Record of discussion of meeting of Exchange Fund Advisory Committee Currency board Sub-Committee held on April 26, 2018

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

(Approved for issue by the Exchange Fund Advisory Committee by Circulation)

Report on the Currency Board operations (December 20, 2017 – April 16, 2018)

The Sub-Committee noted that during the review period, the Hong Kong dollar (HKD) traded within a range of 7.8127 – 7.8500 against the US dollar (USD). The HKD eased gradually against the USD since March 2018, with the weak-side Convertibility Undertaking (CU) being triggered repeatedly between 12 and 16 April. The weakening and triggering largely reflected the increased interest carry trade activities amid the widening of the negative HKD-USD interest rate spreads. The short-dated HKD interbank interest rates generally declined in the first two months of 2018 but picked up in March, partly reflecting the growing expectation of faster US interest rate hikes. Overall, the HKD exchange and interbank markets continued to function normally.

The Sub-Committee noted that the Aggregate Balance decreased due to the triggering of the weak-side CU, but the Monetary Base increased to HK$1,712.09 billion mainly driven by a rise in Certificates of Indebtedness.

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.

Triggering of the weak-side CU

The Sub-Committee noted that the recent triggering of weak-side CU was primarily driven by the negative interest rate differential between the HKD and USD. The triggering of the CU was part and parcel of the design for the HKD interest rate adjustment mechanism under the Currency Board arrangements of the Linked Exchange Rate System. When the weak-side CU was triggered, the Aggregate Balance would contract, creating a more conducive environment for HKD interest rate normalisation.

The Sub-Committee observed that so far the Currency Board arrangements had been operating as designed, and it was neither necessary nor desirable to conduct within zone operations. The Sub-Committee also noted that the Hong Kong Monetary Authority was fully capable of meeting the CU requests and maintaining the stability of the HKD exchange rate. The Monetary Base, standing at more than HK$1.6 trillion currently, was fully backed by liquid USD assets. Hong Kong's foreign currency reserve assets amounted to over US$432 billion, twice the size of the Monetary Base. Banks in Hong Kong were also well-capitalised and held more than HK$4 trillion in highly liquid assets at the end of 2017. All these served as a strong buffer to cope with fund outflows.

Monitoring of risks and vulnerabilities

The Sub-Committee noted that in the US, the pro-cyclical tax reform introduced at a time when the economy was at full employment might drive upside risks to inflation and interest rates. Meanwhile, the uncertainties arising from increased global trade barriers might partly offset the investment-stimulating effects of tax cuts.

The Sub-Committee noted that in Mainland China, growth remained stable, and some progress had been made on both structural reforms and containment of systemic risks. The near-term growth prospects were positive but uncertainties remained.

The Sub-Committee noted that in Hong Kong, economic growth was anticipated to remain solid in the first quarter of 2018 but the US-China trade tensions would cloud the growth outlook down the road. Housing price growth accelerated and transaction remained firm, yet the property market outlook remained uncertain.