

EXCHANGE FUND ADVISORY COMMITTEE

Currency Board Sub-Committee

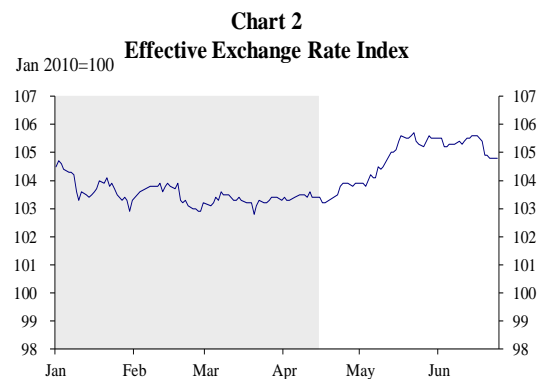
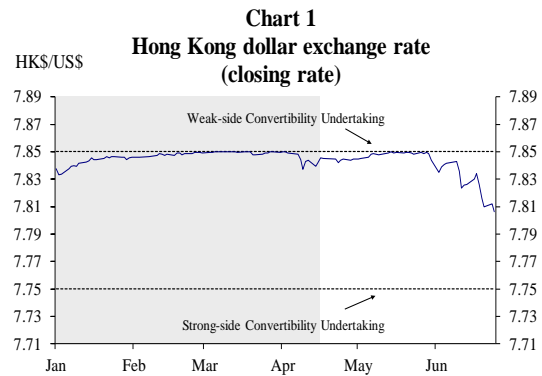
Report on Currency Board Operations

(17 April – 25 June 2019)

During the review period, the Hong Kong dollar (HKD) traded within a range of 7.8065 – 7.8498 against the US dollar (USD). Mainly driven by interest carry trade and weak sentiment in the local stock market, the HKD eased gradually in early part of the review period and remained close to the weak-side Convertibility Undertaking (CU) before the end of May. Thereafter, the HKD strengthened, due partly to unwinding of interest carry trade amid tightened liquidity approaching the end of May and the half-year-end, and partly to a rise of demand for dividend payments. Overall, the HKD exchange and interbank markets continued to trade in a smooth and orderly manner. During the review period, the long-dated HKD interbank interest rates moved up at a gradual pace, while the short-dated rates witnessed more fluctuations. At the end of the review period, the Aggregate Balance remained little changed at around HK\$54.3 billion, while the Monetary Base increased slightly to HK\$1,625.6 billion. 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

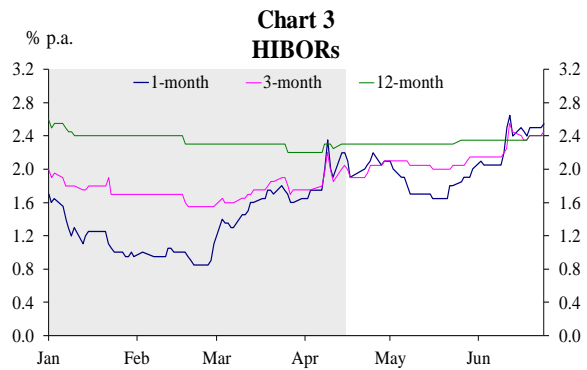
1. During the review period of April 17 to June 25, the **HKD traded within a narrow range of 7.8065 – 7.8498** (closing rate) **against the USD** (Chart 1).¹ Driven by interest carry trade and weak sentiment in the local stock market, the HKD eased gradually in early part of the review period, and stayed close to the weak-side CU before the end of May. Thereafter, the HKD strengthened due partly to unwinding of interest carry trade amid tightened liquidity approaching the end of May and the half-year-end, and partly to a rise of demand for dividend payments. Overall, the HKD continued to trade in a smooth and orderly manner, closing at 7.8065 against the USD at the end of review period. **The nominal effective exchange rate index of the HKD picked up**, partly reflecting the appreciation of the HKD against some Asian currencies (Chart 2).



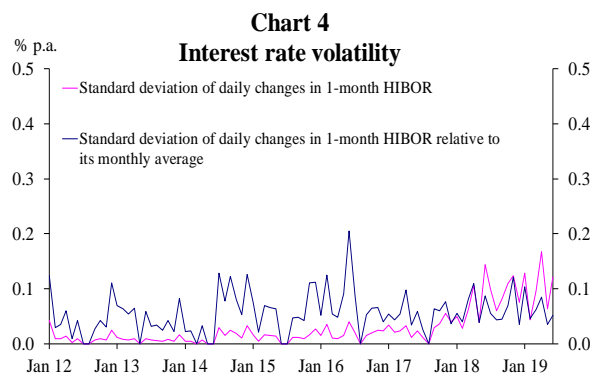
¹ In this report, daily time series charts also cover developments in the preceding review period (as shown in shaded region) for reference and comparison.

Interest rates

2. During the review period, the long-dated HKD interbank interest rates (i.e. HIBORs) moved up at a gradual pace, while the short-dated HIBORs witnessed more fluctuations (Chart 3). After picking up briefly in April, the short-dated HIBORs eased in early May, but rose again amid anticipated funding needs for the end of May, the half-year-end and possible large initial public offerings (IPOs) in the second half. For the review period as a whole, the 1-month, 3-month and 12-month HIBORs increased by 45, 45 and 10 basis points to 2.55%, 2.45% and 2.40% respectively.

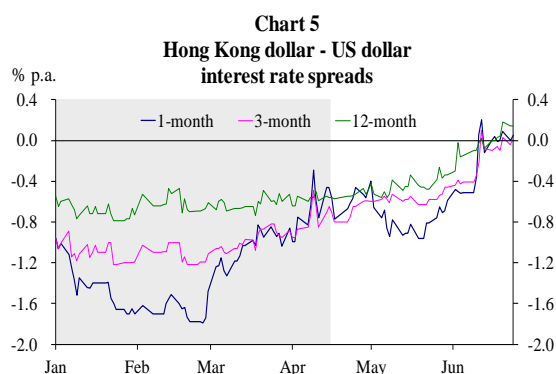


3. **Interest rate volatility**, measured by the standard deviation of daily changes in the 1-month HIBOR, **decreased** to 9.7 basis points in the current review period from 12.4 basis points in the preceding review period (Chart 4). The standard deviation as a ratio of the average of 1-

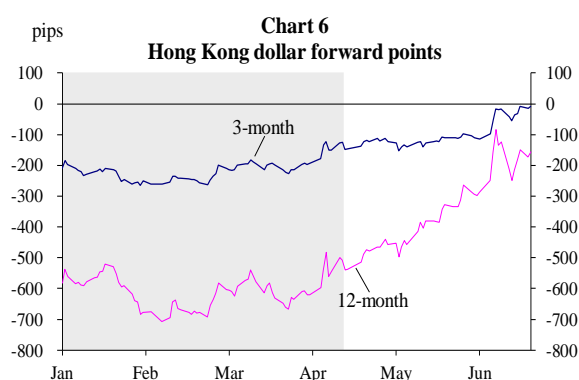


month HIBOR also showed similar movements².

4. **The HKD-USD interbank interest rate spreads generally narrowed during the review period**, as HIBORs increased and their USD counterparts (i.e. LIBORs) declined (Chart 5). Along with the anticipated funding needs for the half-year-end and possible large IPOs in the second half, **the HKD-USD interbank interest rate spreads turned positive briefly in June**. At the end of review period, the 1-month, 3-month and 12-month spreads closed at 5, 1 and 14 basis points, respectively.

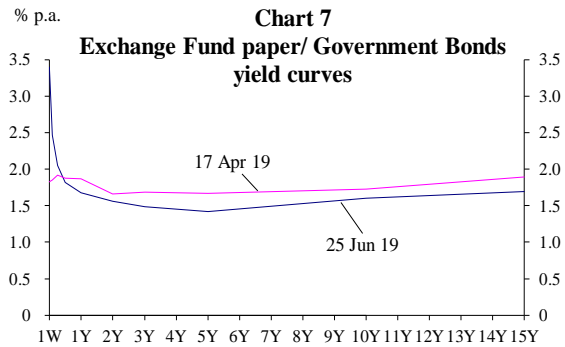


5. Broadly tracking the HKD-USD interbank interest rate spreads, **the discounts of HKD forward points narrowed during the review period** with the 3-month and 12-month HKD forward points closing at -8 pips and -155 pips respectively (Chart 6).



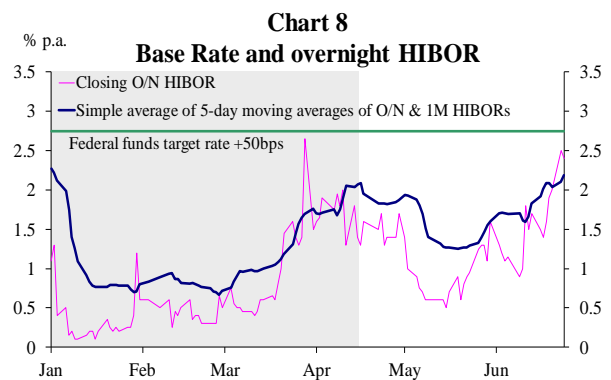
² The ratio of the standard deviation of daily changes in the 1-month HIBOR to its monthly average measures the extent of interest rate fluctuations relative to the average level of interest rates.

6. During the review period, the HKD yield curve shifted slightly downward (Chart 7). The yield of the 1-year Exchange Fund Bill decreased by 19 basis points to 1.68% at the end of the review period, and the yields of the 3-year and 10-year Hong Kong Government Bonds witnessed decreases of 20 basis points to 1.49% and 13 basis points to 1.60% respectively. The negative HKD-USD yield spreads generally narrowed, reflecting larger declines in the USD yields relative to HKD yields (Table 1).

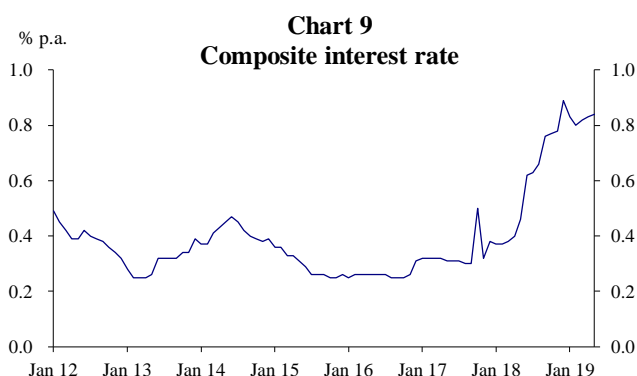


	17 Apr 19	25 Jun 19
3-month EFB	-52	-7
12-month EFB	-57	-25
3-year HKGB	-68	-18
5-year HKGB	-73	-31
10-year HKGB	-87	-40

7. At the April and June meetings, the Federal Open Market Committee (FOMC) decided to keep the Federal Funds Target Rate at 2.25 – 2.50%. As such, the HKMA Base Rate remained unchanged at 2.75% (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. During the review period, **banks kept their Best Lending Rates unchanged.** At the end of the review period, there remained three Best Lending Rates (5.125%, 5.375% and 5.500%) in the market. The average interest rate for newly approved mortgage loans increased to around 2.4% in April amid an increase in 1-month HIBOR since March. The average 1-month HKD time deposit board rate offered by retail banks remained unchanged at 0.14%³ during the review period. **The composite interest rate**⁴, which indicates the average funding cost of retail banks, **edged up** from 0.82% at the end of March to 0.84% at the end of May (Chart 9).



³ The figure refers to the average interest rate offered by major authorized institutions for 1-month time deposits of less than HK\$100,000.

⁴ 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.

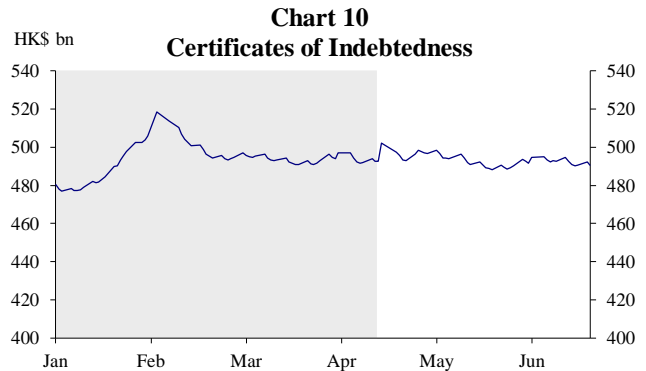
Monetary Base

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), **increased to HK\$1,625.56 billion on 25 June 2019 from HK\$1,624.21 billion on 17 April 2019** (Table 2). Movements of the individual components are discussed below.

(HK\$bn)	17 Apr 19	25 Jun 19
CIs	492.78	490.72
Government-issued Currency Notes and Coins in Circulation	13.01	12.98
Aggregate Balance	54.47	54.30
Outstanding EFBNs	1,063.96	1,067.56
Monetary Base	1,624.21	1,625.56

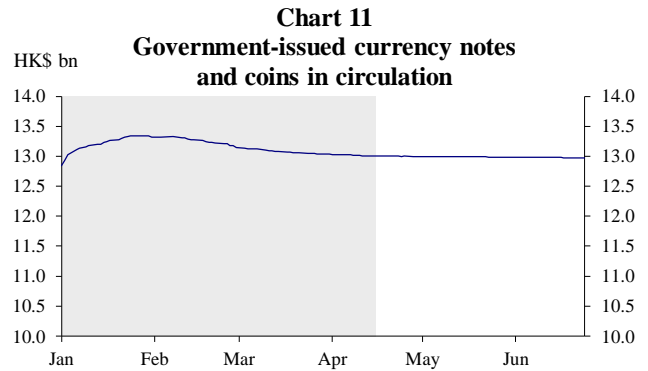
Certificates of Indebtedness

10. During the review period, note-issuing banks redeemed HK\$2.06 billion worth of CIs to the HKMA in exchange for a net amount of US\$264 million. As a result, **the outstanding CIs decreased** to HK\$490.72 billion on 25 June 2019 from HK\$492.78 billion on 17 April 2019 (Chart 10), mainly reflecting a net decrease in currency demand during the review period.



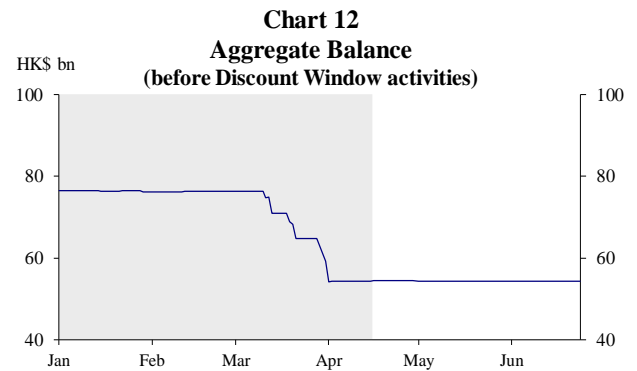
Government-issued currency notes and coins in circulation

11. During the review period, the amount of **government-issued currency notes and coins in circulation edged down** to HK\$12.98 billion on 25 June 2019 from HK\$13.01 billion on 17 April 2019 (Chart 11).



Aggregate Balance

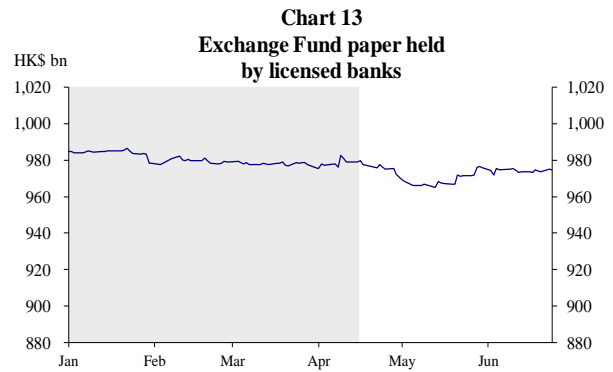
12. During the review period, the CUs were not triggered and **the Aggregate Balance (before Discount Window activities) was little changed**, averaging around HK\$54.3 billion (Chart 12). In the last review period, the Aggregate Balance declined from HK\$76.51 billion to HK\$54.34 billion, with the weak-side CU being triggered 8 times in March.⁵



⁵ Since the first triggering on 12 April 2018, the weak-side CU has been triggered 27 times in 2018 and 8 times in 2019 up to the end of the review period, with total outflows amounting to HK\$125.6 billion.

Outstanding Exchange Fund Bills and Notes

13. **The market value of the outstanding EFBNs increased to HK\$1,067.56 billion from HK\$1,063.96 billion during the review period. Holdings of Exchange Fund paper by the banking sector (before Discount Window activities) edged down to HK\$974.53 billion (91.3% of total) from HK\$979.73 billion (92.1% of total) (Chart 13).**



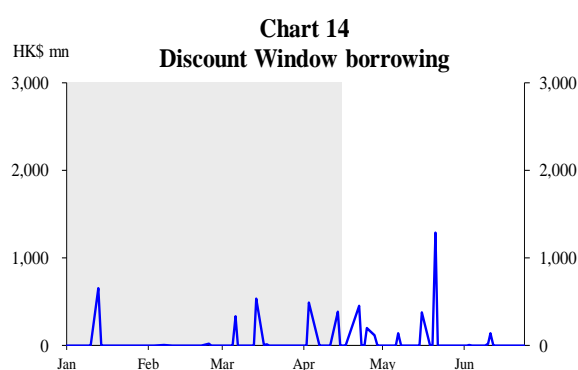
14. **During the review period, interest payments on Exchange Fund paper amounted to HK\$3,921.93 million. A total of HK\$3,910.99 million (in market value) of Exchange Fund paper was issued to absorb these interest payments. The remaining amount was carried forward in the Aggregate Balance at the end of the review period. The Exchange Fund paper issued during the review period was generally well received by the market (Table 3).**

Table 3
Issuance of Exchange Fund Bills and Notes
(17 Apr 19 – 25 Jun 19)

	No. of issues launched	Over-subscription ratio
1-month EFB	2	1.80 - 5.00
3-month EFB	10	0.78 - 2.03
6-month EFB	10	1.88 - 2.94
12-month EFB	2	2.54 - 4.56
2-year EFN	1	3.10

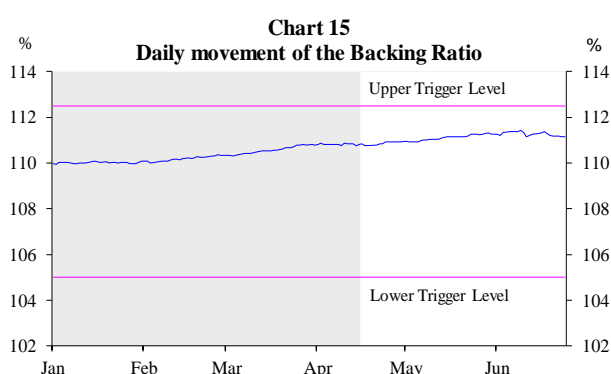
Discount Window activities

15. During the review period, **a total of HK\$2.7 billion was borrowed from the Discount Window**, compared with HK\$2.4 billion in the preceding period from 1 January to 16 April 2019 (Chart 14).



Backing Portfolio

16. The Backing Assets increased to HK\$1,805.79 billion on 25 June 2019, mainly reflecting valuation gains from investments, which offset the net redemption of CIs. **The Backing Ratio increased to 111.14% from 110.83% 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
15 August 2019