

EXCHANGE FUND ADVISORY COMMITTEE

Currency Board Sub-Committee

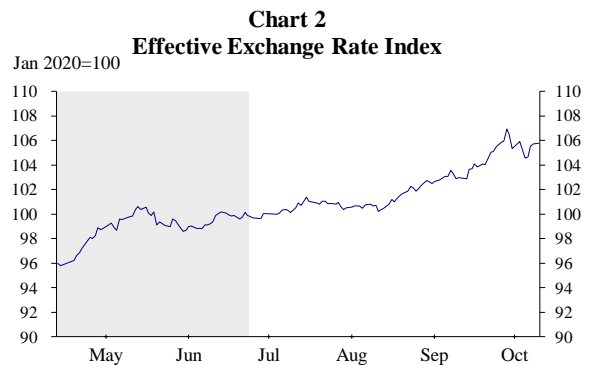
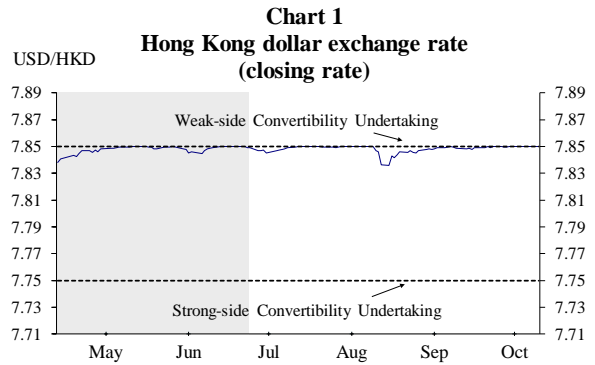
Report on Currency Board Operations

Review period: 24 June 2022 – 10 October 2022

During the review period, the Hong Kong dollar (HKD) traded within a range of 7.8359 – 7.8500 against the US dollar (USD). Along with the increases in the target range for the US federal funds rate, the weak-side Convertibility Undertaking (CU) was triggered 20 times during the review period and the HKMA bought HK\$114.68 billion under the weak-side CU. The Aggregate Balance fell correspondingly to HK\$120.89 billion. With the reduction in the Aggregate Balance and the expectation of further US rate hikes, the HKD interbank interest rates increased during the review period, with the 1-month HKD interbank rate rising to 2.40%. Following the increase in the target range for the US federal funds rate in September, many banks raised their Best Lending Rates by 12.5 basis points, marking the first increase since 2018. 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 Currency Board principles.

Hong Kong dollar exchange rate

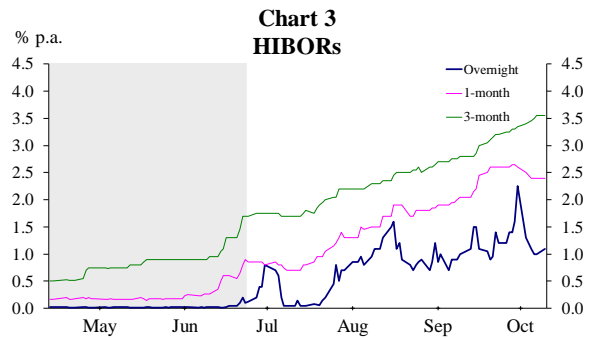
1. During the review period of 24 June 2022 to 10 October 2022, **the HKD traded within a range of 7.8359 – 7.8500 (closing rate) against the USD** (Chart 1).¹ Along with the increases in the target range for the US federal funds rate, the weak-side Convertibility Undertaking (CU) was triggered 20 times during the review period and the HKMA bought HK\$114.68 billion under the weak-side CU. Overall, the HKD continued to trade in a smooth and orderly manner during the review period, closing at 7.8498 on 10 October. During the review period, the nominal effective exchange rate index of the HKD increased, mainly reflecting the appreciation of the HKD alongside the USD appreciation against the currencies of the major trading partners of Hong Kong (Chart 2).



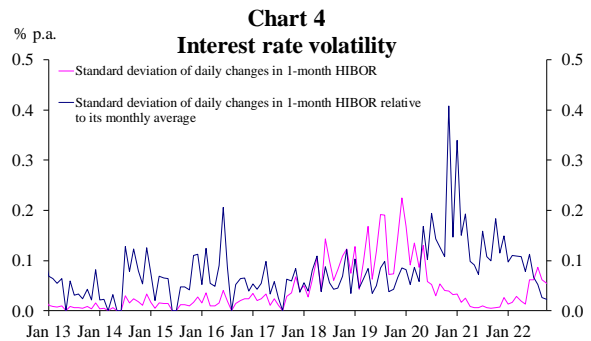
¹ In this report, daily time series charts also cover developments in the preceding review period (as shown in shaded region) for reference and comparison.

Interest rates

2. The HKD interbank market continued to trade in a smooth and orderly manner. With the reduction in the Aggregate Balance and the expectation of further US rate hikes, **the HKD HIBORs increased** (Chart 3). For the review period as a whole, the overnight, 1-month and 3-month HIBORs increased by 98, 155 and 185 basis points to 1.10%, 2.40% and 3.55% respectively.

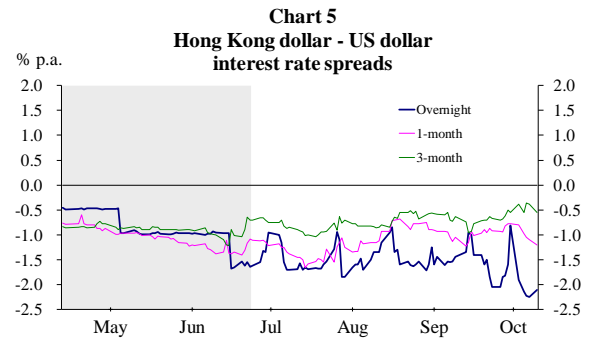


3. **Interest rate volatility**, measured by the standard deviation of daily changes in the 1-month HIBOR, **increased** to 7.0 basis points (or 0.070%) in the current review period from 4.3 basis points (or 0.043%) in the preceding review period (Chart 4). Meanwhile, the standard deviation as a ratio of the average of the 1-month HIBOR declined as the standard deviation increased at a slower pace than the 1-month HIBOR.²

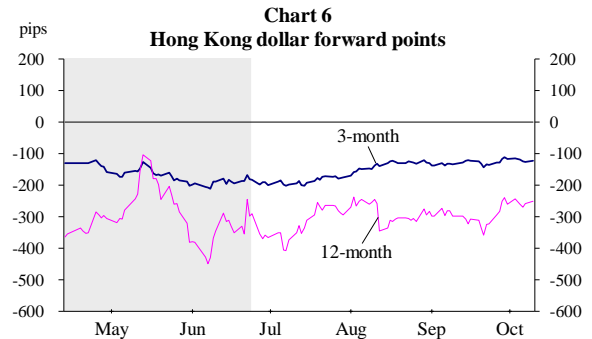


² The ratio of the standard deviation of daily changes in the 1-month HIBOR to its monthly average measures the extent of interest rate fluctuations relative to the average level of interest rates.

4. **The short-term negative HKD-USD interbank interest rate spreads showed mixed changes during the review period (Chart 5).** The overnight and 1-month spreads widened somewhat to -210 and -120 basis points respectively at the end of the review period, while the 3-month spread narrowed slightly, closing at -55 basis points at the end of the review period.



5. Roughly tracking the HKD-USD interbank interest rate spreads, **the shorter-dated (3-month) HKD forward discount narrowed slightly** during the review period, closing at 122 pips at the end of the review period. Meanwhile, **the longer-dated (12-month) HKD forward discount witnessed more fluctuations** during the review period, closing at 250 pips at the end of the review period. (Chart 6).



6. During the review period, the HKD yield curve shifted upwards (Chart 7). The yields of the 1-year Exchange Fund Bill and 10-year Hong Kong Government Bond increased by 152 and 60 basis points to 3.88% and 3.69% respectively. The negative HKD-USD yield spreads generally narrowed at the shorter tenors (i.e. 3-month, 12-month) but widened at the longer tenor (i.e. 10-year) (Table 1).³

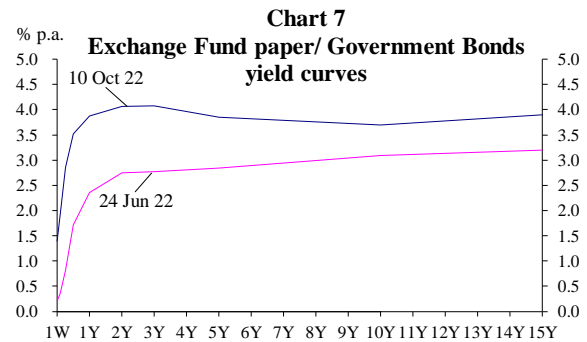
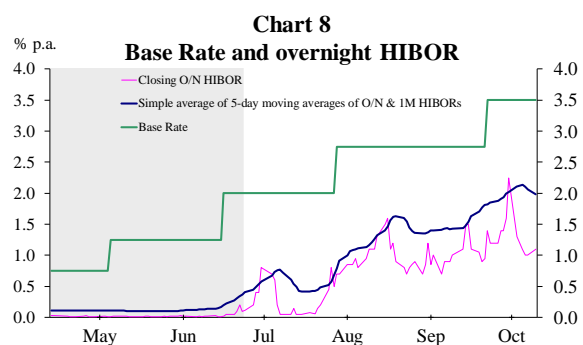


Table 1
Yield spreads of Exchange Fund paper and Hong Kong Government Bonds over US Treasuries (basis points)

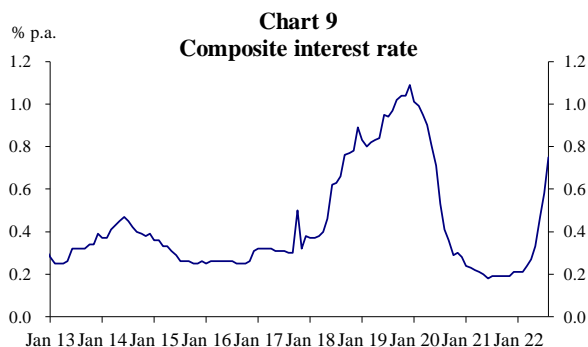
	24 Jun 22	7 Oct 22
3-month EFB	-92	-61
12-month EFB	-47	-43
3-year HKGB	-36	-34
5-year HKGB	-34	-35
10-year HKGB	-4	-27

7. Following the increases in the target range for the US federal funds rate from 1.50% – 1.75% to 2.25% – 2.50% on 27 July 2022 and further to 3.00% – 3.25% on 21 September 2022 (US time), the **HKMA Base Rate increased from 2.00% to 2.75% on 28 July and further to 3.50% on 22 September** (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.



³ As 10 October 2022 was a US holiday, the yield spreads on the preceding trading day, 7 October, were reported in Table 1.

8. Following the increase in the target range for the US federal funds rate on 21 September 2022 (US time), **many banks raised their Best Lending Rates by 12.5 basis points.** At the end of the review period, the Best Lending Rates in the market ranged from 5.125% to 5.500%. The average interest rate for newly approved mortgage loans increased from 1.93% in June 2022 to 2.55% in August 2022. Meanwhile, the average 1-month HKD time deposit board rate offered by retail banks slightly increased from 0.02% to 0.07% at the end of the current review period.⁴ **The composite interest rate,**⁵ which indicates the average funding cost of retail banks, **increased** from 0.47% at the end of June 2022 to 0.75% at the end of August 2022 (Chart 9).



⁴ The figure refers to the average interest rate offered by major authorized institutions for 1-month time deposits of less than HK\$100,000.

⁵ 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.

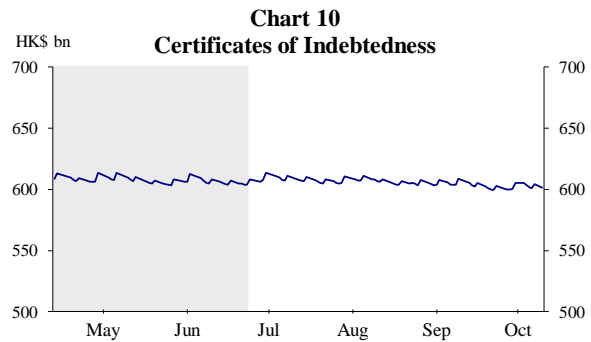
Monetary Base

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\$1,926.05 billion on 10 October 2022 from HK\$2,042.98 billion on 24 June 2022** (Table 2). Movements of the individual components are discussed below.

(HK\$bn)	24 Jun 22	10 Oct 22
CIs	608.20	601.20
Government-issued Currency Notes and Coins in Circulation	13.19	13.12
Aggregate Balance	233.31	120.89
Outstanding EFBNs	1,188.29	1,190.84
Monetary Base	2,042.98	1,926.05

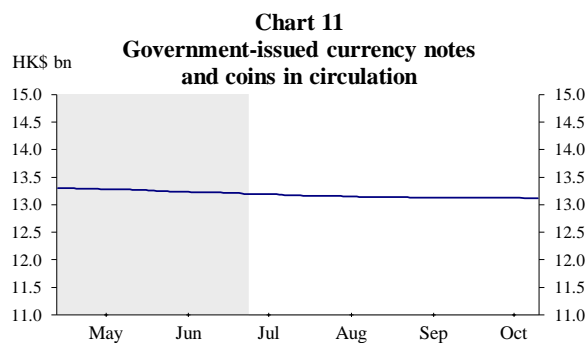
Certificates of Indebtedness

10. During the review period, the note-issuing banks redeemed HK\$7.00 billion worth of CIs to the HKMA in exchange for a net amount of US\$897 million. As a result, **the outstanding CIs decreased to HK\$601.20 billion on 10 October 2022 from HK\$608.20 billion on 24 June 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\$13.19 billion to HK\$13.12 billion (Chart 11).



Aggregate Balance

12. **The Aggregate Balance declined from HK\$233.31 billion to HK\$120.89 billion during the review period** (Chart 12) owing to the triggering of the weak-side CU between 13 July and 7 October (Table 3).⁶ 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.

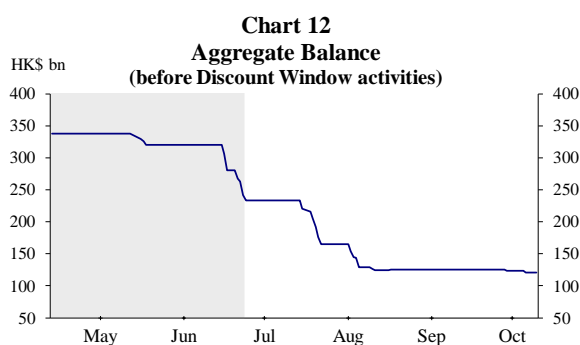


Table 3
HKMA HK\$/US\$ FX Transactions
(24 Jun 22 – 10 Oct 22)

Trade Date	Net purchase of HK\$ (HK\$mn)
13-Jul-22	12,796
14-Jul-22	5,322
15-Jul-22	4,161
15-Jul-22	6,413
18-Jul-22	5,495
18-Jul-22	8,070
19-Jul-22	6,280
19-Jul-22	8,619
20-Jul-22	11,202
29-Jul-22	9,656
29-Jul-22	1,923
01-Aug-22	2,669
01-Aug-22	6,272
02-Aug-22	1,311
03-Aug-22	14,161
08-Aug-22	2,975
09-Aug-22	1,492
27-Sep-22	1,939
03-Oct-22	2,355
07-Oct-22*	1,570
Total	114,681

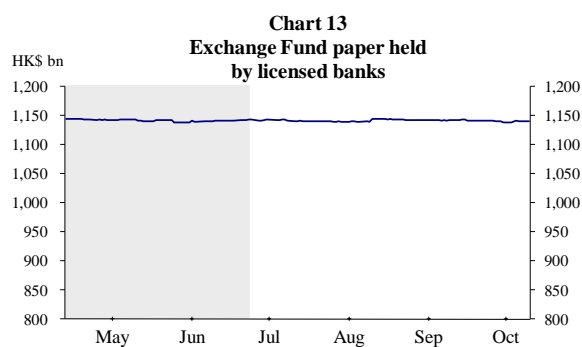
Note: Figures may not add up to total due to rounding.

*The figure was reflected in the Aggregate Balance after the review period. The Aggregate Balance decreased further to HK\$119.32 billion as at 11 October.

⁶ Between the first triggering of the weak-side CU in May 2022 and the end of the review period, the HKMA bought a total of HK\$218.96 billion under the weak-side CU.

Outstanding Exchange Fund Bills and Notes

13. **The market value of the outstanding EFBNs edged up to HK\$1,190.84 billion during the review period. Holdings of Exchange Fund paper by the banking sector (before Discount Window activities) decreased to HK\$1,140.23 billion (95.7% of total) from HK\$1,142.66 billion (96.2% of total) (Chart 13).**



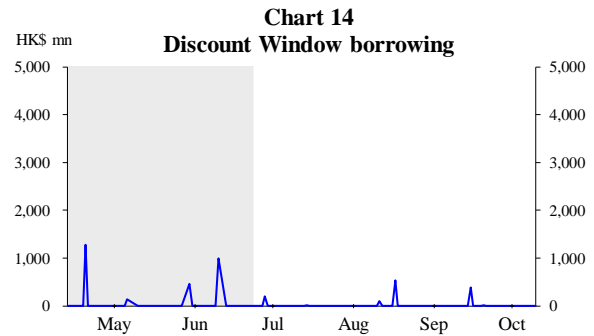
14. During the review period, **interest payments on Exchange Fund paper amounted to HK\$7,664.49 million. A total of HK\$6,915.30 million (in market value) of Exchange Fund paper was issued to absorb these interest payments.** The remaining amount was carried forward in the Aggregate Balance at the 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
(24 Jun 22 – 10 Oct 22)

	No. of issues launched	Over-subscription ratio
1-month EFB	1	2.17
3-month EFB	15	0.67 – 1.51
6-month EFB	15	1.48 – 2.70
12-month EFB	5	2.01 – 5.06
2-year EFN	1	10.95

Discount Window activities

15. During the review period, a total of **HK\$1,243 million** was borrowed from the Discount Window, compared with HK\$2,870 million in the preceding review period from 13 April 2022 to 23 June 2022 (Chart 14).



Backing Portfolio

16. The Backing Assets decreased to HK\$2,122.28 billion on 10 October 2022. **The Backing Ratio increased marginally from 110.04% to 110.18% 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.

