Hong Kong Banking Outlook 2025

80 years of trust

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Foreword

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Welcome to the 2025 edition of the Hong Kong Banking Outlook. 2024 saw an improvement in fortunes for Hong Kong's banking sector, with signs of recovery emerging after a prolonged period of challenges. While geopolitical tensions and global economic uncertainties persisted, the latter part of the year brought renewed optimism, mostly driven by policy shifts in the Chinese Mainland. These developments have laid the groundwork for cautious optimism as we enter 2025.

In this report, we provide our outlook for 2025 and make predictions for the year ahead. We anticipate that 2025 will be shaped by several interconnected factors. Firstly, macroeconomic factors, such as global market dynamics and monetary policies will remain critical. Secondly, regulatory advancements, particularly in areas like third and fourth-party risk management, are expected to enhance the sector's resilience but are an area where senior management need to focus. Finally, innovation initiatives aimed at fast tracking the adoption of technologies such as distributed ledger technology (DLT), reflect the industry's drive for innovation and operational efficiency. Together, these trends indicate an environment where preparedness and adaptability will be key to success.

Despite the improvements seen in 2024, the banking sector continues to face exposure to struggling Mainland property developers and subdued demand, which weigh heavily on the sector. However, we strongly believe that 2025 will bring substantial opportunities for banks that are willing to adapt and innovative. Emerging technologies like Generative AI and virtual assets have the potential to transform operating models. By focusing on cost optimization, data governance, and digital transformation, banks can navigate their current challenges and build a foundation for long-term growth.

Sustainability will also remain a key trend for the sector this year. With the HKMA's 2030 net-zero deadline fast approaching, banks face mounting pressure from regulators to demonstrate leadership in environmental accountability and transparency. Meeting these expectations will require more than just planning – it will demand substantial funding and a clear vision for sustainable growth.

Predicting the future is never an exact science, but as we navigate the year ahead, we hope the insights shared in this outlook are helpful as you plan your strategies for the year ahead. Please get in touch with our team if you'd like to discuss any of these topics in more detail.

Bank's Performance

Paul McSheaffrey
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The last two years have been challenging but both the banking sector and the economy at large have been resilient.

As we stand at the beginning of 2025, we are starting to see some green shoots of recovery. We have, for example, seen in the last quarter an uptick in funds raised on the Hong Kong Stock Exchange. Additionally, we have seen some positive policy measures in China that look to stimulate consumer demand, with the promise of more to come. And finally in our client conversations there is a continued commitment to Hong Kong as an international financial centre that provides access the worlds' second biggest economy.

What does this all mean for the performance of banks in 2025?

For retail and commercial banks, it is all about interest rates. I personally think that the pace of reduction of interest rates is going to be lower than many forecasts, benefiting the retail and commercial banks through preserving their margins. For investment banks, the policy measures mentioned earlier can improve consumer sentiment, which can in turn favour capital raising and M&A activity in China, all to the benefit of Hong Kong. And lastly, on the wealth side, KPMG recently completed a report with the Private Wealth Management Association, once again highlighting the continued resilience of the sector and the real strengths that Hong Kong has as an international trade and wealth management centre.

Putting this all together, I am more optimistic that I have been over the past two years about the prospects of the Hong Kong banking sector in the year to come.

Non-performing Loans

Guy Isherwood
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Hong Kong Banks continue to navigate their troubled Mainland property developer exposures, working through impairment charges and restructuring debts. While this process is painful, the industry is managing the stress. However, Hong Kong banks continue to face additional credit challenges, as local borrowers contend with:

1. The lasting impact of Covid-19,
2. Sluggish growth in Mainland markets
3. Persistent weak demand
4. "Higher for longer" interest rates and
5. Declining real estate prices.

Perhaps unsurprisingly, the HKMA's September 2024 Financial Stability report shows a weakening of Hong Kong's corporate credit quality. Notably, beyond real estate development, investment or construction borrowers, many local corporates continue to support their bank borrowing with property collateral, including portfolios of residential properties. As property prices decline, loan to value ratios are rising, putting more downward pressure on credit quality. At the same time, previously arranged syndicated loans and bonds originated during Covid-19 are now falling due.

With reduced appetite among participating lenders to refinance, lead banks will feel pressure to increase their exposure to support borrowers. In this environment, banks are forbearing as borrowers struggle to service debt, albeit appearing only to enforce collateral as a last resort.

But forbearance does not resolve a borrower's fundamental credit weaknesses. The weakening credit environment requires banks to have a well-functioning, effective Credit Warning Identification process. This is a critical competitive differentiator for a bank. Decisions to support a borrower, or not, must be seen as fair and reasonable. Such decisions should take account of the business fundamentals and access to funding – a point the HKMA stressed last December in its CEO Letter on Lending Practices.

Banks must take difficult judgement calls in these situations. Each situation is unique, with no simple rules on the correct action. Independent professional due diligence reports seem essential in this environment as banks are asked to refinance material exposures. A bank contemplating whether to reduce, mitigate or withdraw credit facilities, should consider the HKMA and Association of Banks' Approach to Corporate Difficulties, issued way back in 1999. These Guidelines remain as relevant today and are a key expectation of the HKMA in 2025.

Regulatory Focus

Tom Jenkins
Partner, Head of Risk Consulting, Hong Kong
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In 2025, the main focus of regulators can be summed up in one word: Resilience.

Resilience against cyber fraud and financial crime, which will remain at the top of the agenda as losses experienced by banks and customers continue to hit the headlines. Resilience against operational failures - ensuring that banks are able to recover critical operations within a reasonable time period under severe but plausible scenarios.

Addressing regulators expectations in these areas is a significant endeavour and much of the focus in 2025 will be on continuing to implement regulations which were introduced in previous years. One area where we do expect regulators to introduce new resilience related requirements in 2025 is on Third Party Risk Management.

These will include new requirements to monitor and manage concentration risk associated with third parties. Regulators will expect firms to know where their third-party concentration risks are and report the concentration risk to senior management - taking it into account in sourcing decisions and assessing it against risk appetites and thresholds.

'Fourth Party Risk' – the risk associated with third party service providers further outsourcing critical operations to fourth parties - is also expected to be addressed in new regulations in 2025.

Finally, we expect Hong Kong regulators to launch further initiatives to further encourage the application of distributed ledger technology (DLT) to the banking industry. This topic is also linked to resilience – resilience against the operational risks associated with traditional settlement and payment infrastructure as well as the resilience of banks' business models in the face of competition from new Fintech market entrants and 'digital natives'.

Just as Electric Vehicles have now significantly disrupted the automotive industry, so DLT has the potential to significantly transform financial markets. Regulators are well aware that the adoption of this new technology will be key to the future stability of the banking industry.



Fraud and Financial Crime

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The rise of financial crime poses significant threats to global economies. Leveraging AI is crucial in combating these crimes and protecting the public.

Globally we are seeing three trends in the use of AI to combat financial crime:

1. Enhanced Fraud Detection involving the use of AI algorithms to detect fraudulent activities and deep fakes.
2. Predictive Modelling for Risk Assessments leveraging AI-driven predictive analytics to assess risks associated with transactions and customers.
3. Automated Compliance Monitoring involving AI being integrated into compliance processes to ensure adherence to regulations and standards.

We are seeing similar trends in China regarding the use of AI to combat financial crime:

1. AI-based transaction monitoring is increasingly being adopted as a complement to traditional rule-based models.
2. Institutions are leveraging both internal and external data and risk alerts to enhance the detection of financial crimes.

Meanwhile, we can observe the following in Hong Kong:

1. Hong Kong is increasingly adopting AI solutions powered to enhance compliance with financial regulations. This will cover all manner of monitoring of suspicious activities.
2. Collaborative Data Sharing Initiatives where financial institutions in Hong Kong are participating in collaborative data-sharing that utilises AI to analyse shared data to identify suspicious activities.

AI adoption will be an unavoidable topic for the financial crime industry for the next two years and we can expect to see authorised institutions and home regulators gear up to address risks and meet regulatory expectations.

Risk Transformation

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There is no doubt that as we enter 2025, the overall risk environment faced by banks is becoming even more complex. Banks' risk functions will need to deal with even more complex scenarios – managing the financial risks associated with an uncertain economic environment as well as the non-financial risks arising from cyber-crime, evolving technology, and changing business models.

In many cases, Chief Risk Officers are under pressure to 'do more with less' as banks focus on improving their cost to income ratio. Even where risk functions are not being asked to cut costs, often they are under pressure to transform their processes to support future growth without adding significant headcount.

Thankfully, there are significant opportunities across many banks to realise efficiencies and improvements in risk management through risk function transformation. Many risk functions still spend more time measuring risk than managing it. Manual processes and duplicated activities across the first and second lines of defence present significant opportunities to streamline and uplift, allowing risk managers to focus on adding value to the business through improved analysis and greater insights.

We see three key areas where banks can take steps in 2025 to transform their risk functions:

1. Rationalising operating and governance models including simplifying roles and responsibilities and reporting lines to eliminate layers, duplication, and confusion. Non-core or repetitive risk processes can be executed in a nearshore or offshore capacity.
2. Streamlining processes - Redefining risk operating models and processes to enable seamless integration into first line of defence agile processes, while maintaining appropriate oversight, governance, and challenge.
3. Technology enablement - Applying digitisation and automation to accelerate and streamline resource-intensive risk processes and using advanced analytics to uplift human reviewers to focused on the most critical elements.

By embarking on a programme of risk function transformation, Chief Risk Officers can better position their organisations to navigate uncertainty, achieve long-term sustainability, and drive business performance.

Cost and Value

Barnaby Robson
Head of Value Creation, China
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Audrey Menard
Director, Deal Strategy & Value Creation
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As we enter 2025, Hong Kong banks face a complex landscape. Hong Kong's recovery continues at a moderate pace, albeit falling a bit short of forecast. Geopolitical uncertainty persists as a second term for Trump in the US is accompanied by fears of tariffs and continued volatility. Banks face rising operational expenses and increasing regulatory requirements, whilst also being expected to innovate and deliver increasingly easy digital experiences, turbocharged by AI. It is against that backdrop that a focus on cost is unavoidable this year.

But instead of simply slashing costs across the board, we expect banks to adopt a more strategic approach: cost optimisation. This requires taking a data-led approach to identifying the root causes of inefficiency and implementing targeted corrective interventions. For example, automation can be an effective tool in rectifying latent inefficiency in core processes across front, middle, and back office. This can deliver increased productivity, thus reducing the Cost to Serve, but can also enhance customer experience and contribute to an increased top line. Our research shows that these targeted interventions would have the biggest impact on Sales & Distribution, Operations and Technology divisions, which account for the largest portions of operating expenditures for banks.

In 2025, we urge bank leaders to adopt an optimisation mindset. They should:

1. Be methodical in identifying areas where value can be increased,
2. Quantify the potential upside of any change programmes, and
3. Make informed decisions that balance cost reduction initiatives with sustainable profitability.

In doing so they will avoid the trap of simply achieving short term cost reduction but rather maximise the overall value of their organisations.

Finance Transformation

Kris Pearson
Director
KPMG China

The banking sector is set for a transformative year in 2025. In particular, many banks are realising that the success of their Finance function should be measured by how fast it can adapt to a change in customer and regulatory demand.

Yet, many finance transformation programmes fail to deliver their promised value because they focus on technology upgrades or cost-cutting in isolation rather than reimagining finance as a strategic driver of business outcomes. The truth is, around two thirds of CFOs are investing in digital transformation, but too often, these efforts degenerate into ledger upgrades that protect value rather than create it.

Imagine this: What if the finance team could spend less time in 2025 reconciling numbers and more time predicting future trends? What if they could shift from reactive reporting to proactive scenario planning? Leading banks are already doing this by embracing outcome-driven transformation—focusing on customer profitability, real-time analytics, and agile risk-based decision-making.

The enablers of this transformation are clear:

1. Data integration and automation to eliminate manual processes.
2. Cloud adoption for scalability and speed.
3. And most critically, people transformation—building teams with digital skills and fostering a culture of innovation.

Digital Transformation

Angel Mok
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As Hong Kong's banks continue to acquire new capabilities through digital transformation, we are seeing a few distinctive trends shaping up in 2025 and the years to come. Generative AI adoption is of course one of them, with more than a third of Hong Kong financial institutions already integrating Gen AI, supported by government initiatives such as the HKMA's recently launched Generative AI Sandbox.

While AI adoption is bound to keep gathering momentum in the near future, virtual assets have also been ranking high on the digital transformation agenda for banks. Initiatives like the HKEX's Virtual Asset Index Series and the HKMA's Project Ensemble Sandbox have helped to accelerate the development of Hong Kong's tokenisation market and we can expect policy support to continue on that front in 2025.

From AI to virtual assets, integrating new digital capabilities can be a challenging task for financial institutions and chief among the issues are data governance and talent acquisition. Here again, government initiatives have been helping to foster a better environment, but banks also have their role to play. In 2025, Hong Kong banks should focus on:

1. Digitising their operations by leveraging resources like Fintech Connect;
2. Expanding their digital-savvy workforce through talent acquisition and upskilling;
3. And future-proofing their digital asset and Generative AI readiness with the establishment of a sound data governance framework.

AI and Trust

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The banking industry continues to evolve, enabled by various emerging technologies, particularly artificial intelligence. As we look to 2025 and beyond, we can expect to see many new possibilities that transform banking operations and service delivery. However, the public is growing increasingly conscious of the pitfalls associated with improper AI use. So, how can banks secure trust in AI in the coming year?

The answer lies in robust AI governance frameworks. These frameworks encompass transparent AI development processes, continuous monitoring for biases and errors, and strict adherence to ethical standards. By implementing comprehensive audit trails and explainability features, we can scrutinize AI decisions, just as we would with human decisions, thereby ensuring accountability and fostering trust.

Trust will play an integral role in propelling further AI adoption in the year ahead. However, driving adoption involves more than merely building use cases or having adequate infrastructure. As they plan for the year ahead, banks need to be thinking about whether their workforce is ready, particularly in embracing the new skills required to apply AI in the banking sector. In many instances, this necessity is often overlooked.

AI is no doubt a revolutionary leap. But to truly elevate the banking industry to new heights, it needs to be used with constant vigilance, a trained and informed workforce, and the appropriate governance structures in place.

ESG Trends

Angus Choi
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KPMG China

Sustainability has been ranking high on the agenda of global policymakers and Hong Kong is no exception. In October 2024, the HKMA released its 8-point Sustainable Finance Action Agenda. There are two key goals in this agenda that banks should note:

Goal 1: Achieve net zero by 2030 for their own operations and by 2050 for the emissions they finance.

Goal 2: Report more transparently on these actions.

Planning for their net zero transformation should thus be at the top of the agenda for banks in 2025, especially since such transition needs considerable funding. Indeed, there is currently an estimated annual funding gap of US$14 to 17 trillion for the global economy to achieve net zero.

With net zero transition, we are not simply talking about drafting an organisation's ESG strategy but rather reimagining a whole new business plan, and some banks have already started to walk this path. From emission baselining to budget allocation, costs are difficult to estimate and are frequently reassessed.

Banks must ask themselves four things:

1. What to aim for with their transition.
2. Where can they benefit from the economy-wide sustainable transition.
3. How to prioritise actions to meet decarbonisation targets.
4. Who are the key stakeholders to focus on.

This last point is essential: broadly speaking, 20% of a bank's customer portfolio represent over 80% of its emissions exposure. These customers too will need funding to finance their net zero transition, and here lies the key for banks to turn climate compliance into a true business opportunity.

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Celebrating 80 years in Hong Kong

80 years of trust

In 2025, KPMG marks "80 Years of Trust" in Hong Kong. Established in 1945, we were the first international accounting firm to set up operations in the city. Over the past eight decades, we've woven ourselves into the fabric of Hong Kong, working closely with the government, regulators, and the business community to help establish Hong Kong as one of the world's leading business and financial centres. This close collaboration has enabled us to build lasting trust with our clients and the local community – a core value celebrated in our anniversary theme: "80 Years of Trust".

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