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# Navigating the flood of liquidity in Hong Kong

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**The persistently low interest rates in Hong Kong have been attracting interest in using the HKD to fund carry trades and other investments. We see risks with this approach, especially from a normalization of short-term HIBOR rates, as well as a potential HKD rebound back to the lower side of the USDHKD trading band. The current HKD weakness though makes China tech stocks even more attractive, but we would shift our investment focus to entertainment platforms. Additionally, we favor the HK exchange and Macau gaming sectors, plus other yield stocks, for their long-term prospects.**

Since falling sharply in the last week of April, the Hong Kong interbank offer rate (Hibor) has remained low across all tenors. From 4.07% on 29 April, the one-month Hibor plunged to 0.57% on 26 May, and it remains low at 1.07%. During January to April 2025, it largely hovered in the 3.5-5.0% range. This low interest rate is attracting attention from investors looking to use the HKD as a funding currency, either for carry trades, or investment in real assets.

While flush liquidity in HK's capital markets will likely keep the Hibor low near term, we would recommend caution when attempting to take advantage of these depressed rates. This is especially so since the USDHKD is firmly stuck on the ceiling of its 7.75-7.85 permitted trading range, where the HKD is weakest. The reasons for caution stem from the potential impermanence of the current situation.

To recap, Hong Kong's (HK) capital market enjoyed a revival in 2025, with over HKD 120bn raised so far. The inflows saw the USDHKD decline from early February until it hit 7.75 four times in three trading days in early May, according to the HKMA. This then prompted the HKMA to sell HKD 129.4bn for USD 16.7bn to defend the floor of the tradable range as part of the USDHKD peg arrangement. The Aggregate Balance (key measure of interbank liquidity) consequently rose from

HKD 45bn to HKD 170bn, which causes short-term interbank interest rates to fall sharply, widening the USD interest rate premium over the HKD. The 1M premium, widened from 0.37 percentage point (pp) in early May to 3.72 pp by end-May.

According to the HKMA, this interest rate premium on the USD, plus a surfeit of HKDs in the market, spurred carry trades that drove the USDHKD up to the 7.85 ceiling. Here, the HKMA intervened in the opposite direction on multiple occasions in June, and lowering the Aggregate Balance to HKD 101.2bn by 11 July. This helped raise the 1M Hibor to almost 1.20% before it retraced slightly, ensuring that the USD's interest rate premium remained wide. The HKMA made it clear that it considers the recent USDHKD and Hibor movements as being in line with the proper functioning of the USDHKD peg mechanism. We agree and see no risk to the peg.

**Beware the risk of retracement.** While the unusually low short-term HKD interest rates make the HKD seem enticing as a funding currency for carry trades, investors need to factor in the potential for reversals in both FX and interest rates. The unusually wide USD interest rate premium over the HKD is being supported in large part by softening credit demand in HK, a hawkish shift in US Fed expectations, and fund flows into HK. These should remain in place for the near term, and the HKMA does seem to be happy about the economic support from low interest rates. However, a spike in domestic credit demand or a reversal of inflows could raise HKD interest rates and prompt a tumble in the USDHKD, which would hurt long-USDHKD carry trades.

**Cheaper HKD could benefit China tech stocks.** China's technology sector's risk-reward profile is improving, supported by the de-escalation in Sino-US tensions, resumption of mid-tier H20 graphics processor imports, continuous AI innovation, and attractive valuations. Many of these stocks are listed in HK and their attractiveness to international investors would have been boosted by the HKD's weakening. Though the earnings outlook for e-commerce platforms has dimmed owing to additional investment needs, China tech's earnings growth for 2025-26 is still supported by resilient entertainment spending, positive cloud trends, and continuous cost optimization initiatives. Within the internet segment in the tech sector, we prefer entertainment platforms over e-commerce given the more benign competition, high earnings visibility, and robust cash flows.

**Opportunities from Hong Kong's liquidity harbor.** We favor the HK exchange and Macau gaming sectors, plus other yield stocks, for their long-term prospects. The surge in inflows mentioned earlier was driven by slew of A-share companies listing in Hong Kong, which already had solid track records on the mainland. International investors that were previously impeded used this to access these companies through their HK listing. The capital market revival is thus attracting global investors, further enhancing liquidity and benefiting companies linked to capital markets activity. The Macau gaming sector is also showing strong signs of recovery amid rising tourism inflows after an easing of travel restrictions. HK equities currently offer an attractive dividend yield of 4%, especially in the insurance, financial, property, and utilities sectors (63% of the MSCI HK).

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