

Response by FS to media enquiries on US rate hike

In response to media enquiries regarding the impacts on Hong Kong of the United States Federal Reserve (US Fed) Board rate hike by 0.5 per cent, the Financial Secretary, Mr Paul Chan, made the following response today (May 5):

"As anticipated by market, the US Fed raised the interest rate by 0.5 per cent during the meeting yesterday. It is the first time in 22 years that the increase has reached 0.5 per cent, and the federal funds rate cumulative increase has reached 0.75 per cent over a month, with its target rate range increased to 0.75 to 1 per cent. Although remarks from US Fed officials have eased the market's worries of a greater extent of rate hikes in future meetings, the trend of rate hikes in the rest of the year remains certain with a cumulative increase reaching 2.5 per cent or more. The US Fed has also determined the pace to reduce the size of its balance sheet.

Under the Linked Exchange Rate System (LERS), the widening of interest rate gaps between the Hong Kong dollar (HKD) and the US dollar (USD) will attract more carry trade activities, causing the HKD to gradually get close to weak-side Convertibility Undertaking of HK\$7.85 to US\$1, eventually causing HKD interbank rates to rise with the USD interest rates. However, changes in the HKD effective exchange rate and the speed and magnitude of the rise in interest rates will still vary depending on local capital funds and the economic situation. The LERS has proven to be very effective in the past 40 years, with the support from the vast foreign currency reserves. The high stability of financial and banking systems also provide a well-established strong buffer and defense mechanism against market risks. We are confident in maintaining the stable and smooth operations of the monetary and financial markets.

In addition to dampening the economic momentum of the United States, the US Fed's monetary policy tightening will also affect global capital flows and the liquidity of other economies, putting pressure on the steady recovery of the global economy and creating a more challenging external environment for Hong Kong. Moreover, fluctuations in the global financial market may increase. Some emerging market economies with weaker fundamentals will face more significant pressure (including currency depreciation and capital outflow). We will continue to pay attention to relevant risks.

Meanwhile, the impact of the interest rate hike on the capital market, credit quality, local consumption and investment activities and economic sentiment as well as the burden imposed on members of the public and small and medium-sized enterprises are areas to watch over.

For members of the public, the rise in HKD interbank rates will increase their mortgage repayment expenses. Although over half of the residential properties in Hong Kong do not have mortgage loans, the recent average mortgage debt service ratio of new residential mortgage loans is at 37 per

cent, and all of them have passed the stress test of raising interest rates by 3 per cent, reflecting that systemic risks have been managed in various aspects. Nonetheless, as the economy has yet fully recovered, with a relatively high unemployment rate and many citizens' income under pressure, the increase in the interest rate may pressurise the mortgage repayment burden of some property owners, as well as their worries about livelihoods.

To small and medium-sized enterprises, the impact of the epidemic on their business continues as global supply chains and logistics transportation are not completely smooth, making business still difficult. Ongoing interest rate hikes means the pressure on their loan repayment is also gradually raising."