

EXCHANGE FUND ADVISORY COMMITTEE

Currency Board Sub-Committee

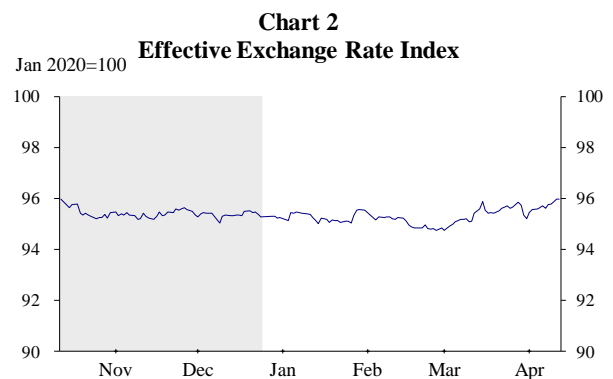
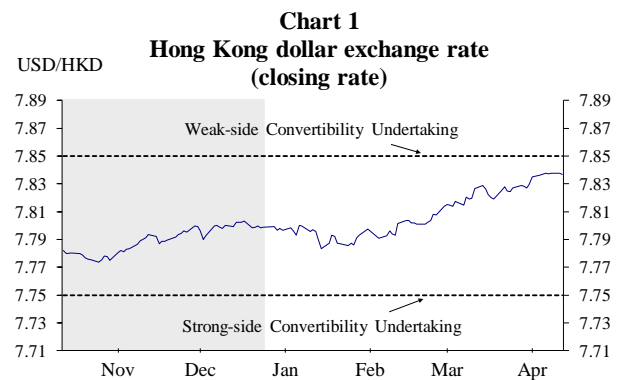
Report on Currency Board Operations

Review period: 25 December 2021 – 12 April 2022

During the review period, the Hong Kong dollar (HKD) traded within a range of 7.7832 – 7.8378 against the US dollar (USD). The HKD had softened since February amid market concerns over the Fed’s policy normalisation and the risk-off sentiment triggered by the Ukraine situation. HKD interbank interest rates (i.e. HIBORs) increased slightly during the review period amid expectation of further US rate hikes, but remained at low levels by historical standards. While the Fed’s policy normalisation process was expected to proceed at a much faster pace than the previous rate hike cycle in 2015-2018, the ample HKD liquidity suggested that increases in HKD interbank rates may lag those of the USD interest rates. The extent of lagging would depend on HKD supply and demand situations in the local market. 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

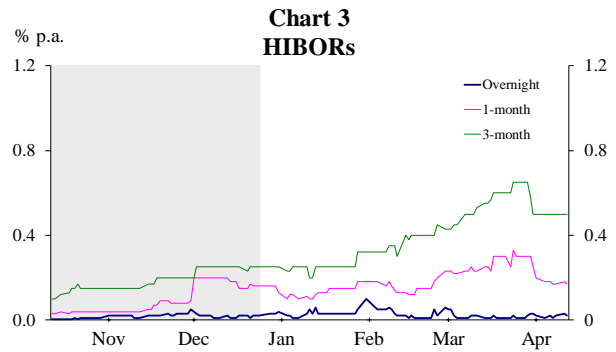
1. During the review period of 25 December 2021 to 12 April 2022, the HKD traded within a range of 7.7832 – 7.8378 (closing rate) against the USD (Chart 1).¹ The HKD had softened since February and reached the recent low of 7.8378 on 11 April amid market concerns over the Fed's policy normalisation and the risk-off sentiment triggered by the Ukraine situation. While the Fed's policy normalisation process was expected to proceed at a much faster pace than the previous rate hike cycle in 2015-2018, the ample HKD liquidity suggested that increases in HKD interbank rates may lag those of the USD interest rates. The extent of lagging would depend on HKD supply and demand situations in the local market. Overall, the HKD continued to trade in a smooth and orderly manner during the review period, closing at 7.8369 on 12 April. Reflecting the exchange rate of the HKD against the currencies of major trading partners of Hong Kong, **the nominal effective exchange rate index of the HKD remained largely steady** during the review period (Chart 2).



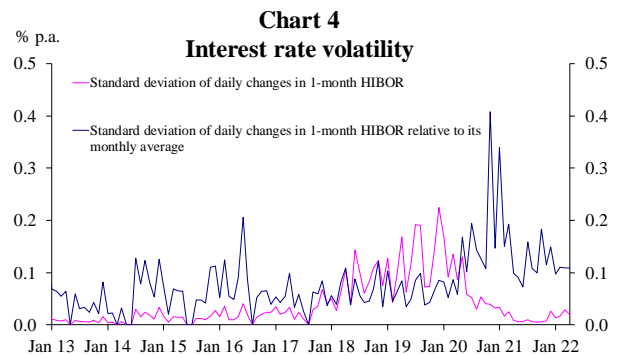
¹ In this report, daily time series charts also cover developments in the preceding review period (as shown in shaded region) for reference and comparison.

Interest rates

2. **The HKD HIBORs generally increased** during the review period due to expectation of further US rate hikes, but remained at low levels by historical standards (Chart 3). The interbank market continued to trade in a smooth and orderly manner. For the review period as a whole, 1-month and 3-month HIBORs increased by 1 and 25 basis points to 0.17% and 0.50% respectively, whereas the overnight HIBOR edged down by 1 basis point to 0.02%.

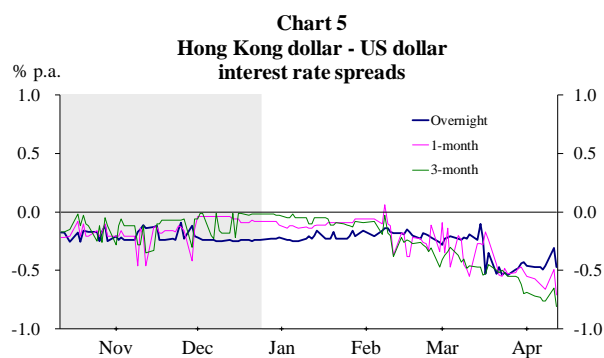


3. **Interest rate volatility**, measured by the standard deviation of daily changes in the 1-month HIBOR, **increased** to 2.1 basis points (or 0.021%) in the current review period from 1.7 basis points (or 0.017%) in the preceding review period (Chart 4). The standard deviation as a ratio of the average of 1-month HIBOR decreased, amid the increase in HIBOR.²

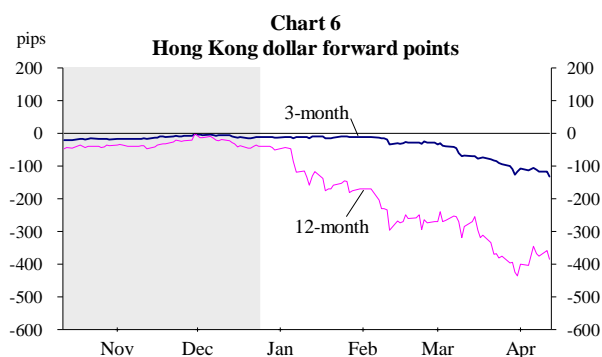


² The ratio of the standard deviation of daily changes in the 1-month HIBOR to its monthly average measures the extent of interest rate fluctuations relative to the average level of interest rates.

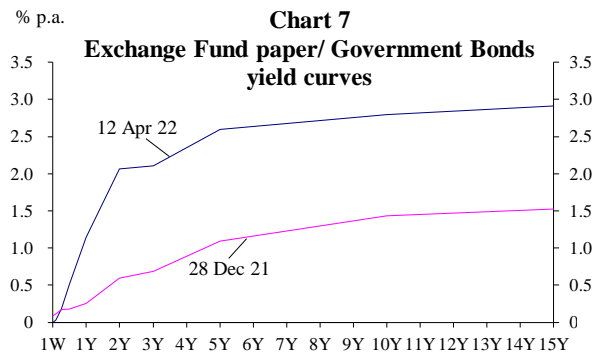
4. Reflecting a broad-based increase in the USD interest rates following the Federal Open Market Committee's rate hike decision, **the negative HKD-USD interbank interest rate spreads widened** during the review period (Chart 5). At the end of the review period, the overnight, 1-month and 3-month spreads closed at -47, -71 and -81 basis points respectively.



5. Broadly tracking the HKD-USD interbank interest rate spreads, **the discounts of HKD forward points widened** during the review period. At the end of review period, the 3-month and 12-month forward discounts closed at 131 pips and 385 pips respectively (Chart 6).

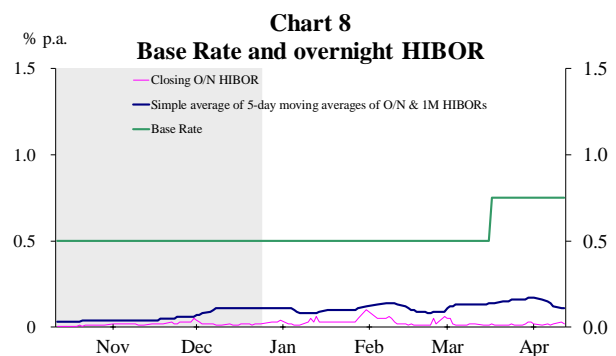


6. During the review period, the HKD yield curve generally shifted upwards (Chart 7). The yield of the 1-year Exchange Fund Bill increased by 89 basis points to 1.14%, and the yield of 10-year Hong Kong Government Bond increased by 136 basis points to 2.79%. As the USD yields rose faster than the HKD yields at shorter tenors (e.g. 3-month to 3-year), the HKD-USD yield spreads generally widened in the negative territory. Yet for longer tenors (e.g. 5-year and 10-year), the HKD yields rose slightly more than the USD counterparts, as shown by the positive increment in yield spreads during the review period (Table 1).

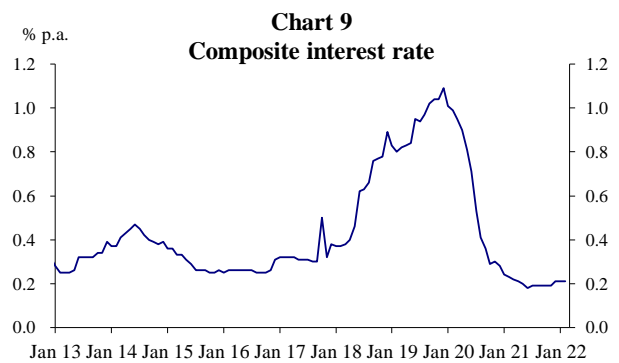


	28 Dec 21	12 Apr 22
3-month EFB	11	-56
12-month EFB	-14	-63
3-year HKGB	-31	-47
5-year HKGB	-18	-7
10-year HKGB	-6	7

7. Following the increase in the target range for the US federal funds rate from 0%-0.25% to 0.25%-0.50% on 16 March 2022 (US time), the HKMA Base Rate increased from 0.50% to 0.75% (Chart 8). According to the established formula, the Base Rate is 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 down from 1.59% in December 2021 to 1.57% in February 2022. 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 0.21% at the end of February 2022 (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.

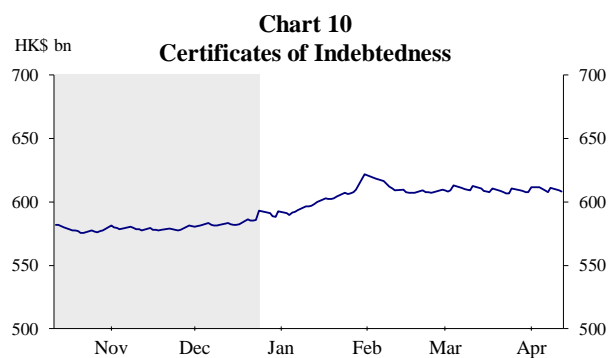
Monetary Base

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), **increased to HK\$2,147.48 billion on 12 April 2022 from HK\$2,130.61 billion on 28 December 2021** (Table 2). Movements of the individual components are discussed below.

(HK\$bn)	28 Dec 21	12 Apr 22
CIs	591.10	608.05
Government-issued Currency Notes and Coins in Circulation	13.33	13.30
Aggregate Balance	377.50	337.55
Outstanding EFBNs	1,148.69	1,188.58
Monetary Base	2,130.61	2,147.48

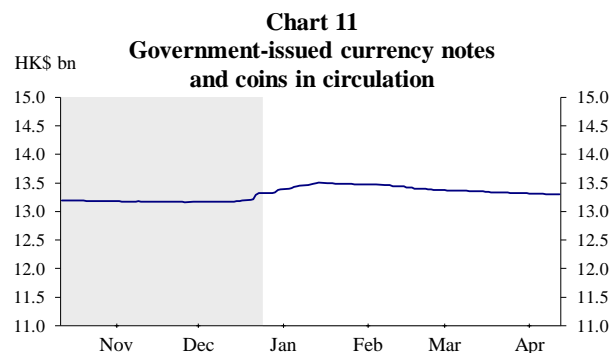
Certificates of Indebtedness

10. During the review period, note-issuing banks submitted a net amount of US\$2.17 billion to the HKMA in exchange for HK\$16.95 billion worth of CIs. As a result, **the outstanding CIs increased to HK\$608.05 billion on 12 April 2022 from HK\$591.10 billion on 28 December 2021** (Chart 10).



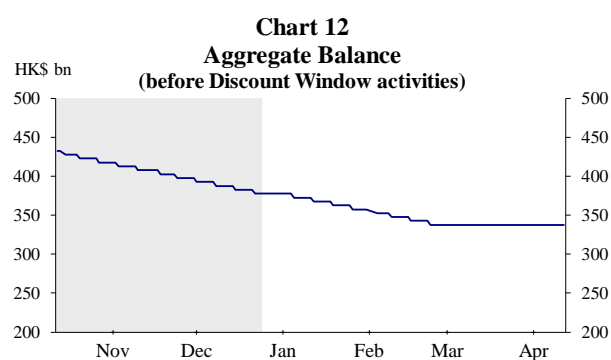
Government-issued currency notes and coins in circulation

11. During the review period, the amount of **government-issued currency notes and coins in circulation edged down** from HK\$13.33 billion to HK\$13.30 billion (Chart 11).



Aggregate Balance

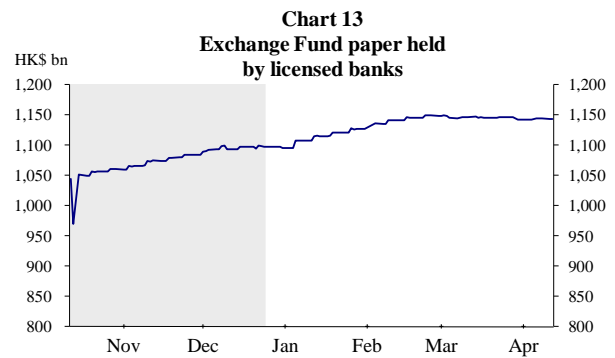
12. Reflecting the increased issuance of Exchange Fund Bills to meet the ongoing demand for Exchange Fund paper by banks amidst the abundance of liquidity in the banking system⁵, **the Aggregate Balance** (before Discount Window activities) **decreased** from HK\$377.5 billion to HK\$337.6 billion during 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 the Aggregate Balance to Exchange Fund paper. The Monetary Base remains fully backed by foreign exchange reserves.



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 during the review period on 4, 11, 18, 25 and 31 January and 8, 15 and 22 February 2022. The additional issuance size of the Bills amounted to HK\$40 billion in total and the Aggregate Balance decreased by the same amount during the review period.

Outstanding Exchange Fund Bills and Notes

13. **The market value of the outstanding EFBNs increased to HK\$1,188.58 billion during the review period, following the increased issuance of Exchange Fund Bills by a total of HK\$40 billion in 8 regular tenders in January and February. Holdings of Exchange Fund paper by the banking sector (before Discount Window activities) picked up to HK\$1,142.80 billion (96.1% of total) from HK\$1,097.04 billion (95.5% of total) (Chart 13).⁶**



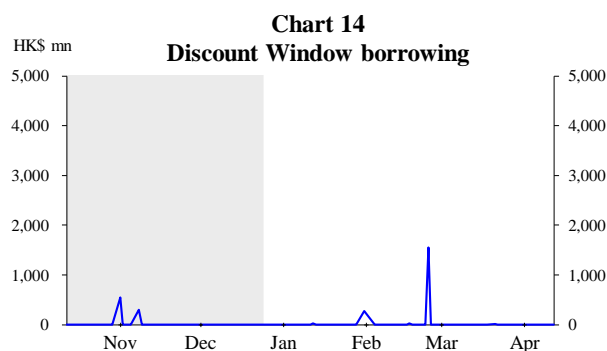
⁶ The transitory drop on 13 Oct 2021 seen in Chart 13 was caused by the postponed EFBN tender settlement due to typhoon.

14. During the review period, **interest payments on Exchange Fund paper amounted to HK\$827.40 million. A total of HK\$716.70 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	0	-
3-month EFB	16	0.94 – 2.83
6-month EFB	16	0.89 – 3.51
12-month EFB	4	2.62 – 8.92
2-year EFN	1	8.44

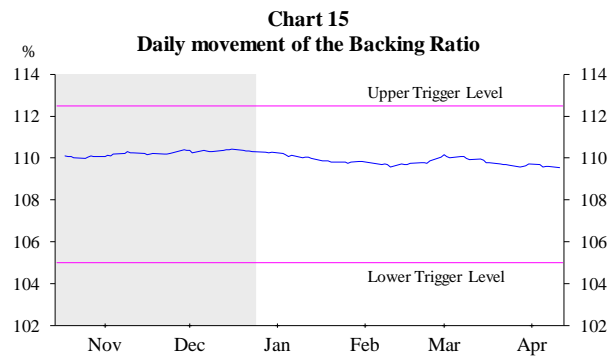
Discount Window activities

15. During the review period, **a total of HK\$1,876 million was borrowed from the Discount Window,** compared with HK\$845 million in the preceding period from 12 October 2021 to 24 December 2021 (Chart 14).



Backing Portfolio

16. The Backing Assets increased to HK\$2,352.96 billion on 11 April 2022. **The Backing Ratio edged down from 110.29% to 109.53% 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 June 2022