

**EXCHANGE FUND ADVISORY COMMITTEE**

**Currency Board Sub-Committee**

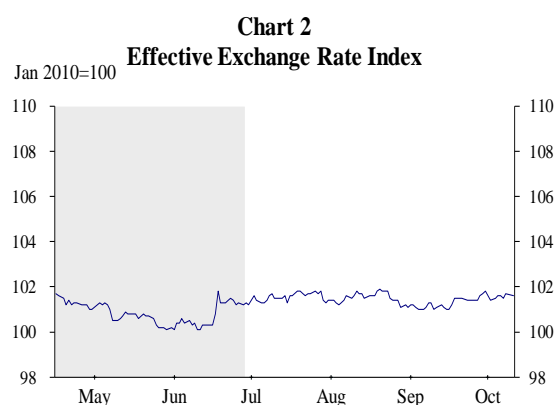
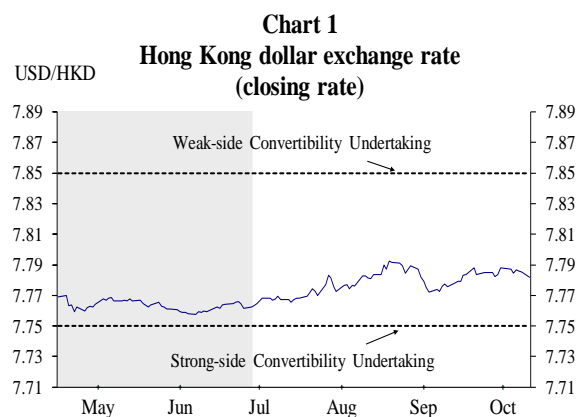
**Report on Currency Board Operations**

**Review period: 29 June 2021 – 11 October 2021**

During the review period, the Hong Kong dollar (HKD) traded within a range of 7.7632 and 7.7924 against the US dollar (USD). The HKD has softened since early July, mainly reflecting risk-off sentiment in the local stock market. With the sizeable Aggregate Balance, HKD interbank interest rates (i.e. HIBORs) remained largely stable at a low level during 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

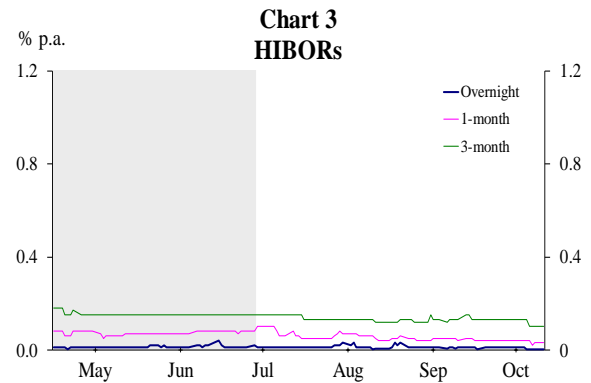
1. During the review period of 29 June to 11 October 2021, the **HKD traded within a range of 7.7632 and 7.7924** (closing rate) **against the USD** (Chart 1).<sup>1</sup> The HKD has softened since early July, mainly reflecting risk-off sentiment in the local stock market and repatriation of funds raised in IPOs. While the HKD rebounded slightly in late August along with improved equity market sentiment and corporates' dividend payment needs, it eased again in late September amid sell-off in the local stock market. Overall, the HKD remained at the strong side of the Convertibility Zone and continued to trade in a smooth and orderly manner during the review period, closing at 7.7817 on 11 October. **The nominal effective exchange rate index of the HKD increased slightly** during the review period, reflecting the appreciation of the USD against some major currencies (Chart 2).



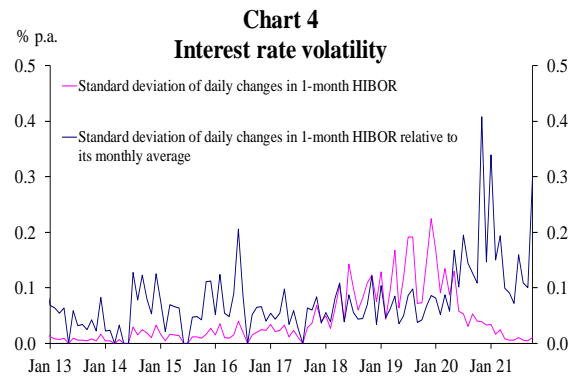
<sup>1</sup> In this report, daily time series charts also cover developments in the preceding review period (as shown in shaded region) for reference and comparison.

## Interest rates

2. During the review period, **the HKD HIBORs remained largely stable at low levels** with the sizeable Aggregate Balance (Chart 3). The interbank market continued to trade in a smooth and orderly manner. For the review period as a whole, the overnight, 1-month and 3-month HIBORs decreased by 0.7, 7 and 5 basis points to 0.003%, 0.03% and 0.10% respectively.

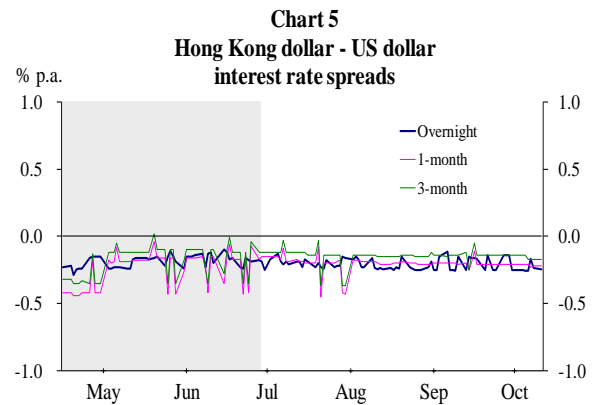


3. **Interest rate volatility**, measured by the standard deviation of daily changes in the 1-month HIBOR, **edged up** to 0.8 basis points (or 0.008%) in the current review period from 0.6 basis points (or 0.006%) in the preceding review period (Chart 4). The standard deviation as a ratio of the average of 1-month HIBOR also increased during the review period.<sup>2</sup>

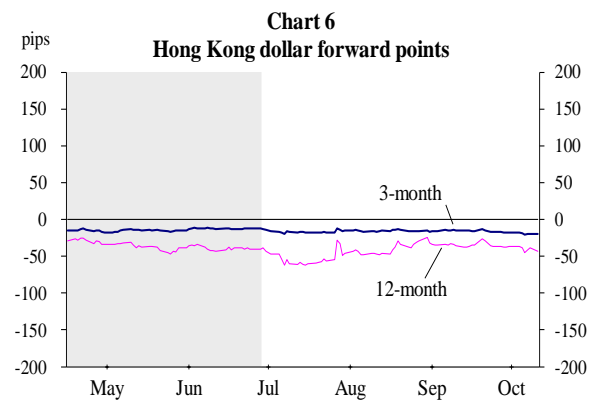


<sup>2</sup> The ratio of the standard deviation of daily changes in the 1-month HIBOR to its monthly average measures the extent of interest rate fluctuations relative to the average level of interest rates.

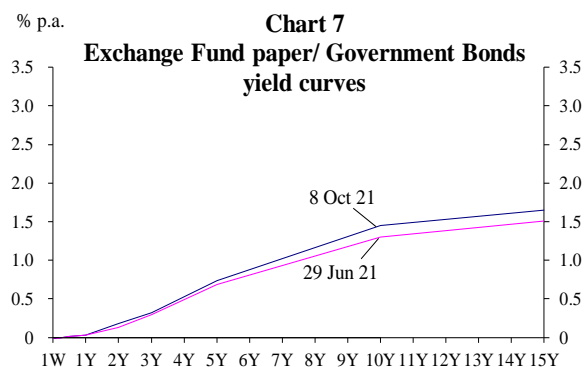
4. During the review period, **the HKD-USD interbank interest rate spreads stayed within a narrow range** (Chart 5). At the end of the review period, the overnight, 1-month and 3-month spreads closed at -25, -22 and -17 basis points respectively.



5. Broadly tracking the HKD-USD interbank interest rate spreads, **the forward points were largely stable** during the review period. At the end of review period, the 3-month and 12-month forward discounts closed at 20 pips and 43 pips respectively (Chart 6).

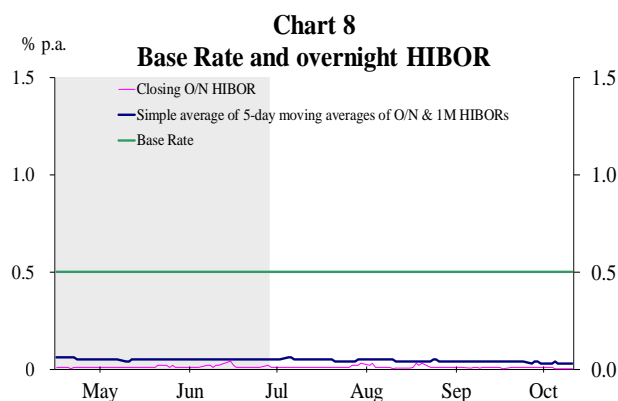


6. During the review period, the HKD yield curve in general shifted upward slightly (Chart 7). The yield of the 1-year Exchange Fund Bill stayed virtually unchanged at 0.03% while that of the 10-year Hong Kong Government Bond increased by 15 basis points to 1.45%. The negative HKD-USD yield spreads generally widened for shorter tenors but narrowed for the longer tenor (i.e. 10-year) (Table 1).

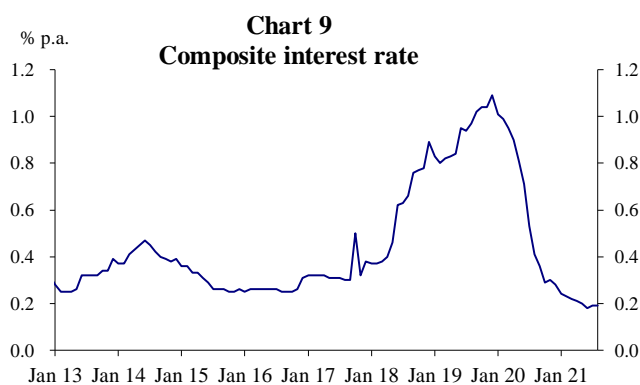


	29 Jun 21	8 Oct 21
3-month EFB	-4	-5
12-month EFB	-5	-6
3-year HKGB	-18	-27
5-year HKGB	-21	-32
10-year HKGB	-19	-16

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%. The average interest rate for newly approved mortgage loans edged down from 1.49% in June 2021 to 1.47% in August 2021. Meanwhile, the average 1-month HKD time deposit board rate offered by retail banks stayed virtually unchanged at 0.02%.<sup>3</sup> **The composite interest rate<sup>4</sup>,** which indicates the average funding cost of retail banks, **edged up** from 0.18% at the end of June 2021 to 0.19% at the end of August 2021 (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.

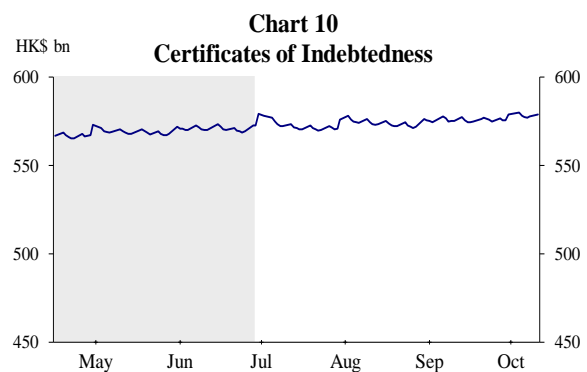
## Monetary Base

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), **edged up to HK\$2,118.34 billion on 11 October 2021 from HK\$2,112.29 billion on 29 June 2021** (Table 2). Movements of the individual components are discussed below.

(HK\$bn)	29 Jun 21	11 Oct 21
CIs	572.52	578.69
Government-issued Currency Notes and Coins in Circulation	13.23	13.19
Aggregate Balance	457.45	432.46
Outstanding EFBNs	1,069.10	1,094.01
<b>Monetary Base</b>	<b>2,112.29</b>	<b>2,118.34</b>

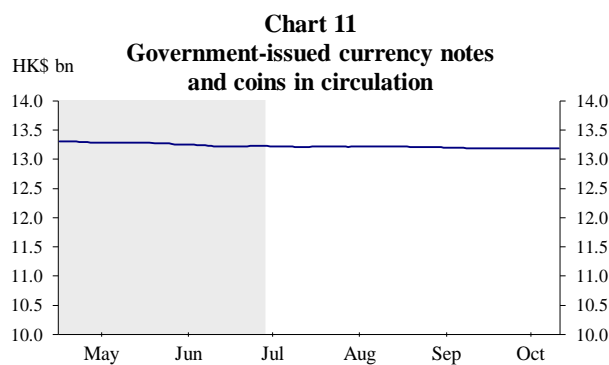
### *Certificates of Indebtedness*

10. During the review period, note-issuing banks submitted a net amount of US\$791.0 million to the HKMA in exchange for HK\$6.17 billion worth of CIs. As a result, **the outstanding CIs increased** to HK\$578.69 billion on 11 October 2021 from HK\$572.52 billion on 29 June 2021 (Chart 10).



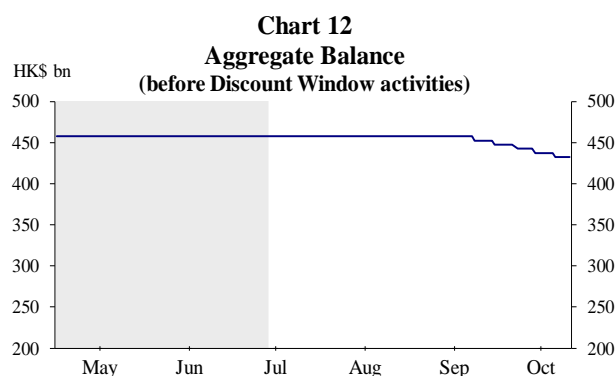
*Government-issued currency notes and coins in circulation*

11. During the review period, the amount of **government-issued currency notes and coins in circulation edged down** from HK\$13.23 billion to HK\$13.19 billion (Chart 11).



*Aggregate Balance*

12. Reflecting the increased issuance of Exchange Fund Bills to meet the ongoing demand for Exchange Fund paper by banks amidst the abundance of liquidity in the banking system<sup>5</sup>, **the Aggregate Balance** (before Discount Window activities) **decreased** from HK\$457.5 billion to HK\$432.5 billion during the review period (Chart 12). The increase in the supply of Exchange Fund Bills is consistent with Currency Board principles, since the additional issuance simply represents a change in the composition of the Monetary Base, with a shift from the Aggregate Balance to Exchange Fund paper. The Aggregate Balance decreased by the same amount as the increase



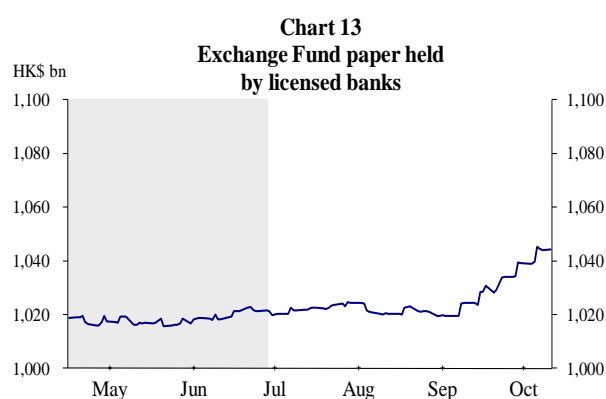
<sup>5</sup> To meet the ongoing demand for Exchange Fund paper by banks amidst the abundance of liquidity in the banking system, the HKMA planned to increase the issuance size of 91-day Exchange Fund Bills by HK\$5 billion in each of the eight regular tenders on 7, 14, 21 and 28 September and 5, 12, 19 and 26 October. During the review period, the additional issuance size of the Bills amounted to HK\$25 billion in total and the Aggregate Balance decreased by the same amount.



in Exchange Fund Bills. The Monetary Base remains fully backed by foreign exchange reserves.

*Outstanding Exchange Fund Bills and Notes*

13. **The market value of the outstanding EFBNs increased to HK\$1,094.01 billion during the review period, following the increased issuance of Exchange Fund Bills by a total of HK\$25 billion in five regular tenders. Holdings of Exchange Fund paper by the banking sector (before Discount Window activities) picked up to HK\$1,044.20 billion (95.4% of total) from HK\$1,021.30 billion (95.5% of total) (Chart 13).**

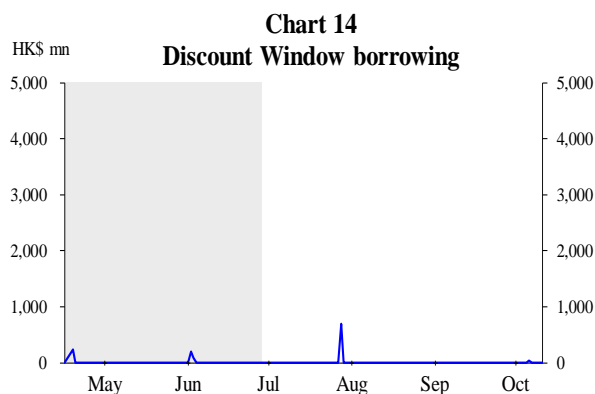


14. During the review period, **interest payments on Exchange Fund paper amounted to HK\$167.28 million. A total of HK\$82.00 million (in market value) of Exchange Fund paper was issued to absorb these interest payments.** The remaining amount was carried forward in the Aggregate Balance at the end of the review period. The Exchange Fund paper issued during the review period was generally well received by the market (Table 3).

	No. of issues launched	Over-subscription ratio
1-month EFB	0	-
3-month EFB	15	1.84 – 6.47
6-month EFB	15	2.79 – 8.60
12-month EFB	5	3.42 – 9.10
2-year EFN	1	11.29

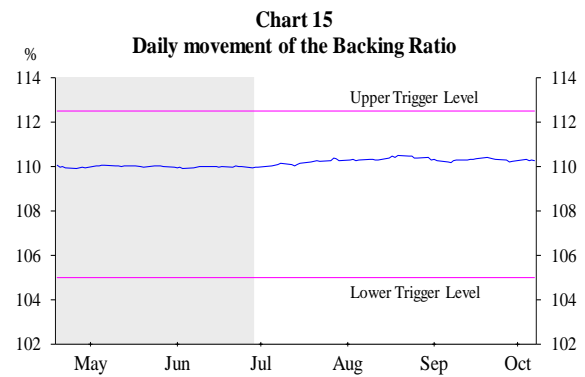
### **Discount Window activities**

15. During the review period, **a total of HK\$736 million was borrowed from the Discount Window,** compared with HK\$521 million in the preceding period from 16 April 2021 to 28 June 2021 (Chart 14).



## **Backing Portfolio**

16. The Backing Assets increased to HK\$2,333.10 billion on 7 October 2021, mainly attributable to the income from investments and the issuance of CIs. With the increase in the Backing Assets outpacing the increase in Monetary Base, **the Backing Ratio edged up from 109.97% to 110.26% 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**  
**1 December 2021**