

Funding the Future

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This is [from the FT this morning](#):

Almost three-quarters of HSBC's Hong Kong commercial property loan book was flashing warning signs by the end of June, as a prolonged slump in retail spending and sluggish demand for office space weighed on Europe's largest bank.

HSBC is Hong Kong's largest lender and the territory is the single largest source of income for the bank by geography. HSBC has made \$32bn of commercial real estate loans in the territory, out of a \$234bn Hong Kong loanbook.

Why flag this particular article on a morning when there is so much else that is going so wrong in the world? My reason is to highlight the fact that whilst the world's media obsesses about government debt, there is, quietly, but undoubtedly inevitably, a growing debt crisis developing in the world banking systems.

Throughout the world, vast quantities of bank lending are secured on domestic and commercial properties. In other words, banks make loans because they can place mortgages over properties that they believe they can sell in the event of their customer defaulting, thereby providing them with the security to make the loan that the customer in question wants, whether that is to buy the property in question or not. This is, of course, how the domestic mortgage market works. It is also how much of commercial bank lending works.

The reason for highlighting what is happening to HSBC in Hong Kong is that the basic assumption made by all bankers worldwide — that property is their security — is something that can go horribly wrong. It did, of course, in the US domestic mortgage market in 2008, and the global financial crisis followed as a consequence. There is every reason to think that this might happen again.

In Hong Kong, the risk arises because there has been a collapse in the rental market in that territory, with the FT noting that rents have fallen by approximately 20 per cent since 2022, whilst the vacancy rate is running at something like 19 per cent, meaning that the properties in question are earning nothing at all.

Elsewhere, the risks differ. For example, in the UK, where approximately 85 per cent of all loans by banks are secured by mortgages, the most significant overall risk comes from the uninsurability of many properties in the future because of the risk that they might be flooded by rising seawater levels. This is true for many domestic properties. However, the problem might be even bigger in the commercial sector. It is thought that up to 80% of all commercial bank loan portfolios are secured on properties that might be subject to this risk. Just look at the flood risk map for central London and you will see precisely why this is the case.

The point I am making, therefore, is a straightforward one. Whilst politicians, neoliberal commentators, the mainstream media, and others wish us to be distracted by the supposed risk that government debt poses to us, and to our grandchildren - the lucky ones of whom will inherit a share of it - the real likely debt risk that will create the next global financial crisis is almost certainly already on the balance sheet of most of the world's major bankers. That is because it is represented by overvalued property where the chance of loan repayment is low precisely because the properties in question will, at some point in the not too distant future, become unsaleable, either because of changes in the market demand for property within the commercial sector, or because flood risks will mean that the buildings in question will be uninsurable, creating a crisis for the banks because the security that they have for their lending will no longer be of any value.

To put this another way, the assumption that 2008 could not happen again is wrong. It could, because the next global financial crisis might well be precipitated by overvalued bank balance sheets, as was the case in 2008, even if the precise reasons for the overvaluation might change.

Bankers never, it seems, learn, and as fools in charge of money, they appear to be all too readily parted from it. We will, of course, all end up eventually paying the price for that.

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