

EXCHANGE FUND ADVISORY COMMITTEE

Currency Board Sub-Committee

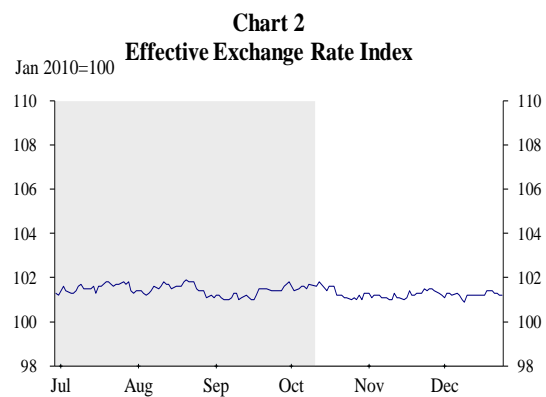
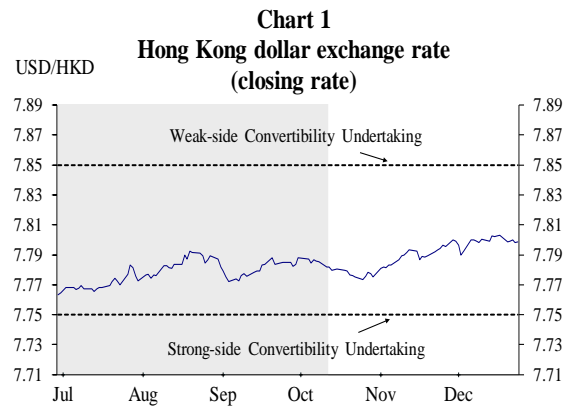
Report on Currency Board Operations

Review period: 12 October 2021 – 24 December 2021

During the review period, the Hong Kong dollar (HKD) traded within a range of 7.7735 and 7.8032 against the US dollar (USD). The HKD drifted lower in November and December amid softened equity market sentiment. HKD interbank interest rates (i.e. HIBORs) remained at low levels during the review period, despite some increases amid tightened liquidity towards the year end. 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

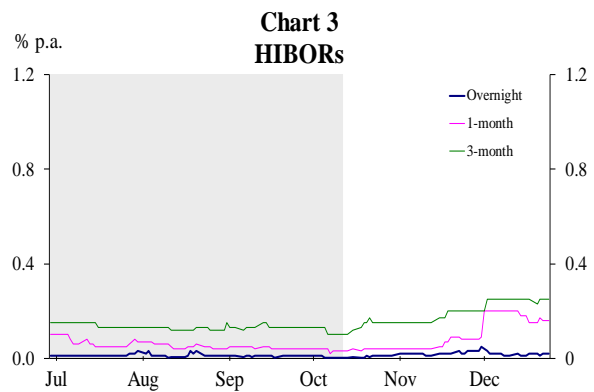
1. During the review period of 12 October to 24 December 2021, **the HKD traded within a range of 7.7735 and 7.8032 (closing rate) against the USD (Chart 1).**¹ The HKD drifted lower in November and December amid softened equity market sentiment. Overall, the HKD continued to trade in a smooth and orderly manner during the review period, closing at 7.7987 on 24 December. **The nominal effective exchange rate index of the HKD decreased slightly** during the review period, reflecting the depreciation of the USD against some major currencies (Chart 2).



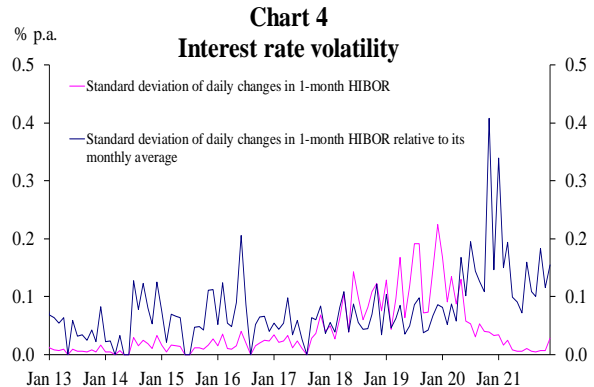
¹ In this report, daily time series charts also cover developments in the preceding review period (as shown in shaded region) for reference and comparison.

Interest rates

2. Driven by anticipated funding needs towards the year end, the **HKD HIBORs edged up** (notably for the 1-month tenor), though still remaining at low levels during the review period (Chart 3). The interbank market continued to trade in a smooth and orderly manner. For the review period as a whole, the overnight, 1-month and 3-month HIBORs increased by 1.7, 13 and 15 basis points to 0.02%, 0.16% and 0.25% respectively.

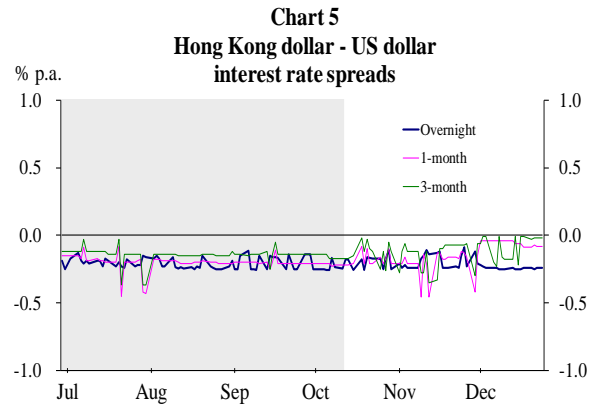


3. **Interest rate volatility**, measured by the standard deviation of daily changes in the 1-month HIBOR, **increased** to 1.7 basis points (or 0.017%) in the current review period from 0.8 basis points (or 0.008%) in the preceding review period (Chart 4). Nevertheless, the standard deviation as a ratio of the average of 1-month HIBOR decreased, amid the increase in HIBOR.²

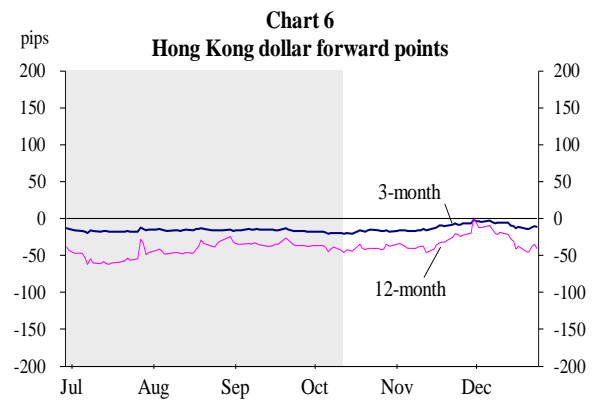


² The ratio of the standard deviation of daily changes in the 1-month HIBOR to its monthly average measures the extent of interest rate fluctuations relative to the average level of interest rates.

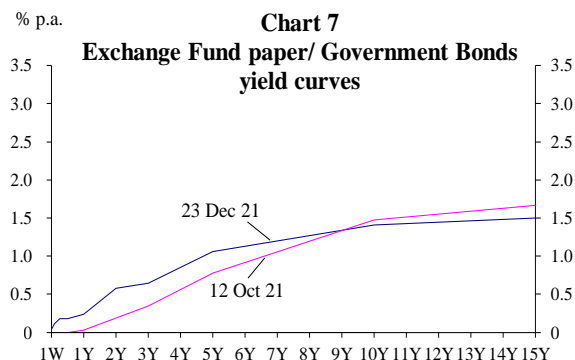
4. During the review period, **the HKD-USD interbank interest rate spreads stayed within a narrow range** (Chart 5). At the end of the review period, the overnight, 1-month and 3-month spreads closed at -24, -8 and -2 basis points respectively.



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 11 pips and 40 pips respectively (Chart 6).

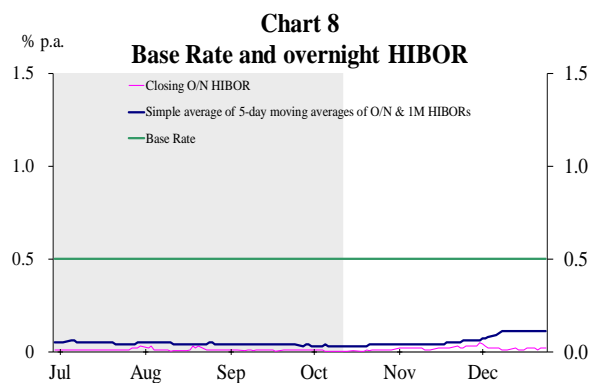


6. During the review period, the HKD yield curve flattened (Chart 7). The yield of the 1-year Exchange Fund Bill increased by 21 basis points to 0.24%, while the yield of 10-year Hong Kong Government Bond decreased by 7 basis points to 1.41%. The HKD-USD yield spread turned positive at the short-end (i.e. 3-month) (Table 1).

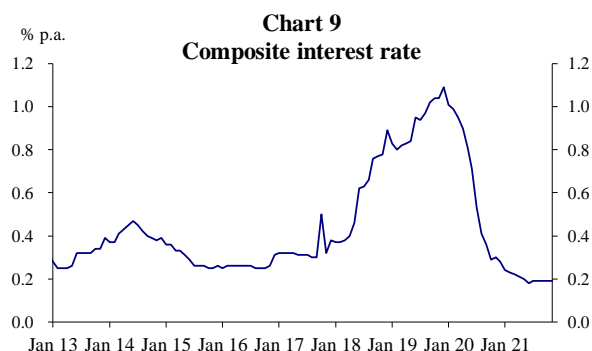


	12 Oct 21	23 Dec 21
3-month EFB	-6	11
12-month EFB	-7	-7
3-year HKGB	-29	-33
5-year HKGB	-30	-19
10-year HKGB	-12	-10

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 edged up from 1.46% in September 2021 to 1.47% in November 2021. Meanwhile, the average 1-month HKD time deposit board rate offered by retail banks remained unchanged at 0.02%.³ **The composite interest rate⁴, which indicates the average funding cost of retail banks, stayed virtually unchanged at 0.19% at the end of November 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.

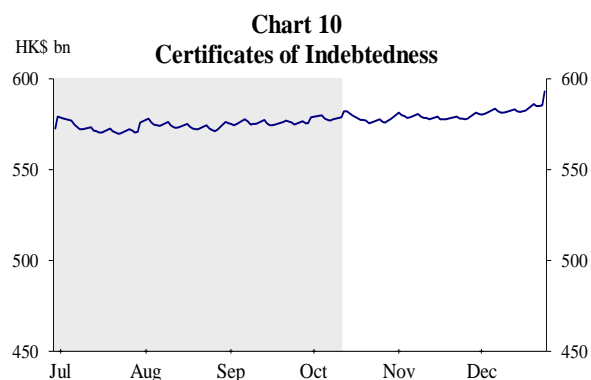
Monetary Base

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\$2,132.65 billion on 24 December 2021 from HK\$2,121.81 billion on 12 October 2021** (Table 2). Movements of the individual components are discussed below.

(HK\$bn)	12 Oct 21	24 Dec 21
CIs	582.15	593.13
Government-issued Currency Notes and Coins in Circulation	13.19	13.32
Aggregate Balance	432.46	377.50
Outstanding EFBNs	1,094.02	1,148.71
Monetary Base	2,121.81	2,132.65

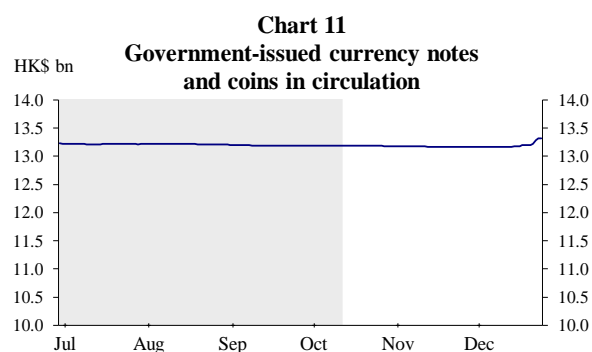
Certificates of Indebtedness

10. During the review period, note-issuing banks submitted a net amount of US\$1.41 billion to the HKMA in exchange for HK\$10.98 billion worth of CIs. As a result, **the outstanding CIs increased** to HK\$593.13 billion on 24 December 2021 from HK\$582.15 billion on 12 October 2021 (Chart 10).



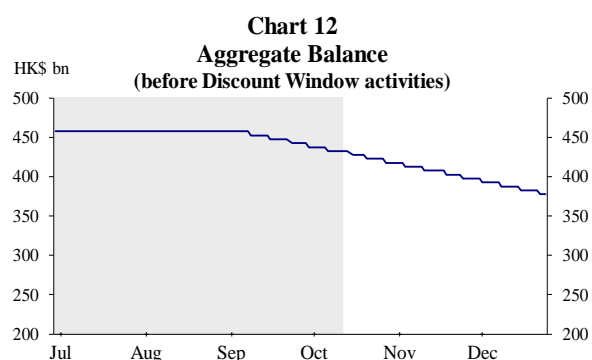
Government-issued currency notes and coins in circulation

11. During the review period, the amount of **government-issued currency notes and coins in circulation edged up** from HK\$13.19 billion to HK\$13.32 billion (Chart 11).



Aggregate Balance

12. Reflecting the increased issuance of Exchange Fund Bills to meet the ongoing demand for Exchange Fund paper by banks amidst the abundance of liquidity in the banking system⁵, **the Aggregate Balance** (before Discount Window activities) **decreased** from HK\$432.5 billion to HK\$377.5 billion during the review period (Chart 12). The increase in the supply of Exchange Fund Bills is consistent with Currency Board principles, since the additional issuance simply represents a change in the composition of the Monetary Base, with a shift from

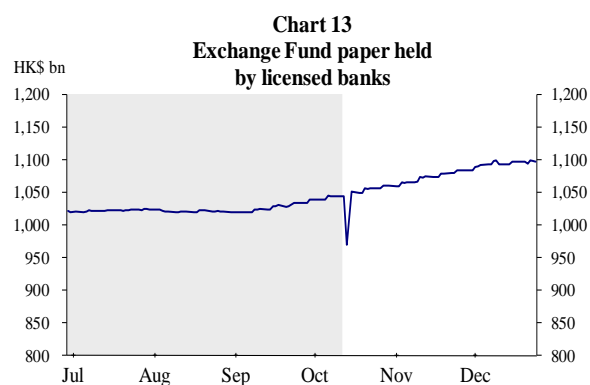


⁵ To meet the ongoing demand for Exchange Fund paper by banks amidst the abundance of liquidity in the banking system, the HKMA increased the issuance size of 91-day Exchange Fund Bills by HK\$5 billion in each of the eight regular tenders on 7, 14, 21 and 28 September and 5, 12, 19 and 26 October. On 20 October 2021, the HKMA announced another plan to increase the issuance size of 91-day Exchange Fund Bills by HK\$5 billion in each of the eight regular tenders on 2, 9, 16, 23 and 30 November and 7, 14 and 21 December 2021. During the review period, the additional issuance size of the Bills amounted to HK\$55 billion in total and the Aggregate Balance decreased by the same amount. On 13 December 2021, the HKMA further announced a plan to increase the issuance size of 91-day Exchange Fund Bills by HK\$5 billion in each of the eight regular tenders on 4, 11, 18, 25 and 31 January and 8, 15 and 22 February 2022. If all the eight

the Aggregate Balance to Exchange Fund paper. The Monetary Base remains fully backed by foreign exchange reserves.

Outstanding Exchange Fund Bills and Notes

13. **The market value of the outstanding EFBNs increased to HK\$1,148.71 billion during the review period, following the increased issuance of Exchange Fund Bills by a total of HK\$55 billion in 11 regular tenders. Holdings of Exchange Fund paper by the banking sector⁶ (before Discount Window activities) picked up to HK\$1,097.66 billion (95.6% of total) from HK\$1,043.87 billion (95.4% of total) (Chart 13).**



planned increases are executed, the issuance size of the Bills will be further increased by HK\$40 billion in total and the Aggregate Balance will be decreased by the same amount.

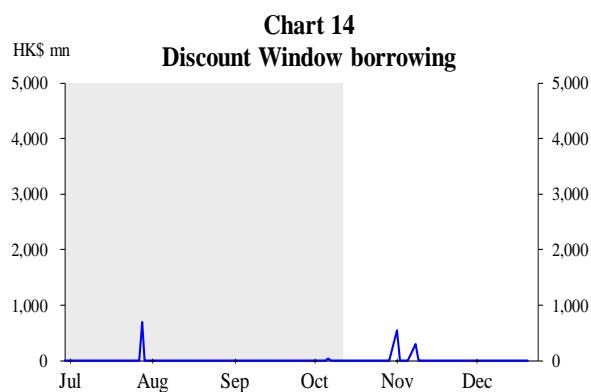
⁶ The transitory drop on 13 Oct 2021 was caused by the postponed EFBN tender settlement due to typhoon.

14. During the review period, **interest payments on Exchange Fund paper amounted to HK\$230.92 million. A total of HK\$115.96 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).

	No. of issues launched	Over-subscription ratio
1-month EFB	1	3.38
3-month EFB	11	0.82 – 1.88
6-month EFB	11	1.22 – 2.74
12-month EFB	3	1.55 – 2.81
2-year EFN	1	4.80

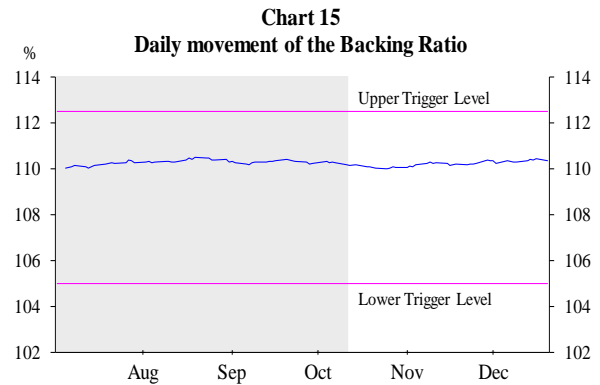
Discount Window activities

15. During the review period, **a total of HK\$845 million was borrowed from the Discount Window,** compared with HK\$736 million in the preceding period from 29 June 2021 to 11 October 2021 (Chart 14).



Backing Portfolio

16. The Backing Assets edged up to HK\$2,343.23 billion on 23 December 2021, mainly reflecting the valuation gains from investments and issuance of CIs. With the increase in the Backing Assets outpacing the increase in the Monetary Base, **the Backing Ratio edged up from 110.16% to 110.30% 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
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