

**EXCHANGE FUND ADVISORY COMMITTEE**

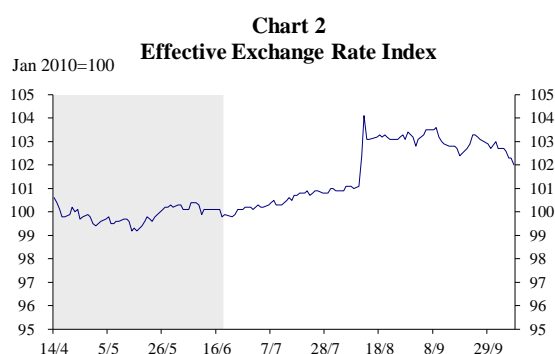
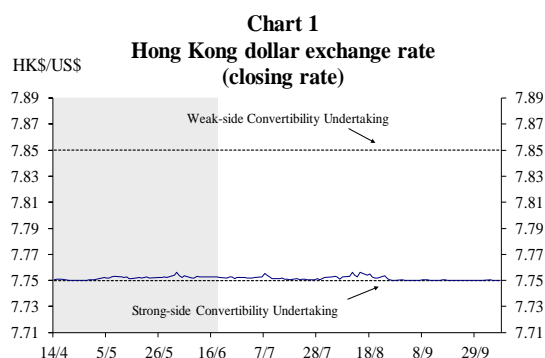
**Currency Board Sub-Committee**

**Report on Currency Board Operations**  
**(19 June – 9 October 2015)**

During the review period, the Hong Kong dollar remained stable and traded within a narrow range of 7.7500–7.7562 against the US dollar, notwithstanding heightened volatility in the global equity and foreign exchange markets. Between 1 September and 8 October, the strong-side Convertibility Undertaking (CU) was triggered intermittently mainly due to conversions into the Hong Kong dollar from the offshore renminbi (CNH) and some ordinary business demands for the Hong Kong dollar. In the money market, the Hong Kong dollar interbank interest rates remained at low levels, while the Hong Kong dollar forward points picked up in late August. During the review period, the Aggregate Balance expanded due to the triggering of the strong-side CU, and the Monetary Base increased to HK\$1,500.65 billion. All changes in the Monetary Base were fully matched by changes in foreign reserves in accordance with the Currency Board principles.

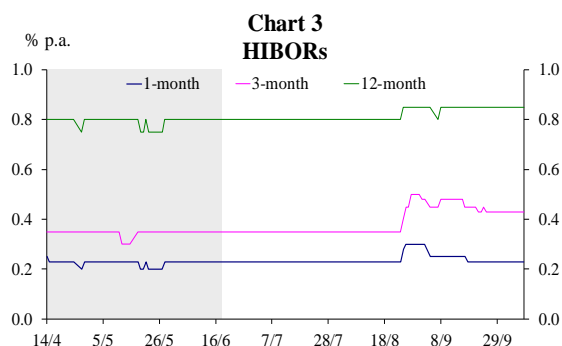
## Hong Kong dollar exchange rate

1. The Hong Kong dollar exchange rate only moved within a narrow range of 7.7500 to 7.7562 against the US dollar and continued to trade in an orderly manner during the review period (Chart 1). This was notwithstanding sell-offs in Mainland China and Hong Kong's equity markets and heightened volatility in the global foreign exchange markets (including renminbi depreciation following a change in the mechanism for determining the central parity rate of the renminbi on 11 August). Moreover, mainly driven by the conversions into the Hong Kong dollar from the offshore renminbi (CNH) and some ordinary business demands for the Hong Kong dollar, the strong-side Convertibility Undertaking (CU) was triggered intermittently between 1 September and 8 October, prompting the HKMA to passively purchase a total of US\$10.4 billion from banks in exchange for HK\$80.3 billion. Meanwhile, the nominal effective exchange rate index of the Hong Kong dollar strengthened during the review period (Chart 2), largely reflecting a stronger Hong Kong dollar against the renminbi.

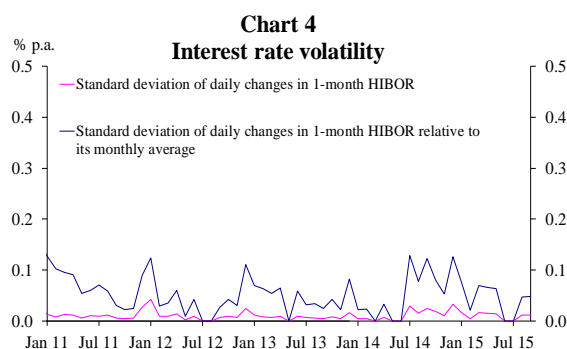


## Interest rates

2. The Hong Kong dollar interbank interest rates remained at low levels during the review period (Chart 3), although seeing some fluctuations in late August amid volatile financial market conditions. Compared with the beginning of the review period, the one-month HIBOR was unchanged at 0.23%, while the three-month and 12-month HIBORs edged up by 8 and 5 basis points to 0.43% and 0.85% respectively.

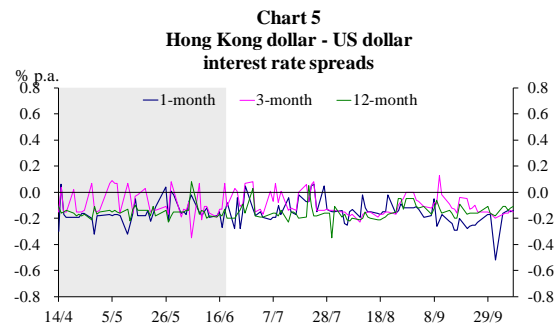


3. Interest rate volatility, measured by the standard deviation of daily changes in the one-month HIBOR, **increased** to 1.2 basis points in August and September from virtually zero in June and July (Chart 4). The standard deviation as a ratio of the average one-month HIBOR also followed similar movement<sup>1</sup>.

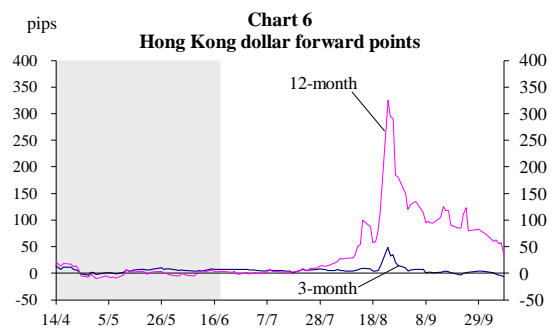


<sup>1</sup> The ratio of the standard deviation of daily changes in the one-month HIBOR to its monthly average measures the extent of interest rate fluctuations relative to the average level of interest rates.

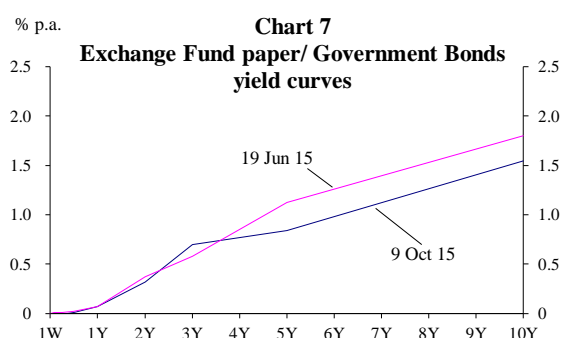
4. The spreads between Hong Kong dollar interest rates and their US dollar counterparts saw moderate fluctuations during the review period (Chart 5). For the whole review period, the one-month, three-month and 12-month spreads averaged -15, -10 and -15 basis points respectively.



5. The Hong Kong dollar forward points picked up noticeably in August. In particular, the 12-month forward point rose to as high as +300 pips in late August amid heightened volatility in the financial market (Chart 6). At the end of the review period, the three-month and the 12-month forward points fell back to -7 pips and +35 pips respectively.

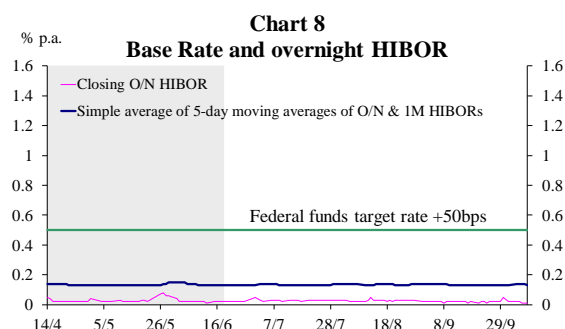


6. **The Hong Kong dollar yield curve flattened at the longer end** during the review period (Chart 7), with the 10-year yield of the Hong Kong dollar Government Bonds declining by 26 basis points to 1.55%. The movement of the Hong Kong dollar yield curve broadly followed that of the US dollar yield curve, so the yield spreads between the Hong Kong dollar Exchange Fund Paper / Government Bonds and the US treasuries were generally little changed (Table 1).

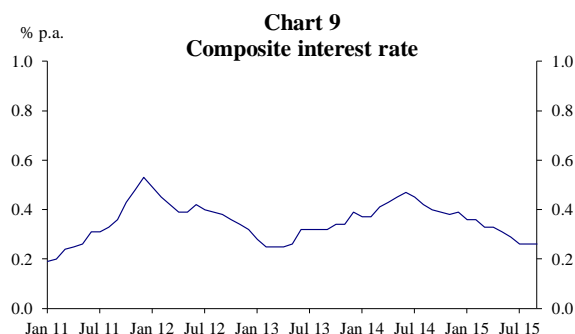


<b>Table 1</b> <b>Yield spreads of Exchange Fund paper and Hong Kong Government Bonds over US Treasuries (basis points)</b>		
	19 Jun 15	09 Oct 15
3-month EFB	0	-2
12-month EFB	-18	-21
3-year HKGB	-41	-26
5-year HKGB	-46	-57
10-year HKGB	-46	-57

7. At the July and September meetings, the US Federal Open Market Committee (FOMC) decided to keep the current range of the Federal Funds Target Rate (FFTR) unchanged at 0—0.25%. **The HKMA Base Rate remained unchanged at 0.5%** (Chart 8). It continued to be set at 50 basis points above the lower boundary of the FFTR target range in accordance with the revised Base Rate formula announced on 26 March 2009.



8. In line with the stable US FFTR, banks kept their Best Lending Rates unchanged. There continued to be two Best Lending Rates, staying unchanged at 5.00% and 5.25% during the review period. The average one-month Hong Kong dollar time deposit rate offered by retail banks remained stable at 0.01%<sup>2</sup>. **The composite interest rate<sup>3</sup>**, which indicates the average cost of funds for retail banks, **decreased to 0.26% in September** from 0.31% in May (Chart 9). On the lending side, the average mortgage interest rates for newly approved mortgage loans remained at a low level.



<sup>2</sup> The figure refers to the average interest rate offered by major authorized institutions for one-month time deposits of less than HK\$100,000.

<sup>3</sup> This is a weighted average interest rate of all Hong Kong dollar interest bearing liabilities, which include deposits from customers, amounts due to banks, negotiable certificates of deposit and other debt instruments, and Hong Kong dollar 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.

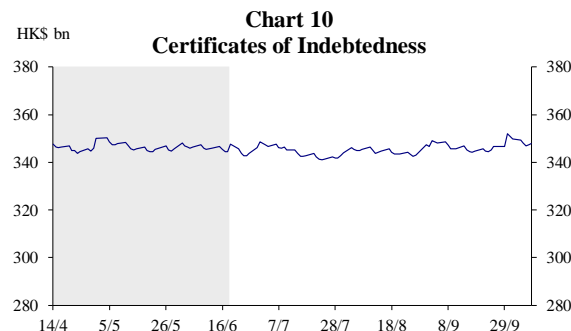
## Monetary Base

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, **increased to HK\$1,500.65 billion on 9 October** from **HK\$1,424.09 billion on 19 June** (Table 2). Movements in the individual components are discussed below.

<b>Table 2</b> <b>Monetary Base</b>		
(HK\$bn)	19 Jun 15	09 Oct 15
CIs	347.58	347.80
Government-issued Currency Notes and Coins in Circulation	11.59	11.62
Aggregate Balance	310.71	361.48
Outstanding EFBNs	754.22	779.76
<b>Monetary Base</b>	<b>1,424.09</b>	<b>1,500.65</b>

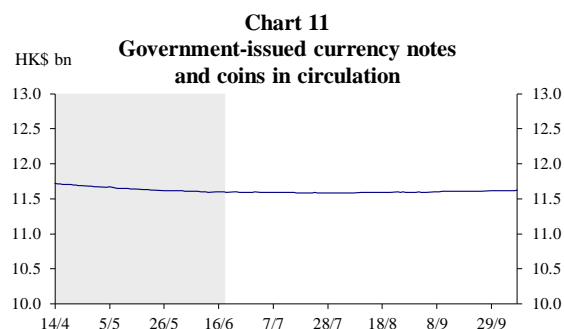
### *Certificates of Indebtedness*

10. During the review period, the three note-issuing banks submitted US\$28 million to the HKMA in exchange for HK\$220 million worth of CIs. As a result, **the outstanding CIs increased slightly** to HK\$347.80 billion on 9 October from HK\$347.58 billion on 19 June (Chart 10).



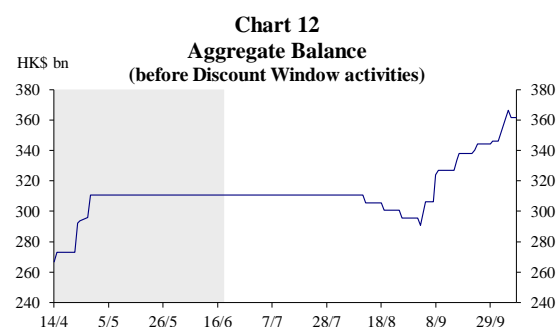
*Government-issued currency notes and coins in circulation*

11. During the review period, the amount of **government-issued currency notes and coins in circulation edged up to HK\$11.62 billion on 9 October from HK\$11.59 billion on 19 June** (Chart 11).



*Aggregate Balance*

12. **The Aggregate Balance expanded to HK\$361.48 billion on 9 October from HK\$310.71 billion on 19 June** (Chart 12). The increase reflected mainly the triggering of the strong-side CU between 1 September and 8 October, which led to an expansion of the Aggregate Balance by HK\$80.3 billion (Table 3). Nonetheless, the increase was partly offset by the issuance of additional Exchange Fund Bills, which amounted to HK\$25 billion in the review period and led to a corresponding decrease in the Aggregate Balance.

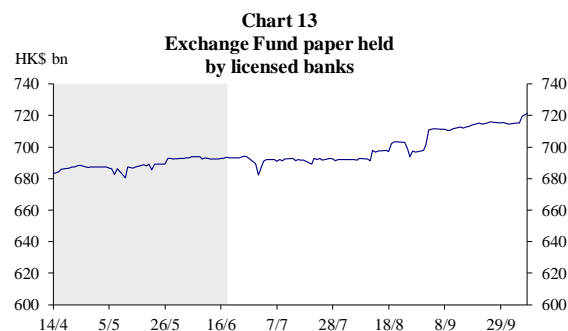


<b>Table 3</b> <b>HKMA HK\$/US\$ FX Transactions</b> <b>(19 Jun – 9 Oct 15)</b>	
Trade Date	Net sale of HK\$ (HK\$mn)
01-Sep-15	15,500.00
02-Sep-15	12,477.50
04-Sep-15	5,192.50
07-Sep-15	3,100.00
14-Sep-15	6,587.50
15-Sep-15	4,262.50
21-Sep-15	2,325.00
22-Sep-15	4,262.50
25-Sep-15	1,550.00
30-Sep-15	12,012.50
01-Oct-15	3,875.00
02-Oct-15	4,650.00
08-Oct-15	4,495.00
<b>Total</b>	<b>80,290.00</b>



*Outstanding Exchange Fund Bills and Notes*

13. The market value of outstanding Exchange Fund Bills and Notes increased to HK\$779.76 billion from HK\$754.22 billion during the review period. Holdings of Exchange Fund paper by the banking sector (before Discount Window activities) increased to HK\$721.32 billion (92.5% of total) from HK\$693.01 billion (91.9% of total) (Chart 13).



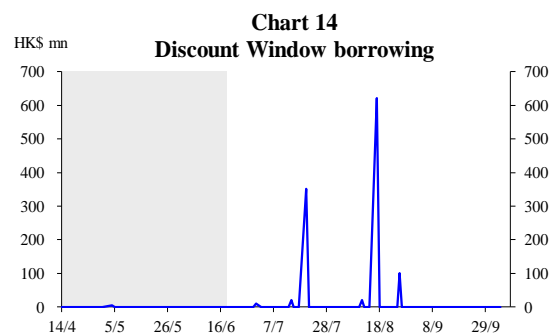
14. The increases were mainly due to the issuance of additional Exchange Fund Bills to meet the strong demand by banks for such bills for liquidity management purpose. During the review period, a total of HK\$25 billion of additional Exchange Fund Bills were issued. The additional issuance is consistent with Currency Board principles, as it represents a change in the composition of the Monetary Base from the Aggregate Balance to Exchange Fund Paper, and the Monetary Base remained fully backed by foreign exchange reserves. During the review period, **HK\$362.64 million** of

interest payments on Exchange Fund paper were made. An additional HK\$245.99 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. The Exchange Fund paper issued during the review period was well received by the market (Table 4).

<b>Table 4</b> <b>Issuance of Exchange Fund Bills and Notes</b> <b>(19 Jun—9 Oct 15)</b>		
	No. of issues launched	Over-subscription ratio
1-month EFB	2	4.77—19.30
3-month EFB	16	2.80—10.79
6-month EFB	15	1.35—12.94
12-month EFB	4	2.66—5.97
2-year EFN	1	6.84

### **Discount Window activities**

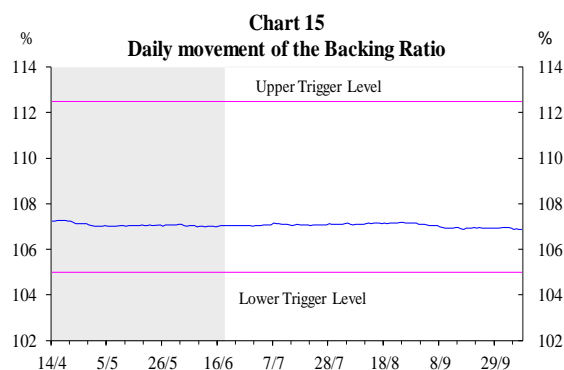
15. During the review period, seven banks borrowed HK\$1.1 billion from the Discount Window, while no banks borrowed in the preceding review period (Chart 14 and Table 5).



<b>Table 5</b> <b>Frequency of individual bank's access to the Discount Window</b> <b>(19 Jun—9 Oct 15)</b>	
Frequency of using Discount Window	No. of banks
1	7

## **Backing Portfolio**

16. The Backing Assets expanded during the review period, to HK\$1,602.22 billion on 9 October mainly reflecting an increase in the Aggregate Balance driven by the triggering of the strong-side CU. As the Backing Assets increased proportionally less than Monetary Base, **the Backing Ratio decreased to 106.86% from 107.03% 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 Hong Kong dollar exchange rate.



**Hong Kong Monetary Authority**  
**9 December 2015**