BNY MELLON

The Aerial View

Morning Briefing

Interesting Developments for the HKD

- **Pressure in HKD forward market had been intensifying**
- **Yesterday's move in HKD was a logical outcome of move in swap points**
- **Options market still cautious**

While events in Hong Kong have been capturing the headlines, it makes sense to consider what’s happening in local markets from a slightly different perspective.

It’s worth remembering that the HKD has been under pressure for virtually all of this year, with spot stuck close to the edge of the band from late January onward and reports in mid-March of buying of deep out of the money HKD puts.

However, as the trade tensions between the US and China began to intensify in May and the CNY began to weaken, these pressures intensified, much as they did for currencies such as the AUD and KRW.

These pressures were felt in two specific ways. Firstly, outflows began to emerge from the Hong Kong equity market (see chart below), helping drive the Hang Seng index around 9% lower over the next month and a half.

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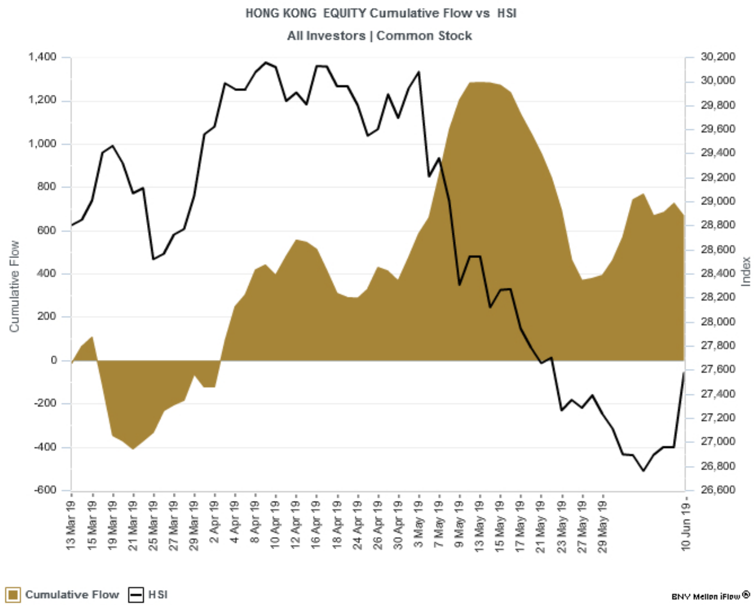
Email >

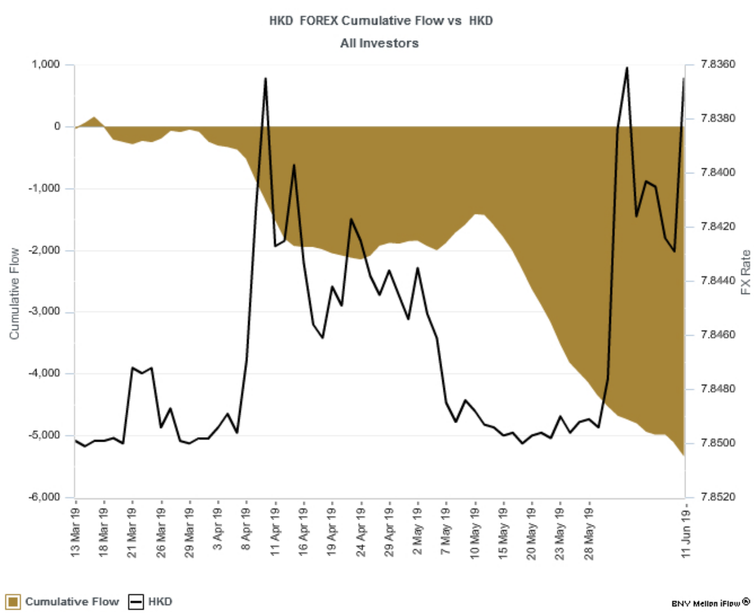
Newswatch

1.

China: Vice Premier Liu He says that the authorities should step up support for the economy and keep ample liquidity in the financial system. He adds that Beijing has plenty of policy tools and is capable of dealing with various challenges. >



Secondly, outflows from the HKD (which first really appeared in mid-March) began to accelerate (see chart below). With spot already glued to the edge of the band, the main place this pressure began to exhibit itself was in the forward market with USD/HKD outrights across the board accelerating rapidly higher.



With spot unable to move and the downward pressures on the HKD failing to abate, it was logical that at some point the demand to borrow the currency in order to hedge the forward risk would drive the points into positive territory.

That finally happened yesterday morning with the one-month swap breaking above zero for the first time since September of last year.

2.

China: China Daily, citing economists, says that Beijing is expected to adjust money and credit supply in coming weeks, including cuts to interest rates or reserve ratio requirements, to counter "downside risks" if trade tensions escalate. >

3.

Oil: A U.K. maritime body says it's investigating an incident in the Sea of Oman after an oil tanker sends a distress signal to a port in the United Arab Emirates. >

4.

Australia: Employment in May rises 42.3 k (Reuters consensus forecast 17.5k; previous 28.4k) >

5.

UK: A motion to set aside House of Commons time later this month to discuss and potentially legislate on mechanisms to prevent a no deal Brexit is defeated by

> ***Spot behaved in the same way it did last September when the one-month swap points last turned positive***

The key question therefore was how the HKD spot price would respond to this sharp rise in funding costs above US rates. A failure to respond at this point would presumably have rung alarm bells for the Hong Kong Monetary Authority.

In the event, the spot price behaved in exactly the same way it did last September, when the one-month swap points last turned positive, with the HKD staging an aggressive one-day rally (before weakening overnight as the swap points eased back towards zero).

Given there is no question about the HKMA's ability and commitment to successfully defend the band, it was therefore logical that the spike in funding costs would see the HKD appreciate sharply.

It was also logical that the HSI would react negatively to the spike in funding costs (which it did).

> ***It appears there remain concerns about the outlook for HKD despite everything***

There has, however, been one other development worth noting.

As the forward outrights came close to the edge of the band in late May, one-year at-the-money-forward implied volatility began to ease back. However, it's noticeable that the implied price has been moving higher again over the past few days.

At the same time, the 25 delta risk reversal has remained fairly firmly stuck at the highest skew in favor of HKD puts since 2016. In short, it appears that there remain concerns about the outlook for the HKD despite everything.

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309 votes to 298. >

On the Radar

June 13, 2019

• SNB monetary policy assessment and news conference (0830 BST)

• EZ Apr industrial production (1000 BST): Reuters consensus forecast -0.5% m/m; previous -0.3% m/m

Featured Article

CNY Policy Back in Focus

Previous summers have seen significant shifts in CNY policy >

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