

Record of discussion of meeting of Exchange Fund Advisory Committee Currency Board Sub-Committee held on October 29

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

(Approved for issue by the Exchange Fund Advisory Committee on November 26)

Report on the Currency Board Operations (June 15 – October 8)

The Currency Board Sub-Committee noted that during the review period, the Hong Kong dollar (HKD) traded within a range of 7.8090 – 7.8500 against the US dollar (USD). Since the first triggering on April 12, the weak-side Convertibility Undertaking (CU) was triggered 27 times and the Hong Kong Monetary Authority bought HK\$103.5 billion under the weak-side CU. Correspondingly, the Aggregate Balance and the Monetary Base declined to HK\$76.58 billion and HK\$1,616.14 billion respectively at the end of the review period. Partly reflecting squaring of interest carry trade positions amid tightening of interbank liquidity ahead of the quarter-end, the HKD exchange rate strengthened in late September, before easing gradually at the end of the review period.

The Sub-Committee noted that largely reflecting reduced interbank liquidity following triggering of the weak-side CU, expectation of US rate hikes, IPO-related funding demand, and seasonal liquidity needs, HKD interbank interest rates broadly picked up during the review period.

The Sub-Committee further noted that, 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 period under review is at the Annex.

Monitoring of risks and vulnerabilities

The Sub-Committee noted that in the US, growth momentum remained strong but its outlook was clouded by trade tensions with its trading partners. Inflationary pressures continued to build up, and the Federal Reserve signalled further gradual tightening ahead.

The Sub-Committee noted that in emerging market economies (EMEs), the recent slump in the Turkish lira and the Argentine peso had sparked

volatility in EME currencies and stocks. Nonetheless, EMEs with stronger fundamentals (mostly in Asia) had been faring better.

The Sub-Committee noted that in Mainland China, growth momentum showed some moderation but economic restructuring remained on track. While the renminbi had depreciated amid the US-China trade conflicts, capital outflow pressure had been limited so far.

The Sub-Committee noted that in Hong Kong, downside risks to growth increased amid stronger external headwinds. That said, banks' asset quality stayed healthy. In addition, the sizeable Monetary Base and the robust banking system provided strong buffer to external shocks.

Linked Exchange Rate System (LERS) Operations since the three refinements – mechanism and theory

The Sub-Committee noted a study which provided a theoretical explanation of the HKD exchange rate dynamics and interest rate differential between the HKD and the USD since 2008. The study found that the LERS had been working according to its design.