

EXCHANGE FUND ADVISORY COMMITTEE

Currency Board Sub-Committee

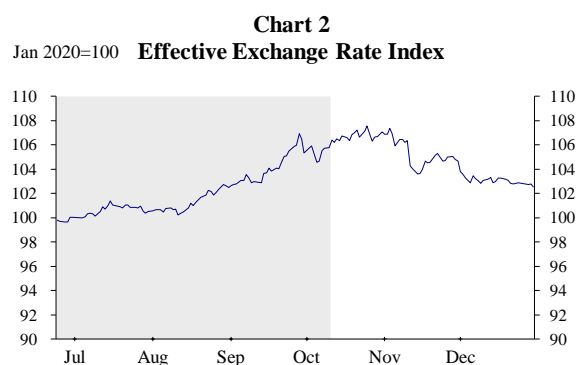
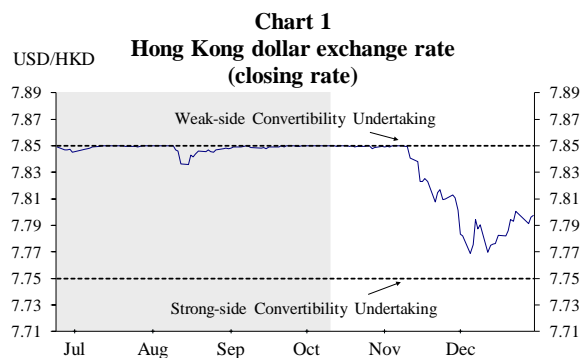
Report on Currency Board Operations

Review period: 11 October 2022 – 30 December 2022

During the review period, the Hong Kong dollar (HKD) traded within a range of 7.7687 – 7.8499 against the US dollar (USD). The HKD stayed close to the weak-side Convertibility Undertaking (CU) in October and early November, and the weak-side CU was triggered multiple times during the period. With the HKMA buying HK\$23.12 billion under the weak-side CU, the Aggregate Balance fell correspondingly to around HK\$96 billion. Since mid-November, the HKD has strengthened as the demand for HKD has increased amid stronger local equity market activities and seasonal year-end funding demand. Alongside the increase in the HKD interbank interest rates, of which the 1-month HIBOR rose to 4.3% after temporarily rising above 5.0%, the negative spreads of the HKD interbank interest rates over its USD counterparts first turned positive at the longer tenors before narrowing to close at around zero. Meanwhile, many banks raised their Best Lending Rates by 25 basis points in early November and another 25 basis points in mid-December, following the increases in the US federal funds target range in November and December. Throughout the review period, the Monetary Base remained fully backed by US dollar foreign reserves, and all changes in the Monetary Base were fully matched by corresponding changes in US dollar foreign reserves in accordance with Currency Board principles.

Hong Kong dollar exchange rate

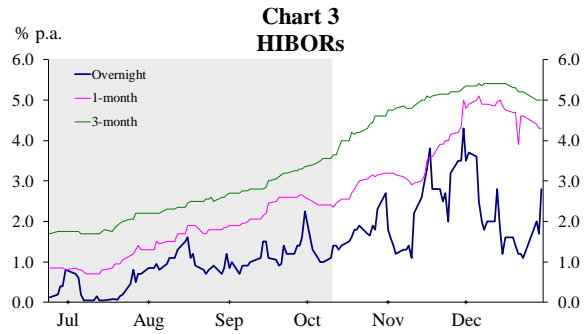
1. During the review period of 11 October 2022 to 30 December 2022, the HKD traded within a range of 7.7687 – 7.8499 (closing rate) against the USD (Chart 1).¹ The Hong Kong dollar (HKD) stayed close to the weak-side Convertibility Undertaking (CU) in October and early November, and the weak-side CU was triggered 7 times from 11 October to 8 November, with the HKMA buying HK\$23.12 billion under the weak-side CU. Since mid-November, the HKD has strengthened as the demand for HKD has increased amid stronger local equity market activities and seasonal year-end funding demand. Overall, the HKD continued to trade in a smooth and orderly manner during the review period, closing at 7.7976 on 30 December. Meanwhile, the nominal effective exchange rate index of the HKD decreased during the review period, mainly reflecting the depreciation of the HKD alongside the USD depreciation against the currencies of the major trading partners of Hong Kong (Chart 2).



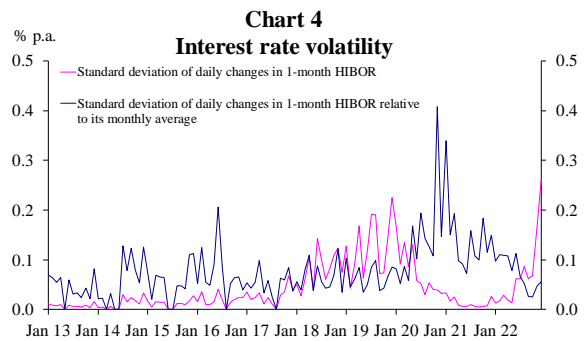
¹ In this report, daily time series charts also cover developments in the preceding review period (as shown in shaded region) for reference and comparison.

Interest rates

2. The HKD interbank market continued to trade in a smooth and orderly manner. With the expectation of further US rate hikes, stronger local equity market activities and seasonal year-end funding demand, **the 1-month and 3-month HIBORs increased** by 195 and 135 basis points to 4.30% and 5.00% respectively during the review period (Chart 3). Meanwhile, **the overnight HIBOR witnessed more fluctuations**, closing at 2.80% at the end of review period.

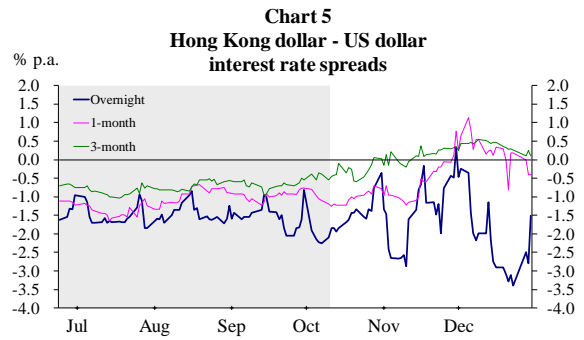


3. **Interest rate volatility**, measured by the standard deviation of daily changes in the 1-month HIBOR, **increased** to 19 basis points (or 0.19%) in the current review period from 7 basis points (or 0.07%) in the preceding review period (Chart 4). Meanwhile, the standard deviation as a ratio of the average of the 1-month HIBOR hovered at a relatively low level.²

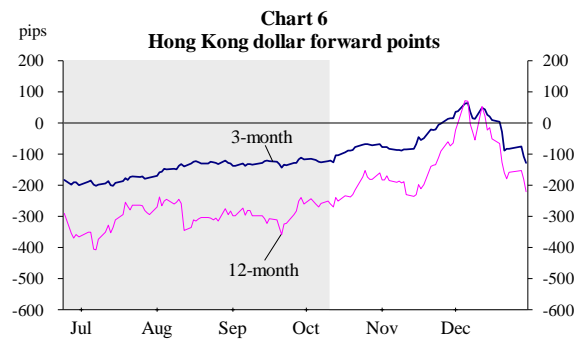


² The ratio of the standard deviation of daily changes in the 1-month HIBOR to its monthly average measures the extent of interest rate fluctuations relative to the average level of interest rates.

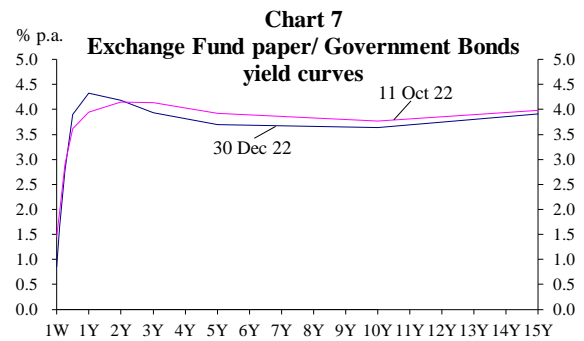
4. The HKD-USD interbank interest rate negative spreads at the longer tenors (1-month and 3 month) first turned positive before narrowing to close at around zero at the end of the review period (Chart 5). The 1-month and 3-month spreads closed at -40 and 10 basis points respectively at the end of the review period. On the other hand, the overnight spread showed more fluctuations and narrowed to -151 basis points at the end of the review period.



5. Roughly tracking the HKD-USD interbank interest rate spreads, both the 3-month and 12-month forward discounts had briefly turned to premia in early-December, before reverting to the negative territory to -127 pips and -220 pips respectively at the end of the review period (Chart 6).

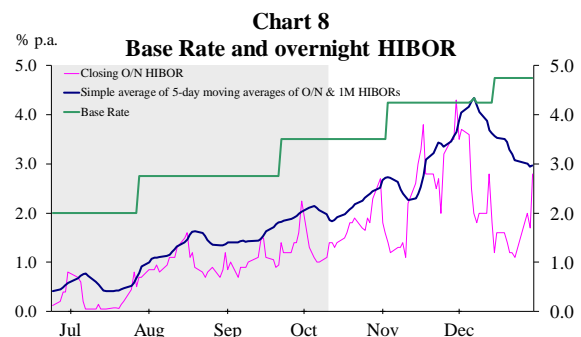


6. During the review period, HKD yields rose slightly at the shorter-end while shifting slightly downwards at the longer-end (Chart 7). The yield of the 1-year Exchange Fund Bill increased by 38 basis points to 4.32%, while the yield of 10-year Hong Kong Government Bond decreased by 14 basis points to 3.63%. The negative HKD-USD yield spreads generally widened (Table 1).

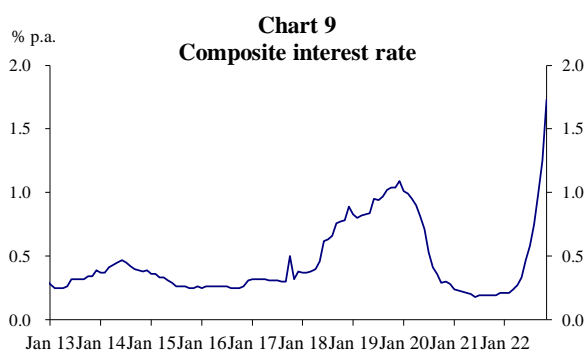


7. Following the increase in the US federal funds target range from 3.00% – 3.25% to 3.75% – 4.00% on 2 November 2022 (US time), the HKMA Base Rate increased from 3.50% to 4.25% on 3 November (Chart 8). In early December, the HIBOR leg of the Base Rate formula was higher than the US federal funds target rate leg for two days and the Base Rate went slightly higher in these two days. The Base Rate was set at 4.75% on 15 December after another increase in the US federal funds target range to 4.25% – 4.50% on 14 December (US time). 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.

	11 Oct 22	30 Dec 22
3-month EFB	-77	-164
12-month EFB	-34	-41
3-year HKGB	-17	-29
5-year HKGB	-22	-29
10-year HKGB	-16	-25



8. During the review period, **many banks raised their Best Lending Rates by 25 basis points in early November and another 25 basis points in mid-December.** At the end of the review period, the Best Lending Rates in the market ranged from 5.625% – 6.125%. The average interest rate for newly approved mortgage loans increased from 2.75% in September 2022 to 3.09% in November 2022. Meanwhile, the average 1-month HKD time deposit board rate offered by retail banks slightly increased from 0.07% to 0.23% at the end of the review period.³ **The composite interest rate,**⁴ which indicates the average funding cost of retail banks, **increased** from 0.99% at the end of September 2022 to 1.73% at the end of November 2022 (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.

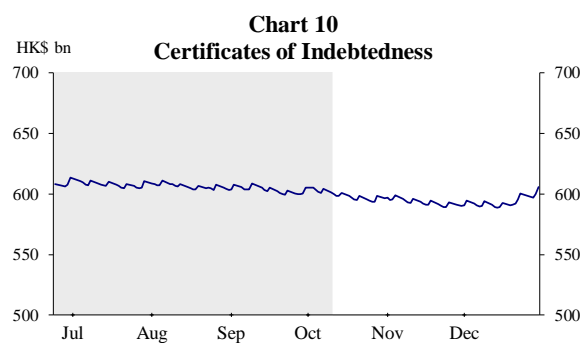
Monetary Base

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), **decreased to HK\$1,916.17 billion on 30 December 2022 from HK\$1,923.15 billion on 11 October 2022** (Table 2). Movements of the individual components are discussed below.

(HK\$bn)	11 Oct 22	30 Dec 22
CIs	599.79	605.58
Government-issued Currency Notes and Coins in Circulation	13.12	13.40
Aggregate Balance	119.32	96.25
Outstanding EFBNs	1,190.92	1,200.94
Monetary Base	1,923.15	1,916.17

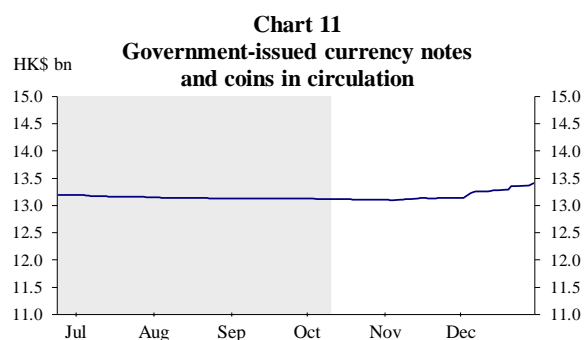
Certificates of Indebtedness

10. During the review period, the note-issuing banks submitted a net amount of US\$742.3 million to the HKMA in exchange for HK\$5.79 billion worth of CIs. As a result, **the outstanding CIs increased to HK\$605.58 billion on 30 December 2022 from HK\$599.79 billion on 11 October 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 up** from HK\$13.12 billion to HK\$13.40 billion (Chart 11).



Aggregate Balance

12. **The Aggregate Balance declined from HK\$119.32 billion to HK\$96.25 billion during the review period** (Chart 12) owing to the triggering of the weak-side CU between 11 October and 8 November (Table 3).⁵ 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.

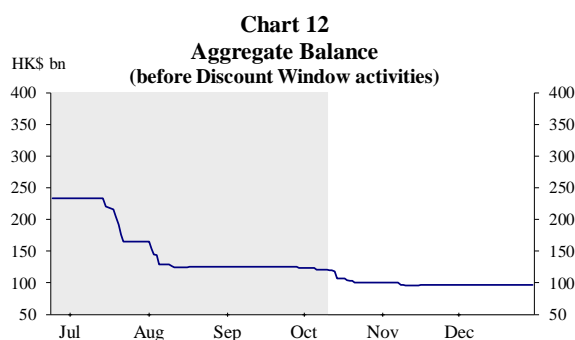


Table 3
HKMA HK\$/US\$ FX Transactions
(11 Oct 22 – 30 Dec 22)

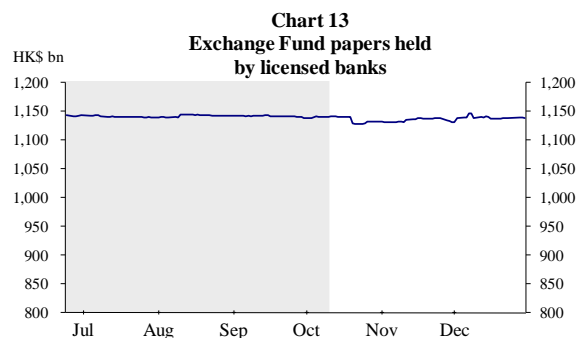
Trade Date	Net purchase of HK\$ (HK\$m)
11-Oct-22	1,021
12-Oct-22	11,697
14-Oct-22	2,591
17-Oct-22	785
19-Oct-22	3,062
04-Nov-22	3,054
08-Nov-22	911
Total	23,118

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

⁵ 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\$242.08 billion under the weak-side CU.

Outstanding Exchange Fund Bills and Notes

13. **The market value of the outstanding EFBNs edged up to HK\$1,200.94 billion during the review period. Holdings of Exchange Fund papers by the banking sector (before Discount Window activities) decreased to HK\$1,137.52 billion (94.7% of total) from HK\$1,140.89 billion (95.8% of total) (Chart 13).**



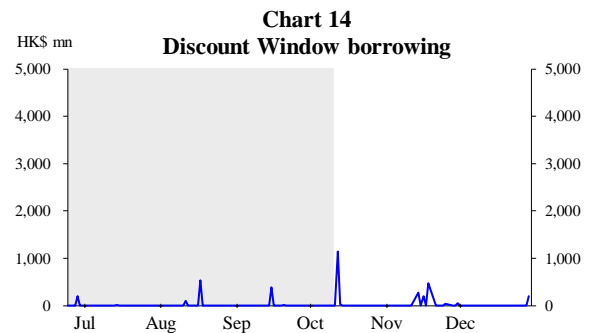
14. During the review period, **interest payments on Exchange Fund papers amounted to HK\$10,215.22 million. A total of HK\$10,168.87 million (in market value) of Exchange Fund papers were issued to absorb these interest payments.** The remaining amount was carried forward in the Aggregate Balance at the end of the review period. The Exchange Fund papers issued during the review period were generally well received by the market (Table 4).

Table 4
Issuance of Exchange Fund Bills and Notes
(11 Oct 22 – 30 Dec 22)

	No. of issues launched	Over-subscription ratio
1-month EFB	1	1.29
3-month EFB	12	0.54 – 2.22
6-month EFB	12	1.52 – 3.89
12-month EFB	3	2.83 – 13.55
2-year EFN	1	7.44

Discount Window activities

15. During the review period, a total of **HK\$2,380 million** was borrowed from the Discount Window, compared with HK\$1,243 million in the preceding review period from 24 June 2022 to 10 October 2022 (Chart 14).



Backing Portfolio

16. The Backing Assets decreased to HK\$2,101.72 billion on 29 December 2022. **The Backing Ratio decreased marginally from 110.18% to 110.01% 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.

