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Instant Thoughts

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Tapering Reaches Our Shore

- **The HKMA unveiled its plan yesterday to mop up excessive liquidity, lifting the issuance size of Exchange Fund Bills by HKD40bn.**
- **Still, the HKMA isn't wave a magic wand and make money disappear like a smoke. As ever, money is just shuffling around.**
- **The recent dip should offer cash at the sideline a much-cherish chance to get back into the game. We still believe the HKD is unlikely to extend its gain in the absence of a positive-carry story.**

The stardust-kissed central banker has always armed with prudential measures and narrative examples to calm the ever-restless investors. This time around, the HKMA decided to gear up before the Fed taper comes in earnest next year. Drawing another arrow from its quiver, the regulator unveiled its plan yesterday to mop up excessive liquidity, lifting the issuance size of Exchange Fund Bills by HKD5bn in each of the eight tenders in September and October.

Some are hasty to declare funding storm is in the making, we are less pessimistic. Still, the HKMA isn't waving a magic wand and make money disappear like a smoke. As ever, money is just shuffling around. The HKMA bought USD at 7.85 and creates permanent HKD reserves prior to its announcement. And now the HKMA repo EFBNs via discount window and creates temporary HKD reserves. If the repo was to rollover forever, theoretically, nothing really changes the day after yesterday.

Practically though, borrowing at the discount window has long carried a stigma because of speculation about whether the borrower is in trouble. So the flow is never

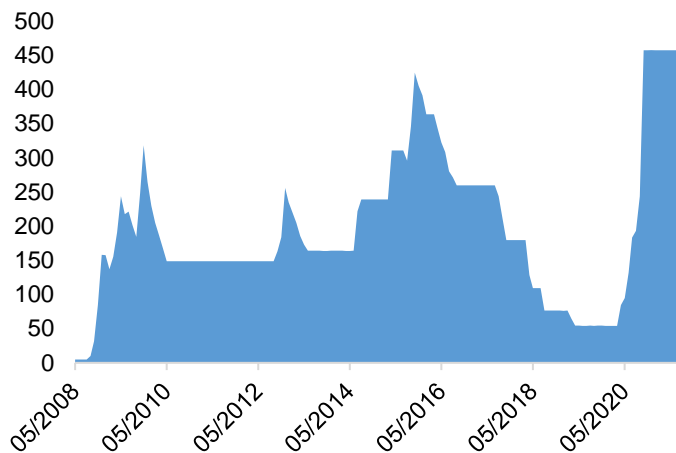


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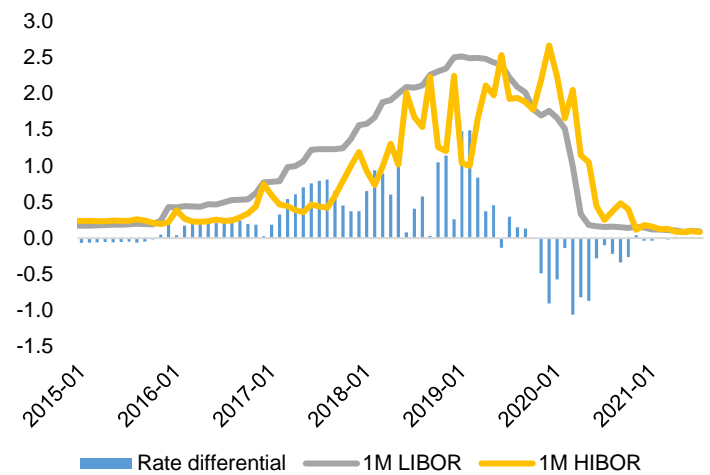
seamless. After all, we are talking about an order of billions, or less than 10% of the staggering aggregate balance of HKD457bn (Exhibit 1). No wonder HKD rate traders remained mostly unfazed amid repeated rounds of EFBs issuance during 2015-2017 (Exhibit 2).

Exhibit 1: Aggregate Balance (HKD bn)



Source: CEIC, Shanghai Commercial Bank

Exhibit 2 : USDKD Rate Differential (Percentage Point)



Source: CEIC, Shanghai Commercial Bank

The USDKD had rallied so fiercely in the past few weeks, leaving bargain-buyer to keep a stiff upper lip. The recent dip should offer cash at the sideline a much-cherish chance to get back into the game. We still believe the HKD is unlikely to extend its gain in the absence of a positive-carry story.



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