

HIBOR: Upside Risks Controlled

“Control, control, you must learn control!” – Master Yoda, Star Wars, Episode V: The Empire Strikes Back

In a Nutshell:

- The **brutal squeeze in 3M HIBOR**, doubling to over 3.2% since mid-August, **could understandably raise concerns of a further upside volatility** to over 4% (consistent with SOFR convergence).
- But that may be the **pitfall of “linear fallacy”**. Whereas *lingering liquidity cushion* meeting a *dovish Fed pivot* suggest **controlled upside set to inflect to a controlled capitulation**.
- To be sure, it is more likely than not that **further convergence** with **SOFR** will happen **eventually**, bound by monetary policy/HKD peg links, but *not necessarily imminently*.
- For one, the **brutality of recent HIBOR move was driven by “biting point”** from liquidity drainage that *abruptly re-sensitized HIBOR rates to HKMA’s intervention*.
- Whereas with **HIBOR-SOFR deviation tamed to ~85bp from 260bp** **further convergence** may be **more measured**, *buffered by relative liquidity cushion*.
- Especially with **aggregate balance at HK\$54bn** that is *nearly HK\$10bn above recent (HK\$45bn)* further underpinned by robust capital inflows.
- Crucially, **Fed rate cuts lined up** means that **HIBOR will be managed well below 4%**, with an **outlook for 2.3-2.8% coming into view into 2026**.
- And as *HIBOR-SOFR erode further, albeit gradually*, **USD/HKD** could **settle into the 7.76-7.77 range**, all else equal.

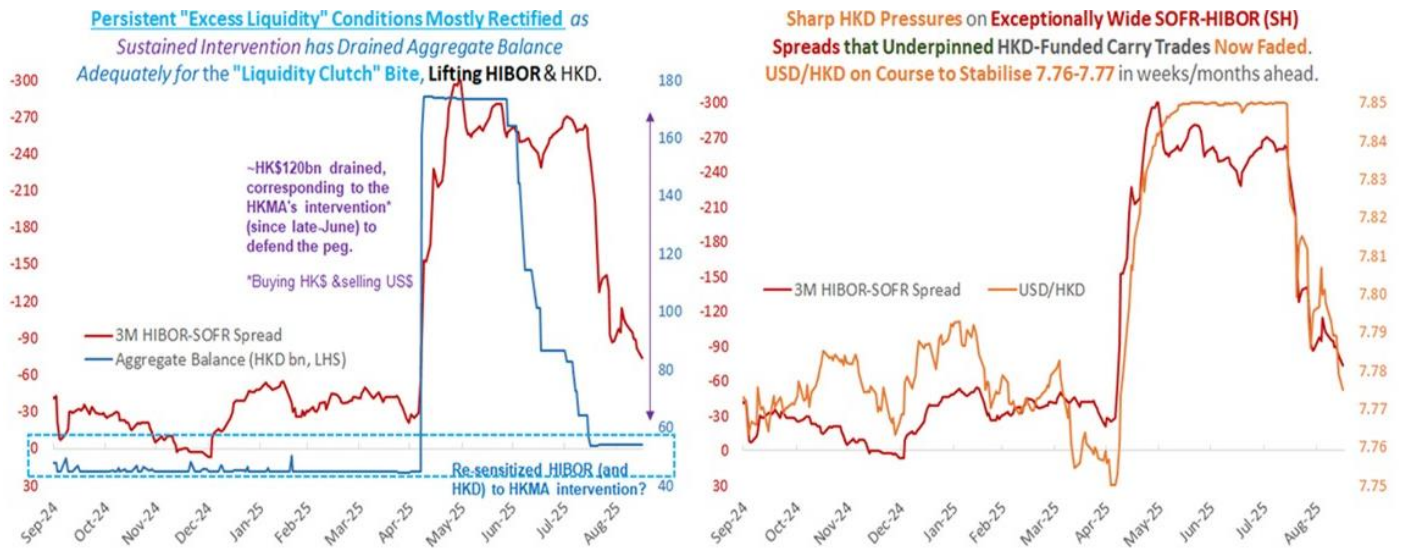


- The **sharp and abrupt jump in HIBOR** has been a **bit of a jolt** for some parts of the markets.
- Afterall, in just a month **3M HIBOR has nearly doubled to over 3.2% from a hair over 1.6% levels in mid-August**.
- But this is **neither unexpected** given sustained HKMA intervention (liquidity drainage), **nor** is it **necessarily unrelenting**.

- To be sure, we have long warned of a *“biting point” that abruptly re-sensitizes rates* as **liquidity drainage** (from **extraordinarily excessive** levels) **hits a certain threshold**.
- Moreover, when that threshold is triggered, HIBOR catch-up (to the corresponding SOFR) is bound to be *non-linear* (with respect to the pace of liquidity drainage).
- Specifically, **subtle shifts** (tightening) **in the aggregate balance may induce outsized response** (upside) in HIBOR.
- With the **corresponding 3M SOFR at just over 4%**, the **HIBOR-SOFR spread is now at 85-90bp** (averaging *sub-100bp in September*).
- This is undeniably a *sharp drop from the over 260bp spread in early August* that understandably invokes concerns about more to come.
- The key questions are whether this **pace of convergence will persist**, *rapidly closing the remaining ~85bp gap*, and consequently **lift (3M) HIBOR over 4% very soon**.
- The answer is a **qualified “Yes”** (to convergence), and an **effective “No”** (to HIBOR over 4%).
- *Yes*, HIBOR will *eventually converge more tightly with SOFR*. *But* it need *not* close the gap *imminently*.
- For a start, **with HIBOR-SOFR spreads significantly tamed from exceptional 260bp levels** (5-6 standard deviations) to below 90bp (<2 S.D.), the **pace of convergence is likely to moderate**.
- Especially given that *aggregate balance is reasonably ample*, **at some HK\$54bn**, (vis-à-vis recent norms of ~HK\$45bn), which provide liquidity cushion for rates.
- What’s more, *if asset/capital market inflows remain robust*, as they have in recent months, then **HIBOR could maintain appreciable 30-80bp discount** (vis-a-vis SOFR) **that fades more gradually**.
- Crucially, **given that the Fed is set to lower rates** (and more likely than not, engage in a series of rate cuts), **HIBOR will effectively not breach, much less endure at/above, 4%**.
- Instead, more carefully **managed liquidity** will likely **dovetail** (no pun intended) **with Fed rate cuts to dampen upside HIBOR volatility**.
- What that means is that an **upward drift from 3.2% in 3M HIBOR will be well managed**, set to quickly **resume a downtrend towards 2.3-2.8% into 2026**.
- All else equal, the **further, but managed, erosion in HIBOR-SOFR spreads** are likely to be **consistent with USD/HKD settling into the 7.76-7.77 range**.

Rates Outlook

	Q3 2025	Q4 2025	Q1 2026	Q2 2026	Q3 2026	Q4 2026
FFR Assumptions	4.00-4.25	3.50-3.75	3.25-3.50	2.75-3.00	2.25-2.50	2.25-2.50
FFR Mid*	4.125	3.625	3.375	2.875	2.375	2.375
SOFR	4.075	3.605	3.425	2.815	2.455	2.575
3M HIBOR	3.30	3.01	2.98	2.54	2.28	2.45
1Y IRS	3.15	2.91	2.86	2.49	2.10	2.31
USD/HKD	7.78	7.77	7.78	7.77	7.76	7.76



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