

EXCHANGE FUND ADVISORY COMMITTEE

Currency Board Sub-Committee

Report on Currency Board Operations

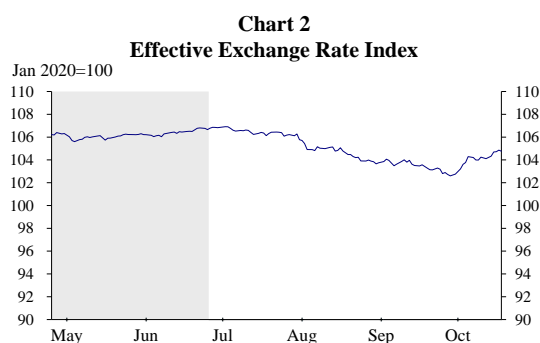
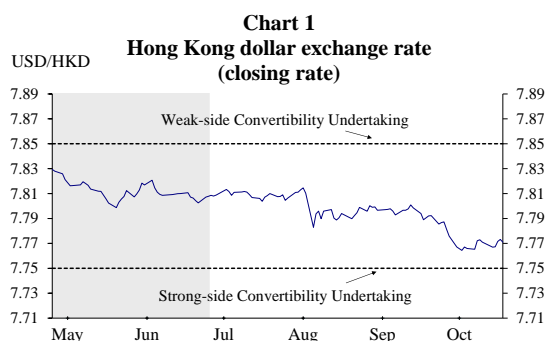
Review period: 26 June – 18 October 2024

During the review period, the Hong Kong dollar (HKD) traded within a range of 7.7644 – 7.8146 against the US dollar (USD). The HKD exchange rate was largely stable between late June and late July. In early August, the HKD strengthened as concerns of a possible US recession and expectation of faster and deeper US Fed rate cuts triggered an unwinding of carry trades and short HKD positions. Sentiment improved in the local stock market following a series of economic stimulus measures announced on the Mainland in late September. Equity-related HKD demand increased, further strengthening the HKD. HKD interbank rates (HIBORs) continued to track the USD rates while also being affected by local supply and demand. Short-term HIBORs tightened in late September due to buoyant equity market and seasonal quarter-end funding demand. In view of the pick-up of payment flows as the capital market turned vibrant, the HKMA has temporarily extended the operating hours of Real-Time Gross Settlement (RTGS) systems for several days as precautionary measures, allowing more time for banks to process payments and manage funding for client flows in late hours. Despite the upswing of capital market activities, HKD interbank market continued to trade in a smooth and orderly manner. Meanwhile, following the decrease in the target range for the US federal funds rate in mid-September, many banks reduced their Best Lending Rates by 25 basis points, and the Best Lending Rates in the market ranged from 5.625% – 6.125%. The Convertibility Undertakings were not triggered and the Aggregate Balance was stable at around HK\$45 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

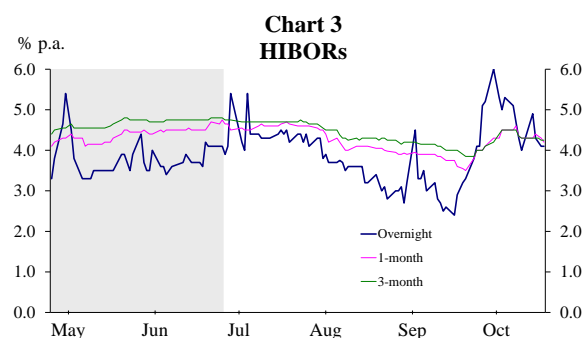
1. During the review period of 26 June to 18 October 2024, the **HKD traded within a range of 7.7644 – 7.8146 against the USD** (Chart 1).¹ The HKD exchange rate was largely stable between late June and late July. In early August, the HKD strengthened as concerns of a possible US recession and expectation of faster and deeper US Fed rate cuts triggered an unwinding of carry trades and short HKD positions. Sentiment improved in the local stock market following a series of economic stimulus measures announced on the Mainland in late September. Equity-related HKD demand increased, further strengthening the HKD. Overall, the HKD continued to trade in a smooth and orderly manner during the review period, closing at 7.7710 on 18 October. The nominal effective exchange rate index of the HKD decreased 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.

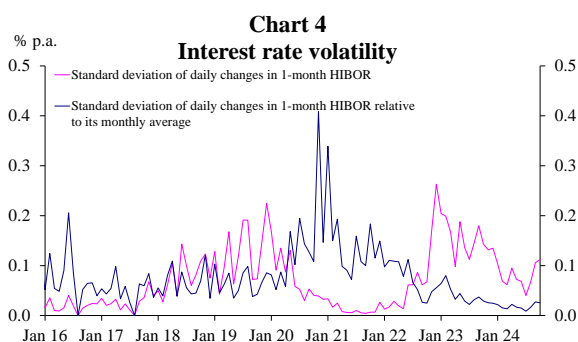
Interest rates

2. The HKD interbank market continued to trade in a smooth and orderly manner. The 1-month and 3-month HIBORs continued to track the USD rates while also being affected by local supply and demand. Short-term HIBORs tightened in late September due to buoyant equity market and seasonal quarter-end funding demand. Hong Kong's equity market turnover surged since late September and recorded its historic high of HK\$446 billion on 27 September, which was overtaken by HK\$506 billion on 30 September and HK\$620 billion on 8 October. These compared with year-to-date average of about HK\$110 billion up until mid-September. In view of the pick-up of payment flows as the capital market turned vibrant, the HKMA has temporarily extended the operating hours of RTGS systems for several days as precautionary measures, allowing more time for banks to process payments and manage funding for client flows in late hours. Despite the upswing of capital market activities, the HKD interbank market continued to trade in a smooth and orderly manner. For the review period as a whole, **the 1-month HIBOR and 3-month HIBOR decreased** by

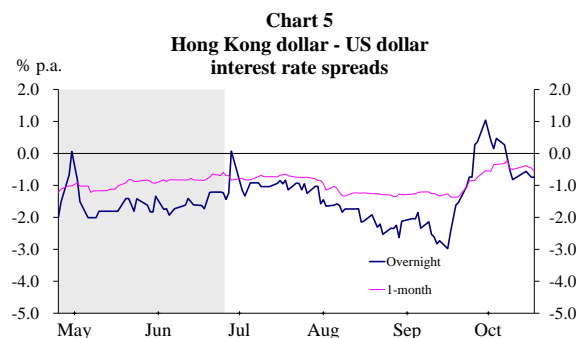


45 basis points and 50 basis points to 4.20% and 4.25% respectively at the end of the review period (Chart 3). Meanwhile, **the overnight HIBOR increased** to 4.10% at the end of the review period.

3. **Interest rate volatility**, measured by the standard deviation of daily changes in the 1-month HIBOR, **increased** to 8 basis points (or 0.08%) 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



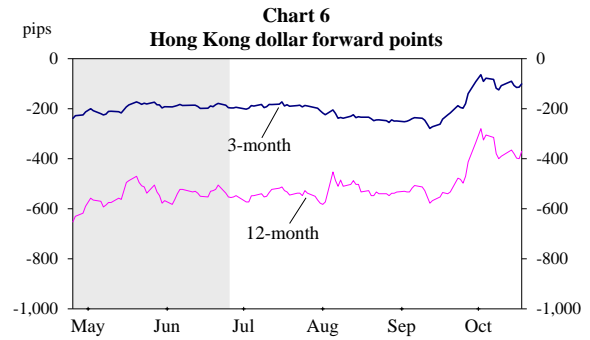
4. **The short-term negative HKD-USD interest rate spreads widened during late June to mid-September and then narrowed**, with the overnight spread once turning positive between late September and early October, and closing at -74 basis points at the end of the review period (Chart 5).³ Meanwhile, the 1-month spread remained negative, closing at -56 basis points .



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.

³ 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.

5. **Both 3-month and 12-month forward discounts narrowed**, closing at 101 pips and 370 pips respectively at the end of the review period. (Chart 6).



6. **During the review period, HKD yield curve shifted downwards** (Chart 7). The yield of the 1-year Exchange Fund Bill decreased by 107 basis points to 3.17% at the end of the review period, and that of the 10-year Hong Kong Government Bond decreased by 47 basis points to 3.02%. While the negative HKD-USD yield spread narrowed at the 3-month tenor, negative yield spreads at other tenors widened. (Table 1).

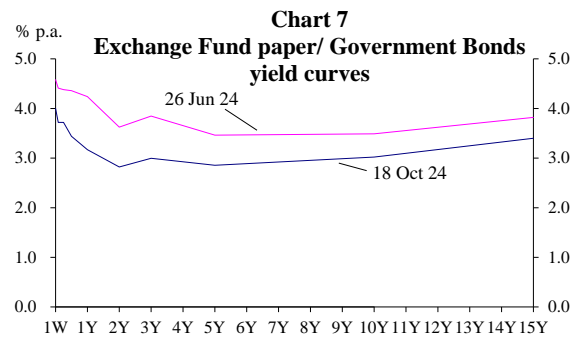
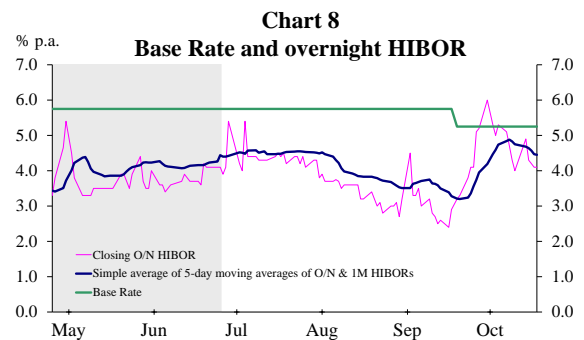


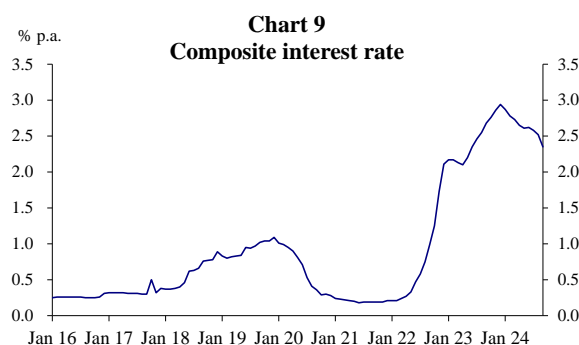
Table 1 Yield spreads of Exchange Fund papers and Hong Kong Government Bonds over US Treasuries (basis points)		
	26 Jun 24	18 Oct 24
3-month EFB	-112	-101
12-month EFB	-89	-102
3-year HKGB	-68	-86
5-year HKGB	-86	-103
10-year HKGB	-83	-106

7. Following the decrease in the US federal funds target range from 5.25% – 5.50% to 4.75% – 5.00% on 18 September 2024 (US time), **the HKMA Base Rate decreased from 5.75% to 5.25% on 19 September 2024** according to the established formula (Chart 8), with the Base Rate 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 decrease in the target range for the US federal funds rate on 18 September 2024 (US time), **many banks reduced their Best Lending Rates by 25 basis points**. 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 remained virtually unchanged at 4.14% between June and August 2024. Meanwhile, the average 1-month HKD time deposit board rate offered by retail banks decreased from 0.57% to 0.51% at the end of the review period.⁴ **The composite interest rate**,⁵ which indicates the average funding cost of retail banks, **decreased** from 2.62% at the end of June 2024 to 2.35% at the end of September 2024 (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.

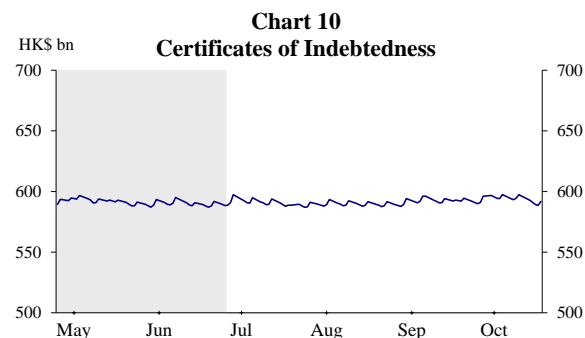
Monetary Base

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), **increased to HK\$1,938.33 billion on 18 October 2024 from HK\$1,917.96 billion on 26 June 2024** (Table 2). Movements of the individual components are discussed below.

Table 2 Monetary Base		
(HK\$bn)	26 Jun 24	18 Oct 24
CIs	588.71	591.84
Government-issued Currency Notes and Coins in Circulation	13.12	13.10
Aggregate Balance	44.96	44.80
Outstanding EFBNs	1,271.17	1,288.60
Monetary Base	1,917.96	1,938.33

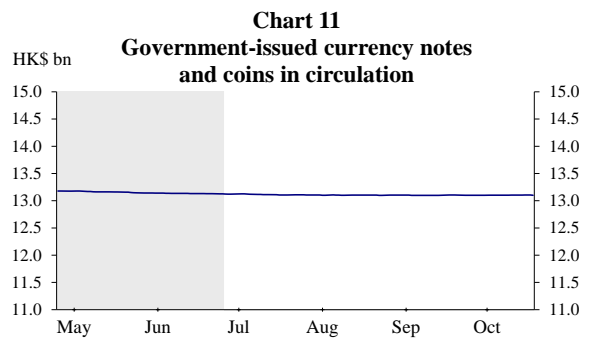
Certificates of Indebtedness

10. During the review period, the note-issuing banks submitted a net amount of US\$0.40 billion to the HKMA in exchange for HK\$3.13 billion worth of CIs. As a result, **the outstanding CIs increased to HK\$591.84 billion on 18 October 2024 from HK\$588.71 billion on 26 June 2024** (Chart 10).



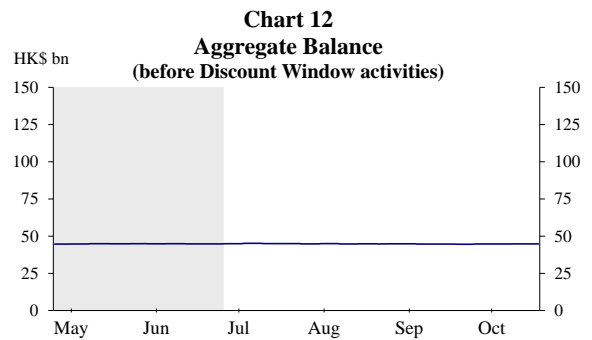
Government-issued currency notes and coins in circulation

11. During the review period, the amount of **government-issued currency notes and coins in circulation** were little changed at HK\$13.10 billion (Chart 11).



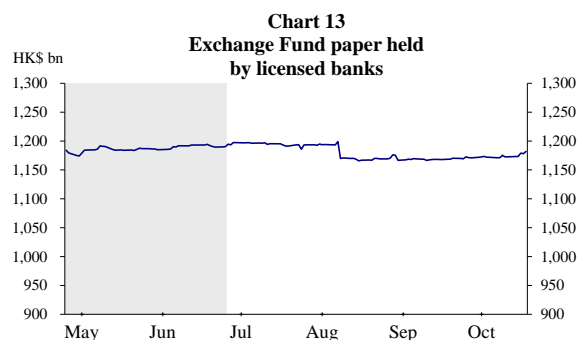
Aggregate Balance

12. During the review period, the Convertibility Undertakings were not triggered and **the Aggregate Balance** was little changed at around **HK\$44.80 billion** (Chart 12).



Outstanding Exchange Fund Bills and Notes

13. **The market value of the outstanding EFBNs increased to HK\$1,288.60 billion during the review period. Holdings of Exchange Fund papers by the banking sector (before Discount Window activities) decreased to HK\$1,182.04 billion (91.7% of total) from HK\$1,194.72 billion (94.0% of total) (Chart 13).**

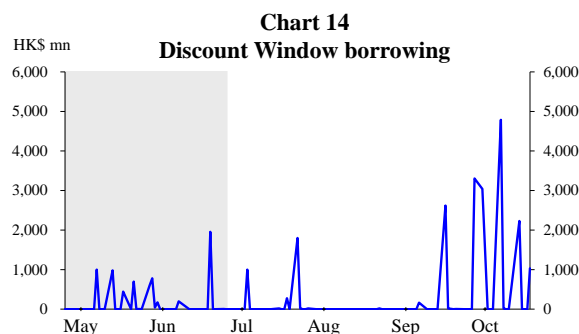


14. During the review period, **interest payments on Exchange Fund papers amounted to HK\$16,532.75 million. A total of HK\$16,550.39 million (in market value) of Exchange Fund papers were issued to absorb these interest payments.** The Exchange Fund papers issued during the review period were generally well received by the market (Table 3).

Table 3 Issuance of Exchange Fund Bills and Notes (26 Jun 24 – 18 Oct 24)		
	No. of issues launched	Over-subscription ratio
1-month EFB	1	2.00
3-month EFB	16	1.16 – 2.00
6-month EFB	16	1.60 – 4.46
12-month EFB	5	1.96 – 3.80
2-year EFN	1	3.18

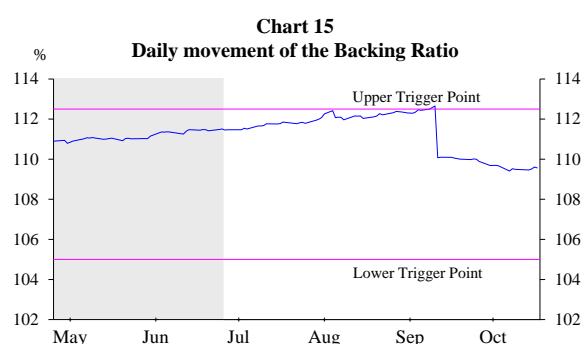
Discount Window activities

15. During the review period, a **total of HK\$20,383 million was borrowed from the Discount Window**, compared with HK\$6,877 million in the preceding review period from 25 April to 25 June 2024 (Chart 14). No abnormality was noted in the relevant usage.



Backing Portfolio

16. The Backing Assets decreased to HK\$2,120.19 billion on 17 October 2024. **The Backing Ratio decreased to 109.57% from 111.45% during the review period** (Chart 15). On 9 September and 10 September 2024, 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 Backing Portfolio, all Exchange



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.

Fund assets are available to support the HKD exchange rate.

Hong Kong Monetary Authority
9 December 2024