

EXCHANGE FUND ADVISORY COMMITTEE

Currency Board Sub-Committee

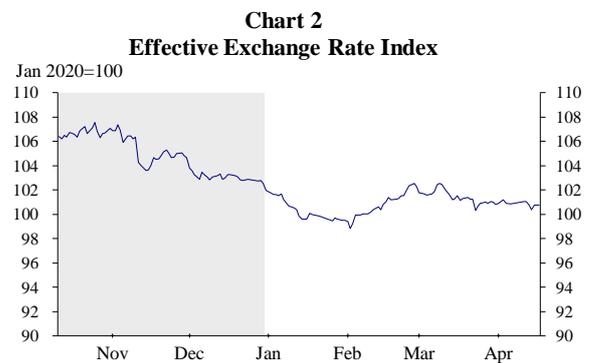
Report on Currency Board Operations

Review period: 31 December 2022 – 17 April 2023

During the review period, the Hong Kong dollar (HKD) traded within a range of 7.8072 – 7.8500 against the US dollar (USD). The HKD softened upon the fading of the seasonal funding demand for HKD at year-end 2022, and the weak-side Convertibility Undertaking (CU) was triggered six times between mid-February and mid-April. With the HKMA buying HK\$39.96 billion under the weak-side CU, the Aggregate Balance fell correspondingly to around HK\$57 billion. The HKD stayed close to the weak-side CU since mid-February amid the selling pressure from carry trades. HKD interbank interest rates decreased during the review period, with widened spreads against the USD counterparts in the negative territory. Throughout the review period, the Monetary Base remained fully backed by USD foreign reserves, and all changes in the Monetary Base were fully matched by corresponding changes in USD foreign reserves in accordance with Currency Board principles.

Hong Kong dollar exchange rate

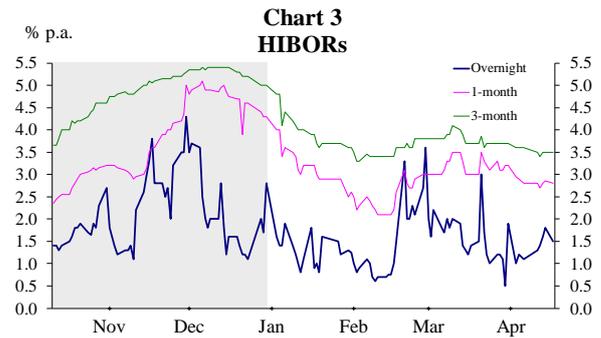
1. During the review period of 31 December 2022 to 17 April 2023, the HKD traded within a range of 7.8072 – 7.8500 against the USD (Chart 1).¹ Moving into 2023, the HKD exchange rate softened upon the fading of the seasonal funding demand for HKD at year-end 2022. The weak-side CU was triggered six times between mid-February and mid-April, with the HKMA buying HK\$39.96 billion under the weak-side CU. As the HKD interest rates remained lower than the USD counterparts, the HKD stayed close to the weak-side CU since mid-February due to the selling pressure from carry trades. Overall, the HKD continued to trade in a smooth and orderly manner during the review period, closing at 7.8499 against the USD on 17 April. The nominal effective exchange rate index of the HKD decreased compared with the end of the preceding review period, despite a rebound in February (Chart 2). This mainly reflected the movement of the USD against the currencies of the major trading partners of Hong Kong.



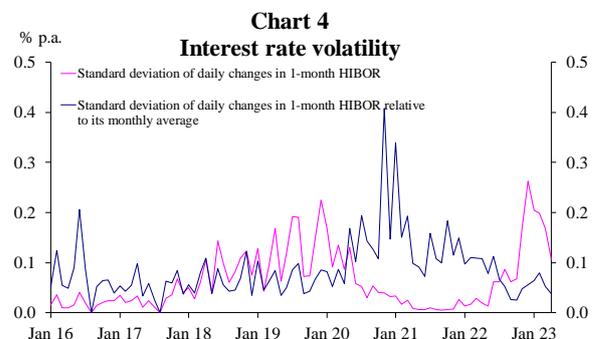
¹ In this report, daily time series charts also cover developments in the preceding review period (as shown in shaded region) for reference and comparison.

Interest rates

2. The HKD interbank market continued to trade in a smooth and orderly manner. As the seasonal demand for HKD funding faded, HKD interbank rates (HIBORs) generally moved lower in the early period of 2023. HIBORs moved up slightly after the weak-side CU triggering in mid-February. For the review period as a whole, **the 1-month and 3-month HIBORs decreased** by 120 and 130 basis points to 2.80% and 3.50% respectively at the end of the review period (Chart 3). Meanwhile, **the overnight HIBOR was sensitive to liquidity condition** as the Aggregate Balance dropped lower after the weak-side CU triggering in February. It closed at 1.50% at the end of the review period.

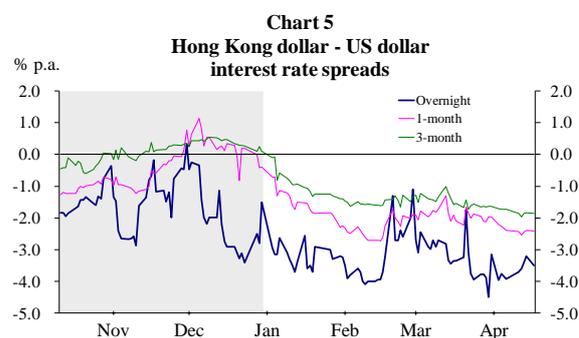


3. **Interest rate volatility**, measured by the standard deviation of daily changes in the 1-month HIBOR, **stayed virtually unchanged** compared with the preceding review period at 19 basis points (or 0.19%) for the current review period as a whole (Chart 4). Meanwhile, the standard deviation as a ratio of the average of the



1-month HIBOR hovered at a relatively low level.²

4. **The spreads of the HKD-USD interbank interest rate generally widened in the negative territory during the review period (Chart 5).** The overnight, 1-month and 3-month spreads closed at -350, -241 and -186 basis points respectively at the end of the review period.

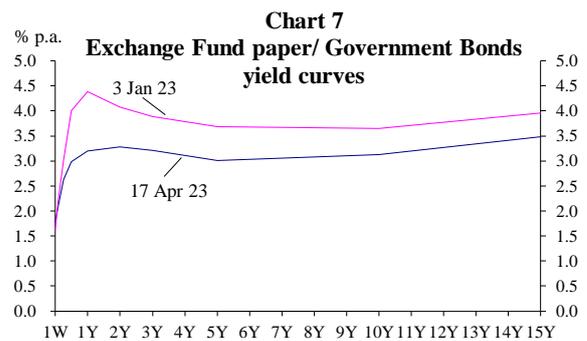


5. Roughly tracking the HKD-USD interbank interest rate spreads, **both the 3-month and 12-month forward discounts widened,** closing at 352 pips and 810 pips respectively at the end of the review period (Chart 6).



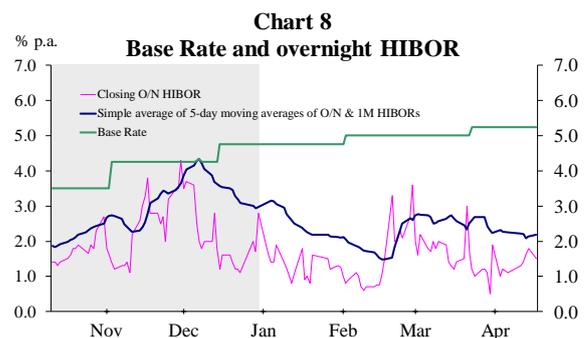
² The ratio of the standard deviation of daily changes in the 1-month HIBOR to its monthly average measures the extent of interest rate fluctuations relative to the average level of interest rates.

6. During the review period, **HKD yields shifted lower** (Chart 7). The yield of the 1-year Exchange Fund Bill decreased by 118 basis points to 3.20% at the end of the review period, and that of the 10-year Hong Kong Government Bond decreased by 52 basis points to 3.12%. The negative HKD-USD yield spreads generally widened across tenors (Table 1).

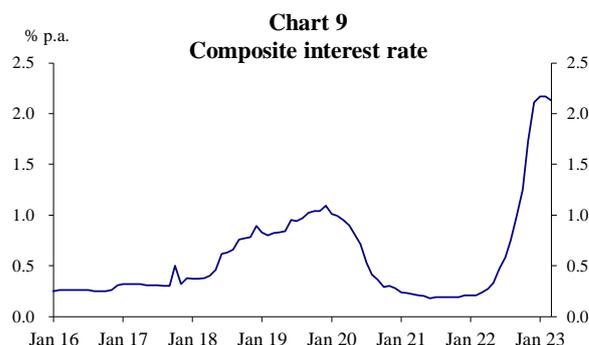


| | 3 Jan 23 | 17 Apr 23 |
|--------------|----------|-----------|
| 3-month EFB | -151 | -258 |
| 12-month EFB | -34 | -160 |
| 3-year HKGB | -30 | -71 |
| 5-year HKGB | -25 | -68 |
| 10-year HKGB | -15 | -48 |

7. Following the increases in the US federal funds target range from 4.25% – 4.50% to 4.50% – 4.75% on 1 February 2023 (US time) and further to 4.75% – 5.00% on 22 March 2023 (US time), **the HKMA Base Rate increased from 4.75% to 5.00% on 2 February 2023 and further to 5.25% on 23 March 2023** (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. Banks kept their Best Lending Rates unchanged during the review period. At the end of the review period, the Best Lending Rates in the market ranged from 5.625% – 6.125%. The average interest rate for newly approved mortgage loans increased from 3.35% in December 2022 to 3.55% in February 2023. Meanwhile, the average 1-month HKD time deposit board rate offered by retail banks increased from 0.29% to 0.41% at the end of the review period.³ **The composite interest rate,**⁴ which indicates the average funding cost of retail banks, **increased** from 2.11% at the end of December 2022 to 2.13% at the end of March 2023 (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.

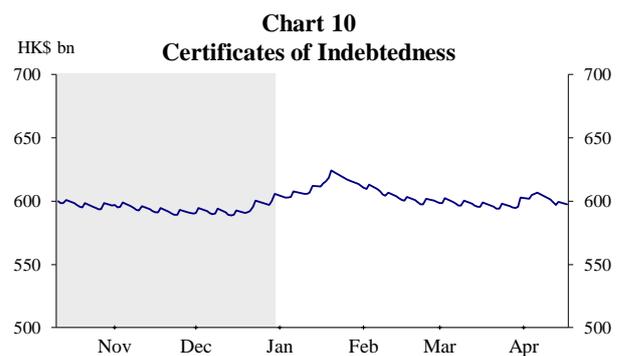
Monetary Base

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), **decreased to HK\$1,879.75 billion on 17 April 2023 from HK\$1,914.27 billion on 3 January 2023** (Table 2). Movements of the individual components are discussed below.

| (HK\$bn) | 3 Jan 23 | 17 Apr 23 |
|---|-----------------|-----------------|
| CIs | 602.67 | 597.30 |
| Government-issued Currency Notes and Coins in Circulation | 13.41 | 13.17 |
| Aggregate Balance | 96.25 | 57.16 |
| Outstanding EFBNs | 1,201.94 | 1,212.12 |
| Monetary Base | 1,914.27 | 1,879.75 |

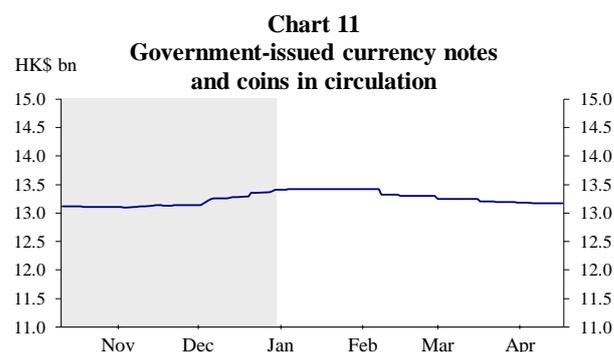
Certificates of Indebtedness

10. During the review period, the note-issuing banks redeemed HK\$5.37 billion worth of CIs from the HKMA in exchange for a net amount of US\$688.5 million. As a result, **the outstanding CIs decreased to HK\$597.30 billion on 17 April 2023 from HK\$602.67 billion on 3 January 2023** (Chart 10).



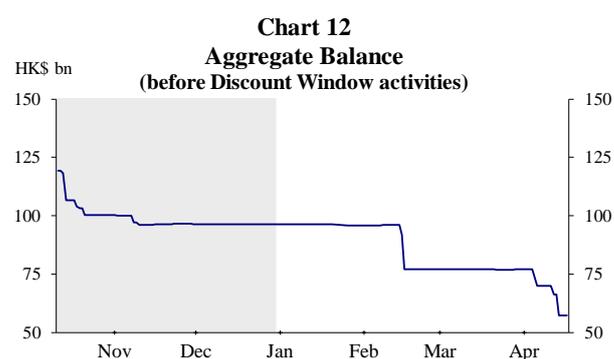
Government-issued currency notes and coins in circulation

11. During the review period, the amount of **government-issued currency notes and coins in circulation edged down** from HK\$13.41 billion to HK\$13.17 billion (Chart 11).



Aggregate Balance

12. **The Aggregate Balance declined from HK\$96.25 billion to HK\$57.16 billion during the review period** (Chart 12) owing to the triggering of the weak-side CU between mid-February and mid-April (Table 3).⁵ These foreign exchange operations were consistent with Currency Board principles, as the decreases in the Monetary Base were matched by equivalent decreases in US dollar reserves.



| Trade Date | Net purchase of HK\$ (HK\$m) |
|--------------|------------------------------|
| 13-Feb-23 | 4,223 |
| 14-Feb-23 | 14,868 |
| 3-Apr-23 | 7,104 |
| 10-Apr-23 | 3,807 |
| 12-Apr-23 | 9,051 |
| 14-Apr-23 | 903* |
| Total | 39,957 |

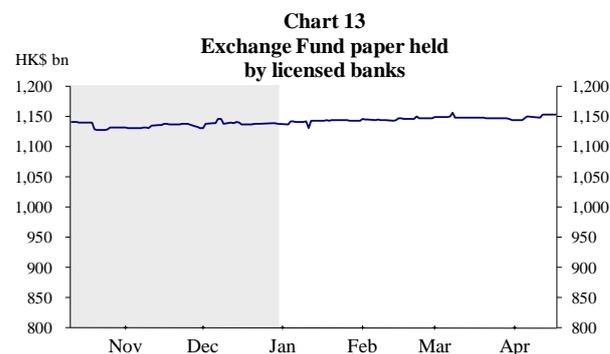
Note: Figures may not add up to total due to rounding.

*The figures would be reflected in the Aggregate Balance after the review period. The Aggregate Balance was projected to decrease further to HK\$56.26 billion as at 18 April.

⁵ Between the first triggering of the weak-side CU in May 2022 and the end of the review period, the HKMA bought a total of HK\$282.03 billion under the weak-side CU.

Outstanding Exchange Fund Bills and Notes

13. **The market value of the outstanding EFBNs edged up to HK\$1,212.12 billion during the review period. Holdings of Exchange Fund papers by the banking sector (before Discount Window activities) increased to HK\$1,153.68 billion (95.2% of total) from HK\$1,137.42 billion (94.6% of total) (Chart 13).**



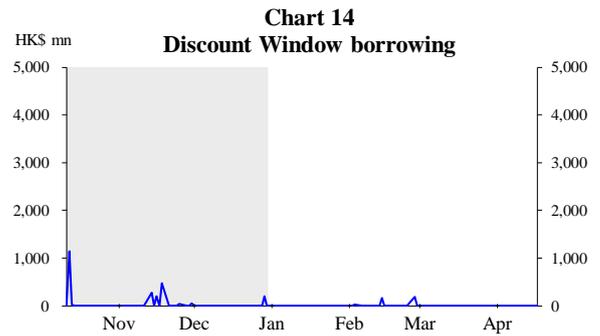
14. During the review period, **interest payments on Exchange Fund papers amounted to HK\$10,314.18 million. A total of HK\$10,421.00 million (in market value) of Exchange Fund papers were issued to absorb these interest payments.** The Exchange Fund papers issued during the review period were generally well received by the market (Table 4).

Table 4
Issuance of Exchange Fund Bills and Notes
(31 Dec 22 – 17 Apr 23)

| | No. of issues launched | Over-subscription ratio |
|--------------|------------------------|-------------------------|
| 1-month EFB | 8 | 1.17 – 5.15 |
| 3-month EFB | 15 | 0.99 – 1.99 |
| 6-month EFB | 15 | 2.16 – 5.48 |
| 12-month EFB | 4 | 7.27 – 17.44 |
| 2-year EFN | 1 | 6.17 |

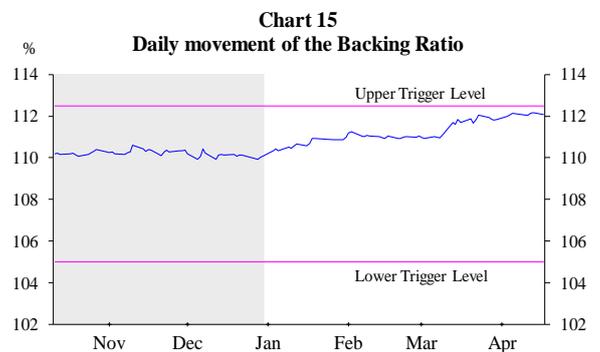
Discount Window activities

15. During the review period, a total of **HK\$377 million** was borrowed from the Discount Window, compared with HK\$2,380 million in the preceding review period from 11 October 2022 to 30 December 2022 (Chart 14).



Backing Portfolio

16. The Backing Assets increased to HK\$2,106.75 billion on 17 April 2023. **The Backing Ratio increased from 110.34% to 112.07% 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 2023