

EXCHANGE FUND ADVISORY COMMITTEE

Currency Board Sub-Committee

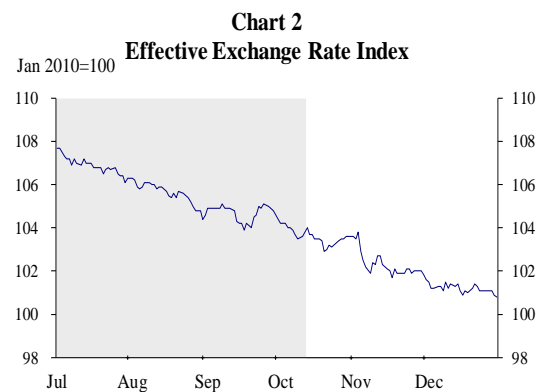
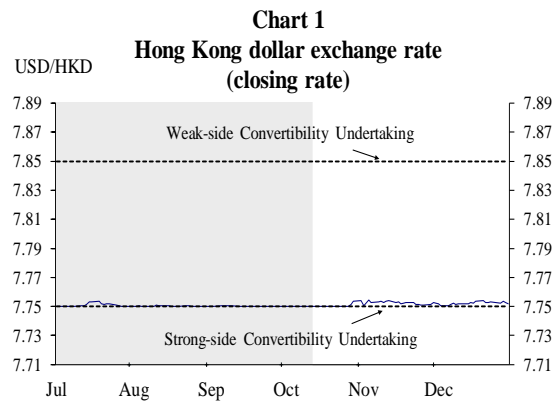
Report on Currency Board Operations

Review period: 14 October 2020 – 31 December 2020

Underpinned by equity-related demand including the southbound Stock-Connect and initial public offering (IPO) activities, the Hong Kong dollar (HKD) remained firm and traded within a narrow range of 7.7500 – 7.7544 against the US dollar (USD) during the review period. The strong-side Convertibility Undertaking (CU) was triggered 20 times between 14 October and 28 October. Since the first triggering on 21 April, the strong-side CU has been triggered 85 times, involving inflows of HK\$383.5 billion. Along with the expansion of the Aggregate Balance, short-term HKD interbank interest rates (i.e. HIBORs) remained soft throughout the review period. 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

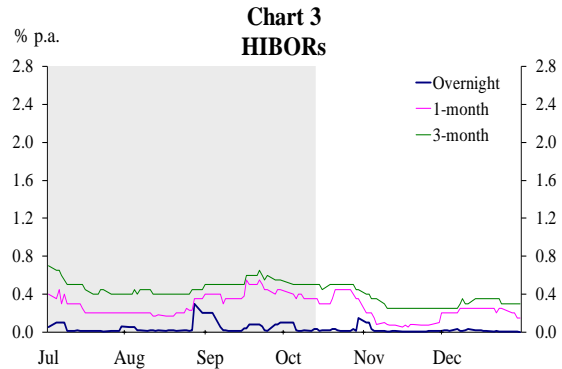
1. Underpinned by equity-related demand including the southbound Stock-Connect and IPO activities, **the HKD remained firm and traded within a narrow range of 7.7500 – 7.7544 (closing rate) against the USD during the review period (Chart 1).**¹ The strong-side CU was triggered 20 times between 14 October and 28 October. Since the first triggering on 21 April, the strong-side CU has been triggered 85 times, involving inflows of HK\$383.5 billion. Overall, the HKD continued to trade in a smooth and orderly manner during the review period, closing at 7.7520 on 31 December. **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).



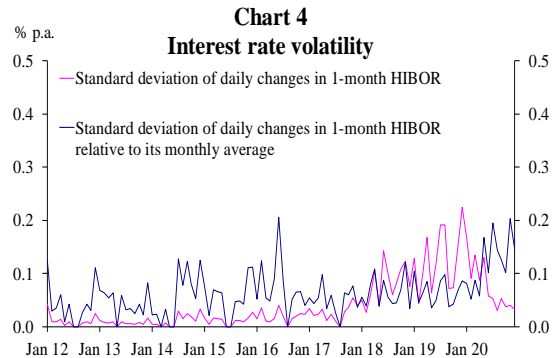
¹ In this report, daily time series charts also cover developments in the preceding review period (as shown in shaded region) for reference and comparison.

Interest rates

2. Along with the expansion of the Aggregate Balance due to the triggering of the strong-side CU, **the short-term HKD HIBORs remained soft throughout the review period, with occasional fluctuations mainly driven by IPO funding demand** (Chart 3). For the review period as a whole, the overnight, 1-month and 3-month HIBORs decreased by 3, 20 and 20 basis points to 0.001%, 0.15% and 0.30% respectively.

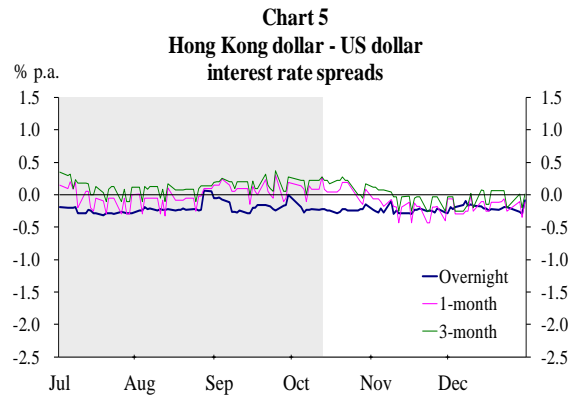


3. **Interest rate volatility**, measured by the standard deviation of daily changes in the 1-month HIBOR, **decreased slightly** to 3.7 basis points in the current review period from 4.6 basis points in the preceding review period (Chart 4). The standard deviation as a ratio of the average of 1-month HIBOR picked up in November amid the lower level of HIBOR.²

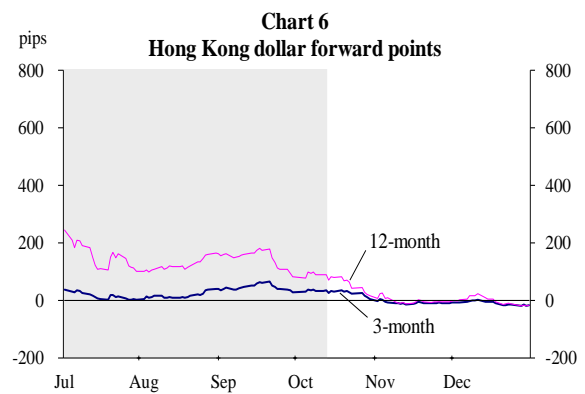


² The ratio of the standard deviation of daily changes in the 1-month HIBOR to its monthly average measures the extent of interest rate fluctuations relative to the average level of interest rates.

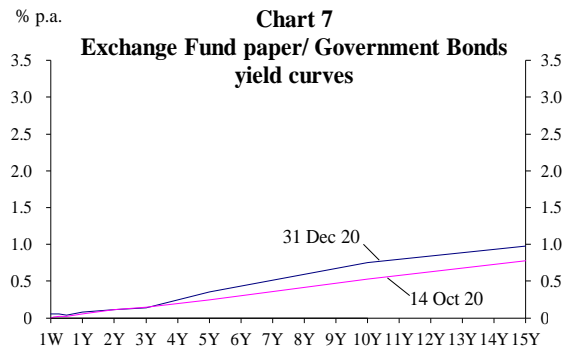
4. **The HKD-USD interbank interest rate spreads only saw modest fluctuations during the review period (Chart 5). At the end of the review period, the overnight, 1-month and 3-month spreads closed at -9, -12 and 1 basis points respectively.**



5. Broadly tracking the HKD-USD interbank interest rate spreads, **the forward points were largely stable and stayed close to zero** in most of the review period. At the end of review period, the 3-month and 12-month forward discounts both closed at 18 pips (Chart 6).

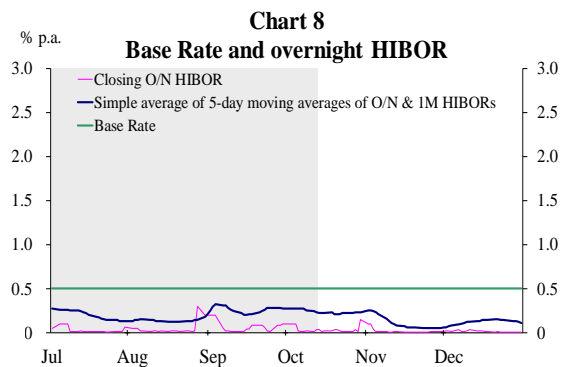


6. During the review period, the HKD yield curve shifted upward slightly (Chart 7). The yield of the 1-year Exchange Fund Bill increased by 3 basis points to 0.08%, and the yield of 10-year Hong Kong Government Bond increased by 22 basis points to 0.75%. The negative HKD-USD yield spreads generally narrowed (Table 1).

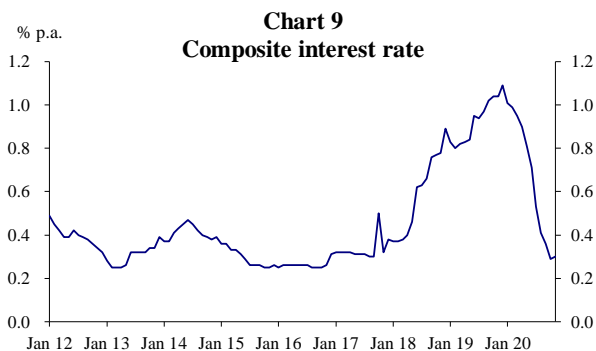


	14 Oct 20	31 Dec 20
3-month EFB	-10	-4
12-month EFB	-8	-2
3-year HKGB	-3	-4
5-year HKGB	-6	-1
10-year HKGB	-20	-18

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 1.93% in September 2020 to 1.62% in November 2020. Meanwhile, the average 1-month HKD time deposit board rate offered by retail banks edged down from 0.03% to 0.02%.³ **The composite interest rate**⁴, which indicates the average funding cost of retail banks, **declined** further from 0.36% at the end of September 2020 to 0.30% at the end of November 2020 (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.

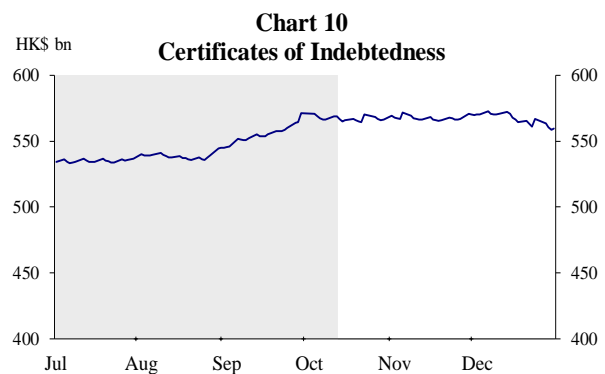
Monetary Base

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), **rose to HK\$2,099.31 billion on 31 December 2020 from HK\$1,942.91 billion on 14 October 2020** (Table 2). Movements of the individual components are discussed below.

(HK\$bn)	14 Oct 20	31 Dec 20
CIs	566.85	559.52
Government-issued Currency Notes and Coins in Circulation	13.14	13.17
Aggregate Balance	293.70	457.47
Outstanding EFBNs	1,069.23	1,069.15
Monetary Base	1,942.91	2,099.31

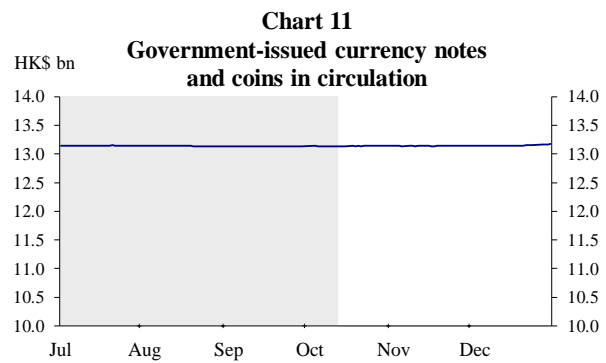
Certificates of Indebtedness

10. Reflecting a net decrease in currency demand during the review period, note-issuing banks redeemed HK\$7.33 billion worth of CIs to the HKMA in exchange for a net amount of US\$940 million. As a result, **the outstanding CIs decreased to HK\$559.52 billion on 31 December 2020 from HK\$566.85 billion on 14 October 2020** (Chart 10), representing a 1.3% decrease.



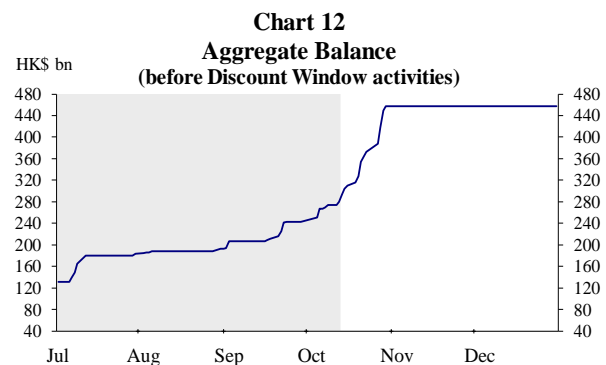
Government-issued currency notes and coins in circulation

11. During the review period, the amount of **government-issued currency notes and coins in circulation edged up** from HK\$13.14 billion to HK\$13.17 billion (Chart 11).



Aggregate Balance

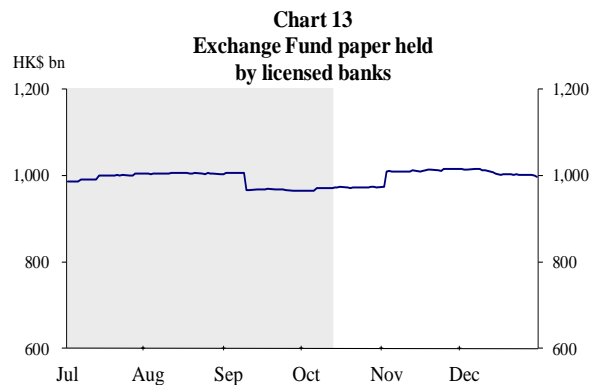
12. **The Aggregate Balance rose from HK\$293.70 billion to HK\$457.47 billion during the review period** (Chart 12), owing to the triggering of the strong-side CU between 14 October and 28 October (Table 3). The foreign exchange operations are consistent with Currency Board principles, as the increases in the Monetary Base were matched by equivalent increases in US dollar reserves.



Trade Date	Net purchase of US\$ (HK\$ mn)
14-Oct	5,534
15-Oct	5,270
16-Oct	12,152
19-Oct	26,335
20-Oct	10,850
21-Oct	8,138
22-Oct	14,973
23-Oct	26,908
26-Oct	3,100
27-Oct	31,798
28-Oct	7,828
Total	152,884

Outstanding Exchange Fund Bills and Notes

13. **The market value of the outstanding EFBNs edged down to HK\$1,069.15 billion from HK\$1,069.23 billion during the review period. Holdings of Exchange Fund paper by the banking sector (before Discount Window activities) increased to HK\$997.39 billion (93.3% of total) from HK\$973.02 billion (91.0% of total) (Chart 13).**

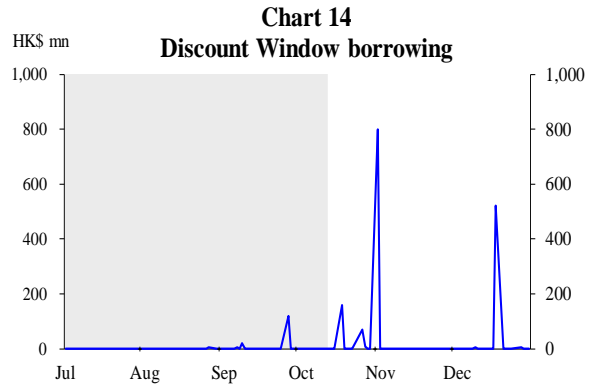


14. During the review period, **interest payments on Exchange Fund paper amounted to HK\$145.90 million. A total of HK\$63.00 million (in market value) of Exchange Fund paper was issued to absorb these interest payments.** The remaining amount was carried forward in the Aggregate Balance at the end of the review period. The Exchange Fund paper issued during the review period was generally well received by the market (Table 4).

	No. of issues launched	Over-subscription ratio
1-month EFB	1	3.39
3-month EFB	12	0.90 – 3.21
6-month EFB	12	1.32 – 2.69
12-month EFB	3	2.61 – 5.06
2-year EFN	1	8.93

Discount Window activities

15. During the review period, a total of **HK\$1,569 million** was borrowed from the Discount Window, compared with HK\$150 million in the preceding period from 3 July 2020 to 13 October 2020 (Chart 14).



Backing Portfolio

16. The Backing Assets increased to HK\$2,305.24 billion on 30 December 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 from 110.60% to 109.92% as at 30 December 2020** (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.

