

**EXCHANGE FUND ADVISORY COMMITTEE**

**Currency Board Sub-Committee**

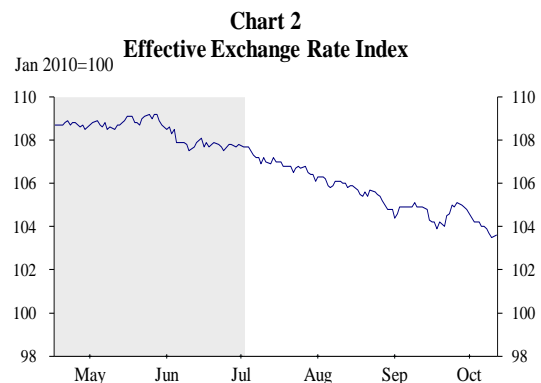
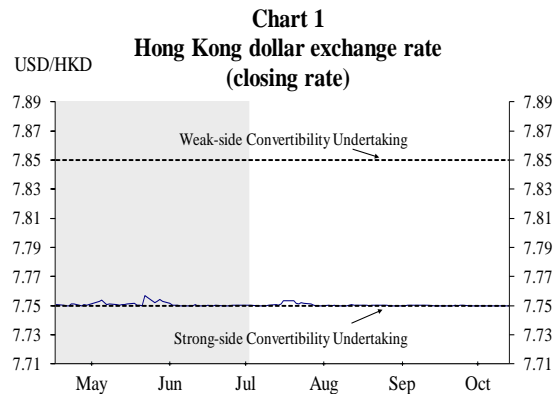
**Report on Currency Board Operations**

**Review period: 3 July 2020 – 13 October 2020**

During the review period, the Hong Kong dollar (HKD) traded close to the strong-side Convertibility Undertaking (CU), moving within a narrow range of 7.7500 – 7.7535 against the US dollar (USD). Mainly driven by equity-related demand including initial public offering (IPO) activities, the southbound Stock-Connect and dividend payments, the strong-side CU was triggered 44 times between 6 July and 13 October. Since the first triggering on 21 April this year, the strong-side CU has been triggered 65 times and the HKMA sold HKD totalling HK\$230.6 billion to the market in exchange for the USD under the strong-side CU. Along with the expansion of the Aggregate Balance to HK\$280.1 billion, the short-term HKD interbank interest rates (i.e. HIBORs) remained low. 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

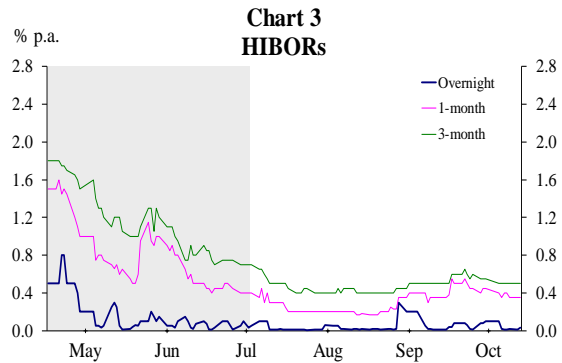
1. During the review period of 3 July to 13 October 2020, the **HKD traded close to the strong-side CU, moving within a narrow range of 7.7500 – 7.7535 (closing rate) against the USD** (Chart 1).<sup>1</sup> Mainly driven by equity-related demand including IPO activities, the southbound Stock-Connect and dividend payments, the strong-side CU was triggered 44 times between 6 July and 13 October. Since the first triggering on 21 April this year, the strong-side CU has been triggered 65 times and the HKMA sold HKD totalling HK\$230.6 billion to the market in exchange for the USD under the strong-side CU. Overall, the HKD continued to trade in a smooth and orderly manner during the review period, closing at 7.7501 on 13 October. **The nominal effective exchange rate index of the HKD declined** during the review period, reflecting the depreciation of the USD against most major currencies (Chart 2).



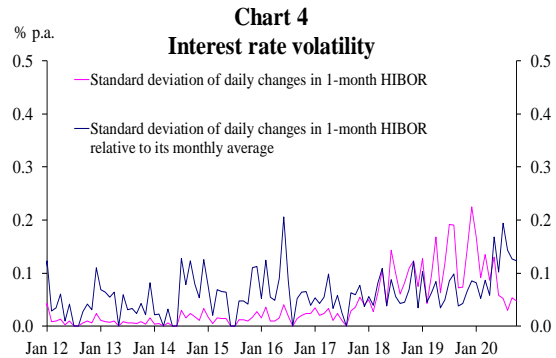
<sup>1</sup> In this report, daily time series charts also cover developments in the preceding review period (as shown in shaded region) for reference and comparison.

## Interest rates

2. During the review period, **the short-term HKD HIBORs remained low** along with the expansion of the Aggregate Balance due to the triggering of the strong-side CU, **despite occasional pick-ups driven by IPO and quarter-end funding demand** (Chart 3). For the review period as a whole, the overnight, 1-month and 3-month HIBORs decreased by 2, 5 and 20 basis points to 0.03%, 0.35% and 0.50% respectively.

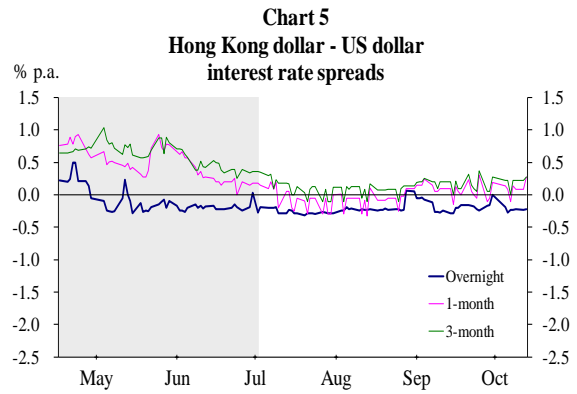


3. **Interest rate volatility**, measured by the standard deviation of daily changes in the 1-month HIBOR, **decreased** to 4.6 basis points in the current review period from 10.0 basis points in the preceding review period (Chart 4). The standard deviation as a ratio of the average of 1-month HIBOR picked up in July amid the lower level of HIBOR, before declining slightly thereafter.<sup>2</sup>

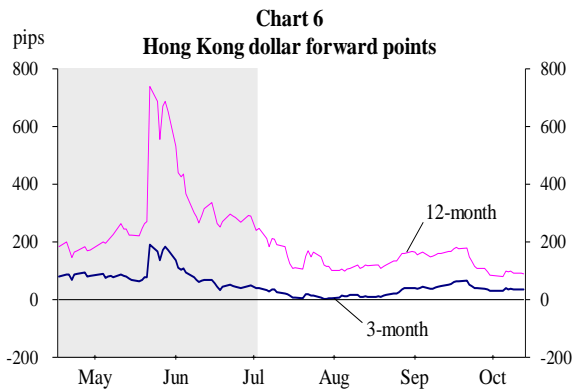


<sup>2</sup> The ratio of the standard deviation of daily changes in the 1-month HIBOR to its monthly average measures the extent of interest rate fluctuations relative to the average level of interest rates.

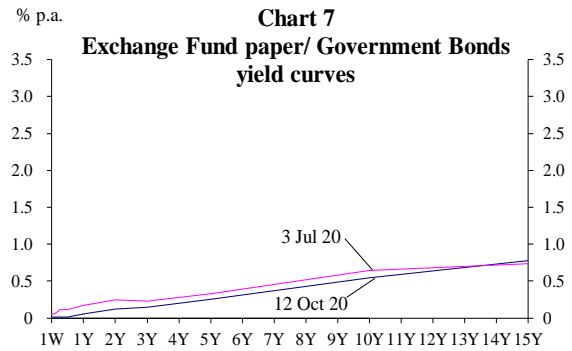
4. **The HKD-USD interbank interest rate spreads saw modest fluctuations during the review period (Chart 5).** At the end of the review period, the overnight, 1-month and 3-month spreads closed at -22, 28 and 27 basis points respectively.



5. After some fluctuations in the preceding review period, **the forward points were largely stable since July**, broadly tracking the HKD-USD interbank interest rate spreads. At the end of review period, the 3-month and 12-month forward premiums closed at 35 pips and 88 pips respectively (Chart 6).

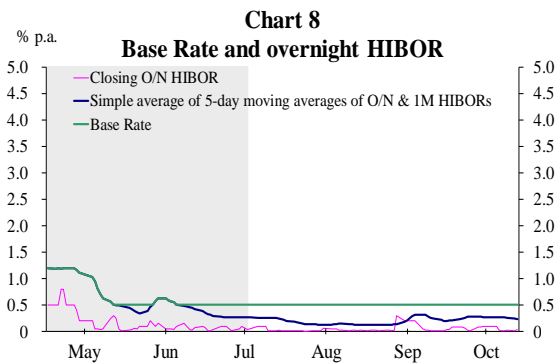


6. During the review period, the HKD yield curve shifted downward slightly (Chart 7). The yield of the 1-year Exchange Fund Bill decreased by 12 basis points to 0.05%, and the yield of 10-year Hong Kong Government Bond decreased by 10 basis points to 0.54%. As the declines in HKD yields were larger than the USD counterparts, the HKD-USD yield spreads in general decreased (Table 1).

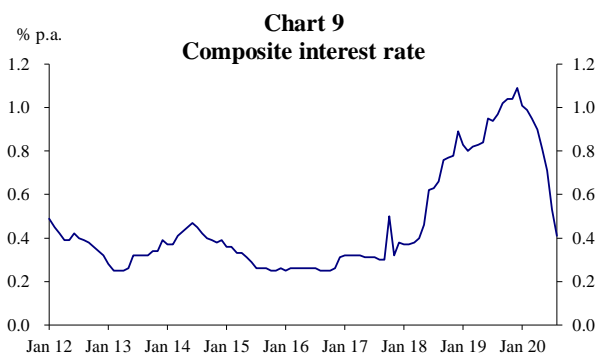


	3 Jul 20	9 Oct 20
3-month EFB	-3	-9
12-month EFB	1	-10
3-year HKGB	4	-5
5-year HKGB	4	-8
10-year HKGB	-4	-25

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%. Along with the decline in 1-month HIBOR, the average interest rate for newly approved mortgage loans declined further from 2.02% in June 2020 to 1.76% in August 2020. The average 1-month HKD time deposit board rate offered by retail banks edged down from 0.04% to 0.03%.<sup>3</sup> **The composite interest rate<sup>4</sup>,** which indicates the average funding cost of retail banks, **declined** from 0.71% at the end of June 2020 to 0.41% at the end of August 2020 (Chart 9).



<sup>3</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>4</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.

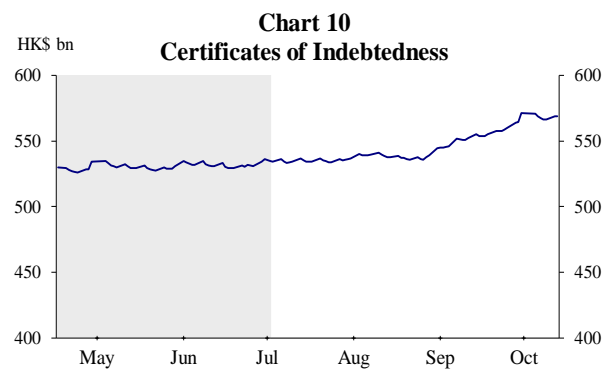
## Monetary Base

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), **rose to HK\$1,931.40 billion on 13 October 2020 from HK\$1,748.06 billion on 3 July 2020** (Table 2). Movements of the individual components are discussed below.

(HK\$bn)	3 Jul 20	13 Oct 20
CIs	534.48	568.90
Government-issued Currency Notes and Coins in Circulation	13.14	13.14
Aggregate Balance	131.61	280.15
Outstanding EFBNs	1,068.83	1,069.22
<b>Monetary Base</b>	<b>1,748.06</b>	<b>1,931.40</b>

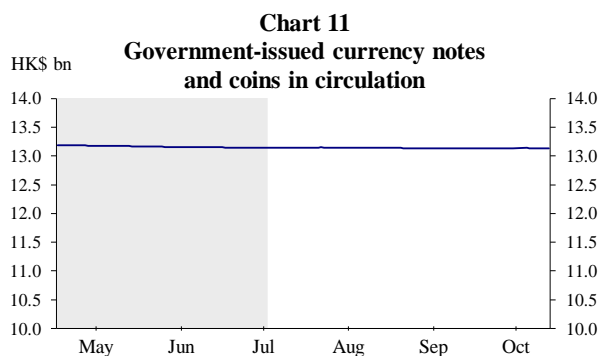
### *Certificates of Indebtedness*

10. Reflecting a net increase in currency demand during the review period, note-issuing banks submitted a net amount of US\$4.41 billion to the HKMA in exchange for HK\$34.42 billion worth of CIs. As a result, **the outstanding CIs increased to HK\$568.90 billion on 13 October 2020 from HK\$534.48 billion on 3 July 2020** (Chart 10), representing a 6.4% increase.



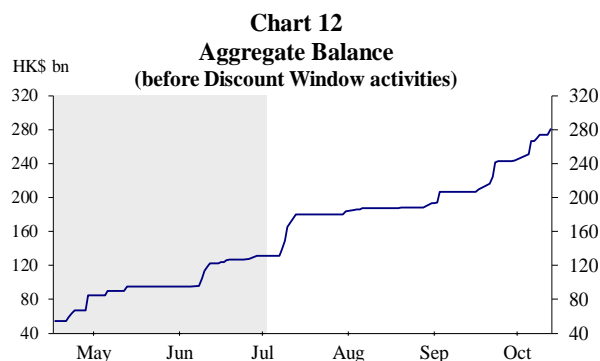
*Government-issued currency notes and coins in circulation*

11. During the review period, the amount of **government-issued currency notes and coins in circulation** stayed **virtually unchanged** at HK\$13.14 billion (Chart 11).



*Aggregate Balance*

12. The **Aggregate Balance** rose from **HK\$131.61 billion** to **HK\$280.15 billion** during the review period (Chart 12), owing to the triggering of the strong-side CU between 6 July and 9 October (Table 3). The foreign exchange operations are consistent with Currency Board principles, as the increases in the Monetary Base were matched by equivalent increases in US dollar reserves.



**Table 3**  
**HKMA US\$/HK\$ FX Transactions**  
**(3 Jul 20- 13 Oct 20)**

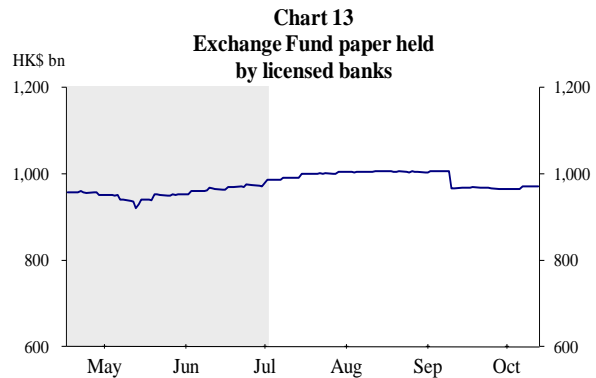
Trade Date	Net purchase of US\$ (HK\$ mn)
06-Jul	7,169
07-Jul	10,331
08-Jul	15,764
09-Jul	15,399
29-Jul	3,100
30-Jul	1,550
31-Jul	1,163
04-Aug	1,659
24-Aug	643
27-Aug	4,650
31-Aug	1,163
01-Sep	12,137
14-Sep	388
15-Sep	2,713
16-Sep	1,550
17-Sep	4,960
18-Sep	8,734
21-Sep	16,872
22-Sep	961
28-Sep	1,039
29-Sep	7,626
30-Sep	15,275
06-Oct	3,139
07-Oct	3,914
08-Oct	1,550
09-Oct	5,115
12-Oct	13,547*
13-Oct	10,881*
<b>Total</b>	<b>172,988</b>

\* The figures would be reflected in the Aggregate Balance after the review period, on 14 October and 15 October respectively. The Aggregate Balance was projected to increase further to HK\$304.57 billion as at 15 October.



*Outstanding Exchange Fund Bills and Notes*

13. **The market value of the outstanding EFBNs edged up to HK\$1,069.22 billion from HK\$1,068.83 billion during the review period. Holdings of Exchange Fund paper by the banking sector (before Discount Window activities) declined to HK\$971.00 billion (90.8% of total) from HK\$985.69 billion (92.2% of total) (Chart 13).**

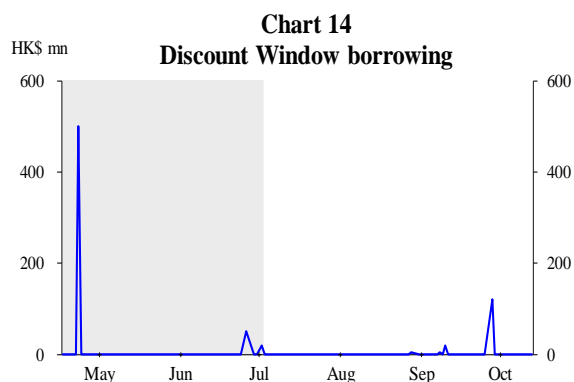


14. During the review period, **interest payments on Exchange Fund paper amounted to HK\$371.72 million. A total of HK\$334.94 million (in market value) of Exchange Fund paper was issued to absorb these interest payments.** The Exchange Fund paper issued during the review period was generally well received by the market (Table 4).

	No. of issues launched	Over-subscription ratio
1-month EFB	0	-
3-month EFB	14	0.95 - 2.42
6-month EFB	14	1.29 - 3.56
12-month EFB	5	1.78 - 3.77
2-year EFN	1	2.85

### Discount Window activities

15. During the review period, a total of HK\$150 million was borrowed from the Discount Window, compared with HK\$570 million in the preceding period from 17 April 2020 to 2 July 2020 (Chart 14).



### Backing Portfolio

16. The Backing Assets increased to HK\$2,135.97 billion on 13 October 2020, mainly due to the purchase of US dollars upon the triggering of the strong-side CU. While the Backing Assets rose by the same amount as the Monetary Base as required under the Currency Board arrangements, the proportional increase was smaller in the former due to its larger size. As such, the **Backing Ratio decreased to 110.66% from 111.67% 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.

