of the Hong Kong SAR Government (CESAR) to give to the Financial Secretary and the Monetary Authority such directions as the CESAR thinks fit with respect to the exercise of their respective functions under the BO. The power vested in the CESAR to issue directions to the HKMA under Section 10 of BO reflects the HKSAR Government's ultimate responsibility to formulate monetary and financial policies and supervise financial markets as enshrined in the Basic Law. Given that the power is included in the BO, it is to be exercised in accordance with the objectives and functions of the BO and in practice would only be used as a tool of last resort to implement specific remedial measures in the most critical and extreme circumstances. The power in fact has never been exercised. There is a deeply embedded constitutional and political convention of restraint that the power would not be exercised lightly. These considerations, together with the institutional arrangements put in place to ensure a high degree of operational autonomy of the HKMA, provide strong backing for the Monetary Authority to exercise supervisory power in an independent and professional manner.
Implement group-wide supervision and risk-based capital requirements as planned. [IA]	The implementation of group-wide supervision framework has commenced on 29 March 2021, with the designation of three insurance holding companies under the framework since 14 May 2021. For the risk-based capital regime, the legislative process on amending the Insurance Ordinance incorporating requirements of the new regime has completed. The new regime has commenced on 1 July 2024, with 3-year transitional measures.
Assess systemic risk of individual insurers (potential FIRO designation), and cross-sector risks. [IA]	The IA has been working on the domestic systemically important insurers ("D-SII") framework to identify individual insurers that will pose a risk to the Hong Kong financial industry. For FIRO designation, in July 2024, the IA has reached out to the insurance sector for feedback on the draft framework. The IA aims to finalize the D-SII framework by late 2024 for it to take effect from early 2025.
Enhance surveillance and monitoring of OTC trades. [SFC]	The OTC securities transactions reporting regime (OTCR) for shares listed on the Stock Exchange of Hong Kong was launched in September 2023. OTCR enhances the SFC's market surveillance function by facilitating the identification of investors conducting OTC securities transactions through intermediaries and by collecting data on off-exchange securities transactions in order to uphold market integrity and bolster investor confidence.
Expand enforcement powers over recognized exchange companies and clearing houses, and	In relation to the recommendation for expansion of enforcement powers (similar to the powers that the SFC has over Part V ATS providers) over recognized exchanges and Part III ATS providers, in particular the ability to impose monetary penalties, the SFC would

Recommendations	**Status**
Part III Automated Trading System providers. [SFC]	need to consider further whether such additional enforcement powers would assist in achieving credible deterrence in the Hong Kong SAR market. The SFC has a wide range of regulatory powers that can be exercised in its supervision of recognized exchanges and Part III ATS providers, and the SFC addresses any relevant issues with the recognized exchanges and Part III ATS providers through the regular supervisory activities. For example, the SFC can make a suspension order on the functions of the board of directors of the recognized exchanges. In addition, the SFC has been supervising recognized exchanges and Part III ATS providers to strengthen corporate governance framework to achieve better compliance of relevant rules and procedures. The SFC and other law enforcement agencies also conduct enforcement actions against any employee of recognized exchanges and Part III ATS providers committing criminal offences under the Securities and Futures Ordinance and other relevant ordinances. The authorities are uncertain that the imposition of monetary penalties on recognized exchanges and Part III ATS providers would provide additional benefits in achieving the regulatory objectives in the short run.
Strengthen the current governance of the HKCC by setting up a proper HKCC board, an independent risk management committee, and decentralized key functions. [HKEX]	The HKEX Board engaged an independent consultant to help conduct a comprehensive review of the HKEX group risk governance. The review was completed in 2021. The SFC notes that the key recommendations of the risk review related to the HKCC include bolstering the ability of risk management to influence decision-making, investing in adequate resources and tools for risk management, restructuring and upgrading the compliance function to improve regulatory engagement and internal controls, developing a structured framework to ensure proper subsidiary governance, and enhancing the HKEX Board's oversight by clarifying its roles and responsibilities and improving interaction and information flows with management. In 2023, HKEX completed implementation of the above recommendations relating to the HKCC. The SFC has noted improvement in the quality of risk analysis in respect of HKEX's proposals and daily operations. Both HKEX's risk unit and compliance unit now have more influence in the decision-making process Improvement is noted in the independence and effectiveness of the HKEX's risk and conflict of interest management thereby addressing the IMF's concerns. The SFC is of the view that it is not necessary to make any changes to the HKCC's governance structure in view of the implementation of the review recommendations.
Adopt a framework to ensure that its prudential mandate is not compromised by development initiatives. [HKMA]	The HKMA's objectives and functions are clearly focused on the effective working and general stability of the banking system (Banking Ordinance s. 7) and the stability and integrity of the monetary and financial systems (Exchange Fund Ordinance s. 3(1A)) of the Hong Kong SAR. There is a strong tradition and

Recommendations	Status
	commitment within the organization, communicated publicly, of recognizing such stability as a prerequisite and cornerstone for the maintenance of the Hong Kong SAR's position as an international financial center. To the extent that action can be taken by the HKMA, using the resources of the Exchange Fund, under the Exchange Fund Ordinance "with a view to maintaining Hong Kong SAR as an international financial center", it must still be for the purpose of maintaining the stability and the integrity of the monetary and financial systems of the Hong Kong SAR. Therefore, the healthy development of the banking system is consistent with the maintenance of stability. For example, whilst technologically advanced financial infrastructure may be developed, or action taken to increase the depth and breadth of the local debt markets, the underlying objective in each case remains the effective working and, by extension, the stability of the local financial system. Within the HKMA, there is clear delineation of responsibilities among departments the work of which contribute to the overall stability and development of the Hong Kong SAR's financial system. The banking departments of the HKMA are primarily responsible for the prudential supervision and conduct supervision of banks, while other departments are undertaking macro-surveillance, liquidity support, and market operations functions to ensure monetary stability. The HKMA notes that in planning for developmental work, an overarching consideration for the HKMA is the implications of the initiatives on monetary and financial stability.
Enhance the risk management framework of the HKCC, including giving HKMA's oversight responsibility over HKCC's liquidity and settlement risks and strengthening HKCC's capacity to manage credit and operational risks. [HKMA/SFC]	See the above response.
Improve the AML/CFT regime, including enhancing prosecution of the laundering of proceeds from foreign offenses, increasing risk understanding, and strengthening supervision of certain nonfinancial sectors. [HKMA/FSTB]	The HKSAR Government attaches great importance to the AML/CFT system of Hong Kong and seeks to improve the system continuously. As captured in the Risk Assessment Report, Hong Kong as an international financial center is exposed to ML threats arising from both internal and external predicate offences. The HKSAR Government has stepped up efforts on enhancing prosecution of the laundering of proceeds from foreign offences. Between 2018-2022, 57.2 percent of the overall ML-related investigations by the Hong Kong Police Force originated from foreign predicate offences. In investigating and prosecuting such cases, law enforcement agencies make use of various channels (e.g., mutual legal assistance (MLA), Court-to-Court process under the Evidence Ordinance (Cap. 8), or other forms of international co-operation

Recommendations	Status
	such as exchanges between financial intelligence units) to obtain necessary information / evidence. Between 2018 and 2022, Hong Kong made 21 MLA requests to other jurisdictions related to ML investigation and/or prosecution. On understanding of ML/TF risk, the HKSAR Government published the second Hong Kong Money Laundering and Terrorist Financing Risk Assessment Report (HRA) in July 2022, the 2022 HRA covers data spanning from 2016 to 2020 and updates the ML/TF threats and vulnerabilities from both the territory-wide and sectoral perspectives. Drawing on the experience in the 2018 HRA and the recommendations of the FATF in relation to ML/TF risk understanding, the HKSAR Government has expanded the 2022 HRA to include more in-depth assessment, namely (a) risk assessment on proliferation financing in Hong Kong; (b) in-depth analysis on the stored value facility and virtual asset service provider sectors; (c) highlights of the latest developments in various sectors, e.g. virtual banks; (d) inclusion of financial leasing, non-bank credit card businesses and credit unions; (e) detailed and focused assessment on threats with foreign or international elements; and (f) expanded coverage of analysis over legal persons and legal arrangements. The HKSAR Government is following up on the risks identified through a multi-pronged approach. On strengthening supervision of non-financial sector, the FATF has approved Hong Kong's regular follow-up report (FUR) through written process. Hong Kong has made good progress in addressing the technical compliance deficiencies identified in its Mutual Evaluation Report, and the FATF has upgraded Hong Kong's rating on R.28 Regulation and supervision of DNFBPs, in particular for estate agents, accounting professionals, legal professionals, and dealers in precious metals and stones.
Crisis Management and Financial Safety Nets	
Update the deposit protection scheme, including expanding the scope of depositor preference, extending the mandate of the Deposit Protection Board to allow it to contribute to resolution costs, and reviewing the size of the Deposit Protection Scheme fund and flexibility of levies. [HKMA]	In the latest comprehensive review of the Deposit Protection Scheme (DPS) initiated in 2021, the Hong Kong Deposit Protection Board (the Board) has examined all major aspects of the DPS, including but not limited to the protection limit, the size of the DPS Fund and the levy system. Arising from the review, a number of policy recommendations aimed at enhancing the DPS were put forward, and gained wide support from the public and other stakeholders during the 3-month public consultation exercise in July-October 2023. A key recommendation is to increase the protection limit to HK$800,000 from the existing HK$500,000. The findings of a review of the DPS funding model conducted by an external consultant indicated that the existing target size of the DPS Fund as a percentage of protected deposits (i.e. 0.25 percent) is still sufficient to cover potential loss to the DPS at the higher protection limit of HK$800,000 and under more pessimistic assumptions. Notwithstanding this, the target fund size, in monetary terms, will increase from HK$6.3 billion to around HK$8.2

Recommendations	Status
	billion. As such, the Board has proposed refinements to the levy system such that the build-up levy rates can be charged again when the protection limit is raised, which will help ensure the new target fund size can be reached within a reasonable timeframe of around three years. The relevant legislative amendments have been passed by the Legislative Council in Hong Kong and will take effect in two phases in October 2024 and January 2025 respectively. Separately, the Board is also studying the feasibility of expanding its mandate to increase its involvement in the resolution decision-making process and resolution funding.
Enhance the implementation of the resolution framework, including resolution planning for non-systemically important banks, close monitoring of Loss-Absorbing Capacity, ex-post resolution levies, resources of nonbank resolution authorities (particularly, for CCPs), and cross-border cooperation. [HKMA/SFC/IA]	Regarding resolution policy, the Financial Institutions (Resolution) (Contractual Recognition of Suspension of Termination Rights—Banking Sector) Rules (Stay Rules) came into operation in August 2021. A Code of Practice (CoP) providing guidance on the operations of the Stay Rules was published in December 2021. In addition, three other CoP chapters setting out the expectations in relation to operational continuity, liquidity and funding needs, and continuity of access to critical financial market infrastructure services respectively, were published in November 2021, July 2022 and February 2024. In relation to resolution execution capability, a Resolution Advisory Framework (RAF) was established in 2020-21 to support efficient engagement of external advisors as needed. The HKMA advanced in 2023 the work on operationalization of resolution stabilization options, including engaging an external legal advisor under the RAF to facilitate the analysis of the legal and practical issues involved in preparing for a resolution transfer. A memorandum of understanding between the Monetary Authority, the IA and the SFC, which establishes a framework to strengthen and support effective cooperation and coordination among the resolution authorities in relation to within scope financial institutions under the FIRO, was signed in December 2023. In addition, the HKMA conducted a comprehensive review of, and made enhancement on, its frameworks and approaches relating to crisis management and resolution execution reflecting on the lessons learnt from the 2023 overseas banking turmoil and taking into account the developments and implementation experiences since the FIRO commenced operations. On resolution planning, the HKMA continues to work with banks to implement the changes needed to enhance their resolvability. In particular, all domestic systemically important banks (D-SIBs) built up a new layer of loss-absorbing capacity (LAC) resources and met their applicable LAC requirements from January 2023, representing a milestone in enhancing the resolvability of these banks. The HKMA conducted a review of LAC implementation from December 2018 to June 2023, the observations from which were set out in the Report on Loss-Absorbing Capacity Requirements Implementation in Hong Kong published in February 2024. Other than LAC,

Recommendations	Status
	implementation of resolution policy on operational continuity, liquidity and funding, contractual recognition of suspension of termination rights, as well as continuity of access to FMIs, has been ongoing. The HKMA also advanced the determination of preferred resolution strategies and implementation of resolution standards for other relevant banks. In addition, the HKMA has continued to oversee banks' development and testing of resolution capabilities. As for international and cross-border cooperation, the HKMA has been leading the regional resolution planning for the Asia resolution group of a global systemically important bank (G-SIB) and participated in cross-border resolution planning of 14 G-SIBs through Crisis Management Groups and Crisis Management Colleges. In addition, the HKMA is actively contributing to international resolution policy development and monitoring through its membership at relevant Financial Stability Board ("FSB") steering and working groups. The HKMA chaired the 2023 FSB Country Peer Review of Switzerland to examine Switzerland's implementation of too-big-to-fail reforms, the report of which was published in February 2024, providing recommendations to further strengthen the supervisory and resolution frameworks. Regionally, the HKMA continues to chair and serve as the secretariat of the Executives' Meeting of East Asia-Pacific Central Banks Study Group on Resolution, and took part in the design and execution of a cross-border crisis simulation exercise in 2022 organized by the BIS's Financial Stability Institute involving 10 authorities in the Asia-Pacific region. In relation to central counterparties (CCPs), the SFC is conducting an assessment of the adequacy of the powers and tools available to it in the event of a CCP resolution, and updating the procedures and processes for the same taking into account the latest global developments. The SFC continues to participate in the FSB's work on Cross Border Crisis Management for FMIs. Within the insurance sector, the IA is developing a resolution framework for relevant insurers which outlines an overarching approach and principles governing the use of resolution powers and addresses proportionality as well as scope of application. The FIRO shall provide an orderly resolution regime for the within scope insurers. Regarding resolution planning, insurance groups are at different stages. One insurance group has a resolution plan in place at the group level. The IA will lead in developing group resolution plans for the remaining 2 IAIGs, with the support from the respective CMGs, according to agreed workplans and timelines. **<u>Enhance the implementation of the resolution framework for ex-post resolution levies.</u>** The FSTB has invited all resolution authorities (RAs) to consider and develop views in relation to the guidelines of imposing ex post levy for their respective sector/cross-sectoral groups, taking into

Recommendations	Status
	account the specificities (including international development) of the sector. The HKMA has included details on their views on the levy framework in the issue of HKMA's Quarterly Bulletin published in September 2019. Having regard to the views and recommendations of the RAs, the FSTB will suitably consider developing and publishing a draft framework for the conditions and pace of post-resolution levies to ensure that market participants are well-informed.
Provide greater clarification on governance and risk management of emergency liquidity assistance. [HKMA]	The HKMA has communicated and restated the framework for the provision of liquidity, incorporating certain refinements to prior arrangements so as to foster a better understanding of the liquidity facilities framework and to also introduce the Resolution Facility. The HKMA continuously works with banks to develop and enhance their readiness for accessing emergency liquidity assistance through putting in place the necessary capabilities for liquidity reporting and projection, as well as collateral identification and mobilization, and also testing and assurance of operational preparedness activities.
Fintech and Financial Innovation	
Promote consistency and facilitate information sharing across financial sectors with respect to cyber risk supervision; review and compare incident reporting frameworks across sectors and apply best practices to other sectors. [HKMA/SFC/IA]	The HKMA, the SFC and the IA have regular meetings on matters related to cyber risk supervision, including feasibility of extending the Hong Kong Association of Banks' cyber threat intelligence platform to other sectors and sharing of information on cyber incident reporting frameworks across sectors. The authorities are considering putting in place more structured exchange on cyber risk supervision, commensurate with the threat landscape. In addition, any significant cybersecurity incidents will also be discussed on an anonymous basis at the meetings so that any lesson learned, and best practices can be shared. For example, the HKMA and the SFC Cybersecurity team have had a discussion to share the industry impacts and lesson learned from the recent CrowdStrike incident. To further enhance the industry's collective preparedness against systemic cyber incidents, the HKMA, SFC and IA participated in a cross-sectoral crisis simulation exercise featuring cyber supply chain attacks in November 2023. During the simulation, communication and information sharing protocols between authorities were tested. The HKMA continues to promote the cross-sectoral link-up of cyber threat intelligence platforms within the Hong Kong banking and financial service sector. In December 2022, the insurance sector's and banking sector's cyber threat intelligence platforms were linked up, enabling banks and insurers to exchange cyber threat intelligence in a secure and controlled manner. The HKMA is facilitating another potential link-up between the regulators of the capital market sector, banking sector and insurance sector in 2024.

Recommendations	Status
Consider undertaking exercise to map network interdependencies. [HKMA/SFC/IA]	The HKMA is undertaking the cyber mapping exercise in collaboration with FSTB, SFC, IA and MPFA and with the assistance of an external consultant. The design phase of the project has been completed. The implementation phase has commenced in H2 2024 with target completion in 2025.
Strengthen systematic data collection of entities to enhance monitoring of holdings of virtual assets; monitor virtual assets trading activities continuously; increase investor education. [FSTB/HKMA/SFC/IA]	On data collection, the HKMA has been collecting the relevant statistics from registered institutions on their virtual asset (VA)-related intermediary activities through regular surveys since July 2022. VA trading platforms (VATPs) are licensed by the SFC The SFC requires the platform operators to submit monthly reports on VA trading activities to the SFC. These requirements have been incorporated into and applied under the licensing regime under the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (AMLO). The regime took effect on 1 June 2023, under which all centralized VATPs carrying on business in Hong Kong or actively marketing to Hong Kong investors need to be licensed with the SFC. In the SFC periodic statutory returns: (i) SFC-licensed corporations are required to report in their periodic statutory returns their proprietary positions in VA, exposures to VATPs and the respective profit or loss (P/L) from VA trading. Licensed corporations' own holding of VA cannot be counted towards their liquid assets when assessing the adequacy of these corporations' regulatory capital; (ii) Licensed VA fund managers also need to report assets under management in respect of funds adopting VA strategies including exposure to VA related derivatives and spot ETFs; (iii) VATPs licensed under AMLO are further required to report their profit and loss from dealing in VA and clients' positions in VA; and (iv) licensed top-level depositaries of SFC-authorized collective investment schemes (relevant CIS) are required to report the relevant CISes' VA under their safe custody and the respective locations. Besides, the SFC and HKMA collect data from intermediaries on their selling of non-exchange traded investment products (including VA funds and other investment products with VA as underlying) to non-institutional investors via the annual SFC/HKMA joint product surveys. Under the proposed regulatory regime for stablecoin issuers, licensed stablecoin issuers will be required to disclose and report the total amount of fiat-referenced stablecoins in circulation, the mark-to-market value and the composition of reserve assets underlying the issuance of the stablecoins. A Bill on the proposed regulatory regime will be introduced into the Legislative Council within 2024.

<table>
<tr><th>Recommendations</th><th>Status</th></tr>
<tr><td></td><td>On investor education, the HKMA and the SFC, through social media and press release from 2018 to 2023, and a radio broadcast in December 2023, alerted the public to some common tactics used in crypto scams and the need to take heed of the risks relating to investing in VA (such as price volatility and possible fraud), and risks of trading on unregulated VATPs. They also enhanced investor education on VA-related products through the Investor and Financial Education Council (IFEC)'s website page "The Chin Family", which has issued a series of articles and hosted online programs reminding investors of the risks associated with VA.

Separately, the SFC posted alert lists of warnings against suspicious VATPs and VA-related investment products, and launched publicity campaigns against investment scams as well as the risks of trading on unregulated VATPs.

The SFC and the IFEC will continue to step up publicity and promotional efforts.</td></tr>
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Appendix VI. Data Issues

Appendix VI. Table 1. Hong Kong SAR: Data Adequacy Assessment for Surveillance

Data Adequacy Assessment Rating 1/

A

Questionnaire Results 2/

Assessment	National Accounts	Prices	Government Finance Statistics	External Sector Statistics	Monetary and Financial Statistics	Inter-sectoral Consistency	Median Rating
	A	A	A	A	A	A	A

Detailed Questionnaire Results

Data Quality Characteristics	National Accounts	Prices	Government Finance Statistics	External Sector Statistics	Monetary and Financial Statistics	Inter-sectoral Consistency
Coverage	A	A	A	A	B	
Granularity 3/	A		A	A	A	
			A		A	
Consistency			A	B		A
Frequency and Timeliness	A	A	A	A	A	

Note: When the questionnaire does not include a question on a specific dimension of data quality for a sector, the corresponding cell is blank.
1/ The overall data adequacy assessment is based on staff's assessment of the adequacy of the country's data for conducting analysis and formulating policy advice, and takes into consideration country-specific characteristics.
2/ The overall questionnaire assessment and the assessments for individual sectors reported in the heatmap are based on a standardized questionnaire and scoring system (see IMF *Review of the Framework for Data Adequacy Assessment for Surveillance*, January 2024, Appendix I).
3/ The top cell for "Granularity" of Government Finance Statistics shows staff's assessment of the granularity of the reported government operations data, while the bottom cell shows that of public debt statistics. The top cell for "Granularity" of Monetary and Financial Statistics shows staff's assessment of the granularity of the reported Monetary and Financial Statistics data, while the bottom cell shows that of the Financial Soundness indicators.

A	The data provided to the Fund is adequate for surveillance.
B	The data provided to the Fund has some shortcomings but is broadly adequate for surveillance.
C	The data provided to the Fund has some shortcomings that somewhat hamper surveillance.
D	The data provided to the Fund has serious shortcomings that significantly hamper surveillance.

Rationale for staff assessment. The economic database is generally comprehensive and of high quality, and data provision is adequate for surveillance.

Hong Kong SAR compiles and disseminates GDP statistics under the production and expenditure approaches. The expenditure measure of GDP, which is more well established, is adopted as the single measure of GDP. The production and expenditure approaches are also compiled in chained volume terms. The statistical discrepancies are explicit under the production approach in current terms. Quarterly GDP is available by expenditure components as well as by industry value added.

The Census and Statistics Department produces and disseminates a monthly CPI index with a lag no longer than 23 days after the end of the reference month. The weights are based on the Household Expenditure Surveys which is conducted once every five years.

Hong Kong SAR complies and disseminates Government Finance Statistics both on cash and accrual basis according to the Fund's Government Finance Statistics Manual (GFSM 1986 and GFSM 2001, respectively).

The HKMA reports monetary data for the central bank and banking institutions to STA on a regular monthly basis, which are published in the IFS. The breadth of coverage on the non-bank financial institution (NBFI) sector, particularly on non-bank credit, leverage, and crypto-asset activities, is however limited relative to the size and complexity of the financial system.

Hong Kong SAR publishes comprehensive balance of payments data and international investment position statistics, submits quarterly external debt statistics to the Quarterly External Debt Statistics (QEDS) database, and participates in the Coordinated Portfolio Investment Survey (CPIS) and the Coordinated Direct Investment Survey (CDIS). However, Net errors and omissions reported in balance of payments data have been relatively large on average, suggesting room to improve the consistency in the data.

Changes since the last Article IV consultation. No changes.

Corrective actions and capacity development priorities. The authorities have prioritized data collection from NBFIs to facilitate better monitoring and stress testing. Staff have recommended bringing NBFIs into the statistical reporting framework, which should also improve coverage of financial flows in the external sector statistics.

Use of data and/or estimates different from official statistics in the Article IV consultation. Commercial micro-level non-financial corporate data is used to assess corporate vulnerabilities.

Other data gaps. Staff do not see any other data gaps for surveillance.

Appendix VI. Table 2. Hong Kong SAR: Data Standards Initiatives

Hong Kong SAR subscribes to the Special Data Dissemination Standard (SDDS) since October 1996 and publishes the data on its National Summary Data Page. The latest SDDS Annual Observance Report is available on the Dissemination Standards Bulletin Board (https://dsbb.imf.org/).

Appendix VI. Table 3. Hong Kong SAR: Table of Common Indicators Required for Surveillance

	Data Provision to the Fund				Publication under the Data Standards Initiatives through the National Summary Data Page			
	Date of Latest Observation	Date Received	Frequency of Data[6]	Frequency of Reporting[6]	Expected Frequency[6,7]	Hong Kong SAR[8]	Expected Timeliness[6,7]	Hong Kong SAR[8]
Exchange Rates	2-Dec-24	2-Dec-24	D	D	D	D	...	1D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Oct-24	7-Nov-24	M	M	M	M	1W	NLT 1W
Reserve/Base Money	Dec-24	29-Nov-24	M	M	M	M	2W	2W
Broad Money	Oct-24	29-Nov-24	M	M	M	M	1M	2M
Central Bank Balance Sheet	Oct-24	29-Nov-24	M	M	M	M	2W	2W
Consolidated Balance Sheet of the Banking System	Oct-24	29-Nov-24	M	M	M	M	1M	2M
Interest Rates[2]	2-Dec-24	2-Dec-24	D	D	D	D	...	1D
Consumer Price Index	Oct-24	23-Nov-24	M	M	M	M	1M	NLT 23D
Revenue, Expenditure, Balance and Composition of Financing[3]–General Government[4]	Oct-24	29-Nov-24	M	M	A	M	2Q	1M
Revenue, Expenditure, Balance and Composition of Financing[3]–Central Government	Oct-24	29-Nov-24	M	M	M	...	1M	...
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Oct-24	29-Nov-24	M	M	Q	...	1Q	...
External Current Account Balance	Q2 2024	20-Sep-24	Q	Q	Q	Q	1Q	1Q
Exports and Imports of Goods and Services	Oct-24	26-Nov-24	M	M	M	M	8W	4W
GDP/GNP	Q3 2024	15-Nov-24	Q	Q	Q	Q	1Q	2M
Gross External Debt	Q2 2024	20-Sep-24	Q	Q	Q	Q	1Q	1Q
International Investment Position	Q2 2024	7-Nov-24	Q	Q	Q	Q	1Q	1Q

[1] Includes reserve assets pledged or otherwise encumbered, as well as net derivative positions.

[2] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

[3] Foreign, domestic bank, and domestic nonbank financing.

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

[5] Including currency and maturity composition.

[6] Frequency and timeliness: ("D") daily; ("W") weekly or with a lag of no more than one week after the reference date; ("M") monthly or with lag of no more than one month after the reference date; ("Q") quarterly or with lag of no more than one quarter after the reference date; ("A") annual.; ("SA") semiannual; ("I") irregular; ("NA") not available or not applicable; and ("NLT") not later than;.

[7] Encouraged frequency of data and timeliness of reporting under the e-GDDS and required frequency of data and timeliness of reporting under the SDDS and SDDS Plus. Any flexibility options or transition plans used under the SDDS or SDDS Plus are not reflected. For those countries that do not participate in the IMF Data Standards Initiatives, the required frequency and timeliness under the SDDS are shown for New Zealand, and the encouraged frequency and timeliness under the e-GDDS are shown for Eritrea, Nauru, South Sudan, and Turkmenistan.

[8] Based on the information from the Summary of Observance for SDDS and SDDS Plus participants, and the Summary of Dissemination Practices for e-GDDS participants, available from the IMF Dissemination Standards Bulletin Board (https://dsbb.imf.org/). For those countries that do not participate in the Data Standards Initiatives, as well as those that do have a National Data Summary Page, the entries are shown as "..."

INTERNATIONAL MONETARY FUND

PEOPLE'S REPUBLIC OF CHINA—HONG KONG SPECIAL ADMINISTRATIVE REGION

December 17, 2024

STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION DISCUSSIONS—INFORMATIONAL ANNEX

Prepared By | Asia and Pacific Department (in consultation with other departments)

CONTENTS

FUND RELATIONS

(As of September 1, 2024)

Membership Status

As a Special Administrative Region of the People's Republic of China, Hong Kong SAR is not a member of the Fund. However, annual consultation discussions have been held with the Hong Kong SAR authorities since October 1990, and the staff also holds discussions with the authorities in connection with the Fund's multilateral surveillance reports. STA has provided Hong Kong SAR with technical assistance in the area of balance of payments statistics and Hong Kong SAR officials have attended IMF Institute courses on statistics, financial programming, and other macro-financial surveillance topics. The mandatory Financial Stability Assessment under the FSAP was concluded by the Executive Board of the IMF on May 21, 2021.

Exchange Rate Arrangement

The Hong Kong dollar has been linked to the U.S. dollar under a currency board arrangement, the Linked Exchange Rate System (LERS), since October 1983 at a rate of HK$7.8/US$1. The Hong Kong Monetary Authority (HKMA) refined the operations of the LERS in May 2005—following two rounds of changes since September 1998. For the first time since the introduction of the LERS in 1983, the HKMA explicitly committed to sell Hong Kong dollar at a preannounced price (set at HK$7.75/US$), which is referred to as the strong-side Convertibility Undertaking. Previously, the HKMA had only committed to buy Hong Kong dollar at a preannounced rate (the weak-side Convertibility Undertaking introduced in October 1998) and could sell Hong Kong dollar at any price. Along with this two-way Convertibility Undertaking, the HKMA also introduced a symmetric trading band of 0.6 percent around a central parity of HK$7.8/US$. There are no restrictions on current or capital account transactions in Hong Kong SAR, and the Hong Kong dollar is freely convertible. The People's Republic of China accepted the obligations under Article VIII, Sections 2, 3, and 4 of the Articles of Agreement on December 1, 1996. The exchange regime is free of restrictions and multiple currency practices.

Resident Representative

The Hong Kong SAR sub-office of the Beijing Resident Representative's office was opened on September 23, 2000. The office's current primary function is to support the IMF's financial market surveillance in the Asia and the Pacific region. Sally Chen is the current Resident Representative.