

**EXCHANGE FUND ADVISORY COMMITTEE**

**Currency Board Sub-Committee**

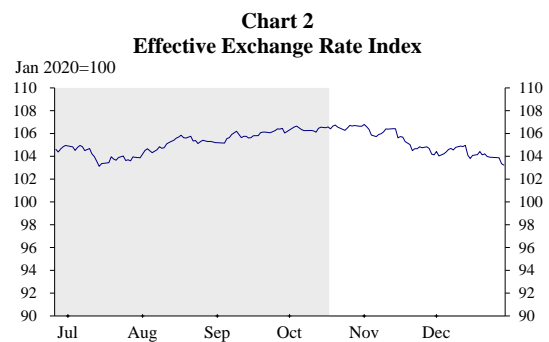
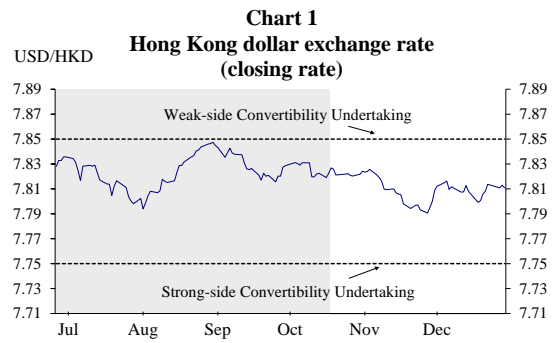
**Report on Currency Board Operations**

**Review period: 18 October 2023 – 29 December 2023**

During the review period, the Hong Kong dollar (HKD) traded within a range of 7.7906 – 7.8269 against the US dollar (USD). The HKD exchange rate strengthened in November, mainly driven by buying flows on firmer HKD interest rates and net buying flows through the Southbound Stock Connect. HKD interbank rates continued to track the USD rates while also being affected by local supply and demand. The HKD interbank market continued to trade in a smooth and orderly manner. The Convertibility Undertakings were not triggered and the Aggregate Balance was stable at around HK\$45 billion. No abnormality was noted in the usage of the Discount Window. Throughout the review period, the Monetary Base remained fully backed by US dollar foreign reserves, and all changes in the Monetary Base were fully matched by corresponding changes in US dollar foreign reserves in accordance with Currency Board principles.

## Hong Kong dollar exchange rate

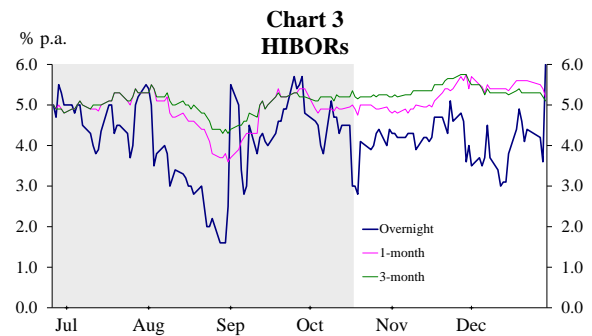
1. During the review period of 18 October 2023 to 29 December 2023, the HKD traded within a range of 7.7906 – 7.8269 against the USD (Chart 1).<sup>1</sup> The HKD exchange rate strengthened during November, mainly driven by buying flows on firmer HKD interest rates and net buying flows through the Southbound Stock Connect. Overall, the HKD continued to trade in a smooth and orderly manner during the review period, closing at 7.8109 on 29 December. The nominal effective exchange rate index of the HKD decreased compared with the end of the preceding review period (Chart 2). This mainly reflected the movement of the USD against the currencies of the major trading partners of Hong Kong.



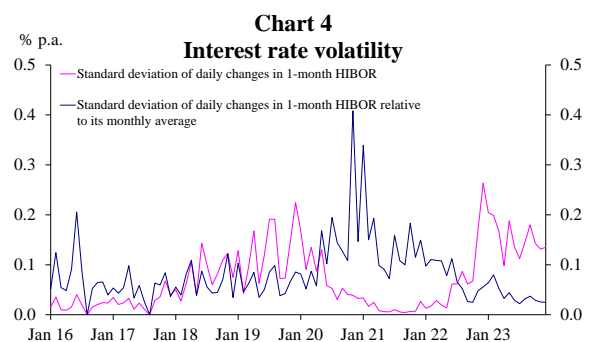
<sup>1</sup> In this report, daily time series charts also cover developments in the preceding review period (as shown in shaded region) for reference and comparison.

## Interest rates

2. The HKD interbank market continued to trade in a smooth and orderly manner. The 1-month and 3-month HKD interbank rates (HIBORs) continued to track the USD rates while also being affected by local supply and demand. For the review period as a whole, **the 1-month HIBOR increased** by 30 basis points to 5.20%, while **the 3-month HIBOR decreased** by 10 basis points to 5.10% at the end of the review period (Chart 3). Meanwhile, **the overnight HIBOR rose** to 6.00% at the end of the review period, driven by seasonal year-end tightness.

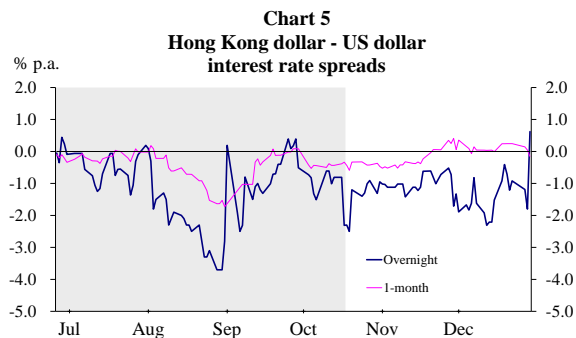


3. **Interest rate volatility**, measured by the standard deviation of daily changes in the 1-month HIBOR, **decreased** to 13 basis points (or 0.13%) in the current review period from 16 basis points (or 0.16%) in the preceding review period (Chart 4). Meanwhile, the standard deviation as a ratio of the average of the 1-month HIBOR hovered at a relatively low level.<sup>2</sup>

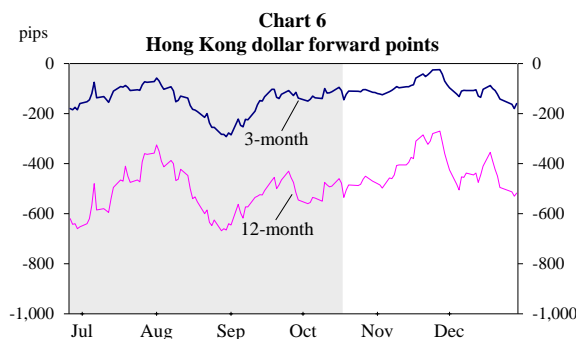


<sup>2</sup> The ratio of the standard deviation of daily changes in the 1-month HIBOR to its monthly average measures the extent of interest rate fluctuations relative to the average level of interest rates.

4. **The short-term negative HKD-USD interest rate spreads showed mixed changes during the review period** (Chart 5).<sup>3</sup> The 1-month interest rate spread temporarily turned positive before narrowing to close at -15 basis points at the end of the review period. On the other hand, the overnight spread showed more fluctuations, closing at 62 basis points at the end of the review period, driven by seasonal year-end tightness.

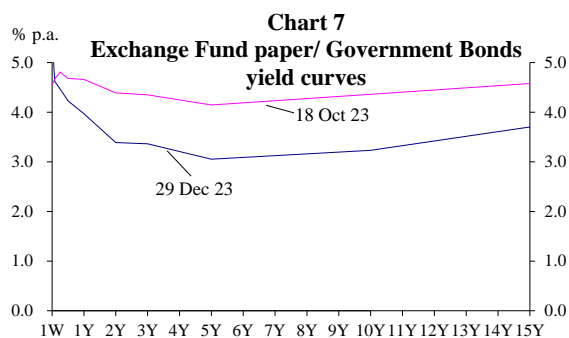


5. **Both the 3-month and 12-month forward discounts narrowed slightly during the review period**, closing at 160 pips and 518 pips respectively at the end of the review period (Chart 6).



<sup>3</sup> The USD London Interbank Offered Rate (LIBOR) has been discontinued since 1 July 2023 and replaced by the Secured Overnight Financing Rate (SOFR) as its alternative reference rate.

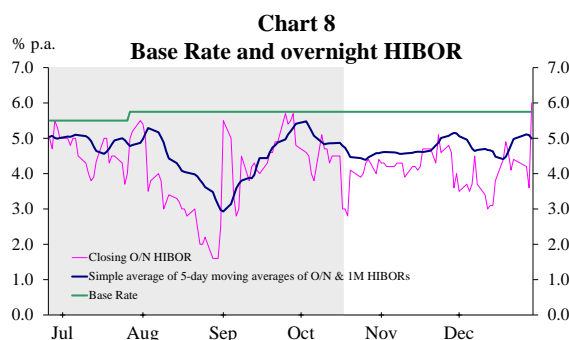
6. During the review period, **HKD yields shifted downward** (Chart 7). The yield of the 1-year Exchange Fund Bill decreased by 69 basis points to 3.97% at the end of the review period, and that of the 10-year Hong Kong Government Bond decreased by 113 basis points to 3.23%. While the negative HKD-USD yield spread narrowed at the 3-year tenor, negative yield spreads at other tenors widened (Table 1).



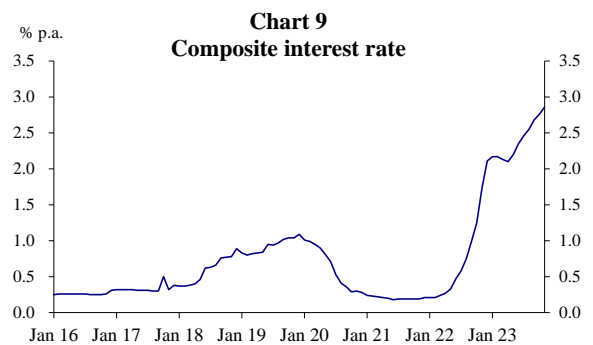
**Table 1**  
**Yield spreads of Exchange Fund papers and Hong Kong Government Bonds over US Treasuries (basis points)**

	18 Oct 23	29 Dec 23
3-month EFB	-80	-93
12-month EFB	-81	-82
3-year HKGB	-68	-65
5-year HKGB	-77	-79
10-year HKGB	-55	-65

7. During the review period, the target range for the US Federal Funds Rate remained unchanged at 5.25% – 5.50%. As such, **the HKMA Base Rate remained unchanged at 5.75%** 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 5.875% – 6.375%. The average interest rate for newly approved mortgage loans increased from 3.86% in September 2023 to 4.13% in November 2023. Meanwhile, the average 1-month HKD time deposit board rate offered by retail banks remained unchanged at 0.57% at the end of the review period.<sup>4</sup> **The composite interest rate,**<sup>5</sup> which indicates the average funding cost of retail banks, **increased** from 2.68% at the end of September 2023 to 2.86% at the end of November 2023 (Chart 9).



<sup>4</sup> The figure refers to the average interest rate offered by major authorized institutions for 1-month time deposits of less than HK\$100,000.

<sup>5</sup> 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.

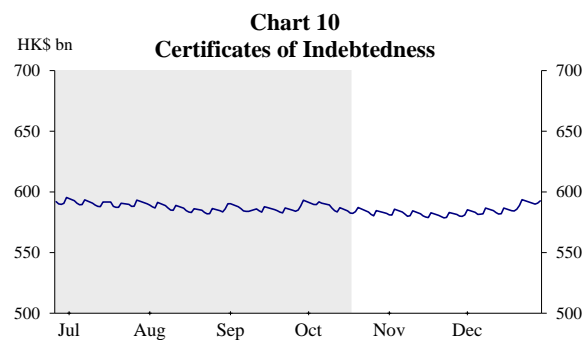
## Monetary Base

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\$1,895.86 billion on 29 December 2023 from HK\$1,872.86 billion on 18 October 2023** (Table 2). Movements of the individual components are discussed below.

(HK\$bn)	18 Oct 23	29 Dec 23
CIs	582.30	592.59
Government-issued Currency Notes and Coins in Circulation	13.08	13.18
Aggregate Balance	45.04	44.95
Outstanding EFBNs	1,232.45	1,245.15
<b>Monetary Base</b>	<b>1,872.86</b>	<b>1,895.86</b>

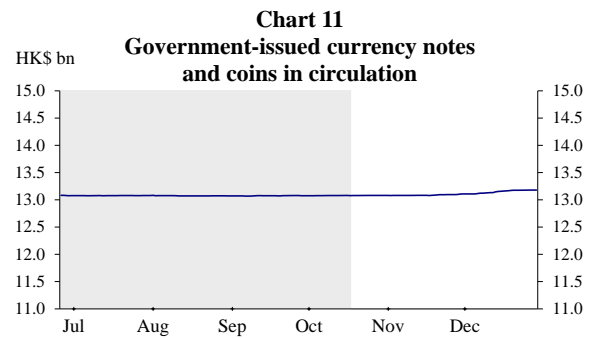
### *Certificates of Indebtedness*

10. During the review period, the note-issuing banks submitted a net amount of US\$1.32 billion to the HKMA in exchange for HK\$10.29 billion worth of CIs. As a result, **the outstanding CIs increased to HK\$592.59 billion on 29 December 2023 from HK\$582.30 billion on 18 October 2023** (Chart 10).



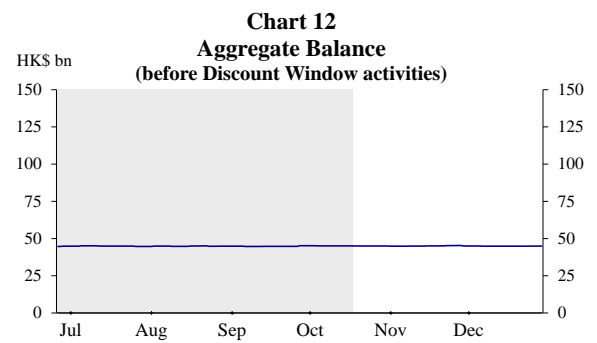
*Government-issued currency notes and coins in circulation*

11. During the review period, the amount of **government-issued currency notes and coins in circulation were little changed** at HK\$13.18 billion (Chart 11).



*Aggregate Balance*

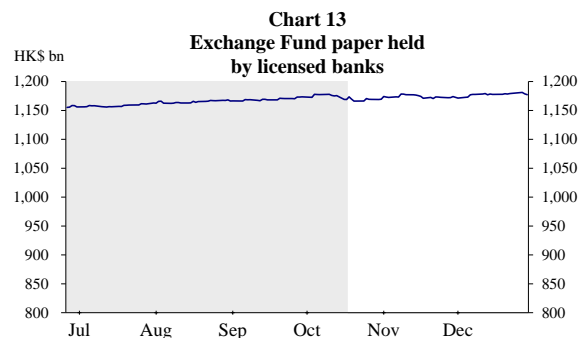
12. During the review period, the Convertibility Undertakings were not triggered and **the Aggregate Balance was little changed at around HK\$44.95 billion** (Chart 12).





*Outstanding Exchange Fund Bills and Notes*

13. **The market value of the outstanding EFBNs increased to HK\$1,245.15 billion during the review period. Holdings of Exchange Fund papers by the banking sector (before Discount Window activities) increased to HK\$1,177.29 billion (94.6% of total) from HK\$1,173.45 billion (95.2% of total) (Chart 13).**

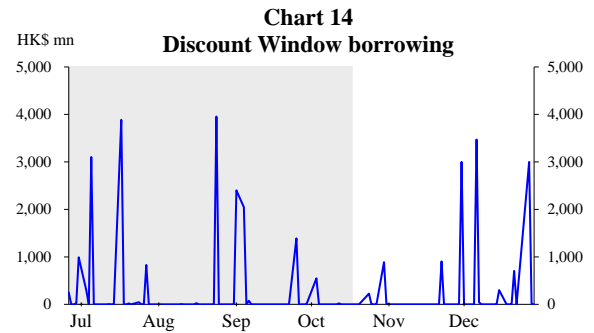


14. During the review period, **interest payments on Exchange Fund papers amounted to HK\$14,163.72 million. A total of HK\$12,311.36 million (in market value) of Exchange Fund papers were issued to absorb these interest payments.** The remaining amount was carried forward in the Aggregate Balance at the end of the review period. The Exchange Fund papers issued during the review period were generally well received by the market (Table 3).

	No. of issues launched	Over-subscription ratio
1-month EFB	4	1.33 – 5.67
3-month EFB	10	1.02 – 2.15
6-month EFB	10	1.95 – 4.73
12-month EFB	3	2.74 – 3.76
2-year EFN	1	1.25

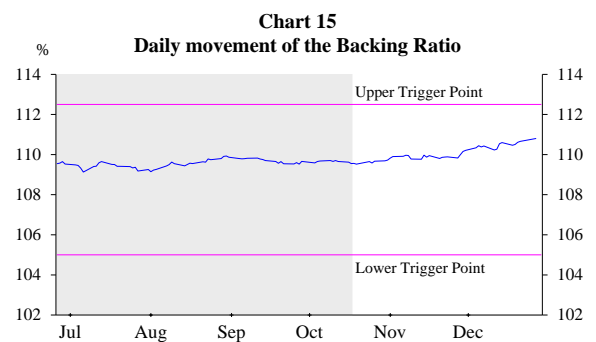
### Discount Window activities

15. During the review period, a total of HK\$12,535 million was borrowed from the Discount Window, compared with HK\$19,909 million in the preceding review period from 26 June 2023 to 17 October 2023 (Chart 14). No abnormality was noted in the relevant usage.



### Backing Portfolio

16. The Backing Assets increased to HK\$2,097.80 billion on 28 December 2023. **The Backing Ratio increased to 110.78% from 109.56% 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**  
**22 February 2024**