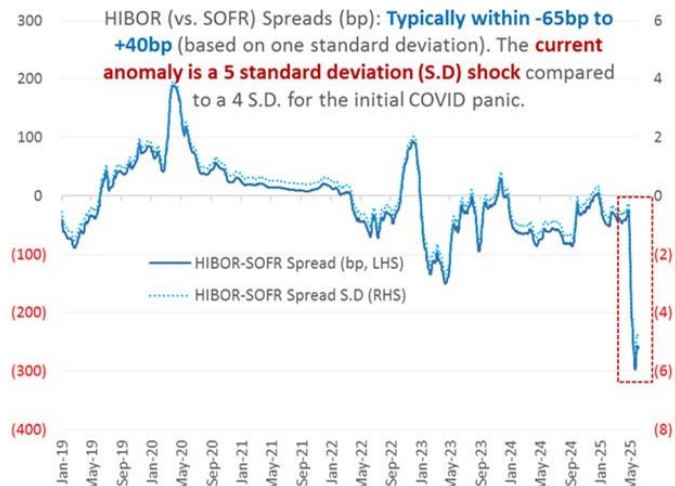
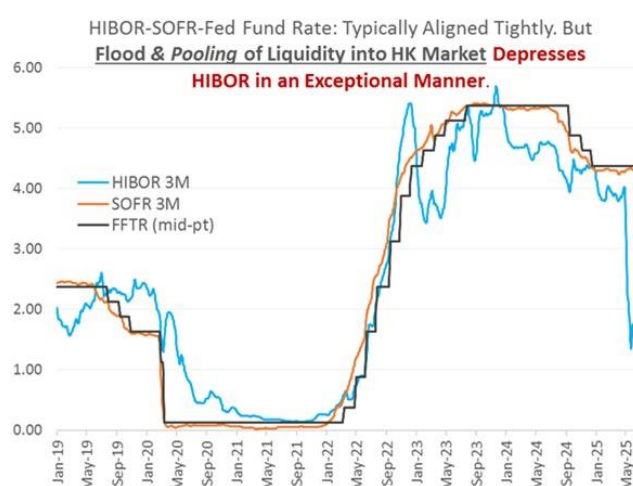


## Temporary HIBOR Departure, Not Irrevocable (Peg) Break

*"The path was worn and slippery. My foot slipped from under me, knocking the other out of the way, but I recovered and said to myself, 'It's a slip and not a fall' " – Abraham Lincoln*

### In a Nutshell:

- The **exceptional 250-300bp drop in HIBOR vis-à-vis corresponding SOFR** is more a **by-product of anomalous flows amplified by geoeconomic flares**, *not an irrevocable fundamental break*.
- Crucially, the **tendency** therefore ought to be **towards (gradual and partial) reversion** (re-tightening in HIBOR-SOFR spreads), **anchored by the monetary/FX peg** and **as the deluge of liquidity is better absorbed**. **Not a catalyst to break the peg**, which is arguably even more important as an anchor for stability.
- Consequently, after the recent precipitous drop, **HIBOR should find a bottom sooner rather than later**; albeit bumpily.
- Admittedly, exceptional geoeconomic factors could mean that a full reversion is unlikely. But a **re-narrowing of the negative gap (vis-à-vis SOFR)**, set to more than offset Fed cuts in coming weeks and months, **could lend itself to higher HIBOR rates** to perhaps test 2.5-2.8%.
- Further out **into 2026, Fed cuts are set to regain dominance of directional cues**, although subject to remnant scope for HIBOR's upward convergence (with SOFR).



- 1) **Anomalous HIBOR Spread Reflects Exceptional Liquidity Deluge:** The **current anomaly**, with HIBOR spreads 250-300bp lower than the corresponding SOFR (which is typically within much tighter tolerances) may be attributed to:
  - i) **Exceptional liquidity inflows** boosted by unusually high Hong Kong IPO demand.
  - ii) Accentuated by a **pooling of this deluge of liquidity** amid somewhat impaired arbitrage outflows.

- iii) Further **underpinned by the "Sell America"** dynamics that has dramatically **increased demand for** (and hence allocation into) **non-USD/non-US assets**, thereby enhancing HKD asset allure.
  - iv) Arguably, **exacerbated as a bearish USD that has diminished the urgency and intensity of HKMA intervention** (hence, less aggressive mopping up of HKD liquidity) to backstop HKD slide.
- 2) Pooling of Liquidity Could Persist: Given the *peculiarities of the geoeconomic circumstances*, this **pooling of liquidity** within Hong Kong markets without offsetting arbitrage outflows, **could persist for a while**. Accordingly, **so could the anomalous HIBOR-SOFR departure** (with HIBOR expected to remain significantly lower than the corresponding SOFR).
  - 3) But Divergence is Extreme: **Nonetheless**, the **divergence**, resulting in exceptional HIBOR discount (vis-a-vis SOFR) **appears to be extremely and perhaps unsustainably stretched at 5 standard deviations (S.D.)**, suggesting that **at least partial reversion is the path of least resistance**. *But not just blindly on statistical anomalies*.
  - 4) Set to Fade on Absorption & Allocation: Instead, HIBOR should reasonably be subject to partial convergence over the next few months **as fund flows stabilize**, and this exceptional (positive) **liquidity shock is better absorbed into the domestic asset markets** (equities, properties, etc), and **allocated**. And to be sure, **Hong Kong markets are well placed for this**.
  - 5) Anchored by the Monetary Peg: What's more, with the HKD at the weak side of the USD/HKD peg range, the **HKMA is also poised to backstop the HKD**, typically involving **mopping up HKD liquidity** onshore. This **ought to help rein in the anomalous HIBOR-SOFR tear**, in turn **facilitating** (albeit subject to bumps) **a bottom in HIBOR sooner rather than later**.
  - 6) Not Undermining the Peg: And **contrary to some misperceptions, the HIBOR-SOFR dissociation is not a bug that undermines the peg, but a feature of the dynamic adjustment and "shock absorption" mechanism that enhances underpins the peg**. Point being, adopting the FX tool means allowing rates to adjust dynamically. *Admittedly, there may always be scope to examine the parameters of the peg to optimize financial condition trade-offs* (present in all policies). Nevertheless, the **prevailing geoeconomic tensions arguably enhance the allure the peg**.
  - 7) Fading HIBOR Tear at Least Partially: Hence, as **extreme onshore liquidity is partially digested, the downward rate (HIBOR) shock is set to gently subside, even if more enduring shifts in asset allocation prevent a full reversion**. So, one can reasonably expect the extreme 5 standard (negative) deviation in **HIBOR to tighten to around 3-4 standard deviation over the next 3-6 months**, with **scope for 2-3 standard deviation divergence further into 2026**.
  - 8) Consistent with Soft Bottoming in HIBOR: This should be **consistent with a tightening to a touch above 150-250bp spread** (vs. SOFR) in coming weeks and months. In turn, lending itself to **some pick-up in HIBOR in coming weeks** (although two-way volatility will likely persist).
  - 9) Spread Re-tightening to Initially Outweigh Fed Cut Expectations: Admittedly, **Fed rate cuts will in theory oppose any pick-up expected in HIBOR from an erosion of the exceptional (negative) spreads**. **But** the exceptionally **stretched spreads probably have more to narrow than the Fed is expected to cut** (markets expect less than 50bp cut) in the next 6 months. So, **Fed expectations may only mute, not more than offset**

**gradual and measured upside HIBOR convergence** in the near-term. The resultant gradual erosion of HIBOR-SOFR deeply negative spreads may be consistent with HIBOR in the 1.6-2.8% range in coming months.

- 10) Fed to Feature More Emphatically Later: **Further out in 2026**, the **pace of Fed cuts may once again be re-established as the main directional catalyst** as acclimatization to fund flows/dynamics stabilizes HIBOR-SOFR spreads (which may be narrower than now although wider than historical norms).

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