

Record of Discussion of the Meeting of the 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 July 26)

Report on Currency Board Operations (April 17-June 25, 2019)

The Sub-Committee noted that the Hong Kong dollar (HKD) exchange rate traded within a range of 7.8065-7.8498 against the US dollar (USD) during the review period. Driven mainly by interest carry trade and weak sentiment in the local stock market, the HKD eased gradually since April and remained close to the weak-side Convertibility Undertaking (CU) before the end of May. Thereafter, the HKD strengthened, due partly to unwinding of interest carry trade amid tightened liquidity approaching the end of May and the half-year-end, and partly to a rise of demand for dividend payments. During the review period, the long-dated HKD interbank interest rates moved up at a gradual pace, while there were more fluctuations in the short-dated rates. Overall, the HKD exchange and interbank markets continued to trade in a smooth and orderly manner.

The Sub-Committee noted that the Aggregate Balance remained little changed at around HK\$54.3 billion, while the Monetary Base increased slightly to HK\$1,625.6 billion at the end of 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 Annex.

Monitoring of Risks and Vulnerabilities

The Sub-Committee noted that in the US, the intensified US-China trade tensions could pose further headwinds to the slowing economy, while communications by the Federal Reserve had reinforced market expectations of interest rate cuts in the coming months.

The Sub-Committee noted that in Europe, elevated political uncertainty

and lingering tariff threats by the US could pose downside risks to the region.

The Sub-Committee noted that in Mainland China, growth outlook was clouded by re-escalation of trade tensions with the US. Capital outflow and depreciation pressures in Asia had re-emerged, notably for economies with higher value-added in China's final demand.

The Sub-Committee noted that in Hong Kong, economic growth slowed in the first quarter and downside risk to growth had increased amid the re-escalation of the US-China trade conflicts. The upward momentum of the housing market also showed signs of softening in recent weeks.

Options Markets' Views about the Linked Exchange Rate System (LERS): An Improved and More Flexible Approach

The Sub-Committee noted a study which used foreign exchange option prices to assess the credibility of the LERS using an improved asset pricing model. The study provided empirical support that the LERS continued to be viewed as highly credible by the market during the period when the weak-side CU was triggered intermittently.