

## **EXCHANGE FUND ADVISORY COMMITTEE**

### **Currency Board Sub-Committee**

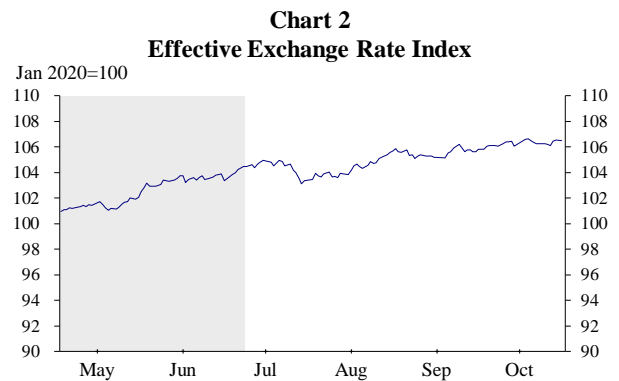
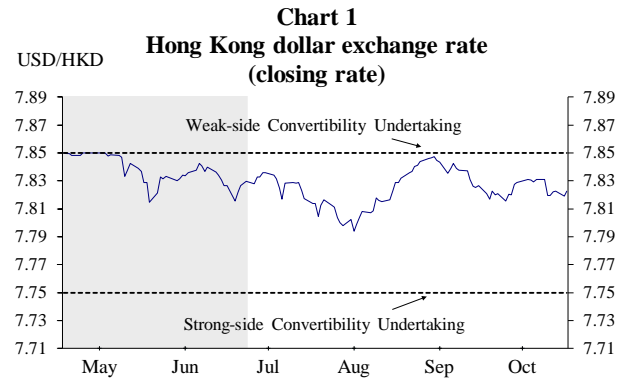
#### **Report on Currency Board Operations**

**Review period: 24 June 2023 – 17 October 2023**

During the review period, the Hong Kong dollar (HKD) traded within a range of 7.7940 – 7.8474 against the US dollar (USD). The HKD exchange rate strengthened during late June to end of July, mainly reflecting seasonal corporate funding needs. The HKD softened in August alongside weak equity market activities and sentiments before rebounding since early September amid quarter-end seasonal demand and net buying flows through Southbound Stock Connect. Amid market expectation of a “high for longer” US policy rate, HKD interbank rates continued to track the USD rates while also affected by local supply and demand. 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 26 July 2023, many banks raised their Best Lending Rates by 12.5 basis points, and the Best Lending Rates in the market ranged from 5.875% – 6.375%. The Convertibility Undertakings were not triggered and the Aggregate Balance was little changed at around HK\$45.05 billion. No abnormality was noted in the usage of the Discount Window. 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

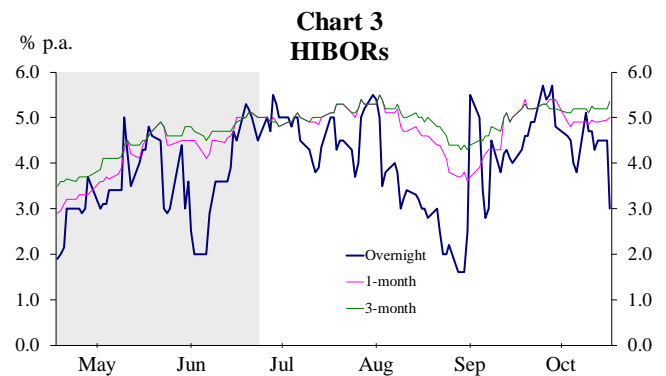
1. During the review period of 24 June 2023 to 17 October 2023, **the HKD traded within a range of 7.7940 – 7.8474 against the USD** (Chart 1).<sup>1</sup> The HKD exchange rate strengthened during late June to end of July, mainly driven by seasonal corporate funding needs. The HKD softened in August alongside weak equity market activities and sentiments before rebounding since early September amid quarter-end seasonal demand and net buying flows through Southbound Stock Connect. Overall, the HKD continued to trade in a smooth and orderly manner during the review period, closing at 7.8225 on 17 October. 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.



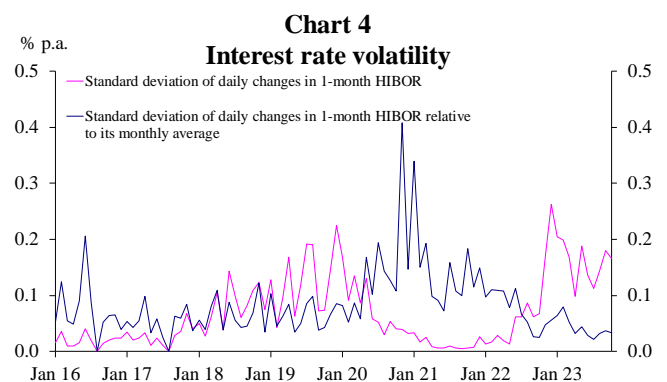
<sup>1</sup> In this report, daily time series charts also cover developments in the preceding review period (as shown in shaded region) for reference and comparison.

## Interest rates

2. The HKD interbank market continued to trade in a smooth and orderly manner. Amid market expectation of a “high for longer” US policy rate, the 1-month and 3-month HKD interbank rates (HIBORs) continued to track the USD rates while also affected by local supply and demand. For the review period as a whole, **the 1-month HIBOR was virtually unchanged at 5.00% whereas the 3-month HIBOR increased by 35 basis points to close at 5.35% respectively at the end of the review period** (Chart 3). Meanwhile, **the overnight HIBOR was sensitive to liquidity condition**. It closed at 3.00% at the end of the review period.

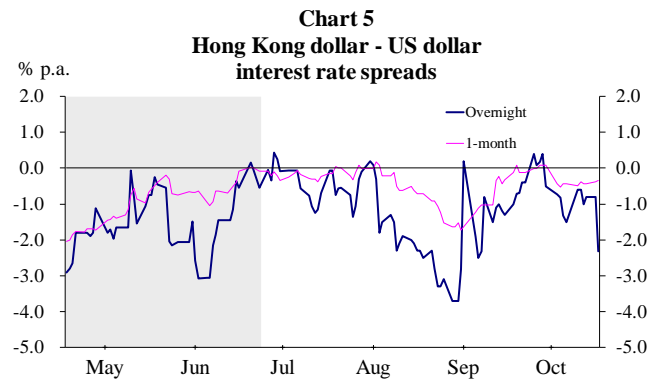


3. **Interest rate volatility**, measured by the standard deviation of daily changes in the 1-month HIBOR, **increased** to 16 basis points (or 0.16%) in the current review period from 15 basis points (or 0.15%) in the preceding review period (Chart 4). Meanwhile, the standard deviation as a ratio of the average of the 1-month HIBOR hovered at a relatively low level.<sup>2</sup>

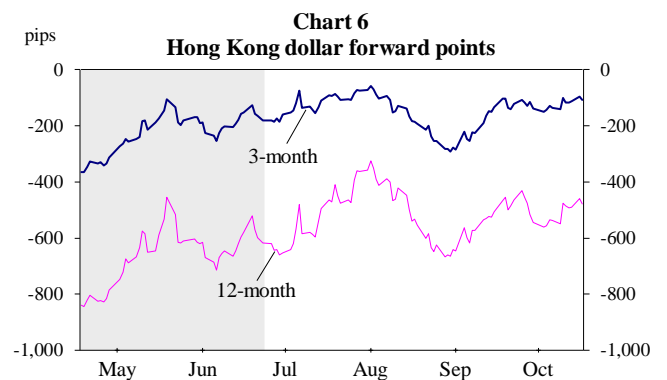


<sup>2</sup> The ratio of the standard deviation of daily changes in the 1-month HIBOR to its monthly average measures the extent of interest rate fluctuations relative to the average level of interest rates.

4. **The spreads of the HKD-USD interest rate widened in the negative territory in August before narrowing again since early September (Chart 5).**<sup>3</sup> The overnight and 1-month spreads closed at -231 and -33 basis points respectively at the end of the review period.

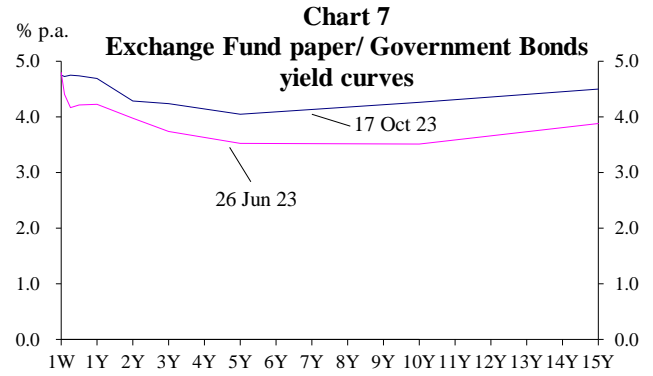


5. Roughly tracking the HKD-USD interbank interest rate spreads, **both the 3-month and 12-month forward discounts narrowed, closing at 108 pips and 478 pips respectively at the end of the review period (Chart 6).**



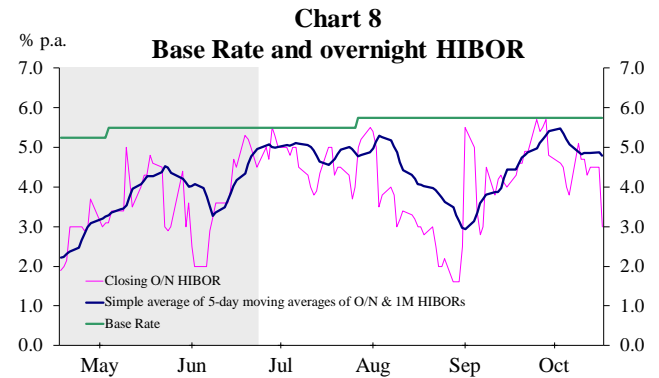
<sup>3</sup> The USD London Interbank Offered Rate (LIBOR) has been discontinued since 1 July 2023 and replaced by the Secured Overnight Financing Rate (SOFR) as its alternative reference rate.

6. During the review period, **HKD yields shifted upward** (Chart 7). The yield of the 1-year Exchange Fund Bill increased by 47 basis points to 4.69% at the end of the review period, and that of the 10-year Hong Kong Government Bond increased by 75 basis points to 4.26%. The negative HKD-USD yield spreads generally narrowed at the shorter tenors but widened at the longer tenors (Table 1).

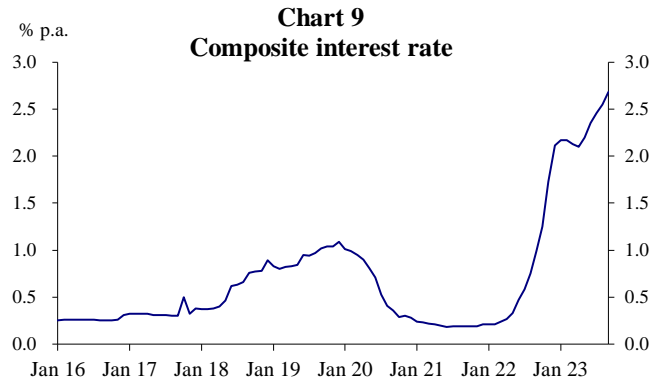


	26 Jun 23	17 Oct 23
3-month EFB	-133	-87
12-month EFB	-105	-79
3-year HKGB	-56	-78
5-year HKGB	-44	-81
10-year HKGB	-21	-57

7. Following the increase in the US federal funds target range from 5.00% – 5.25% to 5.25% – 5.50% on 26 July 2023 (US time), **the HKMA Base Rate increased from 5.50% to 5.75% on 27 July 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 26 July 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 5.875% – 6.375%. The average interest rate for newly approved mortgage loans increased from 3.56% in June 2023 to 3.68% in August 2023. Meanwhile, the average 1-month HKD time deposit board rate offered by retail banks increased from 0.49% to 0.57% at the end of the review period.<sup>4</sup> **The composite interest rate,**<sup>5</sup> which indicates the average funding cost of retail banks, **increased** from 2.35% at the end of June 2023 to 2.68% at the end of September 2023 (Chart 9).



<sup>4</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>5</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.

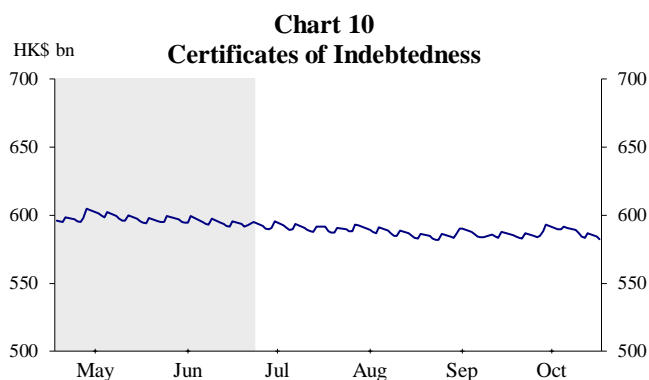
## Monetary Base

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), **increased to HK\$1,872.80 billion on 17 October 2023 from HK\$1,867.07 billion on 26 June 2023** (Table 2). Movements of the individual components are discussed below.

(HK\$bn)	26 Jun 23	17 Oct 23
CIs	592.01	582.56
Government-issued Currency Notes and Coins in Circulation	13.08	13.08
Aggregate Balance	44.70	45.05
Outstanding EFBNs	1,217.29	1,232.12
<b>Monetary Base</b>	<b>1,867.07</b>	<b>1,872.80</b>

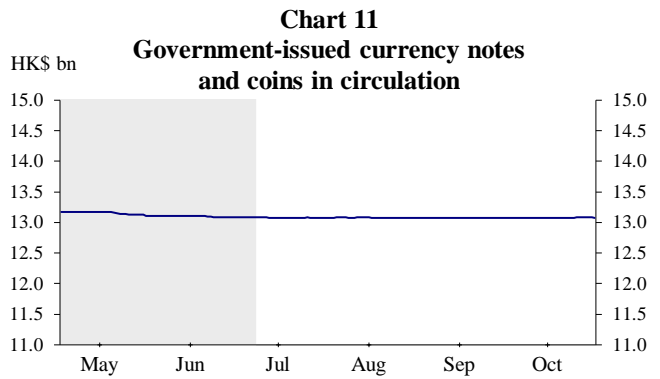
### *Certificates of Indebtedness*

10. During the review period, the note-issuing banks redeemed HK\$9.45 billion worth of CIs from the HKMA in exchange for a net amount of US\$1.21 billion. As a result, **the outstanding CIs decreased to HK\$582.56 billion on 17 October 2023 from HK\$592.01 billion on 26 June 2023** (Chart 10).



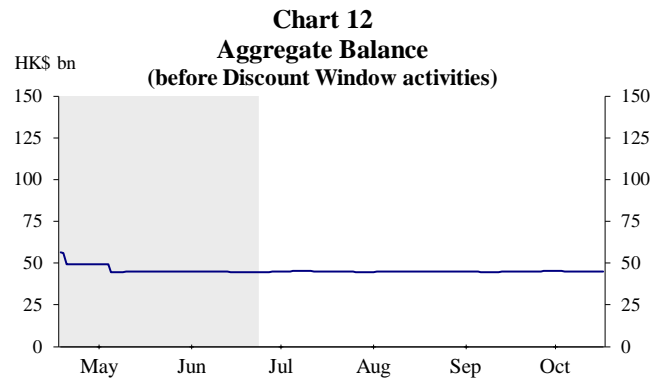
*Government-issued currency notes and coins in circulation*

11. During the review period, the amount of **government-issued currency notes and coins in circulation** were **virtually unchanged** at HK\$13.08 billion (Chart 11).



*Aggregate Balance*

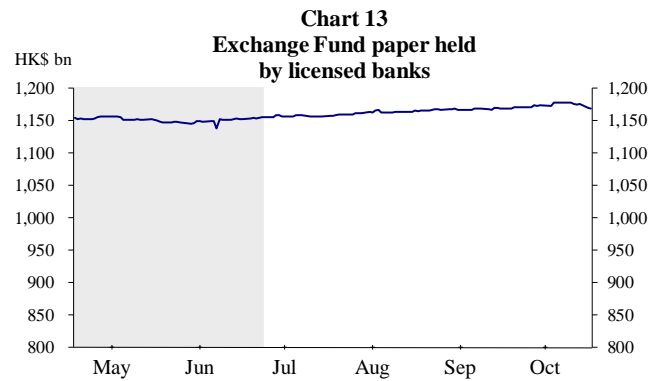
12. During the review period, the Convertibility Undertakings were not triggered and **the Aggregate Balance** was **little changed** at **around HK\$45.05 billion** (Chart 12).





*Outstanding Exchange Fund Bills and Notes*

13. **The market value of the outstanding EFBNs increased to HK\$1,232.12 billion during the review period. Holdings of Exchange Fund papers by the banking sector (before Discount Window activities) increased to HK\$1,169.02 billion (94.9% of total) from HK\$1,155.25 billion (94.9% of total) (Chart 13).**



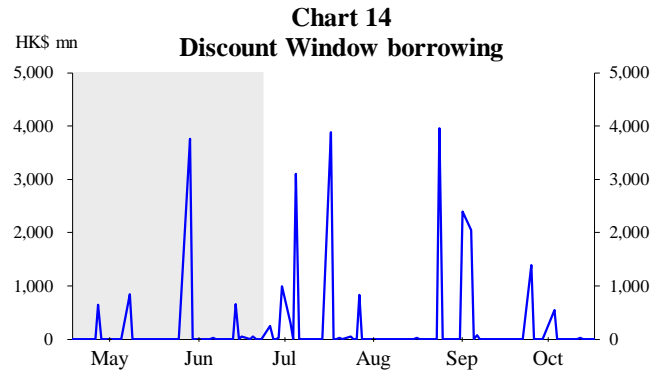
14. During the review period, **interest payments on Exchange Fund papers amounted to HK\$16,735.45 million. A total of HK\$16,437.51 million (in market value) of Exchange Fund papers were issued to absorb these interest payments.** The remaining amount was carried forward in the Aggregate Balance at the end of the review period. The Exchange Fund papers issued during the review period were generally well received by the market (Table 3).

**Table 3**  
**Issuance of Exchange Fund Bills and Notes**  
**(24 Jun 23 – 17 Oct 23)**

	No. of issues launched	Over-subscription ratio
1-month EFB	7	1.00 – 5.83
3-month EFB	17	0.76 – 2.03
6-month EFB	17	1.76 – 4.18
12-month EFB	5	2.57 – 6.79
2-year EFN	1	4.13

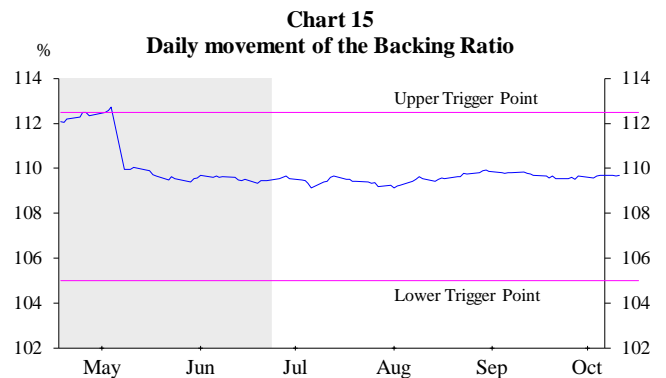
### Discount Window activities

15. During the review period, a total of HK\$19,909 million was borrowed from the Discount Window, compared with HK\$6,026 million in the preceding review period from 18 April 2023 to 23 June 2023 (Chart 14). No abnormality was noted in the relevant usage.



### Backing Portfolio

16. The Backing Assets increased to HK\$2,052.11 billion on 17 October 2023. **The Backing Ratio was virtually unchanged at 109.55% 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**  
**8 December 2023**