Economics

Hong Kong 2025 macro outlook: A cloudy weather

China/Economics/Markets

Group Research

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Executive Summary

Hong Kong's economic outlook is a cloudy one, although we may see the sun peeking through once in a while. Lower interest rates may spur lending, while robust external demand could fuel growth in machinery and electronics exports. Yet the retail sector continues to contend with weak employment as well as shifting consumer preferences, and the real estate market remains weighed down by oversupply. Adding to the complexity are ongoing geopolitical tensions. GDP is projected to grow by around 2.5% in 2025, balancing the opposing forces.

1. **Rates:** 3-month HIBOR is forecast to fall to 2.88-3.38% in 1H25.

2. **Credit:** Looser monetary conditions should ease liquidity pressures for local businesses, while a narrowing HKD-CNY spread may support mainland corporate offshore borrowing. Bank lending is expected to turn positive by mid-2025, with modest growth for the year. M1 is poised to resume growth as households divert more funds back into demand deposits.

3. **Trade:** Electronics exports, buoyed by steady demand for AI components and energy-efficient tech, will drive growth, with emerging market demand bolstering the city's re-export trade.

4. **Consumption:** A weaker Hong Kong dollar will help the struggling retail sector but shifts toward experiences over luxury goods and mainland shopping may limit recovery.

5. **Property:** Although positive “carry” on residential investments may stabilize prices, a glut of new homes suggests full recovery is still distant.

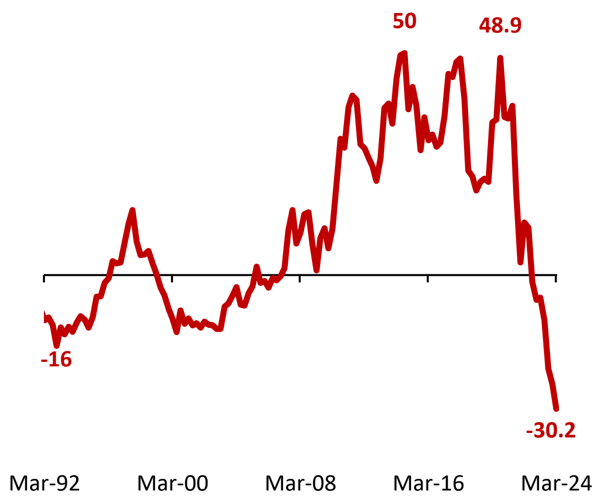
Outlook: Subpar growth

	2023	2024F	2025F	2026F
GDP growth, yoy%	3.3	2.4	2.5	2.5
Inflation, yoy% ave	2.0	1.5	1.5	1.5
HKD per USD, eop	7.81	7.77	7.77	7.78
3M HIBOR, % eop	5.15	3.33	2.88	2.88

Hong Kong's economic recovery has restored pre-pandemic GDP levels, though growth remains below prior trends. We forecast annual GDP expansion of 2.4-2.5% in 2024-2025, lagging the 2010-2019 average of 2.8%.

China's slowdown, intensified geopolitics tensions, and lingering pandemic effects have collectively weighed on the global financial hub. **Monetary conditions tightened as interest rates rose while loan growth weakened, evident in the credit-to-GDP gap declining from 48.9% in 3Q20 to -30.2% in 1Q24.** Rising business retrenchment, restructuring and acquisitions underscore the downturn's impact across beleaguered sectors like retail, food & beverage, manufacturing, and construction.

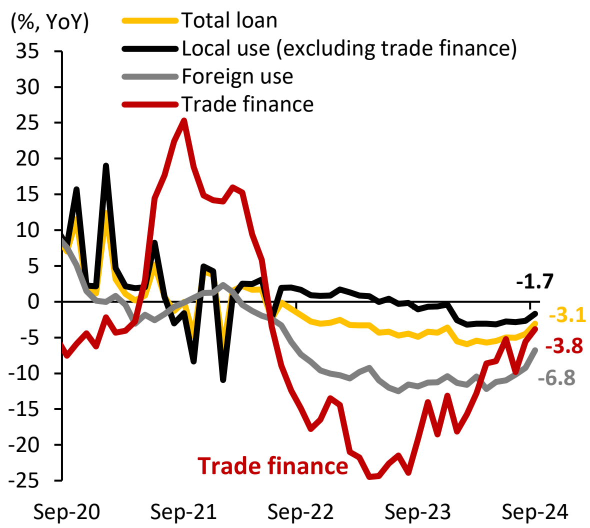
Credit to GDP gaps, %



Source: BIS, DBS

Recent HKMA measures aim to ease capital buffers and restart loan concessions to support small and medium enterprises. Further interest rate cuts coupled with relaxed lending standards should also alleviate liquidity constraints for local firms. **While interbank rates may briefly surge year-end, 3-month HIBOR is forecast to decline in 1H25 to 2.88-3.38%.** Lower rates will benefit investment banking and wealth management at institutions with capital market exposure. A narrowing HKD-CNY spread also supports mainland corporate offshore borrowing. **Bank lending is projected to turn positive in mid-2025, growing modestly for the full year driven by trade finance.**

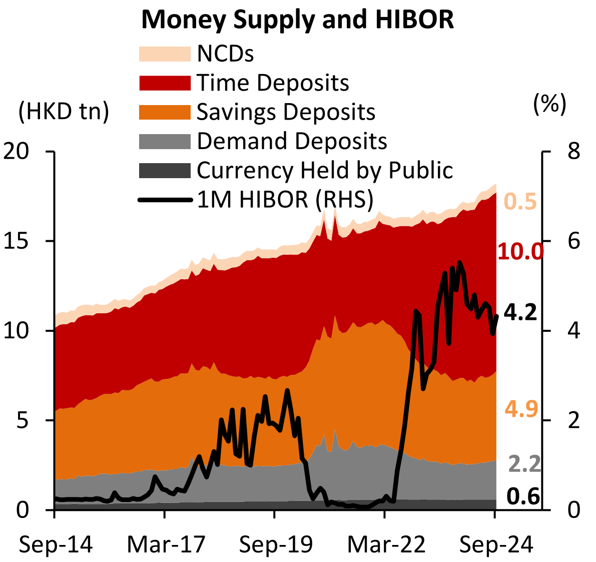
Loan growth, % YoY



Source: CEIC, DBS

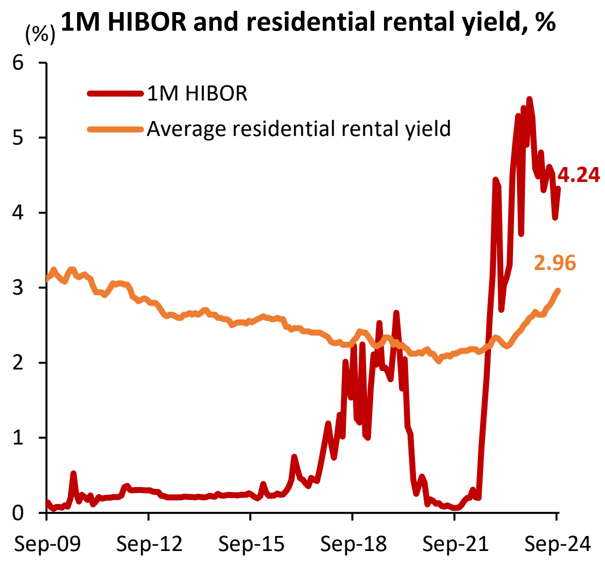
Exports remain a key growth pillar, with AI hardware – particularly chips and accelerators – poised for steady expansion despite slower purchases by hyperscalers. Initiatives to boost energy efficiency will further increase electronics needs. Projected strong worldwide semiconductor sales portend continued momentum in Hong Kong's exports and parts shipments to mainland production hubs across Asia. **Headline export is expected to gain around 7% in 2025.**

Following a sharp 40% contraction from 2021-2024, modest M1 expansion is anticipated as households redirect funds into demand deposits amid lower cash holding costs, potentially lifting spending. Further USD weakness could induce Hong Kong dollar depreciation vis-à-vis other currencies, offering respite to struggling retail and food & beverage sectors. **However, evolving spending habits toward value as visitors seek unique experiences beyond luxury goods, combined with local residents pursuing cheaper mainland options, may curb retail gains.** The proliferation of "experiential stores" reflects this shift toward more frugal tastes.



Source: CEIC, DBS

No straightforward solutions exist for addressing Hong Kong's price competitiveness given its linked exchange rate system precludes currency devaluation. Internal deflation must run its course across a broad spectrum, with office and retail space rents staying depressed. **Positive carry on residential investment could help stabilize house prices after a 25% slump from 2021's peak.** Yet substantial inventory means full recovery remains distant, with downside risks including slower rate cuts and prolonged downturn in China.



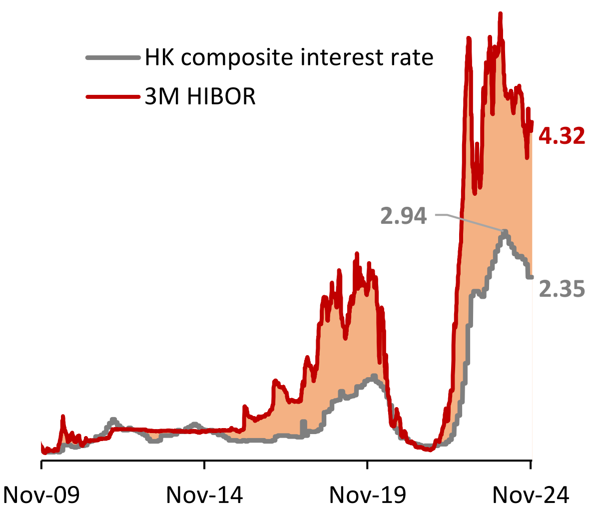
Source: CEIC, DBS

1. Rates poised lower to boost lending

The Federal Reserve has launched an interest rate cutting cycle expected to gradually lower borrowing costs through 2025. After initiating a 50-basis-point cut in September, further steady reductions look set as DBS forecasts rates reaching 3.5% by end-2025. This should filter through to lower Hong Kong interbank rates, driving down prime lending rates.

Based on prior cycles, we anticipate 3-month HIBOR remaining 50-80 basis points below the Fed's target rate. Our models indicate 3-month HIBOR settling at 2.88% in 2H25, aligned with interest rate swap pricing that has shifted lower over the past few months. Lower returns from HIBOR-linked loans will be partly offset by falling banks' funding costs. Composite interest rate declined to 2.35% in November from 2.94% in January and will likely continue easing as time deposit rates edge down - personal deposit rates have already fallen 135 bps YTD across major banks.

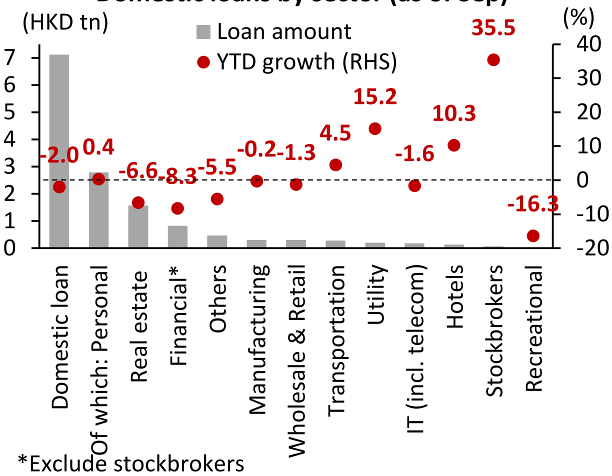
HIBOR and composite interest rate, %



Source: Bloomberg, DBS

Easing monetary conditions should provide tailwinds for Hong Kong's struggling loan market. Lending contracted 2.1% from late 2023 through September overall, with loans for domestic use decreasing 2.0% and those for outside of Hong Kong declining 3.4%. Property development and investment loans especially retreated, shedding HKD111 billion from year-end 2023 to September. Loans to investment and finance firms also dropped.

Domestic loans by sector (as of Sep)

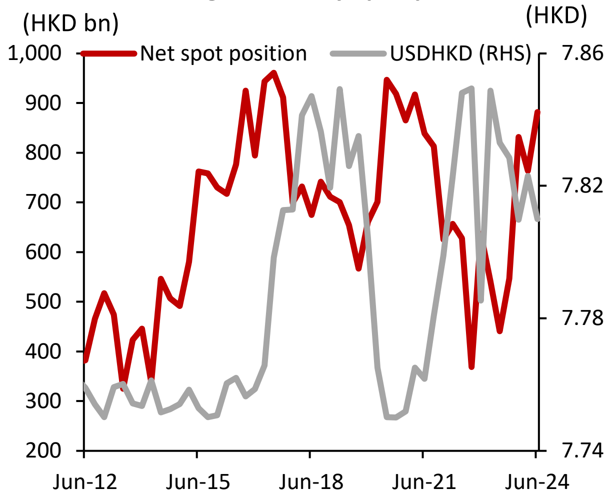


*Exclude stockbrokers
Source: CEIC, DBS

Recent steps taken by the HKMA to reduce capital buffers and restart loan concessions aim to provide relief for small and medium enterprises. Relaxed lending standards (i.e. higher loan-to-value ratio / debt-servicing-ratio on all properties classes; see property section) alongside further rate cuts should also alleviate firms' liquidity constraints. Our model suggests that bank lending will turn positive from 2Q25 onwards and grow modestly by 0.2% in 2025.

Receding domestic interest rates synergized with Fed moves should anchor local money market stability, buttressing both the value and supply of Hong Kong dollars in the period ahead. This will lead to impacts on both the price and quantity of Hong Kong dollars. In terms of price effects, the HKD versus the USD will tend to stay strong, with our FX team's model projecting a USD/HKD rate of 7.77 by 4Q25. In quantitative terms, net Hong Kong dollar liabilities of Hong Kong banks (or net spot foreign currency positions) will continue its rebound after contracting 40% during 2021-2023.

Net foreign currency spot position



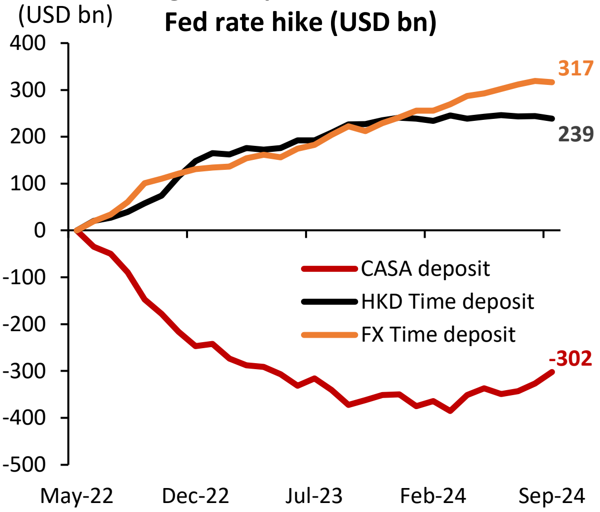
Source: CEIC, DBS

2. Rotations in deposits and investments

M1 is poised to resume modest growth as households divert more funds back into demand deposits. Ever since the Federal

Reserve began tightening rates, CASA deposits, or current and savings accounts, have dropped by USD302 billion as customers shifted funds to locked-in time deposits offering higher yields. However, total time deposits have grown by an even larger USD556 billion over this period. Possible explanations of this discrepancy include capital outflows from the stock market. As the Hang Seng Index plunged from 30,184 to just 14,687 points, risk-averse investors withdrew funds and parked them in the US dollar deposits, which had been averaging returns of around 5%.

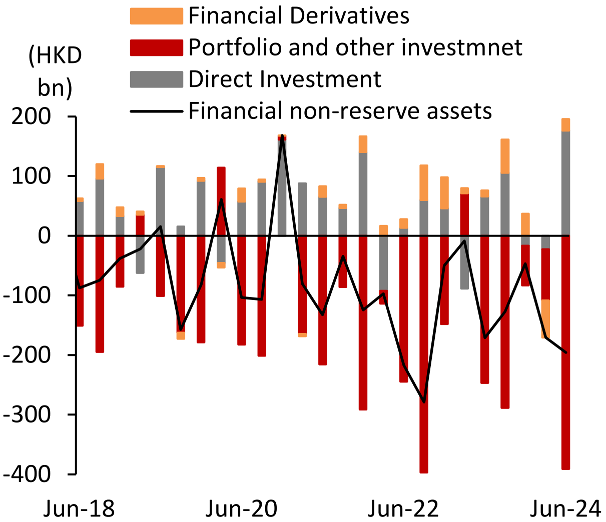
Change in deposit since the first Fed rate hike (USD bn)



Source: CEIC, DBS

Rate reductions may now unwind these trends. **Funds may rotate out of time deposits back into CASA accounts, and potentially flow to equities and other investments.** Our equity strategist forecasts the HSI will appreciate 24% to around 24,000 points by late 2025 on potential market tailwinds. A rebounding stock market may catalyse net capital inflows, following significant private outflows totalling HKD832 billion in portfolio and other investment categories over the past year.

Net fund flows by components

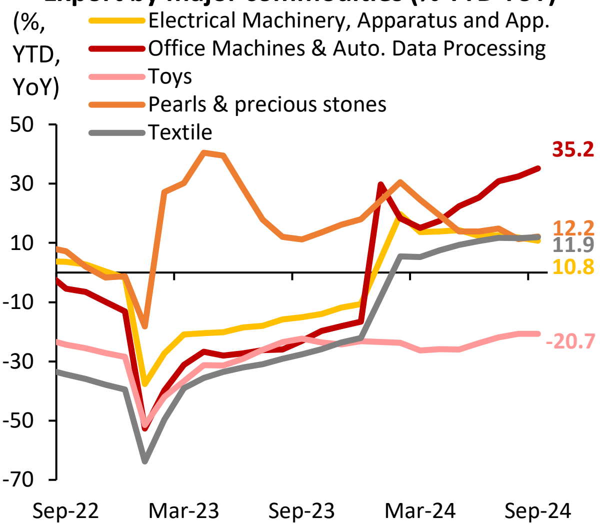


Source: CEIC, DBS

3. Tech exports sustain recovery

Hong Kong maintained strong export growth in 1Q-3Q, up 10.7% YoY. Electronics drove much of this performance, with machinery and office equipment shipments rising over 10% and 30% respectively. Exports to key markets flourished. Mainland China, accounting for over half of Hong Kong's exports, increased 18.2% YoY and remains pivotal to growth. ASEAN nations like Thailand and Vietnam expanded by over 25%, demonstrating resilient regional demand.

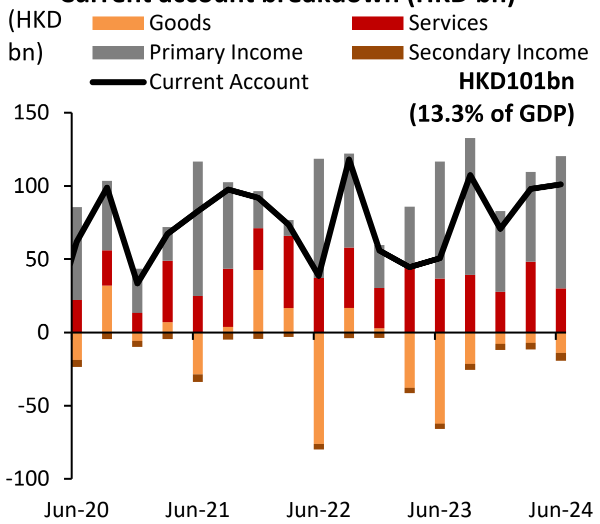
Export by major commodities (% YTD YoY)



Source: CEIC, DBS

Import growth trailed the export momentum, rising 7.1% over the same period. Such differential fuelled a sizable current account surplus of HKD101 billion (13.3% of GDP) in 2Q, substantially narrowing the prior year goods deficit. Underpinning factors also included sustained net primary income and a healthy services balance.

Current account breakdown (HKD bn)



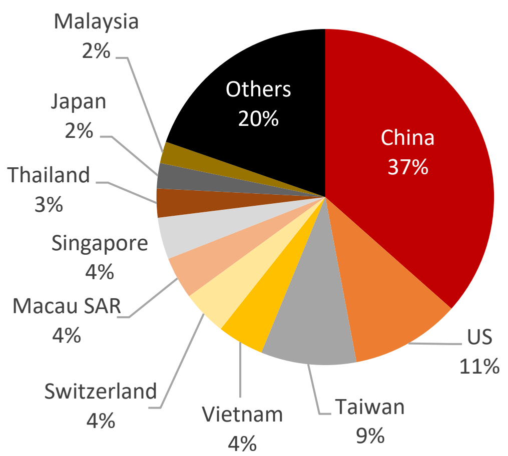
Source: CEIC, DBS

With conditions remaining conducive, we anticipate 7% continued export expansion in 2025. Mainland China's role as the cornerstone market is reinforced by government stimulus targeting 5% GDP growth. Demand from major trade partners also factors strongly given processing linkages within China (i.e. In 2023, 17.0% of Hong Kong's exports to mainland China were for outward processing there, while 59.9% of Hong Kong's re-exports of mainland goods to other places went through outward processing on the mainland).

Notable Southeast Asian resilience, with 5-7% GDP growth in Vietnam, Malaysia and the Philippines in 2Q-3Q stems from enduring electronics, chemicals and commodities needs. Meanwhile, inflation retreated in the US without recession or unemployment spikes. Inflation in the eurozone has also declined, boosting consumer spending power as interest rates fall. All these support Hong Kong's exports going forward.

Electronics will drive export momentum. Despite a slower purchasing pace among hyperscalers, AI hardware such as chips and accelerators are poised for steady growth[1]. Efforts to enhance energy efficiency will likely spur innovation and demand for new products. Global semiconductor sales have also been on the rise since late 2023, with the Semiconductor Industry Association forecasting 16% and 12.5% growth for 2024 and 2025, respectively. Given that electronics make up 70% of Hong Kong's total exports, these trends are highly favourable.

Domestic exports breakdown by destination Jan-Sep 2024



Source: CEIC, DBS

Geopolitical risks remain, but the impact of US President-elect Donald Trump's proposed tariffs is likely to be limited on Hong Kong. As a re-export hub, locally manufactured goods accounted for just 1.3% of total exports in Jan-

[1] AI Outlook Report 2025, TechInsights

Sep 2024, with only 10.5% (HKD4,503 million) sent to the US -- about 0.1% of overall exports (HKD3,312,290 million).

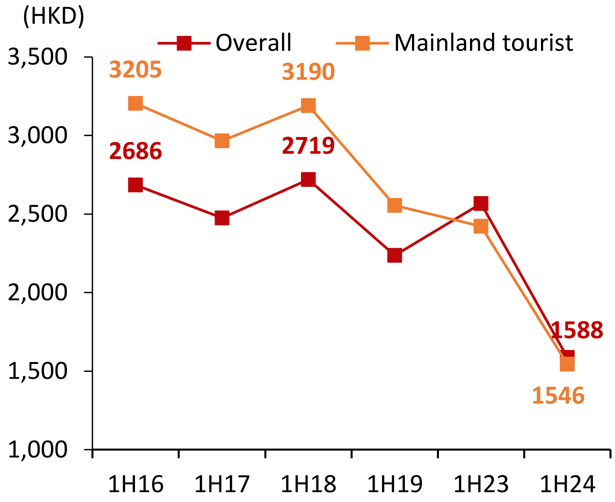
While tariffs on Chinese goods could affect Hong Kong's re-export trade, the risk is manageable. A likely phased implementation may delay the full impact, and if the US extends tariffs to other countries, it could ease pressure on China. Burgeoning demand from emerging markets such as ASEAN, the Middle East, and Latin America could also offset potential losses in US trade. We reckon the full effects of the tariffs to be delayed until late 2025 or early 2026, as US importers frontload purchases to avoid impending hikes (see "China 2025 Macro outlook: Stimulus to offset weak demand and trade", 12 Nov).

4. Frugal spending tempers retail bounce

Retail sales are forecast to modestly rebound 2% in 2025, after a 4% drop in 2024. A potential wealth effect from stock market gains and narrowed US-China rate differentials may stimulate activity by boosting household wealth and strengthening the Chinese yuan. While this could render support for retail and tourism sectors reliant on mainland spending, evolving travellers' consumption behaviour may limit gains.

Tourist spending from mainlanders, who make up 80% of the city's visitors, has sharply declined lately. Between 1H23 and 1H24, overnight visitors cut outlays 22% on average while day-trip spending contracted 46% from 2018 levels. This reflects preferences shifting toward local experiences over luxury goods.

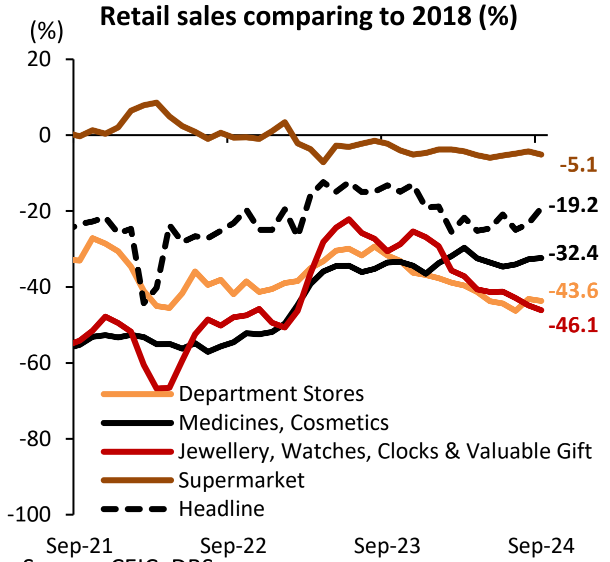
Tourist spending per capita on shopping



Source: HK Gov't, DBS

As visitors prioritize hotels, dining and activities over retail, goods receipts declined from 61% to just 45% of tourist spending from 2018 to mid-2024. Diminishing Chinese household wealth and incomes have weakened purchasing power. **Retailers dependent on mainland clients thus struggle to restore pre-pandemic sales, with jewellery and cosmetics 32-46% under 2018.**

Retail sales comparing to 2018 (%)

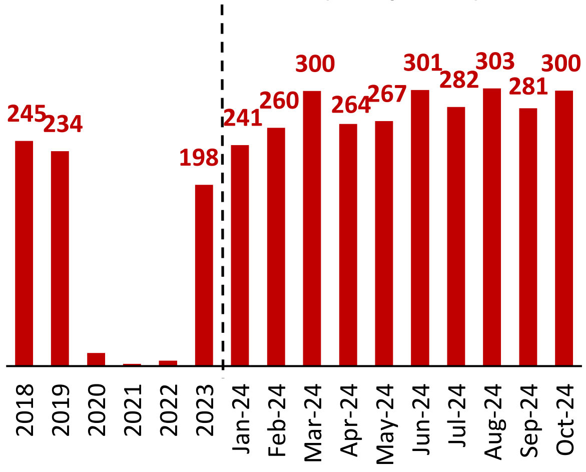


Source: CEIC, DBS

Soft domestic jobs also prevent local consumption offsetting shortfalls. Quarterly median incomes dipped slightly in 2Q24 while unemployment expanded past 114,000, heavily concentrated in vulnerable industries such as construction, retail, accommodation and food services industries. Underemployment also rose, signalling challenges across key sectors and subdued domestic spending.

Changing Hong Kong habits further challenge retailers as many residents now spend weekends across the border taking advantage of lower prices. While inbound tourism reached just 70% of prior levels, outbound HK resident departures via China-HK customs exceeded numbers pre-COVID. This underscores Hong Kong's struggle with price competitiveness absent currency devaluation. Cost decreases must occur organically long-term, already seen in depressed office and retail rents (see property section).

Daily average HK resident departure via China/HK customs ('000 person)



Source: CEIC, DBS

5. Property

Residential - Policy weighed by excess stock

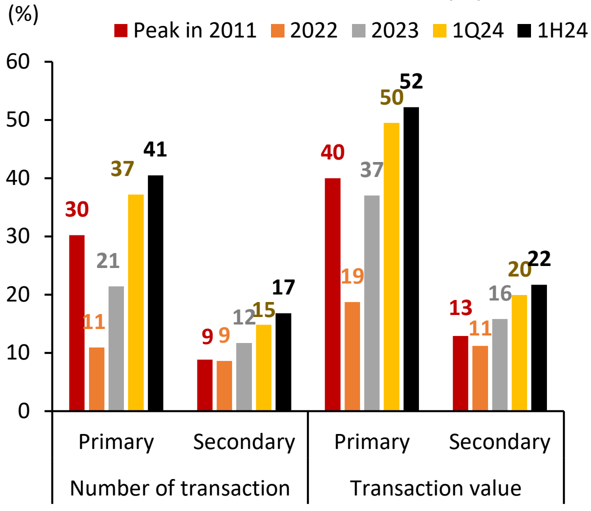
To stimulate its flagging property market, the Hong Kong SAR government recently eased mortgage restrictions. Loan-to-value ratios were raised to 70% for all residential properties and company-held homes, lowering required down payments. The New Capital Investment Entrant Scheme was also expanded to accept higher-value property investments (see "HK policy address: More growth boosting measures", 16 Oct 2024). These measures, alongside a recent influx of high-income professionals through a government initiative, are expected to stimulate demand in the short term.

Key policies
Grant HK residency to buyer of residential property >HKD50mn + HKD20mn holding of financial products
New mortgage requirements seek stimulate investment demand for all residential units through increasing: First time buyer: • LTVs for self-use properties over HKD30mn from 60% to 70% • LTVs for non-self-use from 60% to 70% • DSRs for non-self-use properties from 40% to 50% Non-first time buyer • LTV caps by 10% ppts, which are same as first time buyers • DSR by 10% ppts, which are same as first time buyers

Investment interest could further increase in 2025 if rental yields surpass borrowing costs. Mainland buyers, who comprised over half of primary transactions in 1H24, are anticipated to remain a significant driver of demand.

Nonetheless, oversupply remains a fundamental issue. With unsold inventory sits at a 20-year high, our property analysts estimate housing supply in 2024-2026 will stay 14% above the 1996-2023 average. Developers must therefore competitively price new projects to offload excess stock. While schemes like the New CIES may lift high-end transactions, scale of supply overhang limits broader impact. Lingering economic uncertainty and mainland competition also weigh on sentiment.

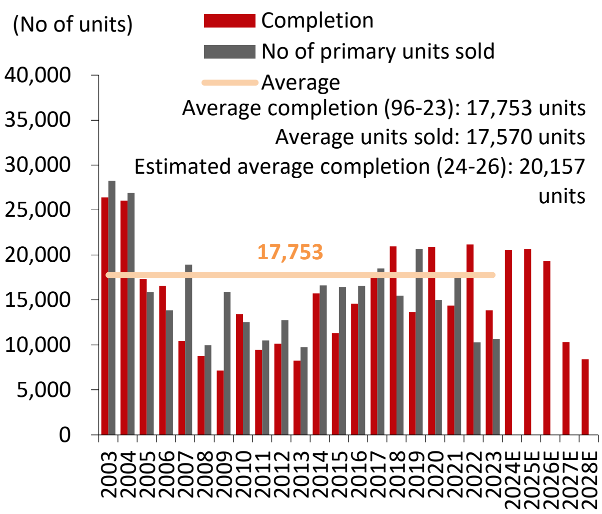
Share of Mainland investors (%)



Source: Midland, DBS

Our property team projects muted price growth until demand stabilizes and floating stock recedes, necessitating a more robust economic rebound to fundamentally recalibrate the beleaguered housing market.

Housing supply



Source: DBS

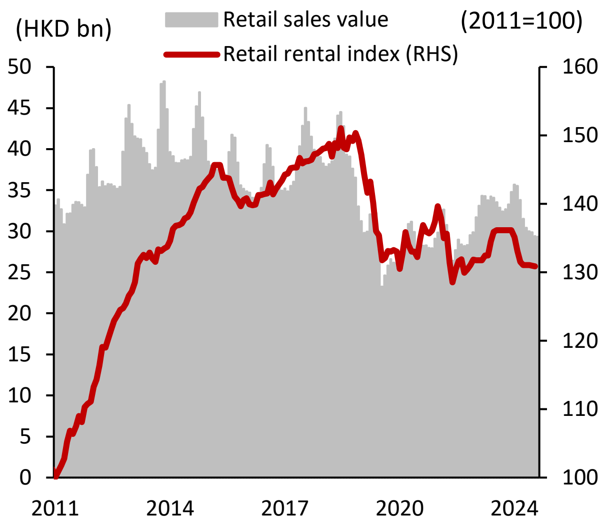
Retail - Structural shifts challenge rental gains

Retail vacancies in key commercial districts have risen sharply. Vacant storefronts in Central, Causeway Bay, Mong Kok and Tsim Sha Tsui swelled to 874 in 3Q24, up from 720 in 1Q24 and representing a vacancy rate of 11.7% - the highest since late 2020[2].

These vacancies signify deeper issues beyond cyclical factors. Traditional retailers face multifaceted challenges from high operating costs, shifting consumer behaviour, and new digital competitors with lean cost structures. E-commerce giants undermine incumbents by offering identical merchandise at lower prices through streamlined supply chains. Matching such competitiveness presents near-insurmountable difficulties for conventional retailers.

High street vacancy rates may stay elevated before long. With many weighed down by mortgage debt and uncompetitive rents, property owners will continuously struggle to attract tenants. **To fill premises, short-term leases for experiential stores catering to frugal consumers have become more prevalent.** This boom in affordable pop-ups however hints at ongoing restricted local spending ability.

Retail sales and retail rental index



Source: CEIC, DBS

[2] 2024Q3 Hong Kong Main Shopping Districts Shop Vacancy and Tenant Mix Research Report, Midland

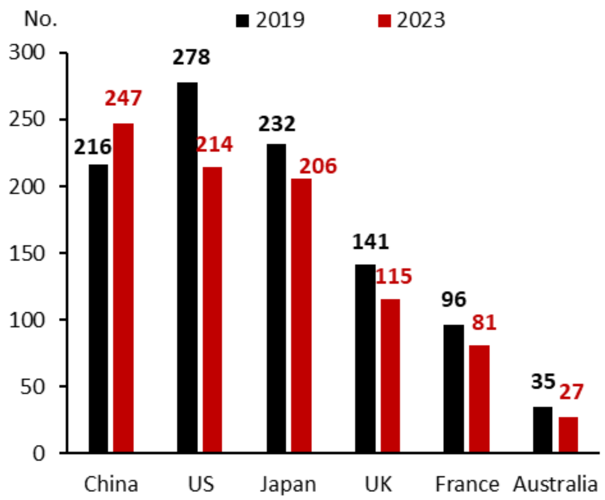
While retail sales have declined back to 2011 levels, rents have increased over 30% in the interim despite recent corrections. Such misalignment suggests Hong Kong's retail rental market is set for further consolidation and rationalization in the era of digital competition.

Office - Huge stockpile faces weak absorption

Similarly, the city's office market continues to face high vacancy and declining rents. In August, the vacancy rate remained elevated at 13.4% as leasing demand has yet to match the sizable supply pipeline. Vacancies worsened across major business hubs such as Central, Wan Chai, Causeway Bay and Tsim Sha Tsui.

Downward pressure on rents intensified with average prices down 6.2% YTD as companies downsized footprints amid economic headwinds. Notably, regional headquarters of multinational corporations contracted significantly since 2019, led by US declines. Chinese firms absorbed some surplus but not enough to fill the void.

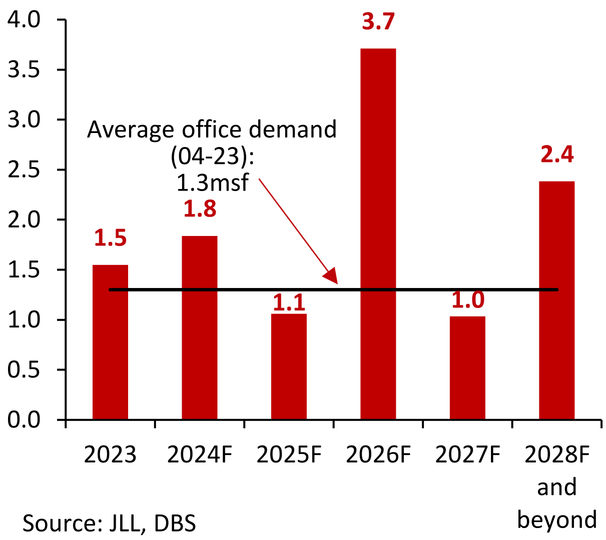
No. of regional headquarters in Hong Kong (no.)



Source: C&SD, DBS

Demand from banking & finance as well as professional services may recover gradually if stock market and IPO momentum sustains into 2025. That said, available supply is forecast to surge 100% to 3.7M sqft by 2026. Unless vacancy absorption meaningfully accelerates, sustained oversupply appears poised to maintain downward pressure on rents, already down 40% from 2019 peaks.

Office supply (msf)



Source: JLL, DBS

Conclusion

Hong Kong's economic outlook for 2025 presents a mixed picture. Interest rate reductions are anticipated to stimulate lending activity. Robust external demand portends continued expansion in the city's machinery and electronics shipments. But retail faces impediments from soft employment and evolving spending patterns. Meanwhile, the protracted oversupply in real estate presents a challenge, as substantial inventory continues depressing prices. Continued policy aid will be instrumental in bolstering recovery fundamentals moving forward.

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