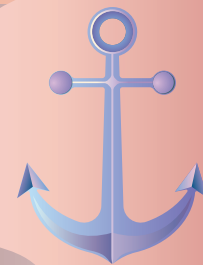


Monetary Stability



In 2023, amid market expectations of a “high for longer” US policy rate, the Hong Kong dollar mostly traded on the weak side of the Convertibility Zone, with the weak-side Convertibility Undertaking being triggered eight times between mid-February and early May. The Hong Kong dollar had regained some momentum since May and traded around the central parity rate of 7.8 at year end. Under the Linked Exchange Rate System, which marked its 40th anniversary in 2023, the Hong Kong Interbank Offered Rates generally track their US dollar counterparts, while also being affected by local supply and demand. Overall, the Hong Kong dollar exchange and money markets remained stable and traded in a smooth and orderly manner. As the cornerstone of Hong Kong’s monetary and financial stability, the Linked Exchange Rate System has shown its strength and resilience to various external shocks time after time.

Monetary Stability

Objectives

The overriding objective of Hong Kong's monetary policy is currency stability. This is defined as a stable external exchange value of Hong Kong's currency, in terms of its exchange rate in the foreign exchange market against the US dollar, within a band of HK\$7.75–7.85 to US\$1. The structure of the monetary system is characterised by Currency Board arrangements, requiring the Monetary Base to be at least 100% backed by US dollar reserves held in the Exchange Fund, and changes in the Monetary Base to be 100% matched by corresponding changes in US dollar reserves.

The Monetary Base (Table 1) comprises:

- Certificates of Indebtedness, which provide full backing to the banknotes issued by the three note-issuing banks;
- Government-issued currency notes and coins in circulation;
- The Aggregate Balance, which is the sum of clearing account balances kept with the HKMA; and
- Exchange Fund Bills and Notes (EFBNs) issued by the HKMA on behalf of the Government.

Table 1 Monetary Base

HK\$ million	31 December 2023	31 December 2022
Certificates of Indebtedness ^a	592,585	605,575
Government-issued currency notes and coins in circulation ^a	12,927	13,151
Balance of the banking system ^b	44,950	96,251
EFBNs issued ^c	1,245,451	1,200,422
Total	1,895,913	1,915,399

- a. The Certificates of Indebtedness and the Government-issued currency notes and coins in circulation shown here are stated at Hong Kong dollar face values. The corresponding items shown in the balance sheet of the Exchange Fund in this *Annual Report* are in Hong Kong dollars equivalent to the US dollar amounts required for their redemption at the prevailing exchange rates on the reporting date. This arrangement is in accordance with the accounting principles generally accepted in Hong Kong.
- b. Balance of the banking system shown here is the carrying value before the amount advanced to the banks under the Discount Window Operations. In accordance with the accounting principles generally accepted in Hong Kong, the corresponding item shown in the balance sheet of the Exchange Fund in this *Annual Report* includes the amount of these advances.
- c. The amount of EFBNs shown here refers to their fair value. In accordance with the accounting principles generally accepted in Hong Kong, the EFBNs held by the HKMA on behalf of the Exchange Fund in relation to its trading of the EFBNs in the secondary market are offset against the EFBNs issued, and the net amount is recorded in the balance sheet. The EFBNs allotted on tender dates but not yet settled are included in the balance sheet but are excluded from the Monetary Base. Therefore, the amount of EFBNs shown here is different from that in the balance sheet of the Exchange Fund in this *Annual Report*.

The stability of the Hong Kong dollar exchange rate is maintained through an automatic interest rate adjustment mechanism and the firm commitment by the HKMA to honour the Convertibility Undertakings (CUs). With the HKMA standing ready to sell (or buy) Hong Kong dollars to (or from) banks in exchange for US dollars upon request at

HK\$7.75 (or HK\$7.85) per US dollar when the strong-side (or weak-side) CU is triggered, the Aggregate Balance will expand (or contract) to push down (or up) Hong Kong dollar interest rates, helping move the Hong Kong dollar back to within the Convertibility Zone of 7.75 to 7.85.

Monetary Stability

Review of 2023

Exchange rate stability

Amid the market expectation of a “high for longer” US policy rate, the Hong Kong dollar remained soft and mostly traded on the weak side of the Convertibility Zone throughout 2023. The weak-side CU was triggered eight times from mid-February to early May. The Hong Kong dollar exchange rate regained some strength during early May to July, partly

driven by dividend payment-related demand from listed companies and half-year-end funding needs by corporates. Thereafter, the Hong Kong dollar was mainly driven by the changes in local funding demands, such as buying flows through the Southbound Stock Connect, and traded around the central parity rate of 7.8 at year end (Chart 1). Overall, the Hong Kong dollar exchange market continued to function normally throughout 2023.

Chart 1

Market exchange rate in 2023



Monetary Stability

From February to May, the HKMA purchased a total of HK\$51.5 billion at the weak-side CU at the request of banks in accordance with the design of the Linked Exchange Rate System (LERS). Reflecting the triggering of the weak-side CU, the Aggregate Balance decreased from HK\$96.3 billion at the end of 2022 to HK\$45.0 billion at the end of 2023.

Meanwhile, the outstanding EFBNs increased slightly from HK\$1,200.4 billion to HK\$1,245.5 billion during the year.

The total of the Aggregate Balance and outstanding EFBNs therefore declined from HK\$1,296.7 billion at the end of 2022 to HK\$1,290.4 billion at the end of 2023 (Chart 2).

The Monetary Base as a whole remained fully backed by foreign exchange reserves.



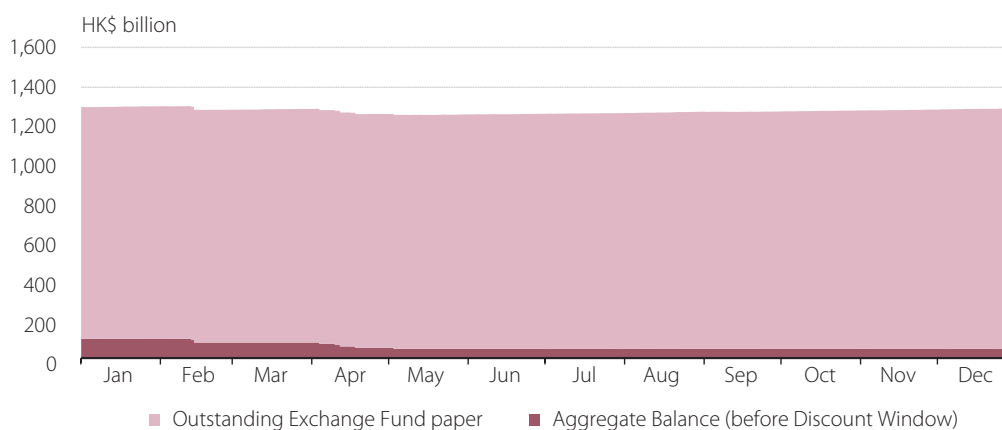
HK\$1,290.4 billion

Total Aggregate Balance and outstanding EFBNs



Chart 2

Aggregate Balance (before Discount Window) and outstanding Exchange Fund papers in 2023



Monetary Stability

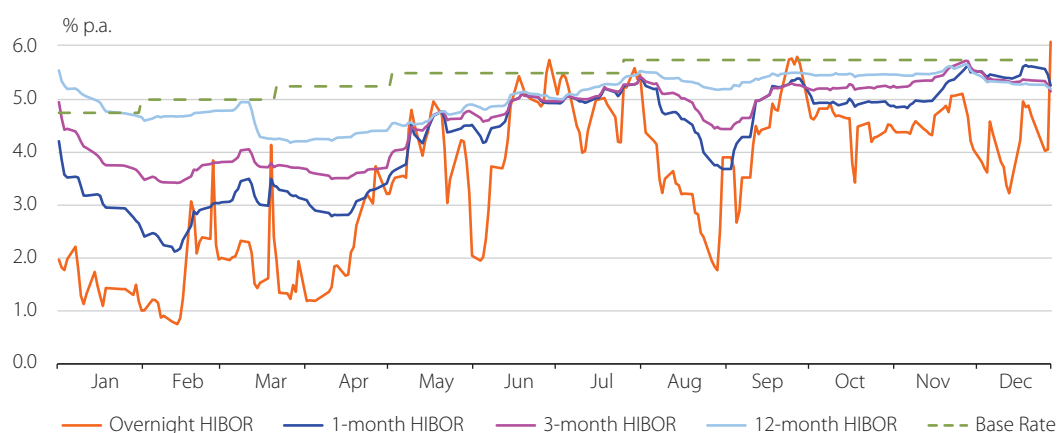
Money market

Under the LERS, the Hong Kong Interbank Offered Rates (HIBORs) generally track their US dollar counterparts. As the US continued to raise interest rates in the first seven months of 2023, the HIBORs generally rose (Chart 3). For the year as a whole, the overnight, 1-month and 3-month HIBORs increased respectively by 286, 92 and 16 basis points to 6.09%, 5.27% and 5.15% at year end.

Following the increases in the target range for the US federal funds rate, the Base Rate was adjusted upwards four times by a total of one percentage point (i.e. 100 basis points) from 4.75% to 5.75%.¹ On the retail front, following the US policy rate hikes, many banks raised their Best Lending Rates by 12.5 basis points in early May and another 12.5 basis points in late July. Some banks also increased the cap on HIBOR-based mortgage rates of newly approved mortgage loans during the year, and the average interest rate of new mortgage loans rose from 3.35% in 2022 to 4.13% in December 2023. Overall, Hong Kong's money markets continued to function normally. Discount Window borrowing increased to HK\$38.8 billion in 2023 from HK\$8.4 billion in 2022 and no abnormality was noted in the relevant usage.

Chart 3

Hong Kong Interbank Offered Rates in 2023



¹ The adjustments of the Base Rate were in accordance with the established formula, which sets the Base Rate at either 50 basis points above the lower bound 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.

Monetary Stability

The Linked Exchange Rate System

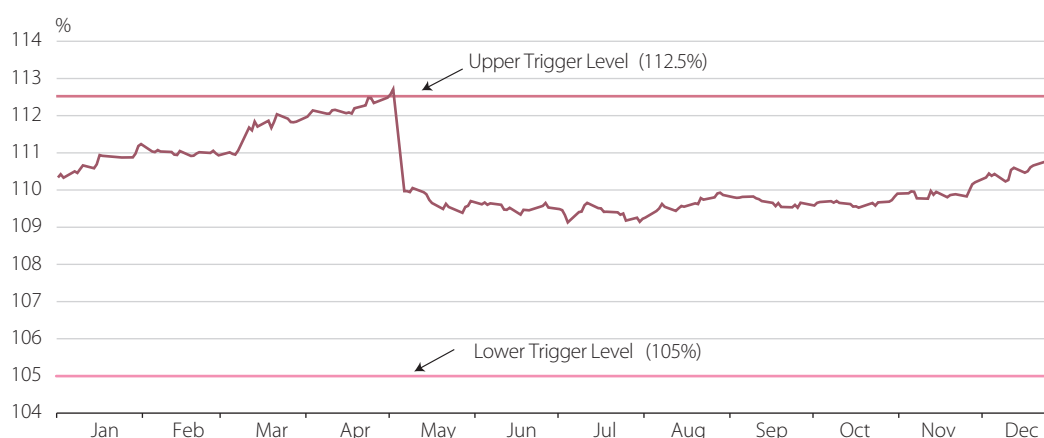
The LERS has been a strong anchor of Hong Kong's financial system for four decades and has shown its strength and resilience to challenges. Despite lingering uncertainties surrounding the US interest rate path and global economic recovery, the Hong Kong dollar exchange and money markets continued to function in an orderly manner, reflecting the robustness of the LERS. The Government is firmly committed to the LERS. In its *2023 External Sector Report*, the International Monetary Fund (IMF) once again reiterated that the credibility of the LERS has been ensured by a transparent set of rules, large fiscal and foreign reserves, strong financial regulation and supervision, a flexible economy and a prudent fiscal framework.

A robust banking system is crucial to the normal functioning of the LERS. Hong Kong's banking sector continued to operate smoothly with liquidity positions and capitalisation faring very well by international standards. To ensure the resilience of the banking sector, the HKMA has been closely monitoring banks' management of credit, liquidity and interest rate risks and stress testing results, and has maintained its supervisory efforts on bank lending.

To improve the transparency of the Currency Board Account, a specific portion of the Exchange Fund assets has been allocated to back the Monetary Base since October 1998.

The Backing Ratio (defined as the Backing Assets divided by the Monetary Base) rose from 110.12% at the end of 2022 to a high of 112.71% on 4 May 2023, surpassing the Upper Trigger Level of 112.5% (Chart 4). This largely reflected the contraction in the Aggregate Balance as a result of the triggering of the weak-side CU in the first half of the year². In accordance with the arrangement approved by the Exchange Fund Advisory Committee and as a result of the redemption of Certificates of Indebtedness, assets were transferred out of the Backing Portfolio to the Investment Portfolio to reduce the Backing Ratio to around 109.97% on 8 May. Thereafter, the Backing Ratio rose steadily to close at 110.73% on 31 December. Under the LERS, while specific Exchange Fund assets have been designated for the Backing Portfolio, all Exchange Fund assets are available to support the Hong Kong dollar exchange rate. The ample financial resources of the Exchange Fund, together with the sound banking system, provide a powerful backstop to Hong Kong's monetary and financial stability.

Chart 4 Daily movement of the Backing Ratio in 2023



² While the Backing Assets decreased by the same magnitude as the Monetary Base, the fractional decrease was smaller in the former because of its larger size, thus increasing the Backing Ratio.

Monetary Stability

Currency Board Sub-Committee

The Currency Board Sub-Committee (CBC) of the Exchange Fund Advisory Committee monitors and reviews issues relevant to monetary and financial stability in Hong Kong. In 2023, the CBC considered issues including the May 2022 stablecoin market crash, the transmission of Federal Reserve's dollar liquidity backstop measures to banks in Hong Kong, and the recent movements in the Hong Kong dollar interest rates. Records of the CBC's discussions on these issues and reports on Currency Board operations submitted to the CBC are published on the HKMA website.



Notes and coins

The below table summarises the value of the notes and coins in circulation at the end of 2023:

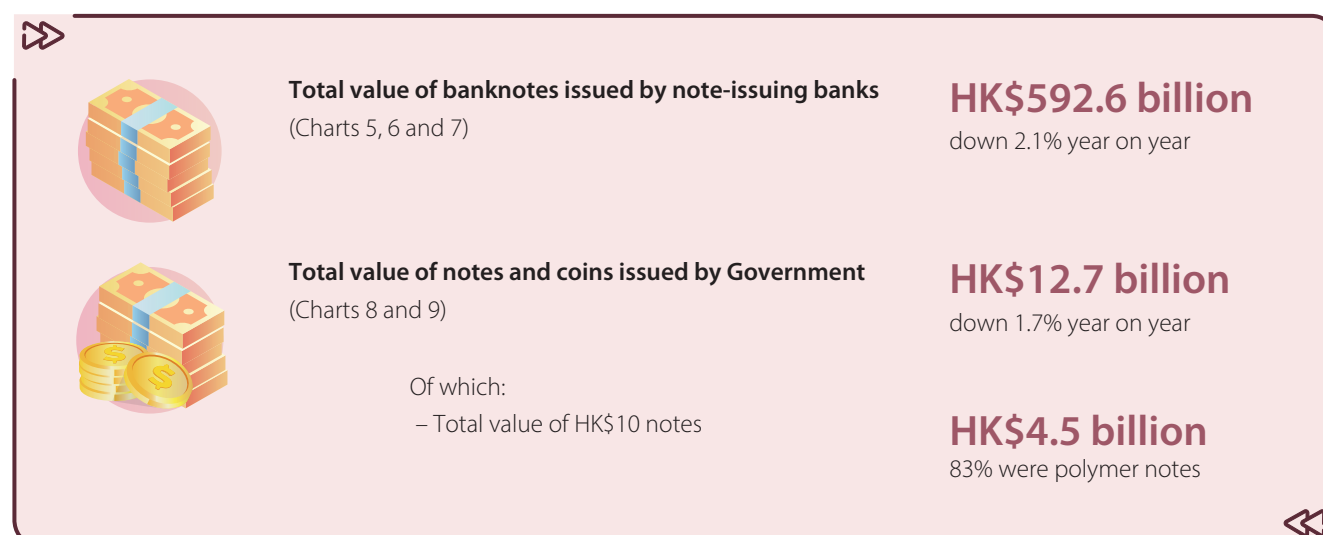
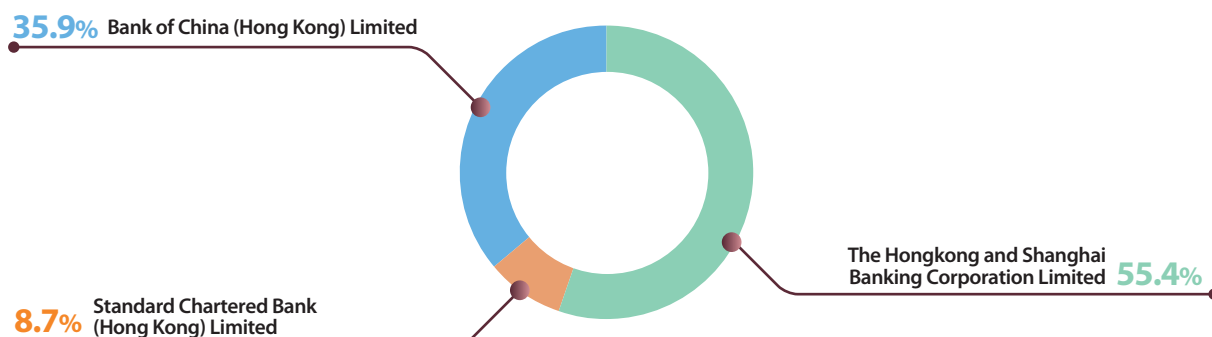


Chart 5

Banknotes in circulation by note-issuing banks at the end of 2023



Monetary Stability

Chart 6 Distribution of banknotes in circulation at the end of 2023

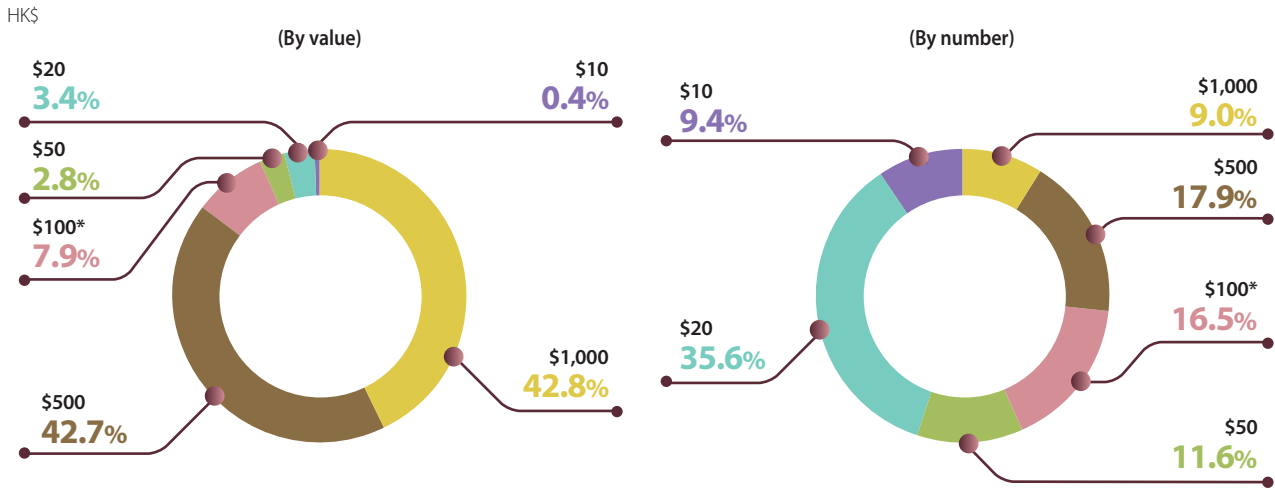


Chart 7 Banknotes in circulation at the end of 2023

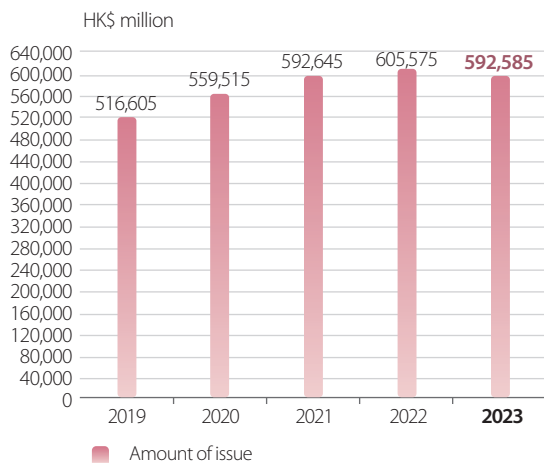
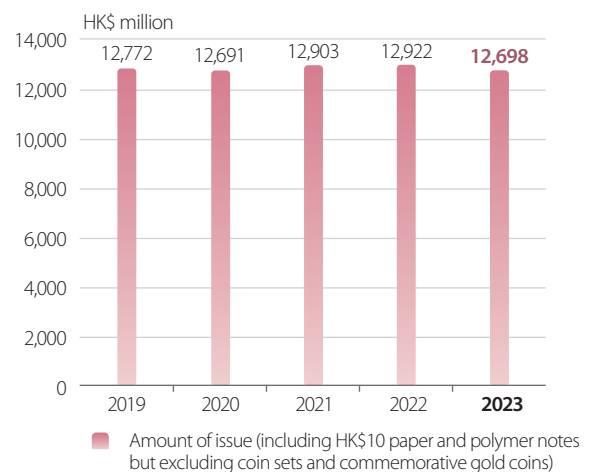
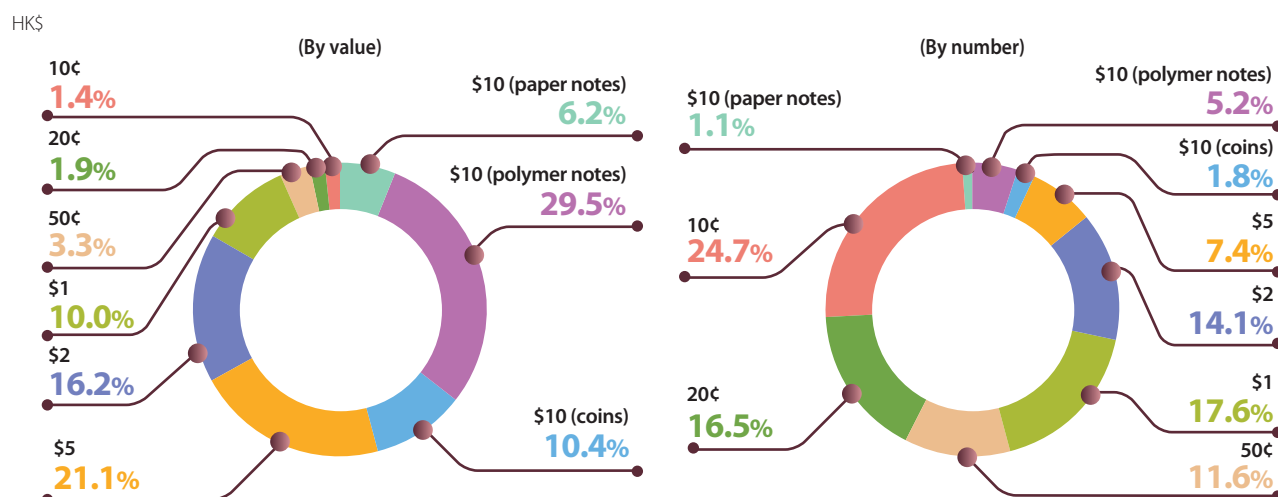


Chart 8 Government-issued currency notes and coins in circulation at the end of 2023



Monetary Stability

Chart 9 Breakdown of Government-issued currency notes and coins in circulation at the end of 2023



Hong Kong banknotes

During the year, the HKMA continued to organise seminars on the design and security features of Hong Kong banknotes for bank tellers, cashiers from retail establishments and students to help enhance their knowledge and skills in authenticating banknotes. During 2023, 15 seminars were arranged for around 3,000 participants.

Coin Collection Programme

The Coin Collection Programme continued to be well received by the public. More information about the Programme can be found in the *Sustainable HKMA* chapter of the *Sustainability Report 2023*.

Exchange Fund Bills and Notes

The EFBN Programme operated smoothly. At the end of 2023, the nominal amount of outstanding Exchange Fund papers stood at around HK\$1,255.4 billion (Table 2).

Table 2 Outstanding issues of EFBNs

HK\$ million	2023	2022
Exchange Fund Bills (by original maturity)		
28 days	2,800	0
91 days	775,680	769,798
182 days	405,800	364,800
364 days	52,700	51,700
Subtotal	1,236,980	1,186,298
Exchange Fund Notes (by remaining tenor)		
1 year or less	7,600	7,600
More than 1 year and up to 3 years	7,200	8,800
More than 3 years and up to 5 years	2,400	2,400
More than 5 years and up to 10 years	1,200	2,400
Subtotal	18,400	21,200
Total	1,255,380	1,207,498

Monetary Stability

Monetary research

The Hong Kong Institute for Monetary and Financial Research (HKIMR)³, the research arm of the Hong Kong Academy of Finance, published 20 working papers and held 17 seminars/webinars on monetary and financial research topics that are of strategic importance to Hong Kong and the region. The HKIMR also published six *eJournals* on the Social Science Research Network (SSRN) to disseminate research outputs to SSRN's global research community. Moreover, to provide

the public with a high-level, non-technical summary of the recently published working papers, the HKIMR published two issues of *Insights from Monetary Research*.

Apart from its research activities, the HKIMR organised four international events, one roundtable and four seminars/webinars with academia, global central banks and international financial institutions to promote dialogue and exchange on economic and financial issues:

9
Mar

A seminar on *China's Rebound: Recent Developments and Outlook* by Dr Steven Alan Barnett, Senior Resident Representative in China of the IMF, and Dr Phakawa Jeasakul, Resident Representative for People's Republic of China – Hong Kong Special Administrative Region (HKSAR) of the IMF, was held. Dr Barnett shared his views on the latest developments in the Chinese economy, as well as short- and medium-term issues that need to be addressed. More than 100 participants attended the seminar.



17
Apr

A seminar on *Navigating Through a Challenging World* was held. Four experts from the IMF shared their views on the analytical chapters of the most recent issues of *World Economic Outlook and Global Financial Stability Report* by the IMF. Over 50 participants attended the seminar.



25
Apr

A seminar with the presentation of the IMF's *April 2023 Global Financial Stability Report* titled *Safeguarding Global Financial Stability amid High Inflation and Interest Rates* by Dr Jason Wu, Assistant Director, and Mr Thomas Pointek, Senior Financial Sector Expert, of the IMF's Monetary and Capital Markets Department was held. More than 80 participants attended the seminar.



³ The HKIMR is a subsidiary of the Hong Kong Academy of Finance.

Monetary Stability

2
May

A fireside chat on *Asia in a Challenging World* was hosted between Mr Krishna Srinivasan, Director of the Asia and Pacific Department of the IMF, and Mr Eddie Yue, Chief Executive of the HKMA. Mr Srinivasan outlined the key messages of the recent IMF *Regional Economic Outlook* report for Asia and shared his views on the key drivers and risks of the global and regional economy. In addition, the dialogue covered many important issues concerning the regional economy and the evolution of the international monetary system. Around 120 participants attended the event.



10
July

The international conference on *Fintech and Financial Stability* was jointly organised by the HKIMR, the University of Hong Kong and the Bank for International Settlements and included leading experts from around the world who shared their views and analyses on the latest developments in this area. Professor Bengt Holmström, 2016 Nobel Prize Laureate in Economics from the Massachusetts Institute of Technology, joined a virtual panel discussion during the conference, with about 70 participants.



24-25
Aug

A workshop on *Recent Developments and Future Prospects of the International Monetary System* was jointly organised by the HKIMR, ASEAN+3 Macroeconomic Research Office (AMRO), European Central Bank, European Stability Mechanism and Bank of Finland Institute for Emerging Economies. Dr Kouqing Li, Director of AMRO, presented his view in the panel discussion on *Policy Initiatives in a Changing International Monetary System*. More than 100 participants from global central banks, the private sector, academia and international financial institutions attended the workshop.



29
Aug

A roundtable on the Hong Kong Economy was co-organised by the HKIMR and AMRO. Director Kouqing Li and delegates from AMRO had extensive discussions with economists from major investment banks and academia. Topics included the macroeconomic outlook, opportunities and challenges of the Hong Kong economy, as well as the role of Hong Kong in connecting Mainland China with the rest of the world.



Monetary Stability

8
Sep

A webinar on *External Rebalancing in Turbulent Times* on the IMF's 2023 *External Sector Report* was held. Mr Enoch Fung, Chief Executive Officer of the Hong Kong Academy of Finance and Executive Director of the HKIMR, gave the opening remarks. Mr Jiaqian Chen, Deputy Division Chief and Mr Lukas Boer, Economist, of the IMF's Research Department shared their analysis on the external rebalancing in turbulent times and the external sector implications of the global dollar cycle. Dr Phakawa Jeasakul, the IMF's Resident Representative for People's Republic of China – HKSAR, moderated the question-and-answer session. Around 50 participants joined the webinar.



27
Oct

The 13th Annual International Conference on the Chinese Economy, titled *China's Economic Development in a Changing Global Environment*, was held and featured a keynote speech on Economic Outlook of China by Professor Yiping Huang, Sinar Mas Chair Professor of Finance and Economics and Deputy Dean of the National School of Development of Peking University. Five experts shared their views in the panel discussion on *Recent Developments and Outlook of the Chinese Economy*. About 120 participants from central banks, private sector, academia and international financial institutions attended the conference.

