

EXCHANGE FUND ADVISORY COMMITTEE

Currency Board Sub-Committee

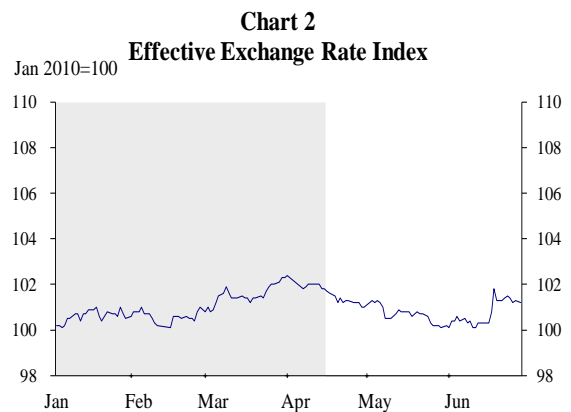
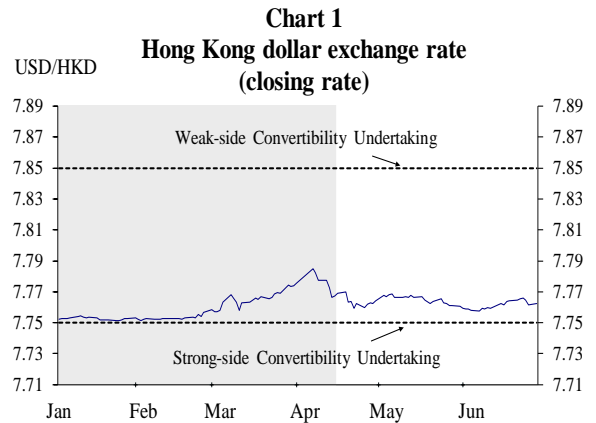
Report on Currency Board Operations

Review period: 16 April 2021 – 28 June 2021

During the review period, the Hong Kong dollar (HKD) traded within a narrow range of 7.7574 and 7.7699 against the US dollar (USD). Despite some selling pressure from the repatriation of funds raised in initial public offerings (IPOs) and share placements, the HKD remained firm due to corporates' dividend payment needs and net inflows from the southbound Stock Connects. With the sizeable Aggregate Balance, HKD interbank interest rates (i.e. HIBORs) stayed at low levels during 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

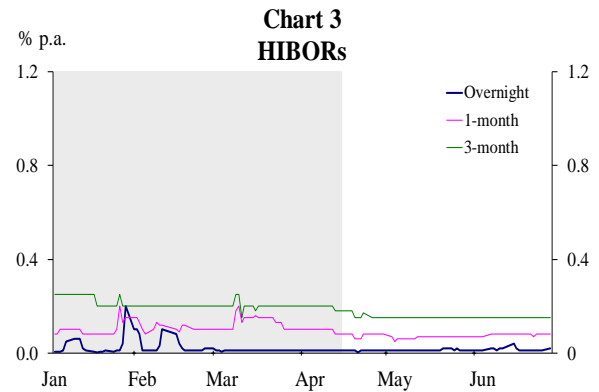
1. During the review period of 16 April to 28 June 2021, the **HKD traded within a narrow range of 7.7574 and 7.7699** (closing rate) **against the USD** (Chart 1).¹ Despite some selling pressure from the repatriation of funds raised in IPOs and share placements, the HKD remained firm due to corporates' dividend payment needs and net inflows from the southbound Stock Connects. Overall, the HKD continued to trade in a smooth and orderly manner during the review period, closing at 7.7625 on 28 June. **The nominal effective exchange rate index of the HKD decreased** during the review period, reflecting the depreciation of the USD against some major currencies (Chart 2).



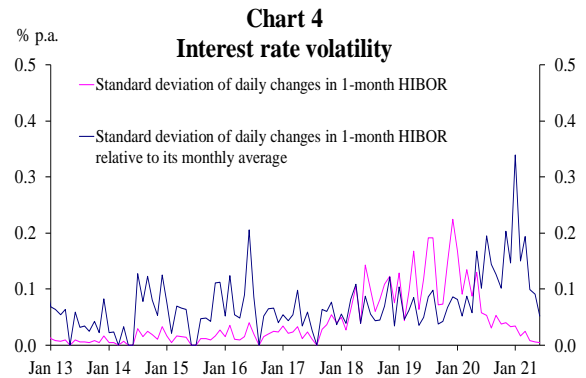
¹ In this report, daily time series charts also cover developments in the preceding review period (as shown in shaded region) for reference and comparison.

Interest rates

2. During the review period, **the HKD HIBORs remained largely stable at low levels** with the sizeable Aggregate Balance (Chart 3). 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 0.02%, while the 1-month HIBOR stayed virtually unchanged at 0.08% and the 3-month HIBOR edged down by 3 basis points to 0.15%.

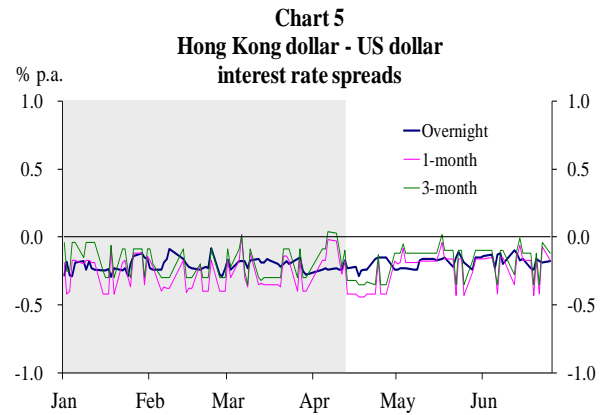


3. **Interest rate volatility**, measured by the standard deviation of daily changes in the 1-month HIBOR, **decreased** to 0.6 basis points in the current review period from 2.4 basis points in the preceding review period (Chart 4). The standard deviation as a ratio of the average of 1-month HIBOR also decreased during the review period.²

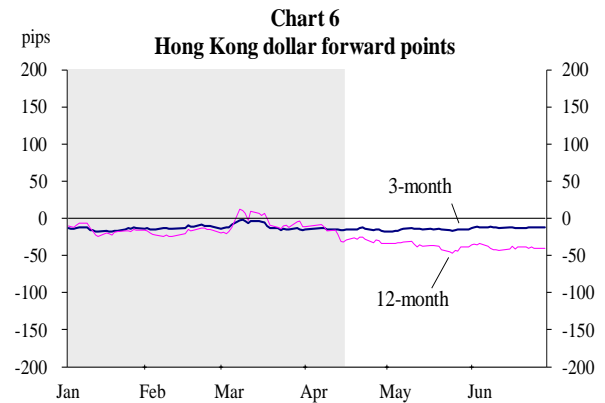


² The ratio of the standard deviation of daily changes in the 1-month HIBOR to its monthly average measures the extent of interest rate fluctuations relative to the average level of interest rates.

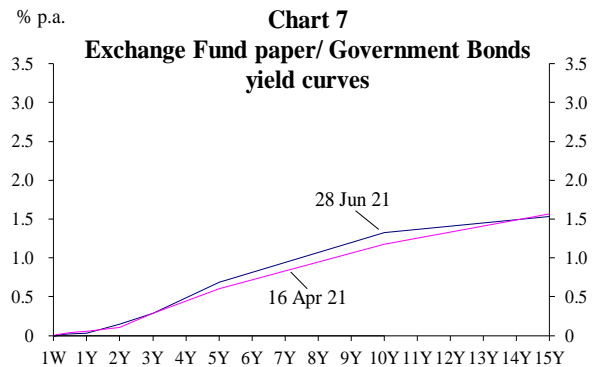
4. During the review period, **the HKD-USD interbank interest rate spreads stayed within a narrow range** (Chart 5). At the end of the review period, the overnight, 1-month and 3-month spreads closed at -18, -17 and -12 basis points respectively.



5. Broadly tracking the HKD-USD interbank interest rate spreads, **the forward points were largely stable** during the review period. At the end of review period, the 3-month and 12-month forward discounts closed at 12 pips and 40 pips respectively (Chart 6).

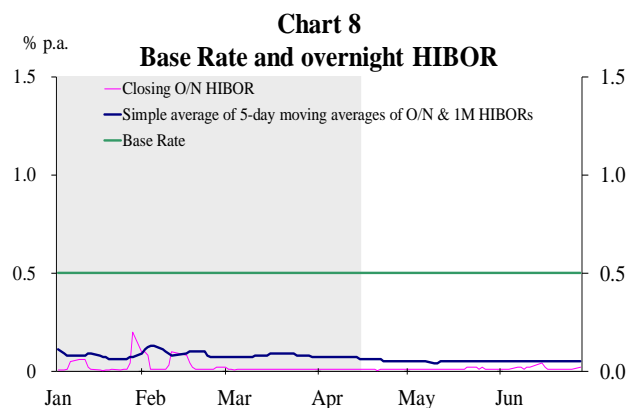


6. During the review period, the HKD yield curve steepened slightly (Chart 7). The yield of the 1-year Exchange Fund Bill edged down by 2 basis points to 0.03% while that of the 10-year Hong Kong Government Bond increased by 15 basis points to 1.32%. The HKD-USD yield spreads generally widened for shorter tenors but narrowed for longer tenors (i.e. 5-year and 10-year) (Table 1).

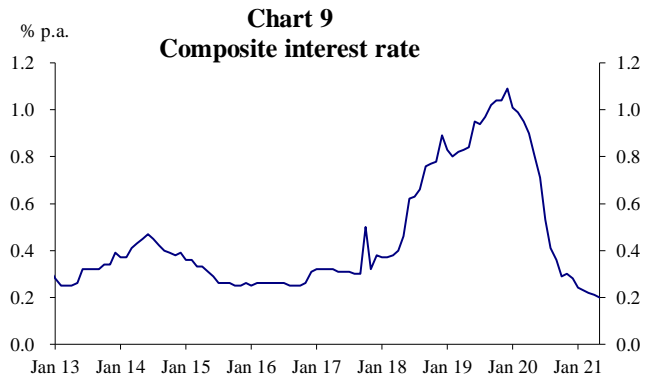


	16 Apr 21	28 Jun 21
3-month EFB	0	-4
12-month EFB	-1	-5
3-year HKGB	-6	-18
5-year HKGB	-24	-21
10-year HKGB	-42	-17

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%. The average interest rate for newly approved mortgage loans declined further from 1.55% in February 2021 to 1.48% in May 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 0.22% at the end of March 2021 to 0.20% at the end of May 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.

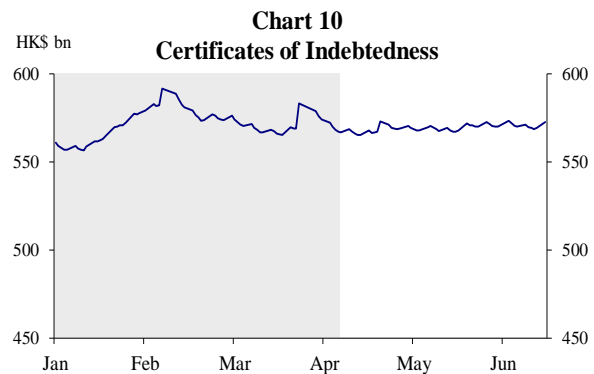
Monetary Base

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\$2,112.44 billion on 28 June 2021 from HK\$2,106.59 billion on 16 April 2021** (Table 2). Movements of the individual components are discussed below.

(HK\$bn)	16 Apr 21	28 Jun 21
CIs	566.74	572.65
Government-issued Currency Notes and Coins in Circulation	13.31	13.23
Aggregate Balance	457.47	457.45
Outstanding EFBNs	1,069.09	1,069.11
Monetary Base	2,106.59	2,112.44

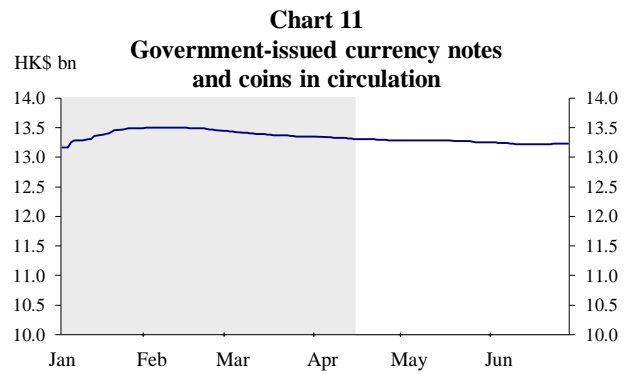
Certificates of Indebtedness

10. During the review period, note-issuing banks submitted a net amount of US\$758 million to the HKMA in exchange for HK\$5.91 billion worth of CIs. As a result, **the outstanding CIs increased** to HK\$572.65 billion on 28 June 2021 from HK\$566.74 billion on 16 April 2021 (Chart 10).



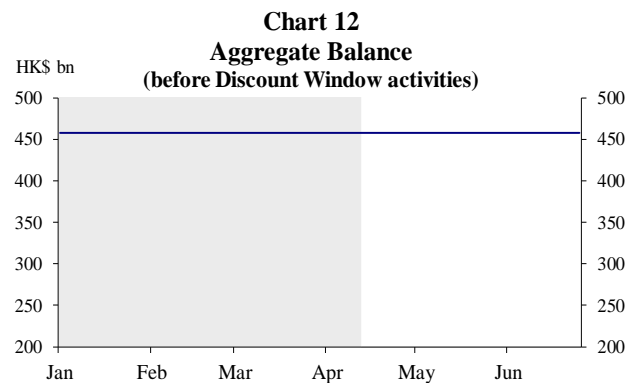
Government-issued currency notes and coins in circulation

11. During the review period, the amount of **government-issued currency notes and coins in circulation edged down** from HK\$13.31 billion to HK\$13.23 billion (Chart 11).



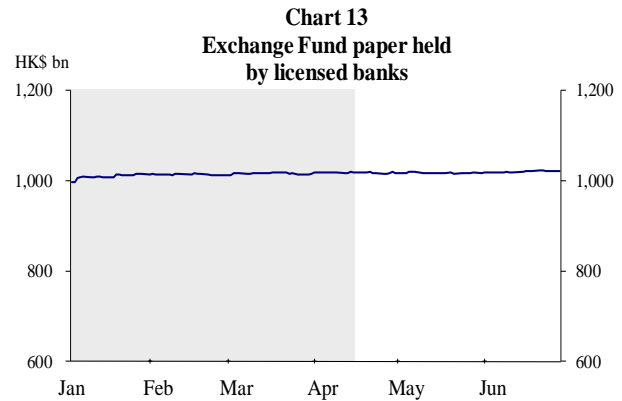
Aggregate Balance

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



Outstanding Exchange Fund Bills and Notes

13. **The market value of the outstanding EFBNs edged up to HK\$1,069.11 billion during the review period. Holdings of Exchange Fund paper by the banking sector (before Discount Window activities) increased to HK\$1,021.43 billion (95.5% of total) from HK\$1,018.75 billion (95.3% of total) (Chart 13).**



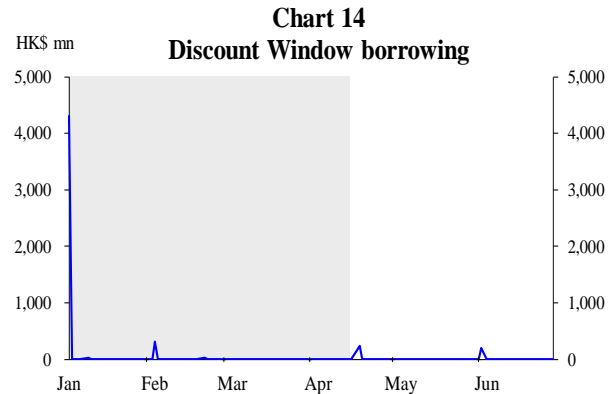
14. **During the review period, interest payments on Exchange Fund paper amounted to HK\$109.32 million. A total of HK\$48.00 million (in market value) of Exchange Fund paper was issued to absorb these interest payments.** The remaining amount was carried forward in the Aggregate Balance at the end of 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
(16 Apr 21 – 28 Jun 21)

	No. of issues launched	Over-subscription ratio
1-month EFB	1	5.13
3-month EFB	10	1.28 – 3.01
6-month EFB	10	3.57 – 6.88
12-month EFB	2	5.84 – 8.07
2-year EFN	1	10.08

Discount Window activities

15. During the review period, a total of HK\$521 million was borrowed from the Discount Window, compared with HK\$4,661 million in the preceding period from 1 January 2021 to 15 April 2021 (Chart 14).



Backing Portfolio

16. The Backing Assets increased to HK\$2,321.70 billion on 28 June 2021, mainly reflecting the increase in CIs. Due to the valuation effect on USD investments, the increase in the Backing Assets was smaller than that of the Monetary Base, and therefore the **Backing Ratio edged down from 110.06% to 109.96% 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.

