

**EXCHANGE FUND ADVISORY COMMITTEE**

**Currency Board Sub-Committee**

**Report on Currency Board Operations**

**(17 April – 14 June 2018)**

During the review period, the Hong Kong dollar (HKD) traded within a narrow range of 7.8427 – 7.8500 against the US dollar (USD). Since the first triggering on 12 April, the weak-side Convertibility Undertaking (CU) was triggered 19 times and the HKMA bought HK\$70.4 billion under the weak-side CU. The Aggregate Balance and the Monetary Base fell correspondingly after the multiple triggering of the weak-side CU, with the Monetary Base declining to HK\$1,643.77 billion at the end of the review period. The HKD firmed again towards the end of review period, in part underpinned by seasonal demand for the HKD (e.g. corporate demand for dividend payments) and interbank demand in preparation for sizable initial public offering (IPO) activities. Largely reflecting IPO-related demand, reduced interbank liquidity following triggering of the weak-side CU, expectation of US rate hikes and seasonal liquidity demand, HKD interbank interest rates picked up across the curve during the review period. Throughout the review period, the Monetary Base remained fully backed by foreign reserves, and all changes in the Monetary Base were fully matched by corresponding changes in foreign reserves in accordance with the Currency Board principles.

### **Hong Kong dollar exchange rate**

1. During the review period, **the HKD traded mostly around a narrow range of 7.8427 – 7.8500 against the USD** (Chart 1). The weak-side CU was triggered six times in the last three trading days (12-16 April) of the last review period, and then seven times at the beginning (17-18 April) of the current review period. The HKD then strengthened briefly due to tightened liquidity amid IPO and month-end demand. As such effects receded after the end of April, interest carry trade activities drove the HKD softer again. The weak-side CU was triggered six times between 15 and 18 May. Towards the end of the review period, the HKD firmed again, underpinned by HKD demand for dividend payments, the half-year end, and an upcoming IPO. The HKD closed at 7.8484 at the end of the review period. **Overall, the weak-side CU was triggered 19 times since the first triggering on 12 April.** The HKD continued to trade in an orderly manner. **The nominal effective exchange rate index of the HKD picked up** during the review period, reflecting the appreciation of the US dollar against most major currencies (Chart 2).

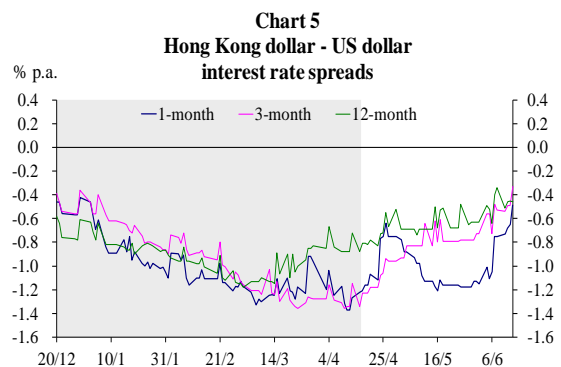
## **Interest rates**

2. **The HKD interbank interest rates (i.e., HIBORs) rose broadly during the review period** (Chart 3). Largely reflecting IPO-related demand, reduced interbank liquidity following triggering of the weak-side CU, and expectation of US rate hikes, the HIBORs picked up across the board in late April. Towards the end of review period, HIBORs rose again on the back of renewed tightness in interbank liquidity, mainly due to increased funding demand for the half year-end and a sizeable IPO in the pipeline. For the review period as a whole, the 1-month and 3-month HIBORs picked up by 75 basis points to 1.60% and 70 basis points to 2.00%, respectively. The 12-month HIBOR moved up by 35 basis points to 2.45%.

3. **Interest rate volatility**, measured by the standard deviation of daily changes in the one-month HIBOR, **increased** to 7.6 basis points in the current review period from 5.6 basis points in the preceding review period (Chart 4). The standard deviation as a ratio of the average of 1-month HIBOR also showed similar movements<sup>1</sup>.

4. **The negative HKD-USD interbank interest rate spreads generally narrowed** with HIBORs rising faster than their USD counterparts (Chart 5). At the end of the review period, the 1-month, 3-month and 12-month spreads narrowed to -49, -33 and -46 basis points, respectively.

5. Broadly tracking the HKD-USD interbank interest rate spreads, **the discounts of HKD forward points narrowed slightly** during the review period (Chart 6). At the end of the review period, the 3-month and 12-month HKD forward points closed at -131 pips and -450 pips respectively.



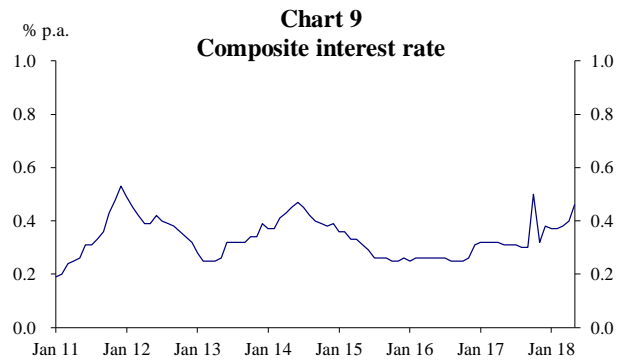
<sup>1</sup> The ratio of the standard deviation of daily changes in the one-month HIBOR to its monthly average measures the extent of interest rate fluctuations relative to the average level of interest rates.

6. Largely following the movement of the USD yield curve, **the HKD yield curve shifted upward and flattened** during the review period (Chart 7). The yield of the 10-year Hong Kong Government Bond increased by 34 basis points to 2.34% at the end of the review period, while the 3-year Government Bond yield rose by an even larger 56 basis points to 2.18%. The negative yield spreads of the Hong Kong Government Bonds over US Treasuries generally narrowed as HKD yields rose more than the USD counterparts (Table 1).

	17 Apr 18	14 Jun 18
3-month EFB	-80	-53
12-month EFB	-89	-62
3-year HKGB	-90	-51
5-year HKGB	-86	-49
10-year HKGB	-82	-60

7. **The HKMA Base Rate increased from 2.00% to 2.25%, following the upward adjustment in the target range for the US Federal Funds Rate** from 1.50%-1.75% to 1.75%-2.00% on 13 June (US time) (Chart 8). The Base Rate continued to be set at 50 basis points above the lower bound of the target range for the US Federal Funds Rate in accordance with the revised Base Rate formula announced on 26 March 2009.

8. **Banks kept their Best Lending Rates unchanged.** The two Best Lending Rates stayed at 5.00% and 5.25% during the review period. The average one-month HKD time deposit board rate offered by retail banks remained stable at 0.01%<sup>2</sup>. **The composite interest rate**<sup>3</sup>, which indicates the average funding cost of retail banks, **picked up** from 0.38% in March 2018 to 0.46% in May 2018 (Chart 9). On the lending side, the average interest rate for newly approved mortgage loans hovered around the prevailing Prime-based cap of 2.15%.<sup>4</sup>



<sup>2</sup> The figure refers to the average interest rate offered by major authorized institutions for one-month time deposits of less than HK\$100,000.

<sup>3</sup> This is a weighted average interest rate of all HKD interest bearing liabilities, which include deposits from customers, amounts due to banks, negotiable certificates of deposit and other debt instruments, and HKD non-interest bearing demand deposits on the books of banks. Data from retail banks, which account for about 90% of the total customers' deposits in the banking sector, are used in the calculation.

<sup>4</sup> Excluding fixed-rate mortgage.

## Monetary Base

9. **The Monetary Base**, which consists of Certificates of indebtedness (CIs), government-issued currency notes and coins in circulation, the Aggregate Balance, and Exchange Fund Bills and Notes (EFBNs), **decreased to HK\$1,643.77 billion on 14 June 2018 from HK\$1,703.97 billion on 17 April 2018** (Table 2). Movements of the individual components are discussed below.

(HK\$bn)	17 Apr 18	14 Jun 18
CIs	471.83	471.06
Government-issued Currency Notes and Coins in Circulation	12.74	12.70
Aggregate Balance	170.11	109.48
Outstanding EFBNs	1049.29	1050.54
<b>Monetary Base</b>	<b>1703.97</b>	<b>1643.77</b>

### *Certificates of Indebtedness*

10. During the review period, note-issuing banks redeemed around HK\$770 million worth of CIs to the HKMA in exchange for US\$98.7 million. As a result, **the outstanding CIs decreased slightly** to HK\$471.06 billion on 14 June 2018 from HK\$471.83 billion on 17 April 2018 (Chart 10).

### *Government-issued currency notes and coins in circulation*

11. During the review period, the amount of **government-issued currency notes and coins in circulation edged down** to HK\$12.70 billion on 14 June 2018 from HK\$12.74 billion on 17 April 2018 (Chart 11).

*Aggregate Balance*

12. **The Aggregate Balance fell from HK\$170.11 billion to HK\$109.48 billion during the review period** (Chart 12) owing to the triggering of the weak-side CU during mid-April and mid-May (Table 3). These foreign exchange operations are consistent with Currency Board principles, as the decreases in the Monetary Base were matched by equivalent decreases in US dollar reserves.

Trade Date	Net purchase of HK\$ (HK\$mn)
17-Apr-18	14,680
18-Apr-18	17,631
15-May-18	1,570
16-May-18	9,499
17-May-18	1,963
18-May-18	5,990
<b>Total</b>	<b>51,333*</b>

\* Including the weak-side CU transactions in the last three trading days (12-16 April) of the preceding review period, the net purchase of HK\$ by the HKMA amounted to HK\$70,352 million.

*Outstanding Exchange Fund Bills and Notes*

13. **The market value of the outstanding EFBNs increased to HK\$1,050.54 billion from HK\$1,049.29 billion during the review period. Holdings of Exchange Fund paper by the banking sector (before Discount Window activities) decreased to HK\$975.24 billion (92.8% of total) from HK\$976.34 billion (93.0% of total) (Chart 13).**



14. During the review period, **interest payments on Exchange Fund paper amounted to HK\$2,422.35 million. A total of HK\$2,308.88 million (in market value) of Exchange Fund paper was issued to absorb these interest payments.** The remaining amount was carried forward in the Aggregate Balance. The Exchange Fund paper issued during the review period was generally well received by the market (Table 4).

	No. of issues launched	Over-subscription ratio
1-month EFB	0	n.a.
3-month EFB	9	0.80-1.73
6-month EFB	9	1.02-3.08
12-month EFB	3	2.30-4.62
2-year EFN	1	4.21

**Discount Window activities**

15. During the review period, **4 banks borrowed a total of HK\$636 million from the Discount Window**, compared with a total borrowing of HK\$6,804 million in the preceding period (Chart 14 and Table 5).

Frequency of using Discount Window	No. of banks
1	4

### **Backing Portfolio**

16. The Backing Assets decreased to HK\$1,792.76 billion on 14 June 2018, mainly reflecting the sale of USD backing assets under the weak-side CU. Taking into account the interest received and revaluation gains related to the Backing Assets, **the Backing Ratio edged up to 109.06% from 108.58% during the review period** (Chart 15). Under the Linked Exchange Rate system, while specific Exchange Fund assets have been designated for the Backing Portfolio, all Exchange Fund assets are available to support the HKD exchange rate.

**Hong Kong Monetary Authority  
8 August 2018**