

EXCHANGE FUND ADVISORY COMMITTEE

Currency Board Sub-Committee

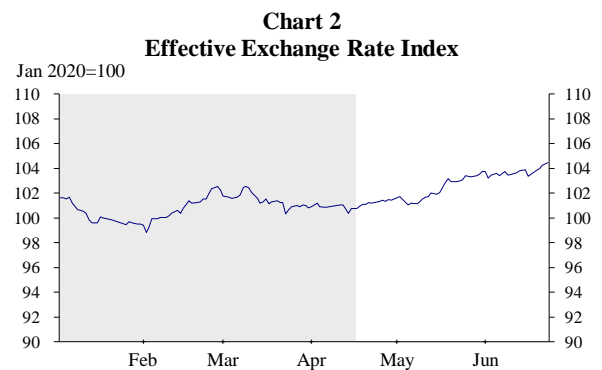
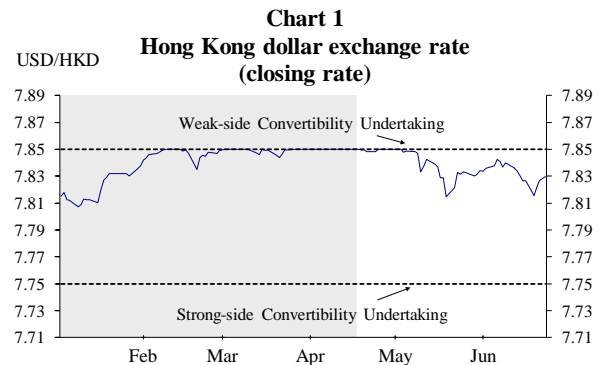
Report on Currency Board Operations

Review period: 18 April 2023 – 23 June 2023

During the review period, the Hong Kong dollar (HKD) traded within a range of 7.8148 – 7.8500 against the US dollar (USD). The HKD stayed close to the weak-side Convertibility Undertaking (CU) between mid-April and early May, and the weak-side Convertibility Undertaking (CU) was triggered twice during the period. The HKD exchange rate has strengthened since early May, mainly driven by dividend payment-related demand from listed companies and half-year-end funding needs by corporates. With the HKMA buying HK\$11.59 billion under the weak-side CU, the Aggregate Balance fell correspondingly to around HK\$45 billion. Amid the reduction in the Aggregate Balance, HKD interbank rates picked up and the negative spreads against their USD counterparts generally narrowed in the review period. Overall, the HKD interbank market continued to trade in a smooth and orderly manner. Following the increase in the target range for the US federal funds rate on 3 May 2023, many banks raised their Best Lending Rates by 12.5 basis points, and the Best Lending Rates in the market ranged from 5.750% – 6.250%. 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

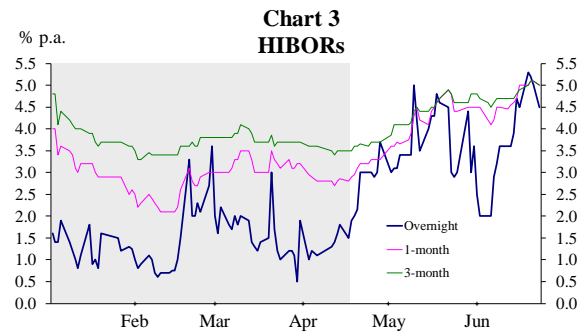
1. During the review period of 18 April 2023 to 23 June 2023, the **HKD traded within a range of 7.8148 – 7.8500 against the USD** (Chart 1).¹ The HKD stayed close to the weak-side Convertibility Undertaking (CU) between mid-April and early May, and the weak-side CU was triggered twice, with the HKMA buying HK\$11.59 billion under the weak-side CU. The HKD exchange rate has strengthened since early May, mainly driven by dividend payment-related demand from listed companies and half-year-end funding needs by corporates. Overall, the HKD continued to trade in a smooth and orderly manner during the review period, closing at 7.8295 on 23 June. The nominal effective exchange rate index of the HKD increased compared with the end of the preceding review period (Chart 2). This mainly reflected the movement of the USD against the currencies of the major trading partners of Hong Kong.



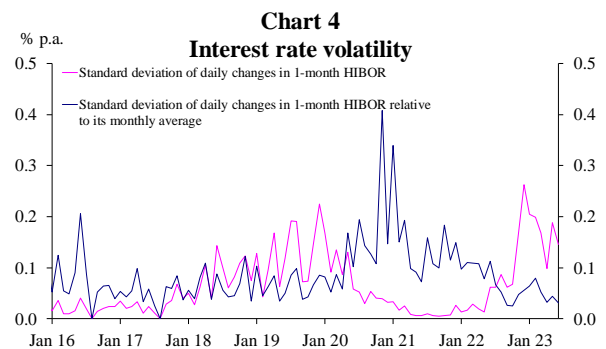
¹ In this report, daily time series charts also cover developments in the preceding review period (as shown in shaded region) for reference and comparison.

Interest rates

2. The HKD interbank market continued to trade in a smooth and orderly manner. During the review period, partly reflecting the reduction in the Aggregate Balance, **the 1-month and 3-month HKD interbank rates (HIBORs) increased** by 210 and 150 basis points respectively, with both interest rates closing at 5.00% at the end of the review period (Chart 3). Meanwhile, **the overnight HIBOR was sensitive to liquidity condition** amid the reduction in the Aggregate Balance. It closed at 4.50% at the end of the review period.

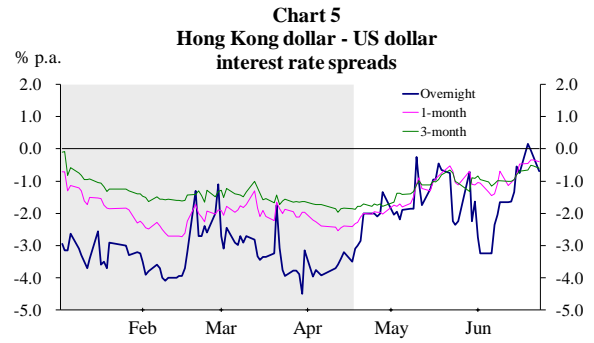


3. **Interest rate volatility**, measured by the standard deviation of daily changes in the 1-month HIBOR, **decreased** to 15 basis points (or 0.15%) in the current review period from 19 basis points (or 0.19%) in the preceding review period (Chart 4). Meanwhile, the standard deviation as a ratio of the average of the 1-month HIBOR hovered at a relatively low level.²

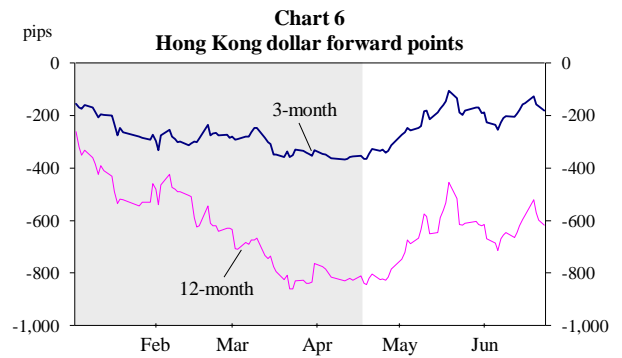


² The ratio of the standard deviation of daily changes in the 1-month HIBOR to its monthly average measures the extent of interest rate fluctuations relative to the average level of interest rates.

4. **The negative spreads of the HKD-USD interbank interest rate generally narrowed during the review period (Chart 5).** The overnight, 1-month and 3-month spreads closed at -70, -40 and -61 basis points respectively 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 narrowed,** closing at 180 pips and 618 pips respectively at the end of the review period (Chart 6).



6. During the review period, **HKD yields shifted upward** (Chart 7). The yield of the 1-year Exchange Fund Bill increased by 98 basis points to 4.24% at the end of the review period, and that of the 10-year Hong Kong Government Bond increased by 40 basis points to 3.60%. The negative HKD-USD yield spreads generally narrowed across tenors (Table 1).

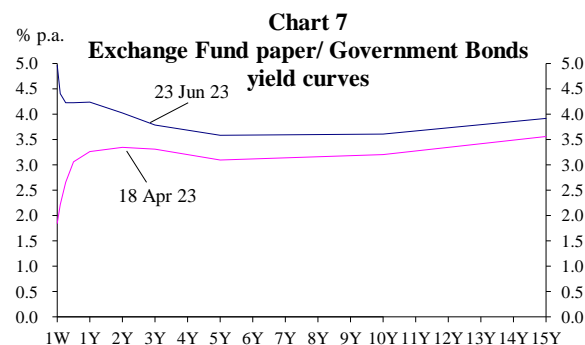
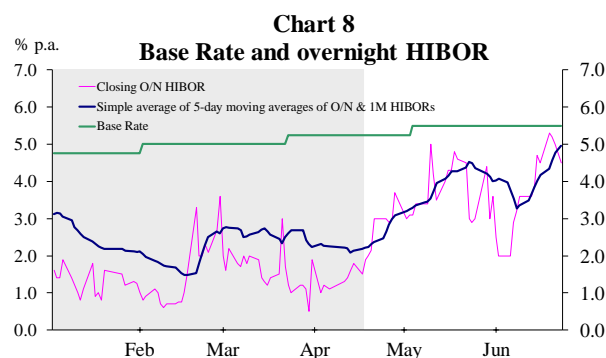


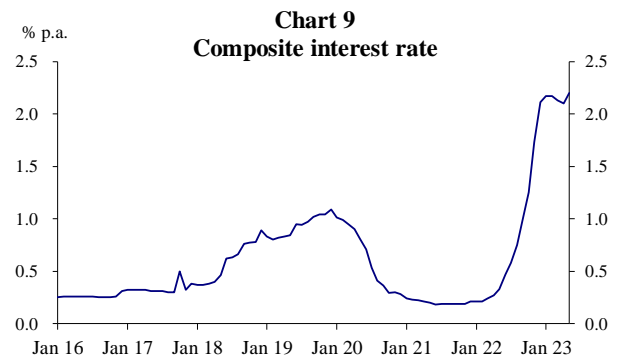
Table 1
Yield spreads of Exchange Fund papers and Hong Kong Government Bonds over US Treasuries (basis points)

	18 Apr 23	23 Jun 23
3-month EFB	-254	-119
12-month EFB	-155	-101
3-year HKGB	-62	-54
5-year HKGB	-59	-41
10-year HKGB	-38	-14

7. Following the increase in the US federal funds target range from 4.75% – 5.00% to 5.00% – 5.25% on 3 May 2023 (US time), **the HKMA Base Rate increased from 5.25% to 5.50% on 4 May 2023** (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.



8. Following the increase in the target range for the US federal funds rate on 3 May 2023, **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 5.750% – 6.250%. The average interest rate for newly approved mortgage loans edged up from 3.53% in March 2023 to 3.54% in May 2023. Meanwhile, the average 1-month HKD time deposit board rate offered by retail banks increased from 0.41% to 0.49% at the end of the review period.³ **The composite interest rate**,⁴ which indicates the average funding cost of retail banks, **increased** from 2.13% at the end of March 2023 to 2.20% at the end of May 2023 (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.

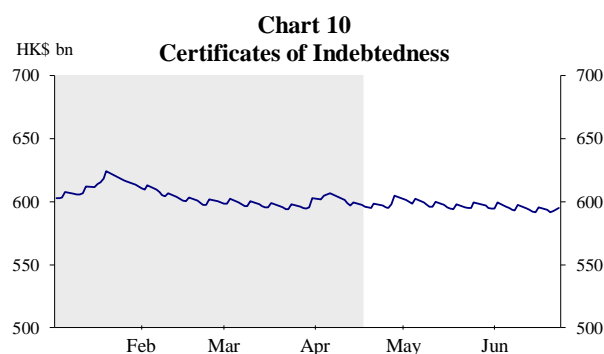
Monetary Base

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\$1,869.35 billion on 23 June 2023 from HK\$1,877.64 billion on 18 April 2023** (Table 2). Movements of the individual components are discussed below.

(HK\$bn)	18 Apr 23	23 Jun 23
CIs	596.00	594.93
Government-issued Currency Notes and Coins in Circulation	13.17	13.08
Aggregate Balance	56.26	44.70
Outstanding EFBNs	1,212.21	1,216.64
Monetary Base	1,877.64	1,869.35

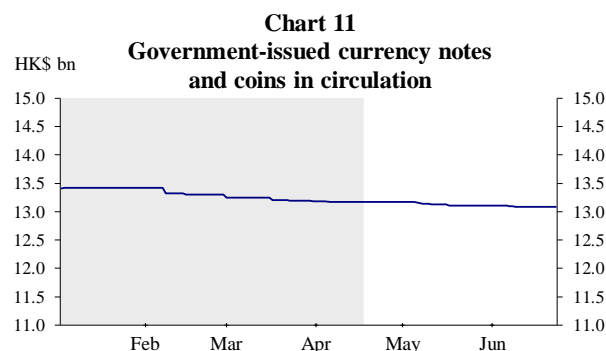
Certificates of Indebtedness

10. During the review period, the note-issuing banks redeemed HK\$1.07 billion worth of CIs from the HKMA in exchange for a net amount of US\$137.2 million. As a result, **the outstanding CIs decreased to HK\$594.93 billion on 23 June 2023 from HK\$596.00 billion on 18 April 2023** (Chart 10).



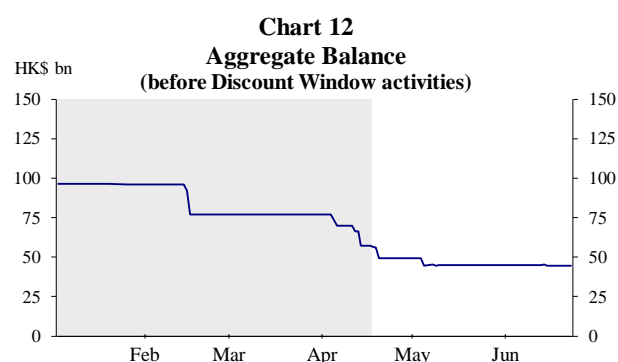
Government-issued currency notes and coins in circulation

11. During the review period, the amount of **government-issued currency notes and coins in circulation edged down** from HK\$13.17 billion to HK\$13.08 billion (Chart 11).



Aggregate Balance

12. **The Aggregate Balance declined from HK\$56.26 billion to HK\$44.70 billion during the review period** (Chart 12) owing to the triggering of the weak-side CU in mid-April and early May (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.



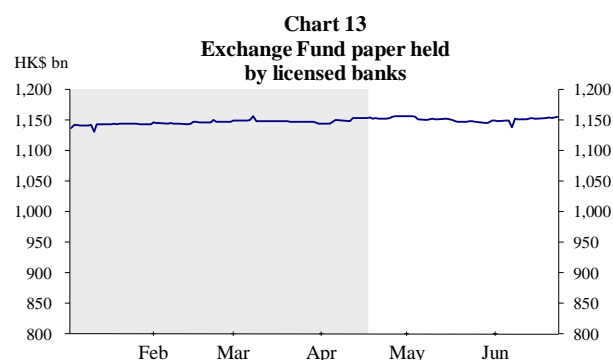
Trade Date	Net purchase of HK\$ (HK\$m)
18-Apr-23	6,916
3-May-23	4,671
Total	11,587

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\$293.62 billion under the weak-side CU.

Outstanding Exchange Fund Bills and Notes

13. **The market value of the outstanding EFBNs increased to HK\$1,216.64 billion during the review period. Holdings of Exchange Fund papers by the banking sector (before Discount Window activities) increased to HK\$1,154.94 billion (94.9% of total) from HK\$1,154.09 billion (95.2% of total) (Chart 13).**



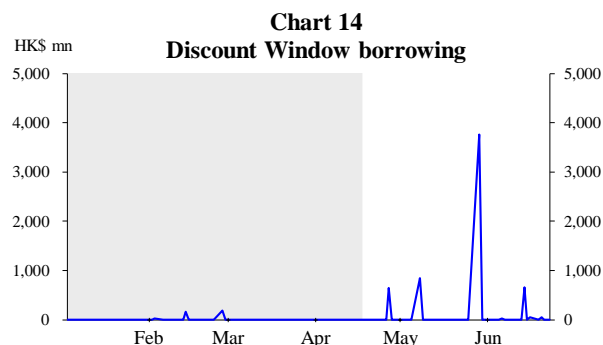
14. During the review period, **interest payments on Exchange Fund papers amounted to HK\$8,174.03 million. A total of HK\$8,182.43 million (in market value) of Exchange Fund papers were issued to absorb these interest payments.** The Exchange Fund papers issued during the review period were generally well received by the market (Table 4).

Table 4
Issuance of Exchange Fund Bills and Notes
(18 Apr 23 – 23 Jun 23)

	No. of issues launched	Over-subscription ratio
1-month EFB	4	3.77 – 5.58
3-month EFB	10	0.77 – 1.61
6-month EFB	10	1.13 – 4.44
12-month EFB	2	5.86 – 6.61
2-year EFN	1	5.47

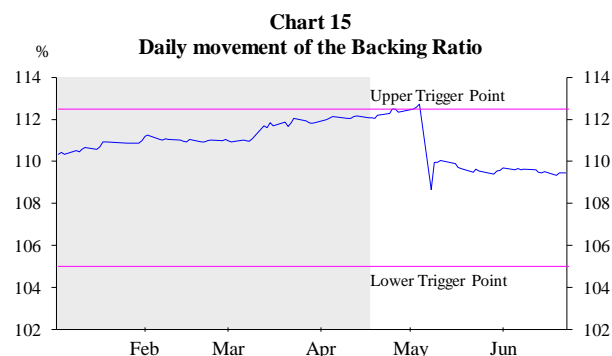
Discount Window activities

15. During the review period, a total of **HK\$6,026 million** was borrowed from the Discount Window, compared with HK\$377 million in the preceding review period from 31 December 2022 to 17 April 2023 (Chart 14). Amid the reduction in the Aggregate Balance, more usage of the Discount Window by banks was expected. No abnormality was noted in the relevant usage.



Backing Portfolio

16. The Backing Assets decreased to HK\$2,043.73 billion on 22 June 2023. **The Backing Ratio decreased from 112.09% to 109.45% during the review period** (Chart 15). On 3 May and 4 May 2023, the Backing Ratio reached the upper trigger point of 112.5% and assets were transferred from the Backing Portfolio to the Investment Portfolio and the Backing Ratio was brought down to around 110.0%.⁶ Under the Linked Exchange Rate System, while specific Exchange Fund assets have been designated for the



⁶ The Backing Ratio should be maintained between 105% and 112.5%. When the Backing Ratio reaches 112.5% (the upper trigger point), assets will be transferred out of the Backing Portfolio to the Investment Portfolio of the Exchange Fund assets to reduce the ratio to 110%. Conversely, should the ratio drop to 105% (the lower trigger point), assets will be injected from the Investment Portfolio to restore it to 107.5%. This arrangement enables a higher investment return on excess assets while ensuring sufficient liquid assets in the Backing Portfolio.

Backing Portfolio, all Exchange Fund assets are available to support the HKD exchange rate.

Hong Kong Monetary Authority
14 August 2023