

EXCHANGE FUND ADVISORY COMMITTEE

Currency Board Sub-Committee

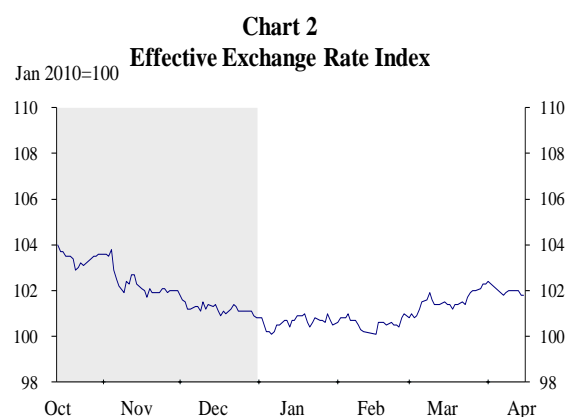
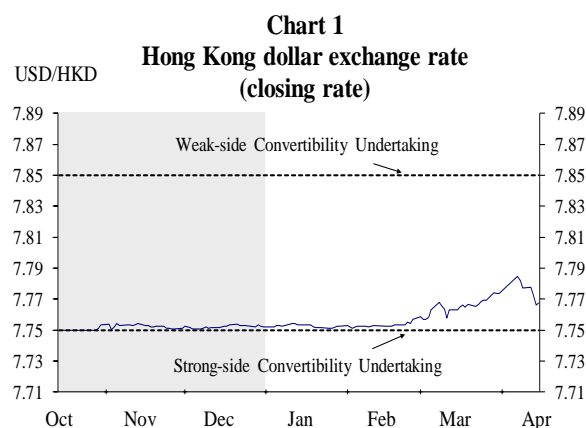
Report on Currency Board Operations

Review period: 1 January 2021 – 15 April 2021

During the review period, the Hong Kong dollar (HKD) traded within a range of 7.7512 - 7.7848 against the US dollar (USD). Mainly driven by equity-related demand arising from fund-raising activities and the southbound Stock Connects, the HKD stayed firm and traded close to the strong-side Convertibility Undertaking (CU) in January and February. Along with the stock market correction, the HKD has softened slightly since March as a result of the lower southbound buying flows and the repatriation of initial public offering (IPO) proceeds by some newly-listed companies. With the sizeable Aggregate Balance, HKD interbank interest rates (i.e. HIBORs) stayed at a low level throughout the review period. Overall, the HKD exchange and interbank markets continued to trade in a smooth and orderly manner. 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

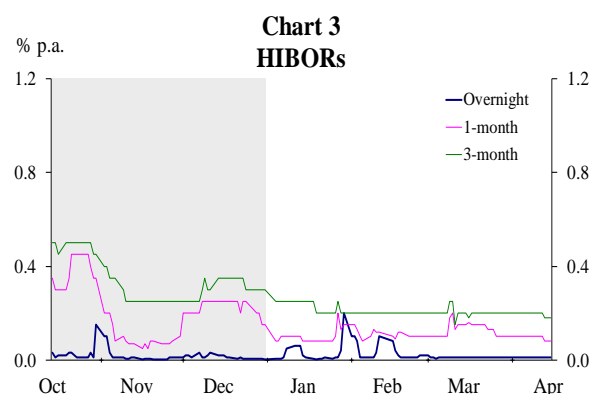
1. During the review period of 1 January to 15 April 2021, **the HKD traded within a range of 7.7512 - 7.7848 (closing rate) against the USD (Chart 1).**¹ Mainly driven by equity-related demand arising from fund-raising activities and the southbound Stock Connects, the HKD stayed firm and traded close to the strong-side CU in January and February. Along with the stock market correction, the HKD has softened slightly since March as a result of the lower southbound buying flows and the repatriation of IPO proceeds by some newly-listed companies. Overall, the HKD continued to trade in a smooth and orderly manner during the review period, closing at 7.7674 on 15 April. **The nominal effective exchange rate index of the HKD increased** during the review period, reflecting the appreciation of the USD against major currencies (Chart 2).



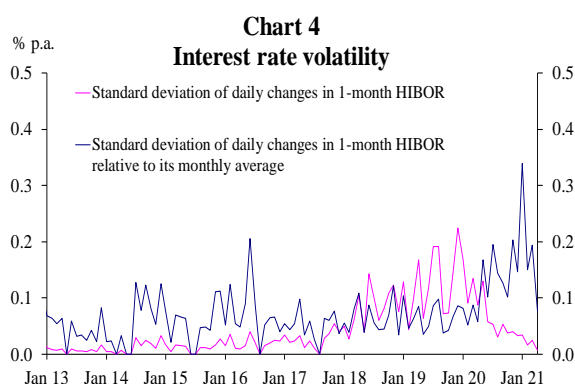
¹ In this report, daily time series charts also cover developments in the preceding review period (as shown in shaded region) for reference and comparison.

Interest rates

2. **The HKD HIBORs stayed at a low level** throughout the review period (Chart 3). While there were sizeable IPO activities during the review period, the impacts on local interest rates remained limited as HIBORs of various tenors did not witness large fluctuations. The interbank market continued to trade in a smooth and orderly manner. For the review period as a whole, the overnight HIBOR edged up by 1 basis point to 0.01%, the 1-month HIBOR stayed virtually unchanged at 0.08%, while the 3-month HIBOR edged down by 7 basis points to 0.18%.

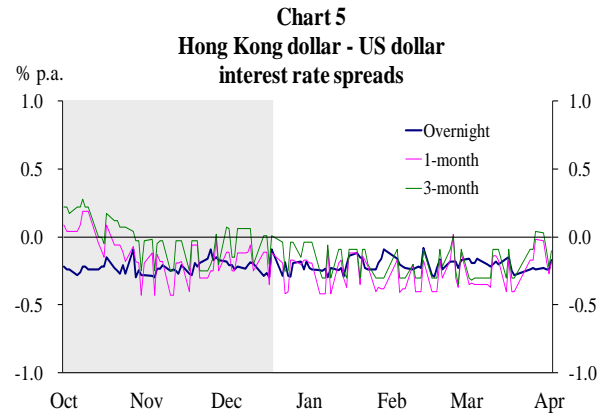


3. **Interest rate volatility, measured by the standard deviation of daily changes in the 1-month HIBOR, decreased slightly** to 2.4 basis points in the current review period from 3.7 basis points in the preceding review period (Chart 4). The standard deviation as a ratio of the average of 1-month HIBOR picked up in January amid the lower level of HIBOR.²

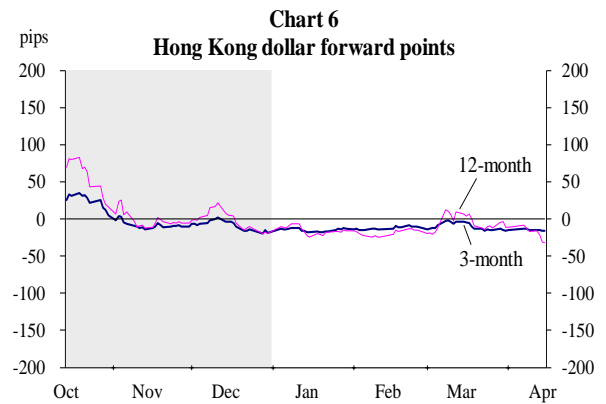


² The ratio of the standard deviation of daily changes in the 1-month HIBOR to its monthly average measures the extent of interest rate fluctuations relative to the average level of interest rates.

4. **The HKD-USD interbank interest rate spreads stayed within a narrow range**, only seeing modest fluctuations during the review period (Chart 5). At the end of the review period, the overnight, 1-month and 3-month spreads closed at -17, -18 and -10 basis points respectively.



5. Broadly tracking the HKD-USD interbank interest rate spreads, **the forward points were largely stable and stayed close to zero** during the review period. At the end of review period, the 3-month and 12-month forward discounts closed at 16 pips and 32 pips respectively (Chart 6).



6. During the review period, the HKD yield curve steepened, with the yields shifting upward at the longer end (Chart 7). The yield of the 1-year Exchange Fund Bill edged down by 1 basis point to 0.05%, while the yield of 10-year Hong Kong Government Bond increased by 54 basis points to 1.26%. The HKD-USD yield spreads generally narrowed for shorter tenors, but widened for longer tenors (Table 1).

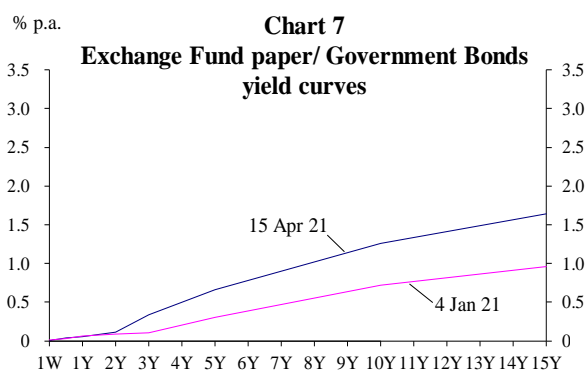
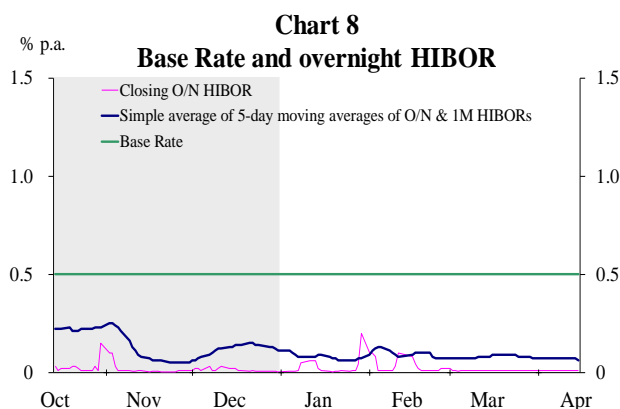
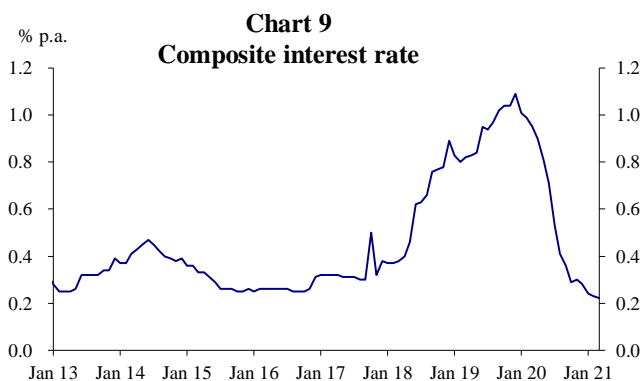


Table 1 Yield spreads of Exchange Fund paper and Hong Kong Government Bonds over US Treasuries (basis points)		
	4 Jan 21	15 Apr 21
3-month EFB	-7	0
12-month EFB	-4	-1
3-year HKGB	-5	1
5-year HKGB	-6	-15
10-year HKGB	-21	-30

7. During the review period, the target range for the US Federal Funds Rate remained unchanged at 0%-0.25%. As such, **the HKMA Base Rate remained unchanged at 0.50%** according to the established formula (Chart 8), with the Base Rate set at either 50 basis points above the lower end of the prevailing target range for the US federal funds rate or the average of the five-day moving averages of the overnight and one-month HIBORs, whichever is the higher.



8. During the review period, **banks kept their Best Lending Rates unchanged.** The Best Lending Rates in the market continued to range from 5.00% to 5.50%. Along with the decline in 1-month HIBOR, the average interest rate for newly approved mortgage loans declined further from 1.67% in December 2020 to 1.55% in February 2021. Meanwhile, the average 1-month HKD time deposit board rate offered by retail banks stayed virtually unchanged at 0.02%.³ **The composite interest rate**⁴, which indicates the average funding cost of retail banks, **declined** further from 0.28% at the end of December 2020 to 0.22% at the end of March 2021 (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-rate-sensitive liabilities, which include deposits from customers, amounts due to banks, negotiable certificates of deposit and other debt instruments, and all other liabilities that do not involve any formal payment of interest but the values of which are sensitive to interest rate movements (such as 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.

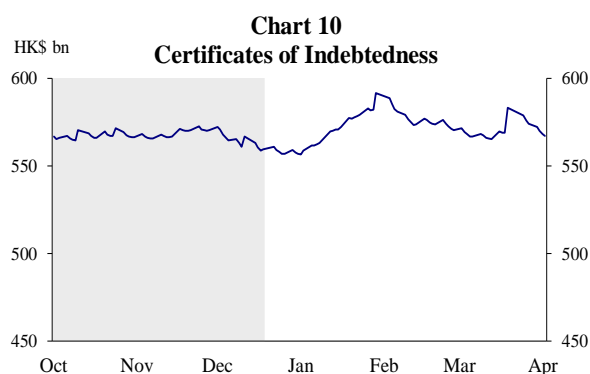
Monetary Base

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), **edged up to HK\$2,107.09 billion on 15 April 2021 from HK\$2,100.65 billion on 4 January 2021** (Table 2). Movements of the individual components are discussed below.

Table 2 Monetary Base		
(HK\$bn)	4 Jan 21	15 Apr 21
CIs	560.83	567.26
Government-issued Currency Notes and Coins in Circulation	13.17	13.31
Aggregate Balance	457.47	457.47
Outstanding EFBNs	1,069.20	1,069.06
Monetary Base	2,100.65	2,107.09

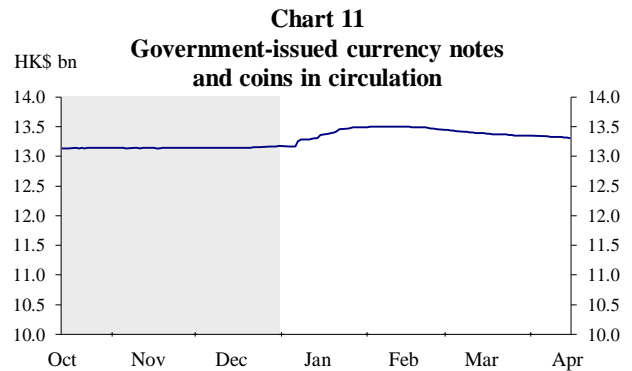
Certificates of Indebtedness

10. During the review period, note-issuing banks submitted a net amount of US\$824.4 million to the HKMA in exchange for HK\$6.43 billion worth of CIs. As a result, **the outstanding CIs increased** to HK\$567.26 billion on 15 April 2021 from HK\$560.83 billion on 4 January 2021 (Chart 10), with fluctuations mainly driven by increased demand for banknotes ahead of the Chinese New Year holidays and the Easter holidays.



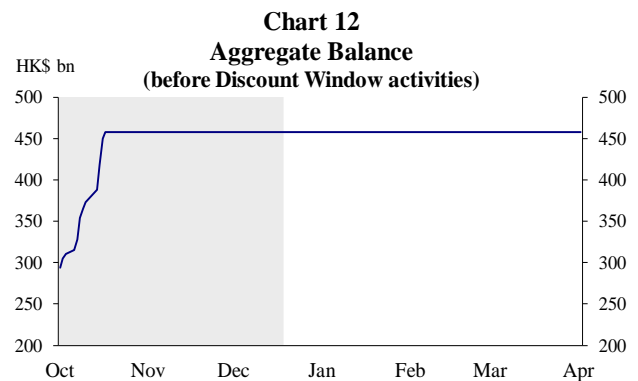
Government-issued currency notes and coins in circulation

11. During the review period, the amount of **government-issued currency notes and coins in circulation** increased from HK\$13.17 billion to HK\$13.31 billion (Chart 11).



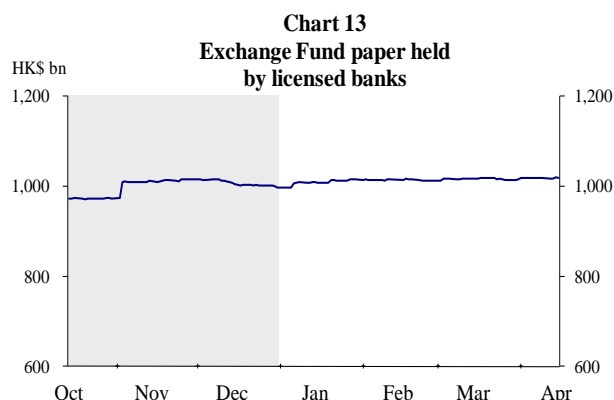
Aggregate Balance

12. During the review period, the Convertibility Undertakings were not triggered and **the Aggregate Balance** (before Discount Window activities) **was little changed**, averaging around HK\$457.5 billion (Chart 12).



Outstanding Exchange Fund Bills and Notes

13. **The market value of the outstanding EFBNs edged down to HK\$1,069.06 billion from HK\$1,069.20 billion during the review period. Holdings of Exchange Fund paper by the banking sector (before Discount Window activities) increased to HK\$1,018.76 billion (95.3% of total) from HK\$997.35 billion (93.3% of total) (Chart 13).**

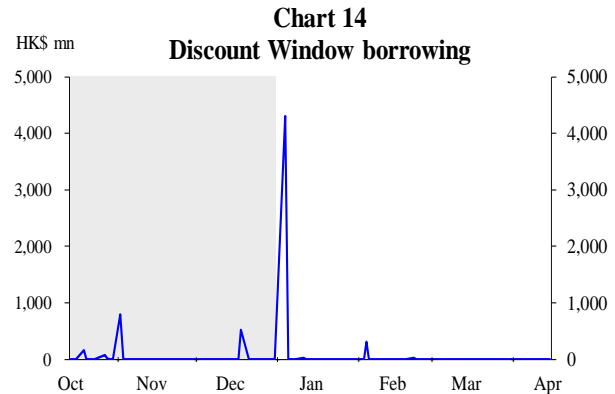


14. During the review period, **interest payments on Exchange Fund paper amounted to HK\$281.37 million. A total of HK\$203.98 million (in market value) of Exchange Fund paper was issued to absorb these interest payments.** The remaining amount was carried forward in the Aggregate Balance at the end 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 (1 Jan 21 – 15 Apr 21)		
	No. of issues launched	Over-subscription ratio
1-month EFB	0	-
3-month EFB	15	0.86 – 2.49
6-month EFB	15	1.15 – 4.33
12-month EFB	4	5.20 – 15.24
2-year EFN	1	3.46

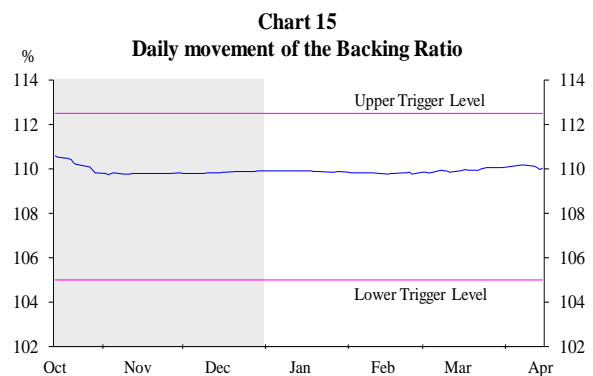
Discount Window activities

15. During the review period, a total of **HK\$4,661 million** was borrowed from the **Discount Window**, compared with HK\$1,569 million in the preceding period from 14 October 2020 to 31 December 2020 (Chart 14).



Backing Portfolio

16. The Backing Assets increased to HK\$2,317.45 billion on 15 April 2021, mainly reflecting the increase in CIs. **The Backing Ratio edged up from 109.91% to 110.04% 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
9 June 2021