Record of discussion of meeting of Exchange Fund Advisory Committee Currency Board Sub-Committee held on July 5

The following is issued on behalf of the Hong Kong Monetary Authority:

(Approved for Issue by the Exchange Fund Advisory Committee on August 1, 2023)

Report on Currency Board Operations (April 18 – June 23, 2023)
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The Currency Board Sub-Committee (Sub-Committee) noted that the Hong Kong dollar (HKD) traded within a range of 7.8148 – 7.8500 against the US dollar (USD) during the review period. 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 during the period. The HKD had strengthened since early May, mainly driven by dividend payment-related demand from listed companies and half-year-end funding needs by corporates. With the Hong Kong Monetary Authority 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. Following the increase in the target range for the US federal funds rate in May, many banks raised their Best Lending Rates by 12.5 basis points, and the Best Lending Rates in the market ranged from 5.750 per cent – 6.250 per cent at the end of the review period. Overall, the HKD exchange and interbank markets continued to trade in a smooth and orderly manner.

The Sub-Committee noted that the Monetary Base decreased to HK$1,869.35 billion at the end of the review period. In accordance with the Currency Board principles, all changes in the Monetary Base had been fully matched by changes in foreign reserves.

The Report on Currency Board Operations for the review period is at Annex.

Monitoring of Risks and Vulnerabilities
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The Sub-Committee noted that as the US banking problem gradually stabilised and the US debt ceiling issues were eventually resolved, market attention had shifted back to the US inflation outlook. With the still-firm core inflationary pressures and resilient labour market conditions, markets had pared back expectations of rate cuts in the near term. However, the high-for-longer US interest rate outlook might expose other vulnerabilities in the global financial system. Meanwhile, there were concerns in the market over the quality of commercial real estate (CRE) loans to which small US banks had relatively high exposure, as the US CRE market faced pressures from ongoing shift to hybrid working and tightened lending standards.

The Sub-Committee noted that Mainland China's economic recovery showed signs of moderation moving into Q2 2023 amid weak private sector confidence, renewed softening in the housing market, and lingering funding pressures on local government financing vehicles. As for the Asia-Pacific region, the external environment remained challenging, with subdued export demand from the US and other major economies.

The Sub-Committee noted that in Hong Kong, economic activities resumed positive growth in Q1 2023 and improved further stepping into Q2 2023 as both inbound tourism and domestic demand recovered strongly along with the reopening of Mainland China and Hong Kong, as well as the disbursement of consumption vouchers. While the unemployment rate fell further to a very low level, the underlying inflation remained largely in check. It was expected that economic growth would rebound visibly in 2023, although the outlook would be subject to evolving risks relating to the US Fed's policy rate path, the global economic environment and lingering geopolitical tensions. Meanwhile, following a strong rebound in Q1 2023, housing prices and transactions saw signs of stabilisation in Q2 2023 as market sentiment turned cautious amid rising interest rates.

Transmission of Federal Reserve's Dollar Liquidity Backstop Measures to the Hong Kong banking sector

The Sub-Committee noted a paper that studied the transmission of Federal Reserve's dollar liquidity backstop measures to banks in Hong Kong.