Curious Activity in the HKD - Revisited

- **Shorter-dated forward outrights in USD/HKD are trending higher once more**

- **HKD pressure may be partly down to rallying Chinese stocks**

- **The emergence of these pressures raises some interesting questions**

As we first mentioned a fortnight or so ago, USD/HKD forward outrights are sending out some curious signals in light of the HKMA’s undeniable resolve to defend the HKD band.

As we have noted, just as upward pressures on the CNY began to abate at the start of December, a fresh set of strains began to emerge in the HKD market.

Since then there has been an 86% negative correlation between the performance of the HKD against the USD and that of the CNY against the USD. Or put another way, since December, a stronger CNY has more often than not coincided with a weakening in the HKD.

Yet while the upward pressure on the CNY has abated in recent weeks, downward pressure on the HKD, it would seem, has not. USD/HKD has remained at the top of its 7.75-7.85 trading band since late February which has required repeated intervention to maintain the band’s integrity.

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**Newswatch**

1. White House adviser Kudlow speaks of "grander discussion than anything we’ve had before in US-China trade relations"

2. Aussie retail sales far exceed expectations for February whilst services activity in China
In fact, the HKMA bought HKD 4.97 bn of the currency on Saturday morning, its seventh intervention in a month. Moreover, after edging lower late in March, shorter-dated forward outrights in USD/HKD are once again on a course towards the top of the band.

It might be said that this pressure on the HKD’s peg is a nod to the “impossible trinity” in a world of rising US interest rates. Certainly, the rise in USD/HKD reflected the rise in the three-month Libor/Hibor spread from the start of 2017 and it arrived at the top of the band last March just as the spread reached it widest point since 2007.

However, with HIBOR under some pressure from HKMA intervention and with US rates reflecting a more dovish Fed, the spread, although still elevated at 80bp+, has actually moved in favor of the HKD this past month.

One source of downward pressure on the HKD has been the stellar rise in Chinese stocks. Offshore investors in the SAR have been active buyers of A-list shares via the Stock Connect link between the Shanghai and Hong Kong exchanges.

This requires swapping currencies for CNY and such flows into China hit CNY 121 bn in January and February, 3.7 times more than during the same period last year.

One source of downward pressure on the HKD is the stellar rise in Chinese stocks

This constitutes a carry trade of sorts driven by cheaper HKD funding and one that is being well rewarded: the Shanghai Composite had already risen 25% year-to-date as of Monday morning, before a pick up in the March PMIs appeared to imply that repeated stimulus measures may be finding their target. The index now stands 6.2%
above its opening level on Friday.

To date the only time that forward outrights - at least those out to one-year - have ever breached the top of the band came in January 2016, at the time devaluation pressures began to build on the CNY (in that case it was the longer-dated outrights that broke the level).

While there is no question about the HKMA’s ability and commitment to successfully defend the band, the emergence of these pressures raises some interesting questions.

It will therefore be interesting to see what happens if the outrights break through this time. It will also be interesting to see whether, this time, it coincides with CNY strength.

Please direct questions or comments to:

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