

**EXCHANGE FUND ADVISORY COMMITTEE**

**Currency Board Sub-Committee**

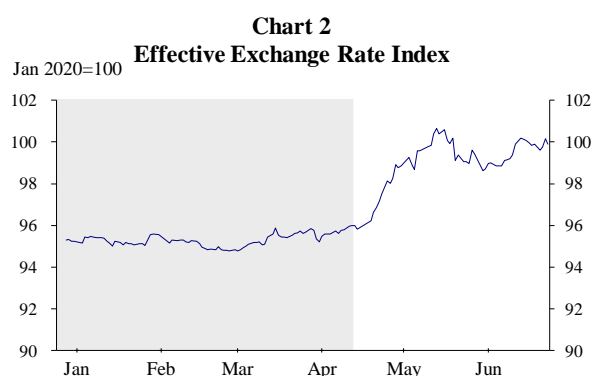
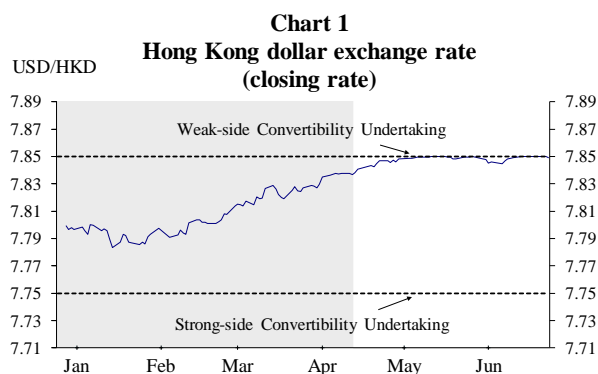
**Report on Currency Board Operations**

**Review period: 13 April 2022 – 23 June 2022**

During the review period, the Hong Kong dollar (HKD) traded within a range of 7.8381 – 7.8500 against the US dollar (USD). With the lacklustre performance of the local stock market and market concerns over the US monetary policy normalisation, the HKD softened further against the USD since late April. The weak-side Convertibility Undertaking (CU) was eventually triggered 14 times during the review period and the HKMA bought HK\$104.28 billion under the weak-side CU. The Aggregate Balance and the Monetary Base fell correspondingly after the repeated triggering of the weak-side CU. The HKD interbank interest rates generally increased during the review period due to expectation of further US rate hikes, but remained at low levels by historical standards. 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

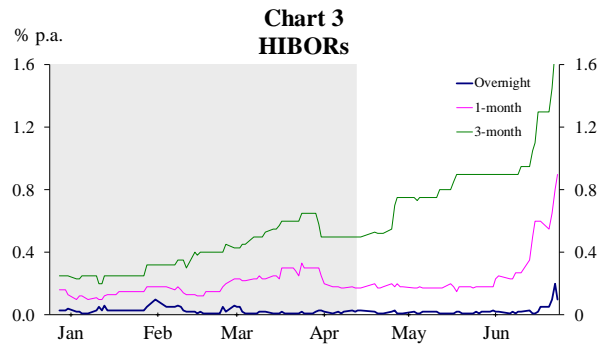
1. During the review period of 13 April 2022 to 23 June 2022, **the HKD traded within a range of 7.8381 – 7.8500 (closing rate) against the USD** (Chart 1).<sup>1</sup> With the lacklustre performance of the local stock market and market concerns over the US monetary policy normalisation, the HKD softened further against the USD since late April. The weak-side Convertibility Undertaking (CU) was eventually triggered 14 times during the review period and the HKMA bought HK\$104.28 billion under the weak-side CU. Overall, the HKD continued to trade in a smooth and orderly manner during the review period, closing at 7.8490 on 23 June. During the review period, the nominal effective exchange rate index of the HKD increased, mainly reflecting the appreciation of the HKD against the currencies of major trading partners of Hong Kong (Chart 2).



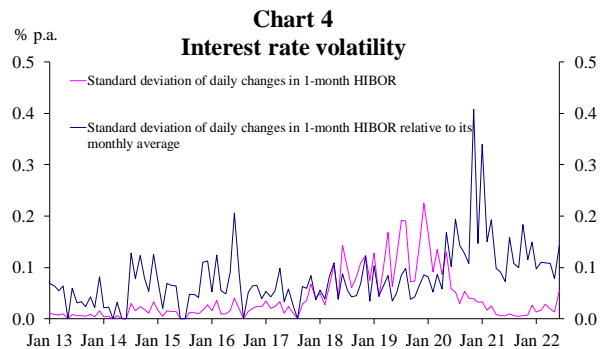
<sup>1</sup> In this report, daily time series charts also cover developments in the preceding review period (as shown in shaded region) for reference and comparison.

## Interest rates

2. **The HKD HIBORs generally increased** during the review period due to expectation of further US rate hikes, but remained at low levels by historical standards (Chart 3). The interbank market continued to trade in a smooth and orderly manner. For the review period as a whole, overnight, 1-month and 3-month HIBORs increased by 7, 73 and 120 basis points to 0.10%, 0.90% and 1.70% respectively.

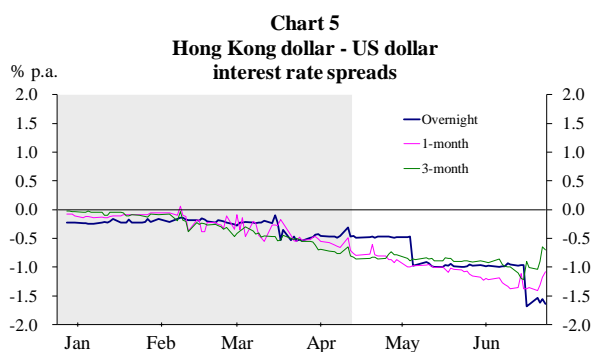


3. **Interest rate volatility, measured by the standard deviation of daily changes in the 1-month HIBOR, increased** to 3.4 basis points (or 0.034%) in the current review period from 2.1 basis points (or 0.021%) in the preceding review period (Chart 4). The standard deviation as a ratio of the average of 1-month HIBOR also rose during the review period.<sup>2</sup>

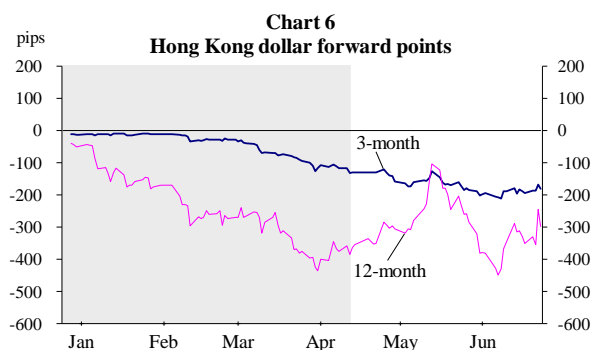


<sup>2</sup> The ratio of the standard deviation of daily changes in the 1-month HIBOR to its monthly average measures the extent of interest rate fluctuations relative to the average level of interest rates.

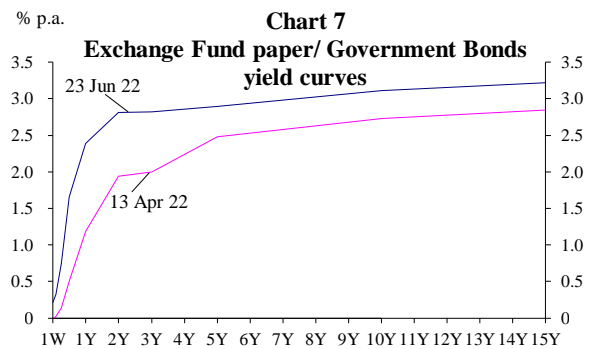
4. Reflecting a broad-based increase in the USD interest rates following the Federal Open Market Committee's rate hike decision, **the negative HKD-USD interbank interest rate spreads generally widened** during the review period (Chart 5). At the end of the review period, the overnight, 1-month and 3-month spreads closed at -164, -108 and -70 basis points respectively.



5. Roughly tracking the HKD-USD interbank interest rate spreads, **the shorter-dated (3-month) HKD forward discount widened** during the review period, closing at 181 pips at the end of the review period. Meanwhile, **the longer-dated (12-month) HKD forward discount witnessed more fluctuations** during the review period. It temporarily narrowed in mid-May when the weak-side CU was repeatedly triggered, but the discount widened afterwards, closing at 298 pips at the end of the review period. (Chart 6).

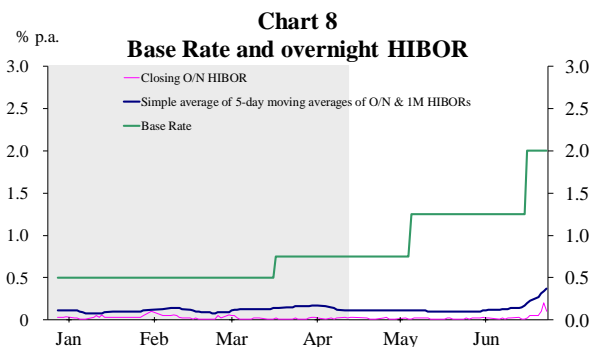


6. During the review period, the HKD yield curve shifted upwards (Chart 7). The yield of the 1-year Exchange Fund Bill and 10-year Hong Kong Government Bond increased by 121 and 39 basis points to 2.39% and 3.12% respectively. While the negative HKD-USD yield spreads widened at 3-month tenor, yield spreads at longer tenors showed mixed changes (Table 1).

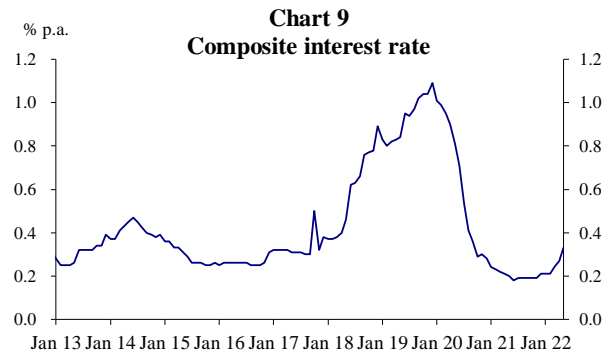


7. Following the increases in the target range for the US federal funds rate from 0.25%-0.50% to 0.75%-1.00% on 4 May 2022 and further to 1.50%-1.75% on 15 June 2022 (US time), the HKMA Base Rate increased from 0.75% to 1.25% on 5 May and further to 2.00% on 16 June (Chart 8). According to the established formula, the Base Rate is 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.

	13 Apr 22	23 Jun 22
3-month EFB	-61	-91
12-month EFB	-60	-39
3-year HKGB	-57	-30
5-year HKGB	-18	-25
10-year HKGB	3	3



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 decreased from 1.67% in March 2022 to 1.57% in May 2022. Meanwhile, the average 1-month HKD time deposit board rate offered by retail banks remained unchanged at 0.02%.<sup>3</sup> **The composite interest rate**<sup>4</sup>, which indicates the average funding cost of retail banks, **increased** from 0.24% at the end of March 2022 to 0.33% at the end of May 2022 (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.

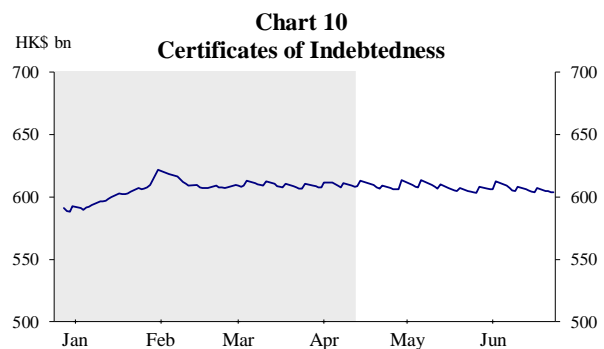
## Monetary Base

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), **decreased to HK\$2,046.93 billion on 23 June 2022 from HK\$2,148.23 billion on 13 April 2022** (Table 2). Movements of the individual components are discussed below.

(HK\$bn)	13 Apr 22	23 Jun 22
CIs	608.68	603.62
Government-issued Currency Notes and Coins in Circulation	13.30	13.20
Aggregate Balance	337.59	241.89
Outstanding EFBNs	1,188.66	1,188.23
<b>Monetary Base</b>	<b>2,148.23</b>	<b>2,046.93</b>

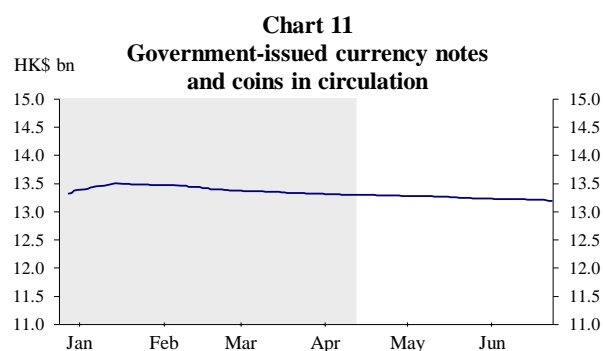
### *Certificates of Indebtedness*

10. During the review period, note-issuing banks redeemed HK\$5,060.0 million worth of CIs to the HKMA in exchange for a net amount of US\$648.7 million. As a result, **the outstanding CIs decreased to HK\$603.62 billion on 23 June 2022 from HK\$608.68 billion on 13 April 2022** (Chart 10).



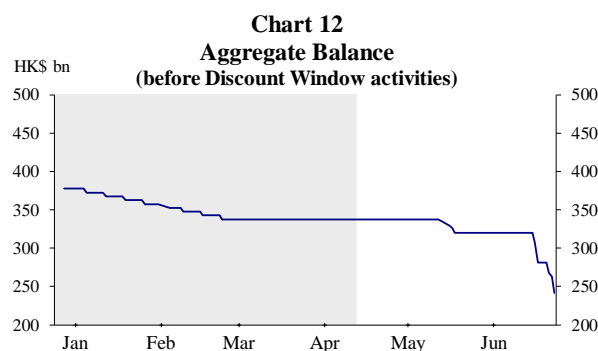
*Government-issued currency notes and coins in circulation*

11. During the review period, the amount of **government-issued currency notes and coins in circulation edged down** from HK\$13.30 billion to HK\$13.20 billion (Chart 11).



*Aggregate Balance*

12. **The Aggregate Balance declined from HK\$337.59 billion to HK\$241.89 billion during the review period** (Chart 12) owing to the triggering of the weak-side CU in May and June (Table 3). These foreign exchange operations were consistent with Currency Board principles, as the decreases in the Monetary Base were matched by equivalent decreases in US dollar reserves.



**Table 3**  
**HKMA HK\$/US\$ FX Transactions**  
**(13 Apr 22 - 23 Jun 22)**

Trade Date	Net purchase of HK\$ (HK\$m)
11-May-22	1,586
12-May-22	4,082
12-May-22	2,865
13-May-22	3,164
16-May-22	5,888
14-Jun-22	4,396
14-Jun-22	9,255
15-Jun-22	11,775
15-Jun-22	13,824
17-Jun-22	12,819
20-Jun-22	5,220
21-Jun-22	9,577
21-Jun-22	11,249
22-Jun-22	8,580*
<b>Total</b>	<b>104,279</b>

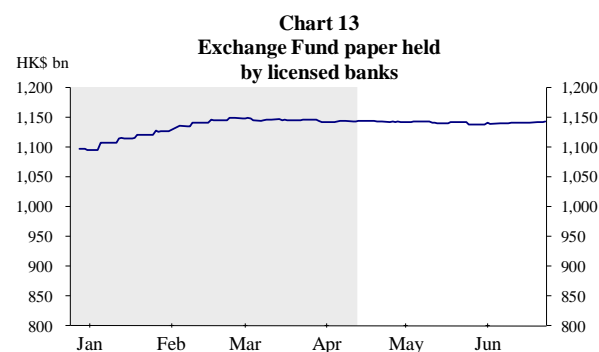
Note: Figures may not add up to total due to rounding.

\* The figures would be reflected in the Aggregate Balance after the review period. The Aggregate Balance was projected to decrease further to HK\$233.31 billion as at 24 June.



*Outstanding Exchange Fund Bills and Notes*

13. **The market value of the outstanding EFBNs edged down to HK\$1,188.23 billion during the review period. Holdings of Exchange Fund paper by the banking sector (before Discount Window activities) decreased to HK\$1,142.71 billion (96.2% of total) from HK\$1,143.74 billion (96.2% of total) (Chart 13).**



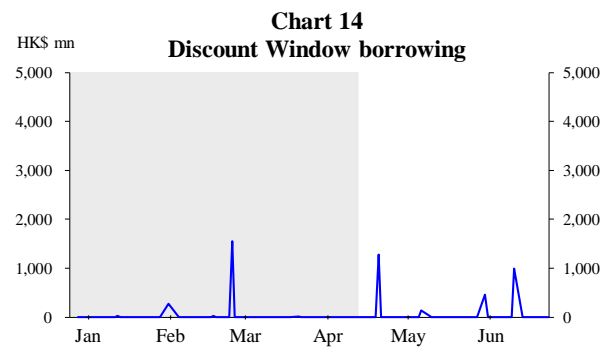
14. During the review period, **interest payments on Exchange Fund paper amounted to HK\$1074.61 million. A total of HK\$975.38 million (in market value) of Exchange Fund paper was issued to absorb these interest payments.** The remaining amount was carried forward in the Aggregate Balance at the end of the review period. The Exchange Fund paper issued during the review period was generally well received by the market (Table 4).

**Table 4**  
**Issuance of Exchange Fund Bills and Notes**  
**(13 Apr 22 – 23 Jun 22)**

	No. of issues launched	Over-subscription ratio
1-month EFB	1	6.10
3-month EFB	10	0.87 – 1.51
6-month EFB	10	1.17 – 3.33
12-month EFB	2	2.53 – 3.58
2-year EFN	1	6.46

### Discount Window activities

15. During the review period, a total of **HK\$2,870 million** was borrowed from the Discount Window, compared with HK\$1,876 million in the preceding period from 25 December 2021 to 12 April 2022 (Chart 14).



### Backing Portfolio

16. The Backing Assets decreased to HK\$2,252.20 billion on 23 June 2022. **The Backing Ratio increased marginally from 109.66% to 110.04% 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.

