

APOLLO

Outlook for the Hong Kong dollar

Apollo Global Management

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Unless otherwise noted, information as of August 2025

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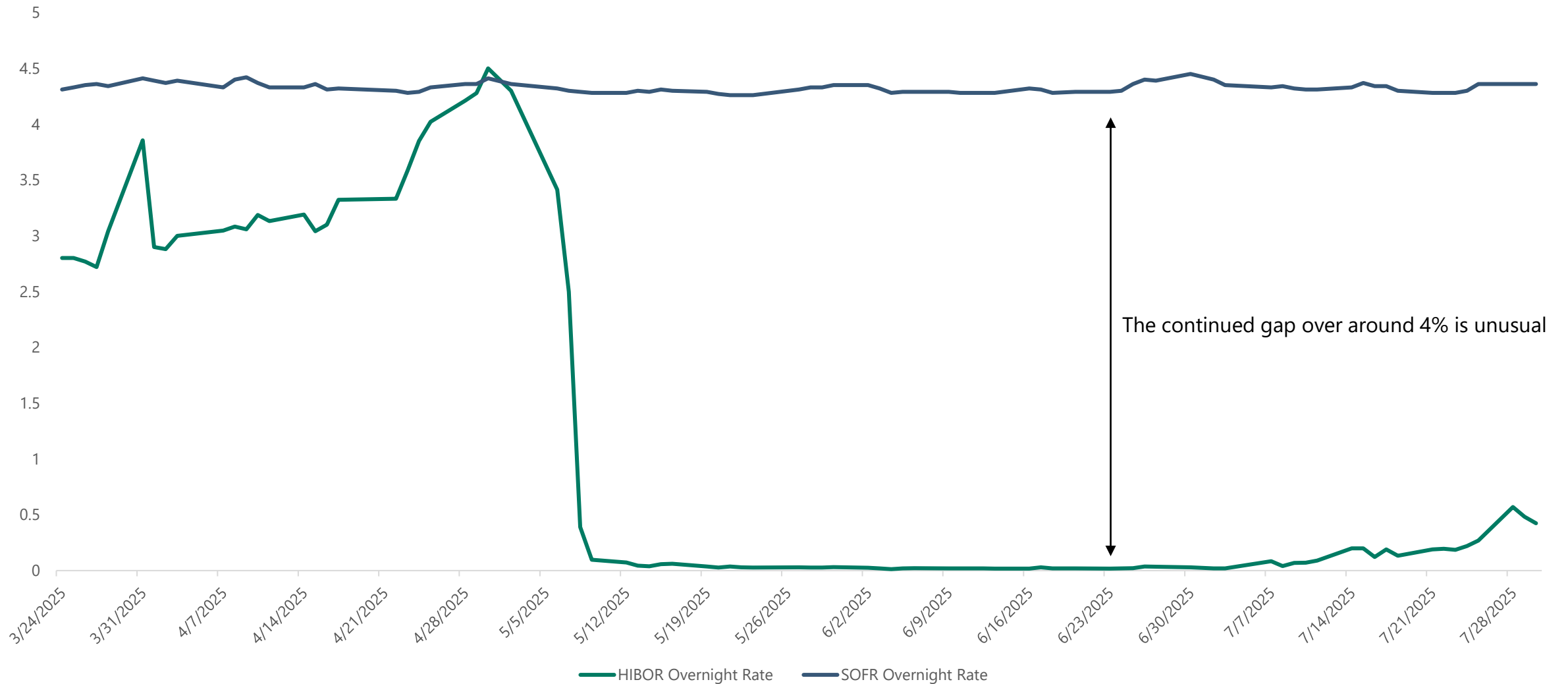
It should not be assumed that investments made in the future will be profitable or will equal the performance of the investments shown in this document.

Overview

1. We expect that the Hong Kong dollar peg will hold. The HKMA has large reserves to intervene, and the peg is a cornerstone of Hong Kong's success as a global financial center. Hong Kong's monetary base is fully backed by USD assets held in the exchange fund.
2. But there are pressures on the Hong Kong dollar peg. After Liberation Day, the US dollar depreciated significantly. As a result, capital started flowing into Hong Kong, and the Hong Kong dollar appreciated so much that it reached the strong limit of the trading band relative to the US dollar.
3. In response, a few weeks after Liberation Day, the HKMA lowered Hong Kong interest rates to zero. As a result, there is now a significant gap between interest rates in the US and in Hong Kong, which is putting pressure on the peg because investors can now borrow in Hong Kong dollars and invest in US dollars, earning a significant return as long as the peg holds.
4. This has increased discussion among macro investors about the Fleming-Mundell policy trilemma, which says that a country cannot simultaneously have 1) a fixed exchange rate, 2) free capital movement, and 3) an independent monetary policy.
5. The bottom line is that we expect the Hong Kong dollar peg to hold and the HK government is benefiting from a firm peg and lower rates. However, investors should be aware of the pressures building, because if the peg is abandoned, it will have significant implications for global markets.

The continued gap in HIBOR vs SOFR is unprecedented

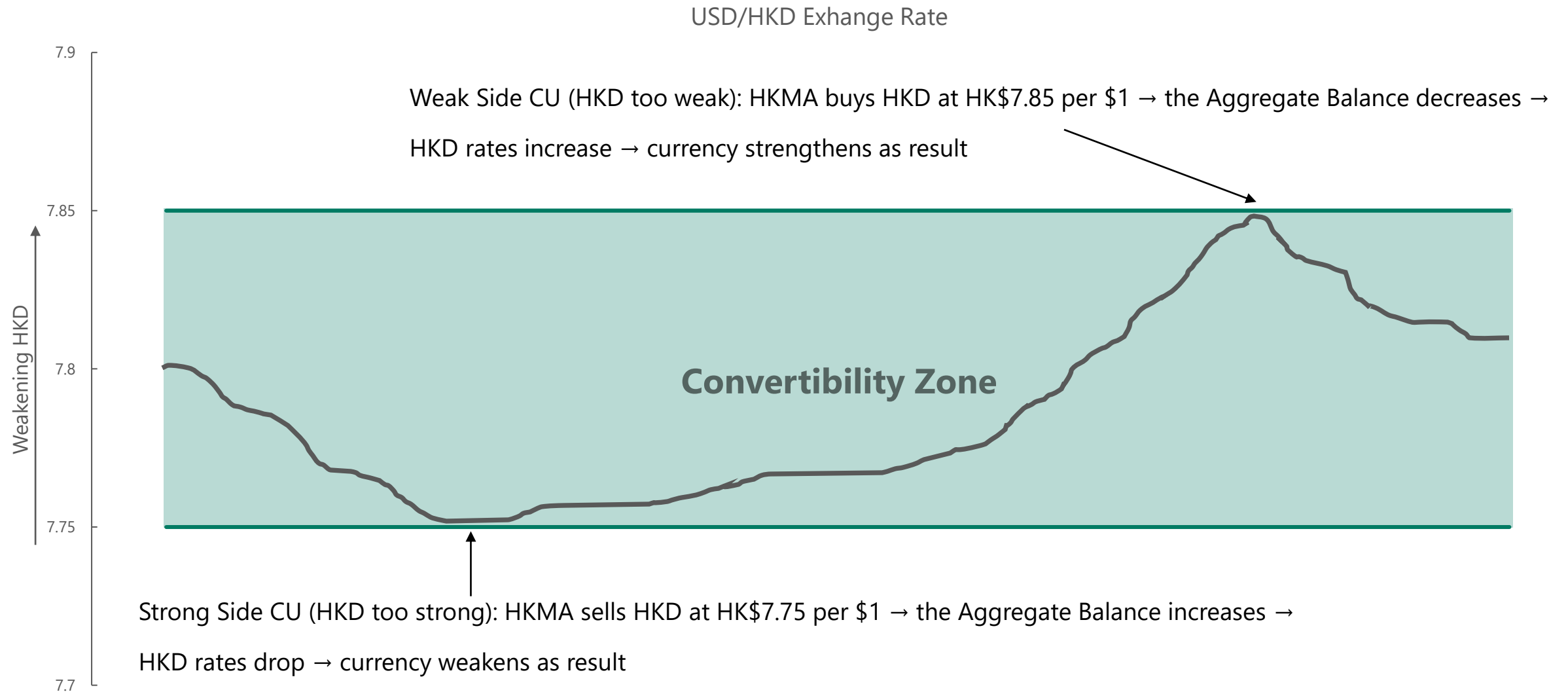
Hong Kong HIBOR vs US SOFR



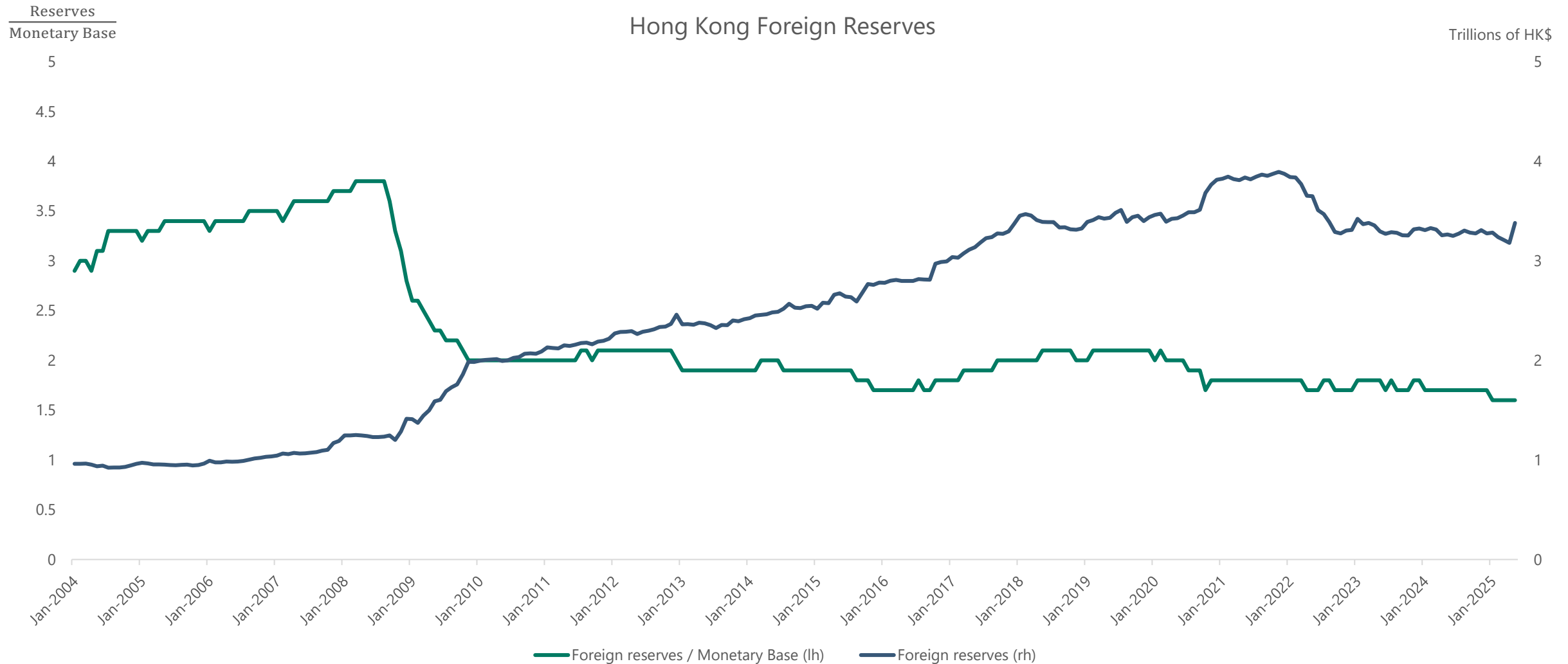
The Hong Kong Dollar

- The Hong Kong dollar is pegged to the US dollar at HK\$7.8 to \$1 and has a HK\$7.75-7.85 trading band. It has been pegged since 1972, though at different values.
- The Hong Kong Monetary Authority (HKMA) has large foreign reserves to maintain currency stability using the Linked Exchange Rate System. LERS involves either buying or selling HKD.
- Buying or selling HKD changes the Aggregate Balance which is a component of the monetary base and represents cash in the banking system. This alters HKD interest rates to either strengthen or weak the currency. These actions are called convertibility undertakings (CUs).
- The HKD-USD peg has survived repeated crises in the past and is seen by many as the cornerstone of Hong Kong's success. LERS has provided stability for over 40 years.

Illustrating Convertibility Undertakings (i.e. FX interventions)

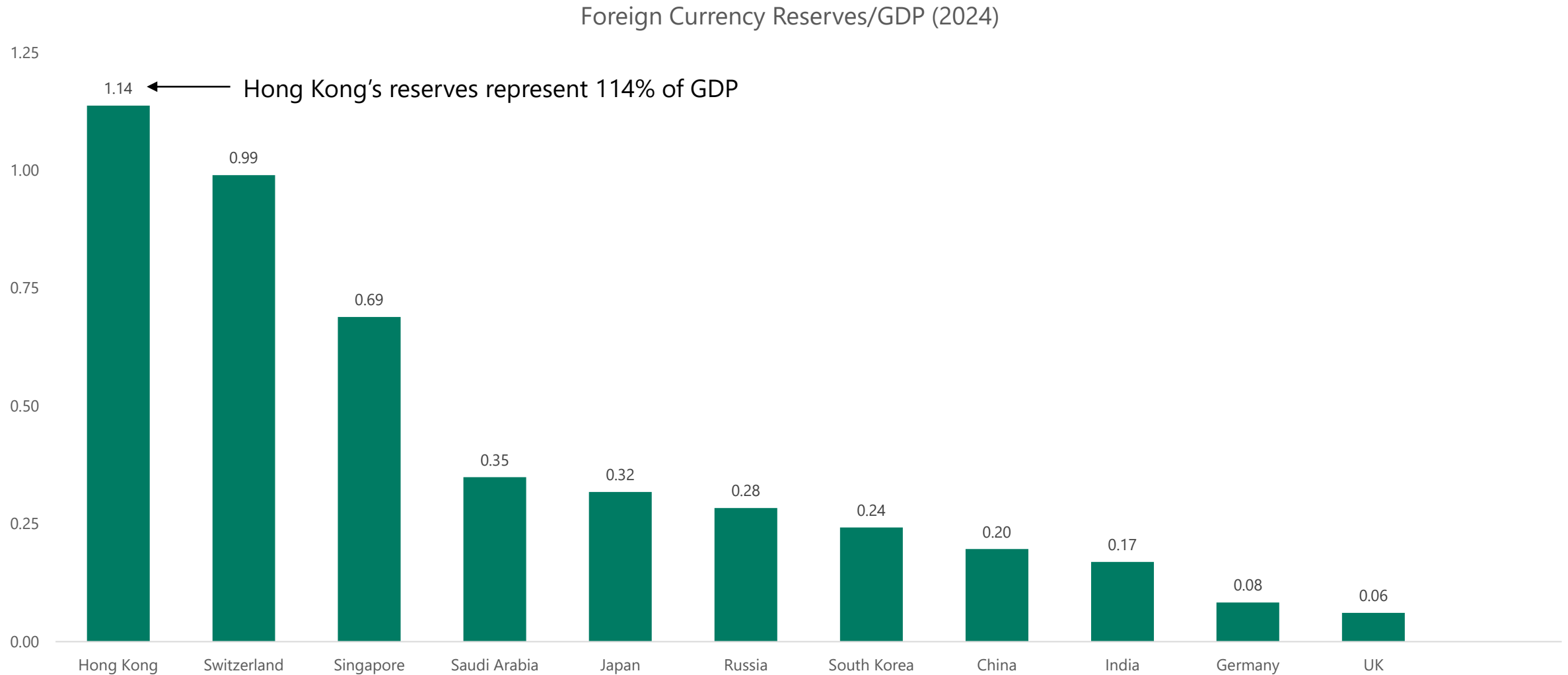


Hong Kong foreign reserves are large and the HKMA Investment Portfolio is one of the largest sovereign wealth funds in the world



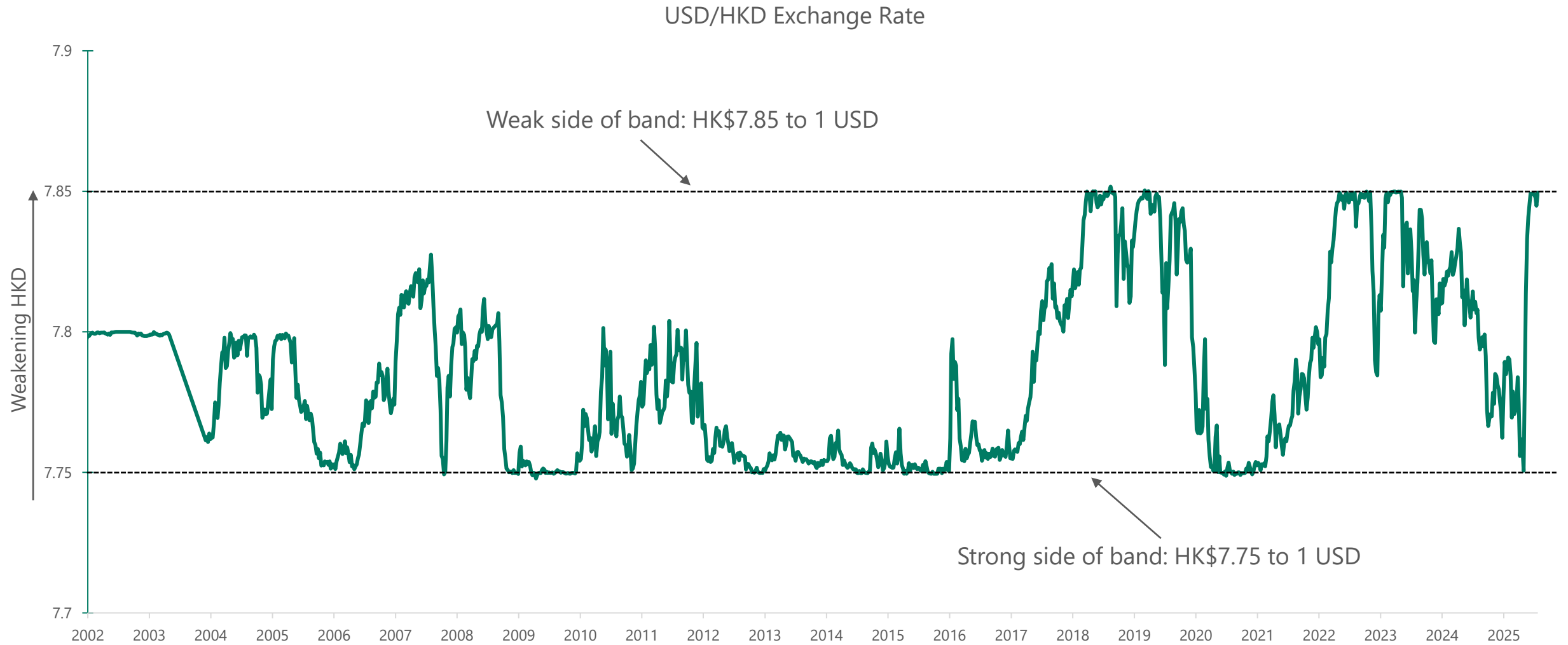
Note: All references to Hong Kong refer to the Hong Kong S.A.R., China. Source: HKMA, Apollo Chief Economist

The HKD monetary base is fully backed by USD assets, and the reserve is large relative to Hong Kong's size



Note: All references to Hong Kong refer to the Hong Kong S.A.R., China. Source: World Bank, Apollo Chief Economist

Hong Kong's Linked Exchange Rate System (LERS) has worked successfully for decades

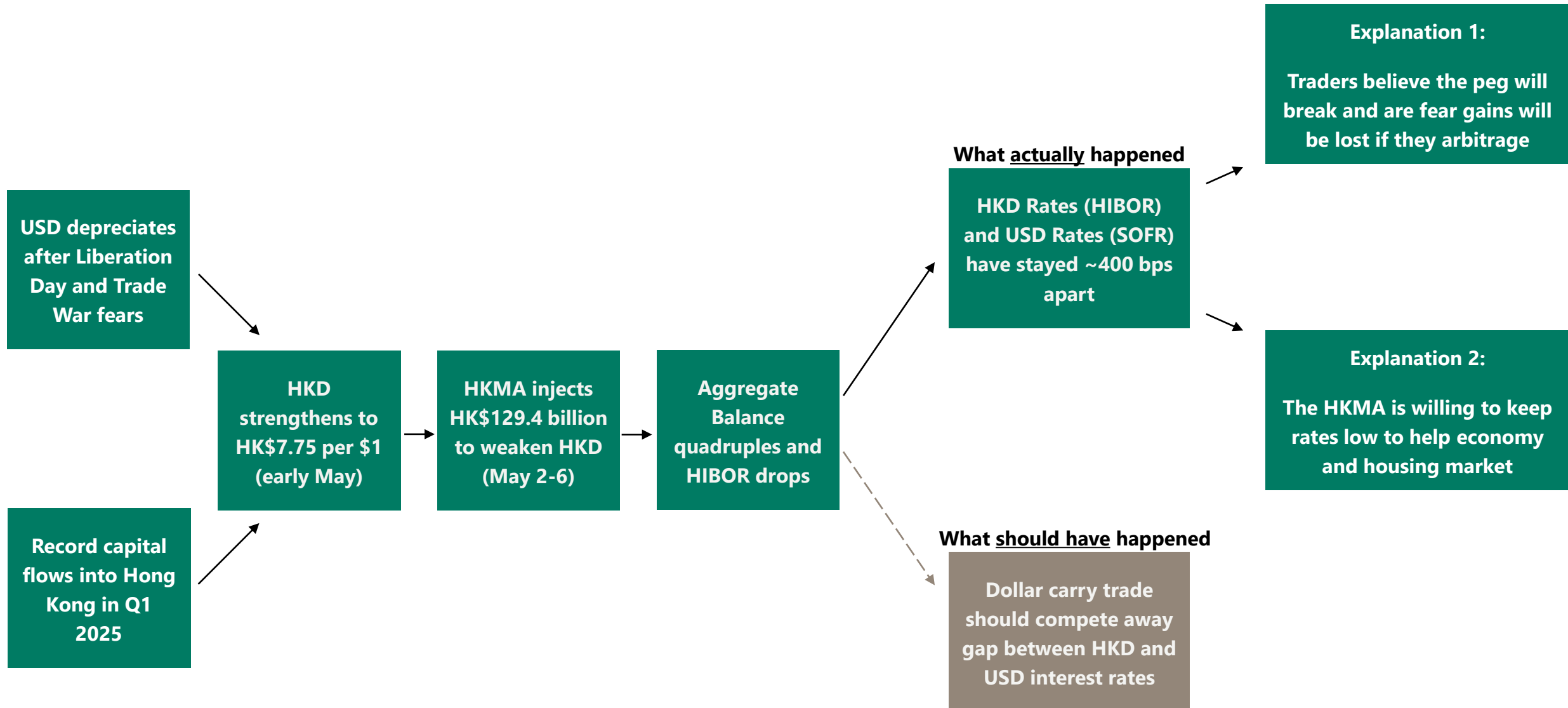


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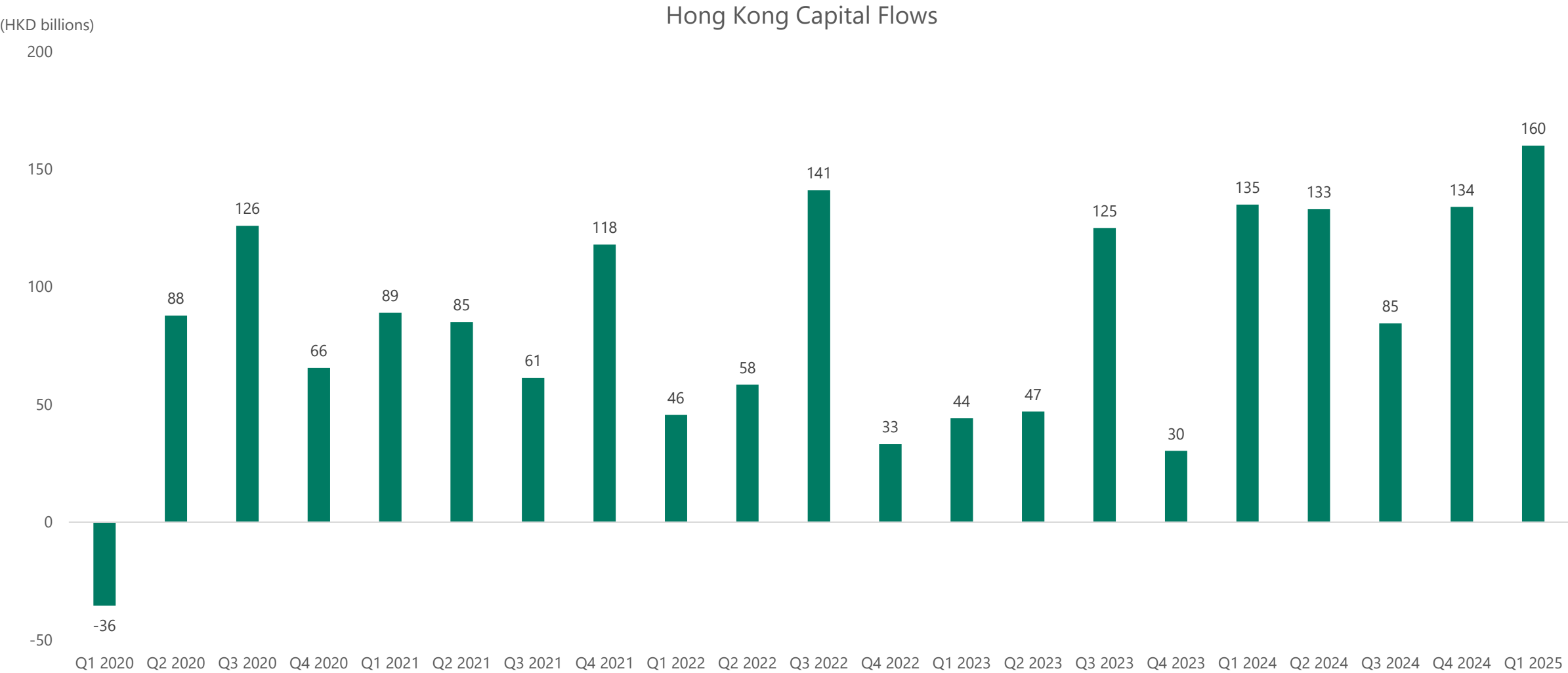
What happened in summer of 2025?

- Weakness in the USD in early 2025 and large capital inflows caused the HKD to appreciate to the HK\$7.75 strong side of the trading band. This triggered a historically large, strong side convertibility undertaking and the HKMA sold HK\$129.4 billion to weaken the currency.
- As a result, aggregate balance increased by 4x which pushed down market interest rates to near-zero and sent the HKD to the weak side of the band. The HKMA has needed to intervene in the opposite direction, spending billions of HKD to keep it away from weakening too much.
- Normally, traders would borrow in the low-rate currency, the HKD, and invest in a high-rate currency, in this case, the USD. While the HKD is currently on the weak side of the band (7.85), a quick snapback to the strong side (7.75) could lead to meaningful losses.
- However, the gap between the Hong Kong Interbank Offered Rate (HIBOR) and United States Secured Overnight Financing Rate (SOFR) has not closed yet. The question is **why**.

Overview of the current situation

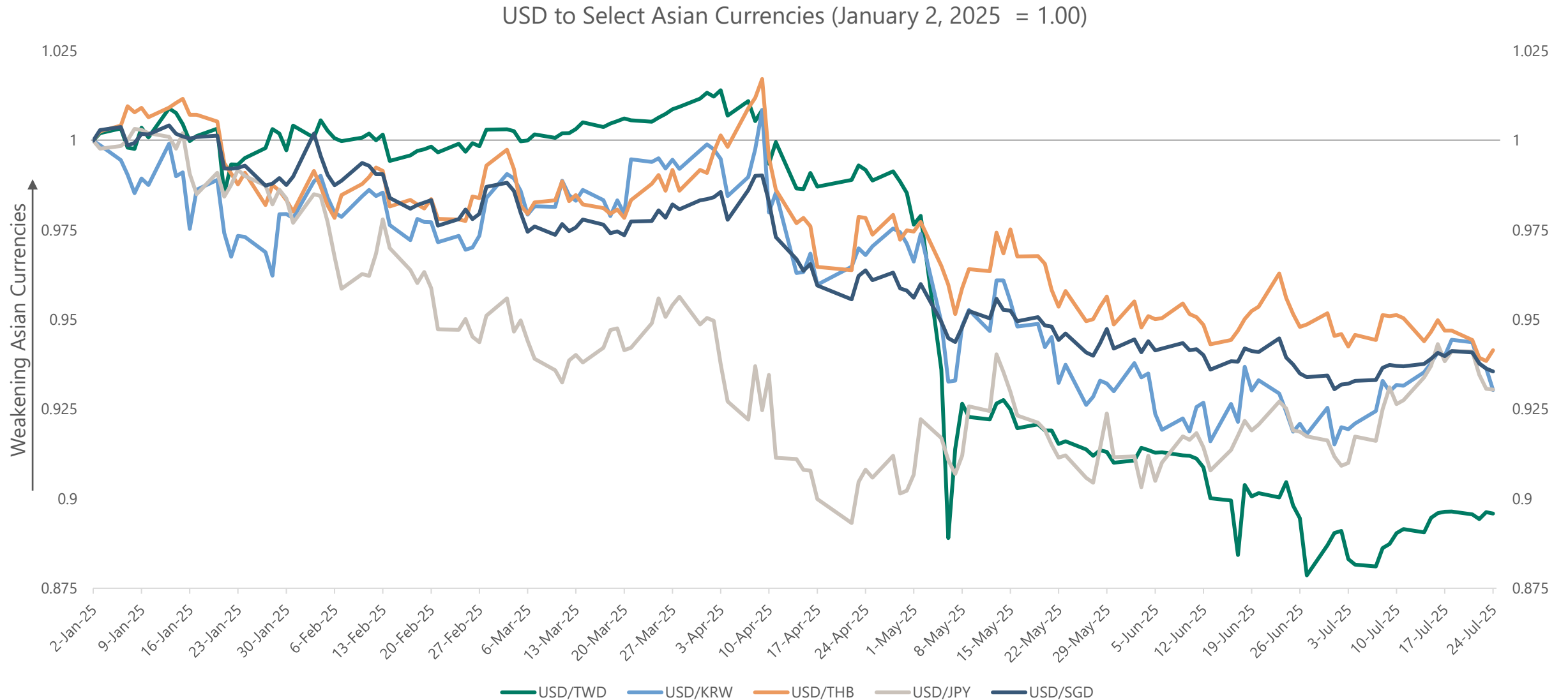


Record capital flows, including being the largest IPO market worldwide in 2025H1, boosted the Hong Kong Dollar



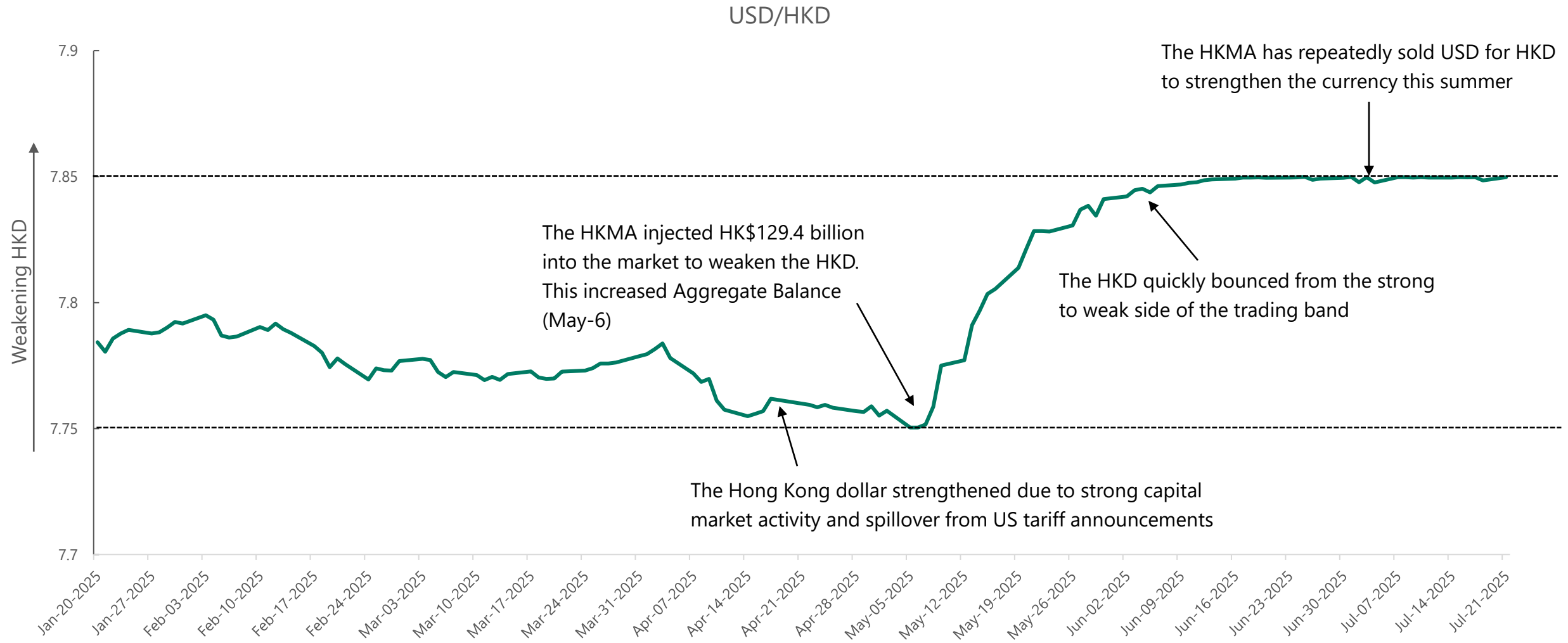
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Other currencies in Asia faced similar appreciation as the HKD

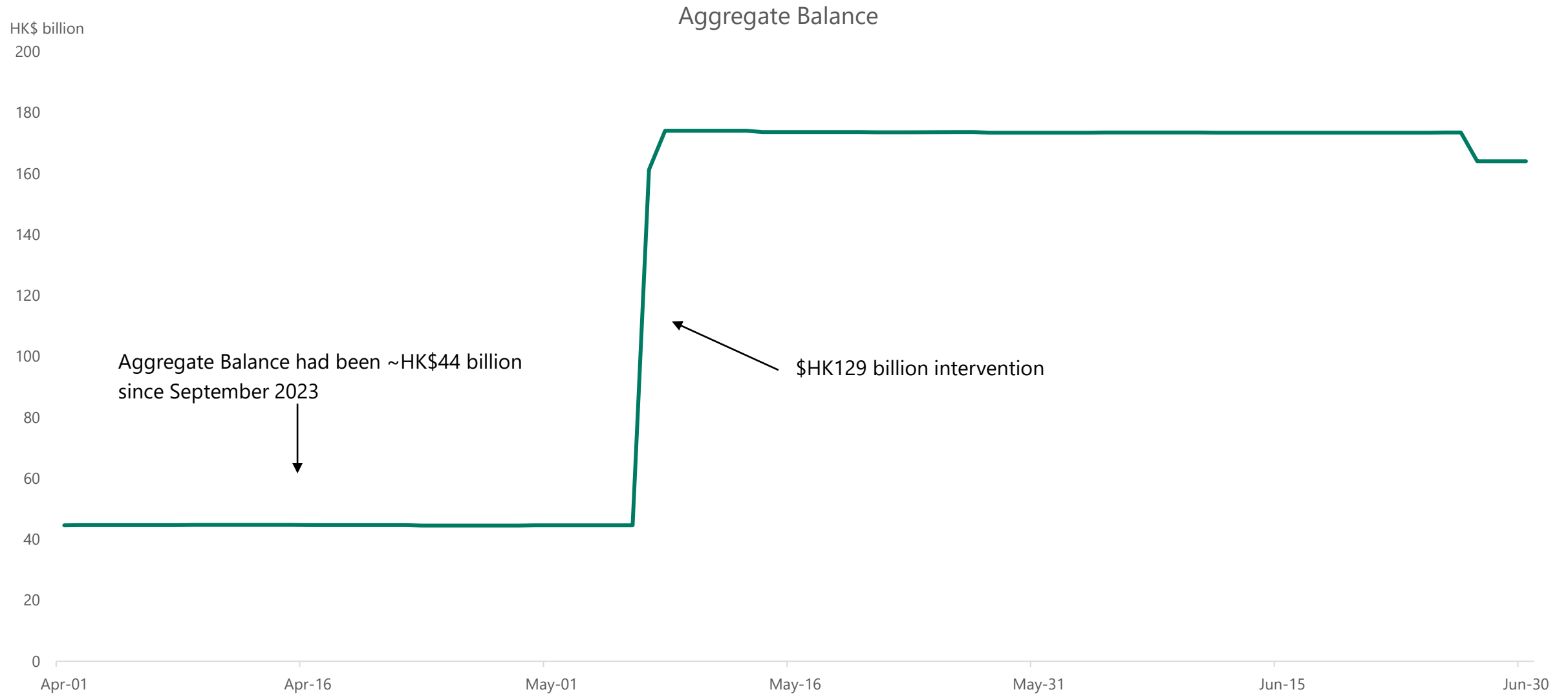


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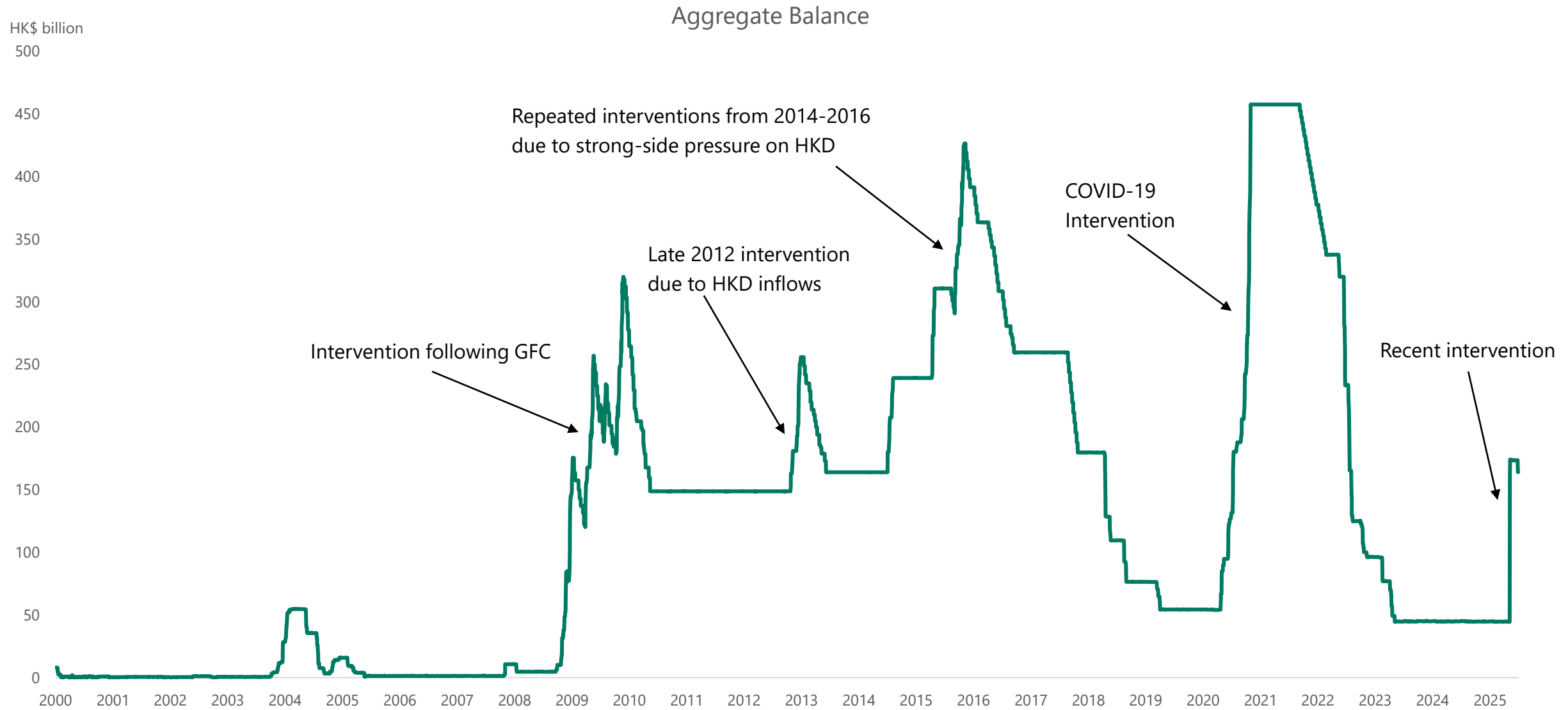
Movements in the Hong Kong dollar since the beginning of the year



The Aggregate Balance increased drastically in May 2025



However, this increase in Aggregate Balance is not unprecedented



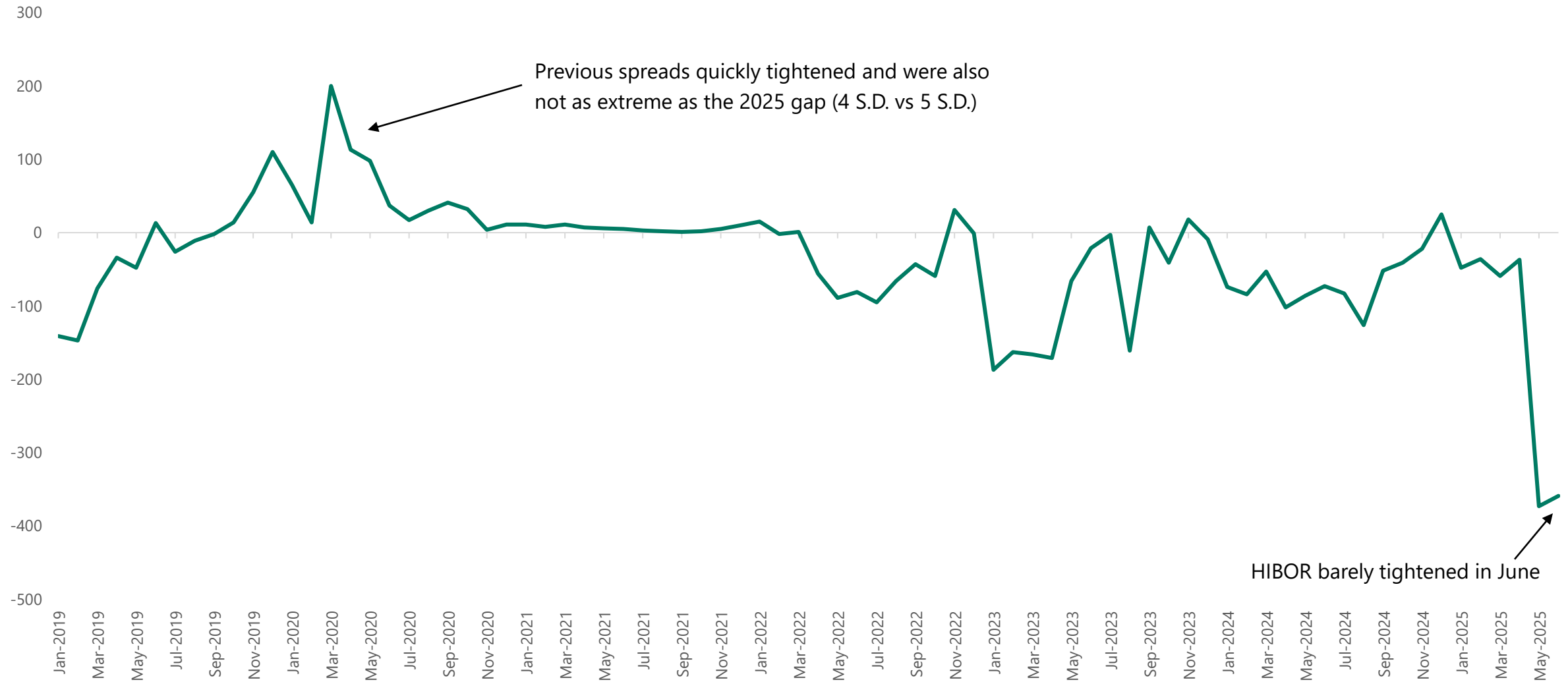
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Why the gap in rates and will the peg break?

- Usually, dollar carry trades or borrowing HKD and selling against higher-yield US assets, competes away the interest rate gap, but this has not happened. This may indicate that traders assume the peg will break and wipe out their gains.
- The HKMA officially does not have an interest rate policy. However, keeping rates low may be a tactic to help the real estate sector. Over 90% of Hong Kong mortgages are tied to HIBOR.
- While the carry trade looks attractive, a quick snapback to the strong side (7.75) from the weak side (7.85) where the HKD currently sits could lead to meaningful losses for traders.
- Despite Hong Kong's large reserves and the HKMA's proven ability to maintain the peg, analysts have predicted for years that the peg will break. Some have predicted that the HKD could peg to the yuan due to increased economic ties with China. However, this has issues of its own.

The magnitude of the gap is also unique

1-month HIBOR fixing minus 1-month term SOFR



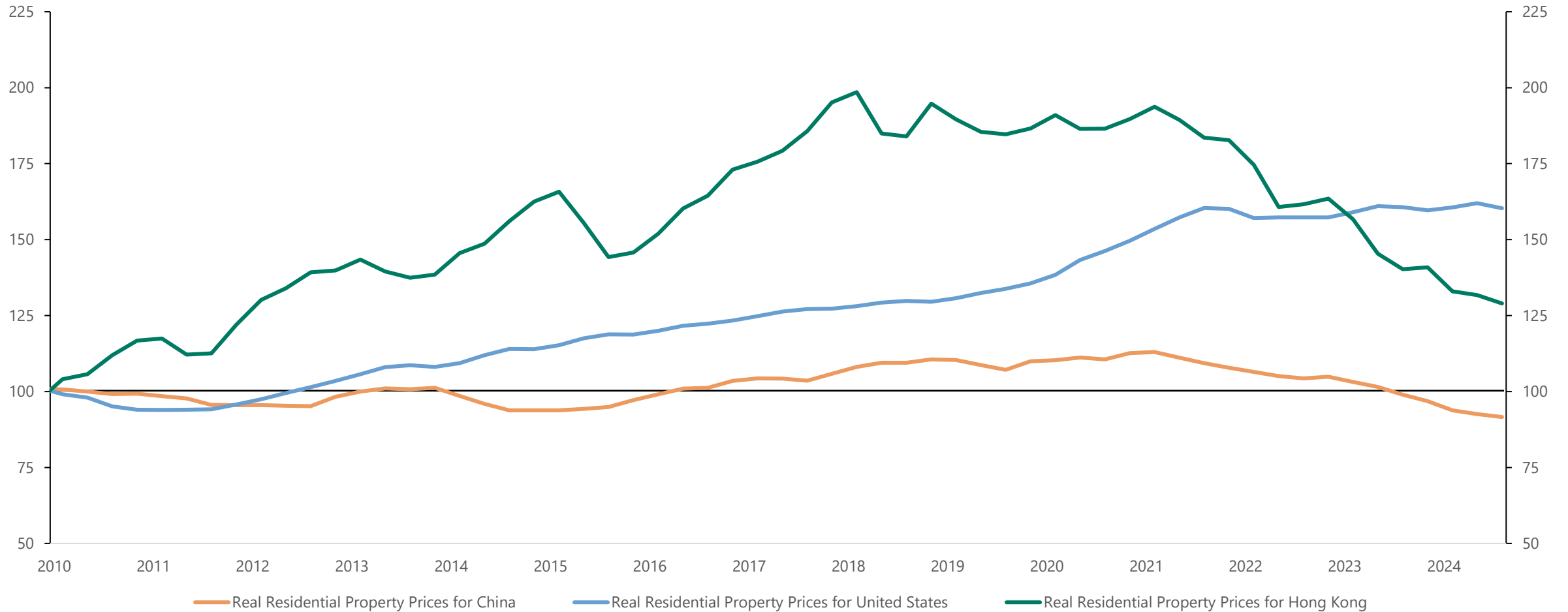
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Pressures on the peg

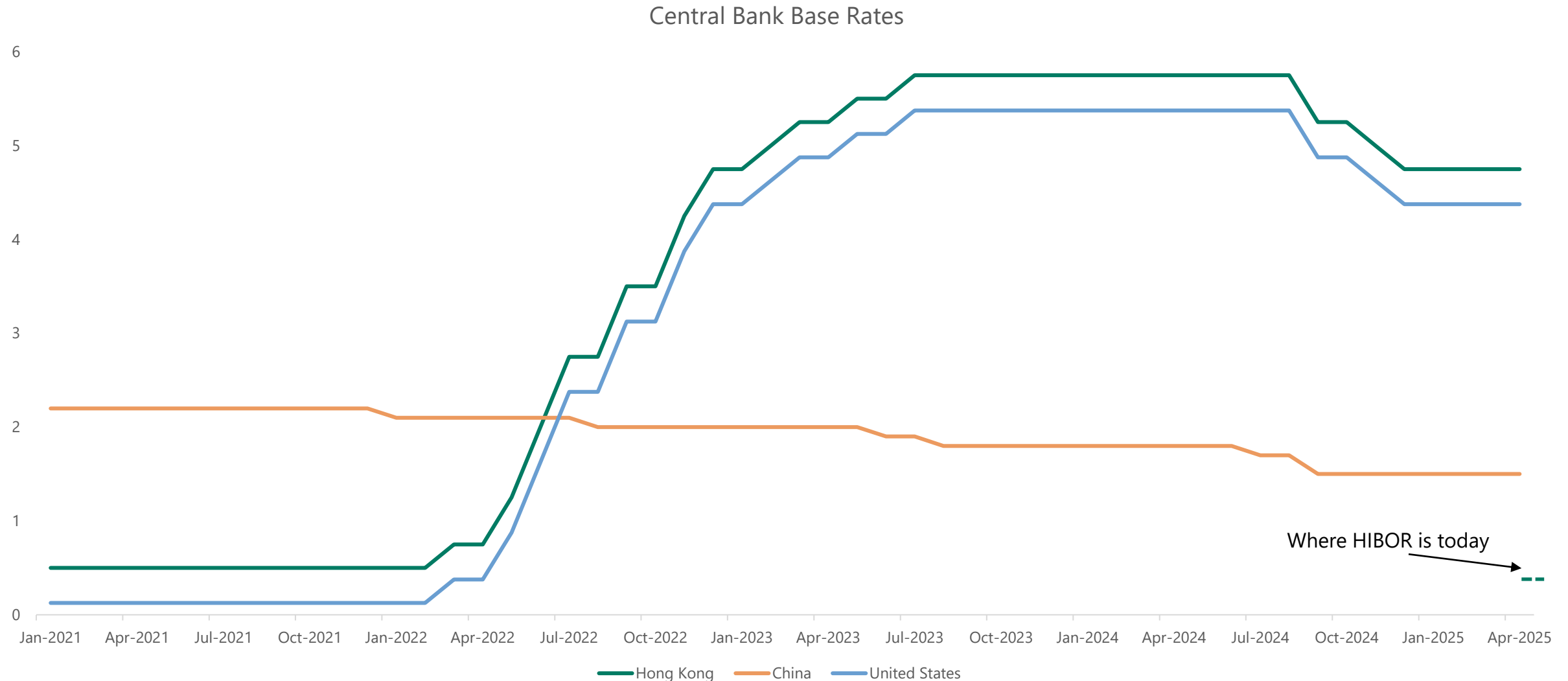
Weakening domestic economy <ul style="list-style-type: none">- Hong Kong has had to maintain higher rates than its neighbors despite a struggling real estate market and economy to maintain the peg.	Increasing integration with China <ul style="list-style-type: none">- As Hong Kong and China become more integrated, their economic performance becomes increasingly linked. Conforming to monetary policy from the Fed may not work for Hong Kong in the future as it has in the past.
Lack of credibility <ul style="list-style-type: none">- If traders believe that the peg will break, they will not borrow cheap HKD and invest in higher-yield US assets. This trade normally regulates the interest rate gap but if it does not happen, then rates may stay far apart for an unsustainable amount of time.	Repeated Intervention <ul style="list-style-type: none">- While the HKMA has large reserves, repeated interventions in short succession, to both weaken and strengthen the HKD, may be a sign of instability.

Hong Kong's real estate prices are down 30% since 2021 and housing benefits from lower rates

Real Residential Property Prices (2010=100)



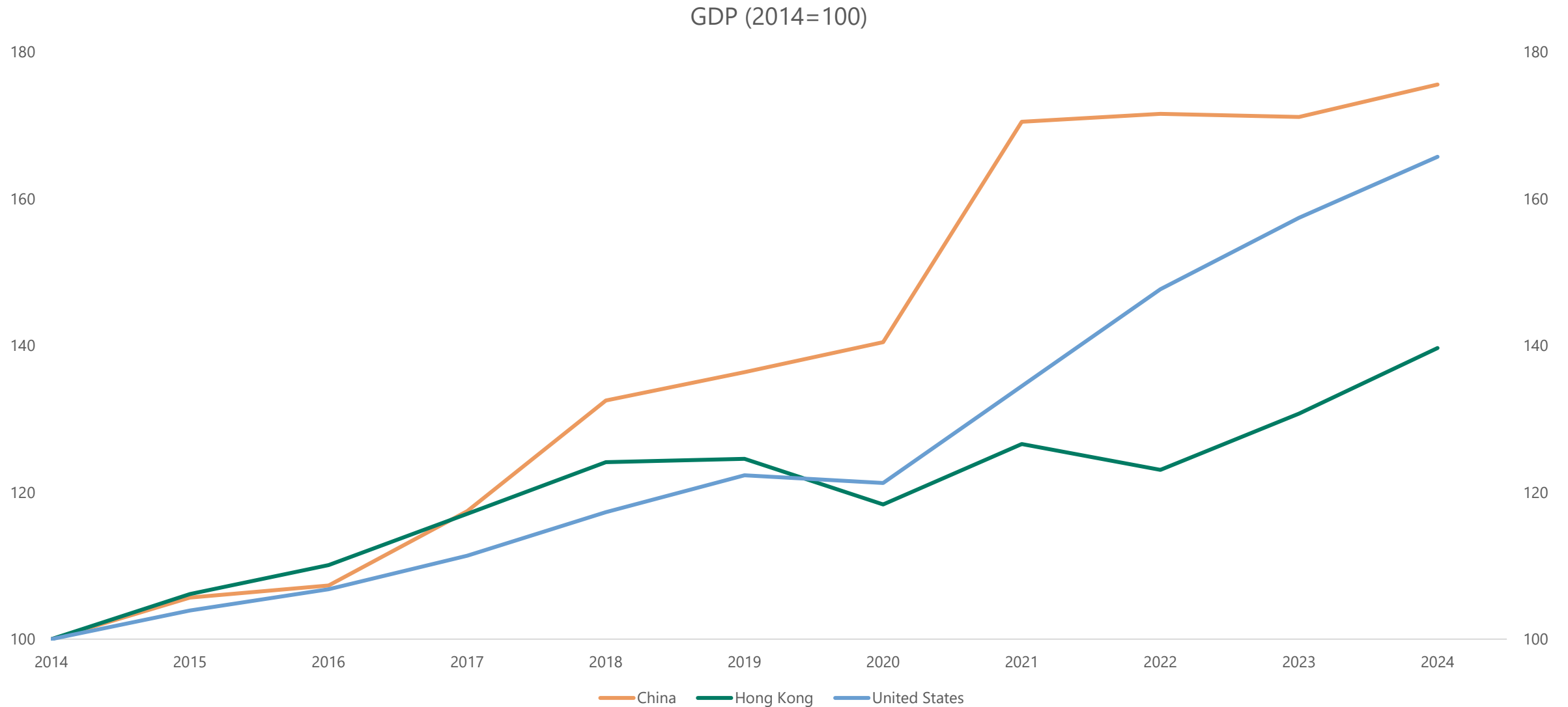
Hong Kong has had to keep rates high historically while China has been able to cut



Source: International Financial Statistics, Apollo Chief Economist

Note: Despite the fact that Hong Kong's HIBOR has dropped to near zero, the HKMA has not altered their base rate, and it remains at 4.75. Note: Series deflated using CPI. All references to Hong Kong refer to the Hong Kong S.A.R., China

Hong Kong's economy has lagged the US and China in the last decade



Source: World Bank

Note: GDP statistics are expressed in US dollars and are not adjusted for changes in price level. All references to Hong Kong refer to the Hong Kong S.A.R., China

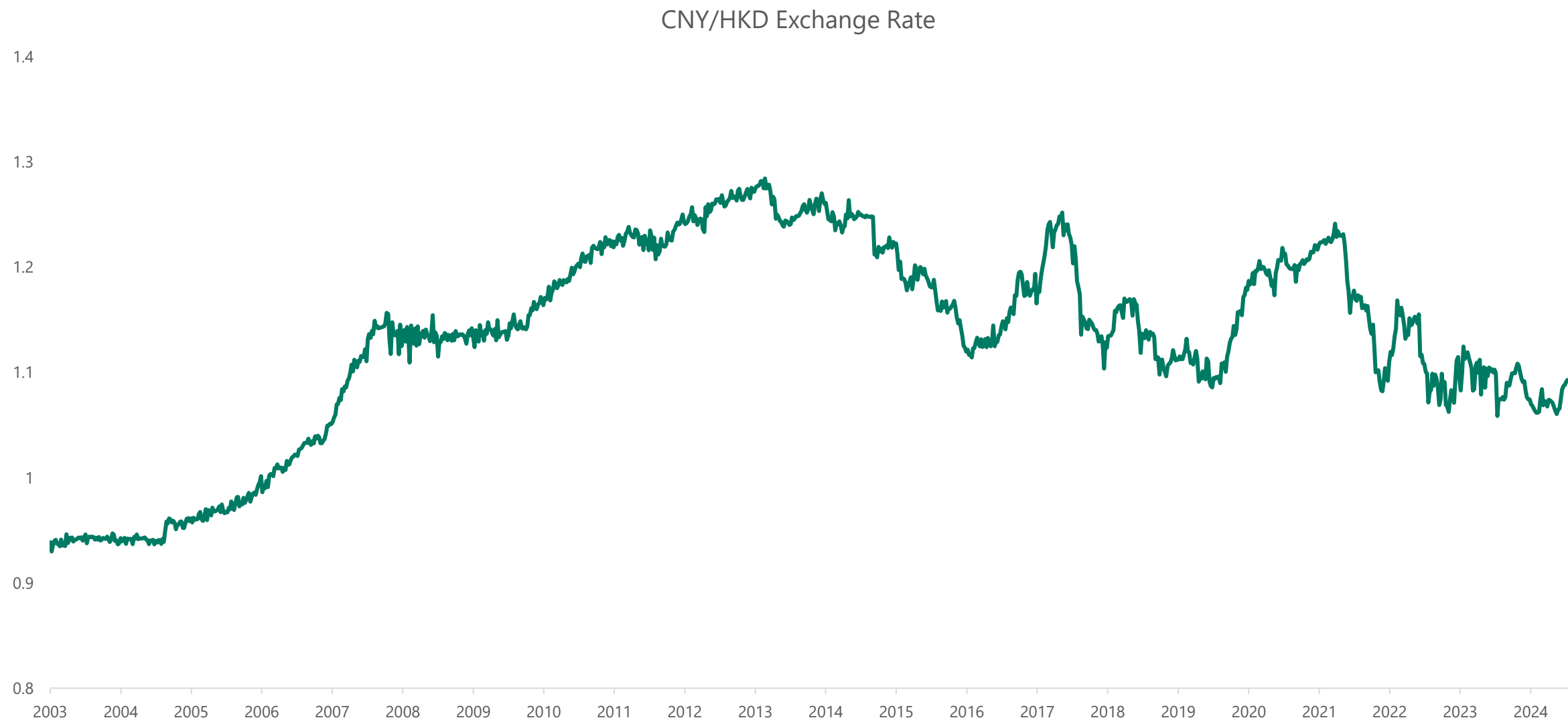
Parallel Currencies in China

- China maintains two parallel currencies: the offshore CNH and mainland CNY. The CNH can circulate and trade freely while the CNY is restricted.
- This system allows the yuan to be used internationally while still maintaining strict capital controls domestically.
- The People's Bank of China manages the CNH and CNY 1:1 peg daily by controlling bank flows and money supply.
- Example: In 2015-2016, the yuan depreciated relative to the USD which led to a gap between CNH and CNY. In response, authorities lowered the flows that banks could make between CNY and CNH. As a result, CNH deposits dropped relative to CNY deposits, and the peg was maintained

Capital controls in China

	Can Do	Cannot Do
Chinese Citizens	- Convert up to a certain amount in foreign currency and invest in approved funds abroad	- Buy foreign stocks/property directly or send money without approval
Foreigners in China	- Open local foreign exchange accounts or repatriate income	- Move large amounts of capital abroad
Domestic Firms	- Invest abroad with approval and set up overseas subsidiaries, also with approval	- Move large amounts of capital abroad
Foreign Firms	- Repatriate income and invest domestically through certain approved programs	- Move large amounts of capital abroad or own certain amounts of critical sectors

The HK dollar is not pegged to the Chinese yuan

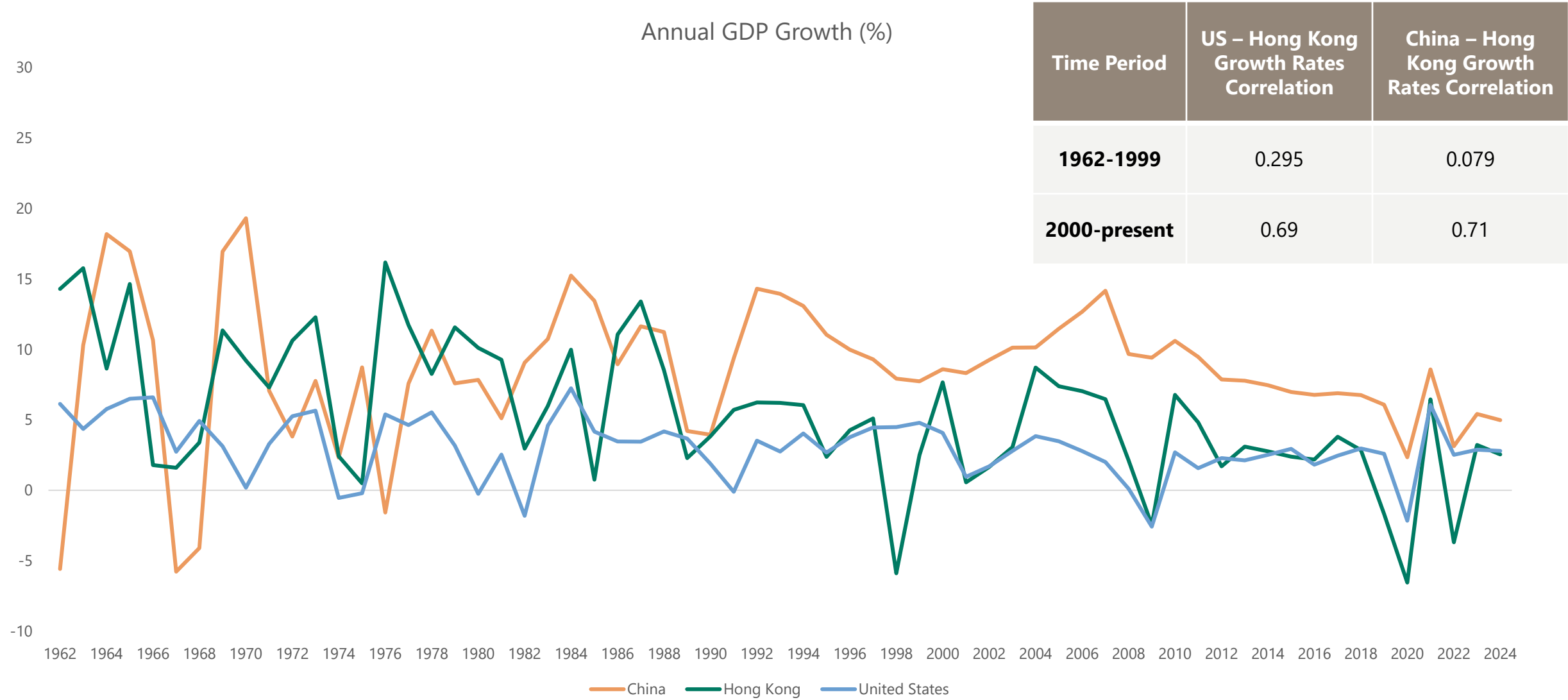


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What if the HKD used the yuan as a peg?

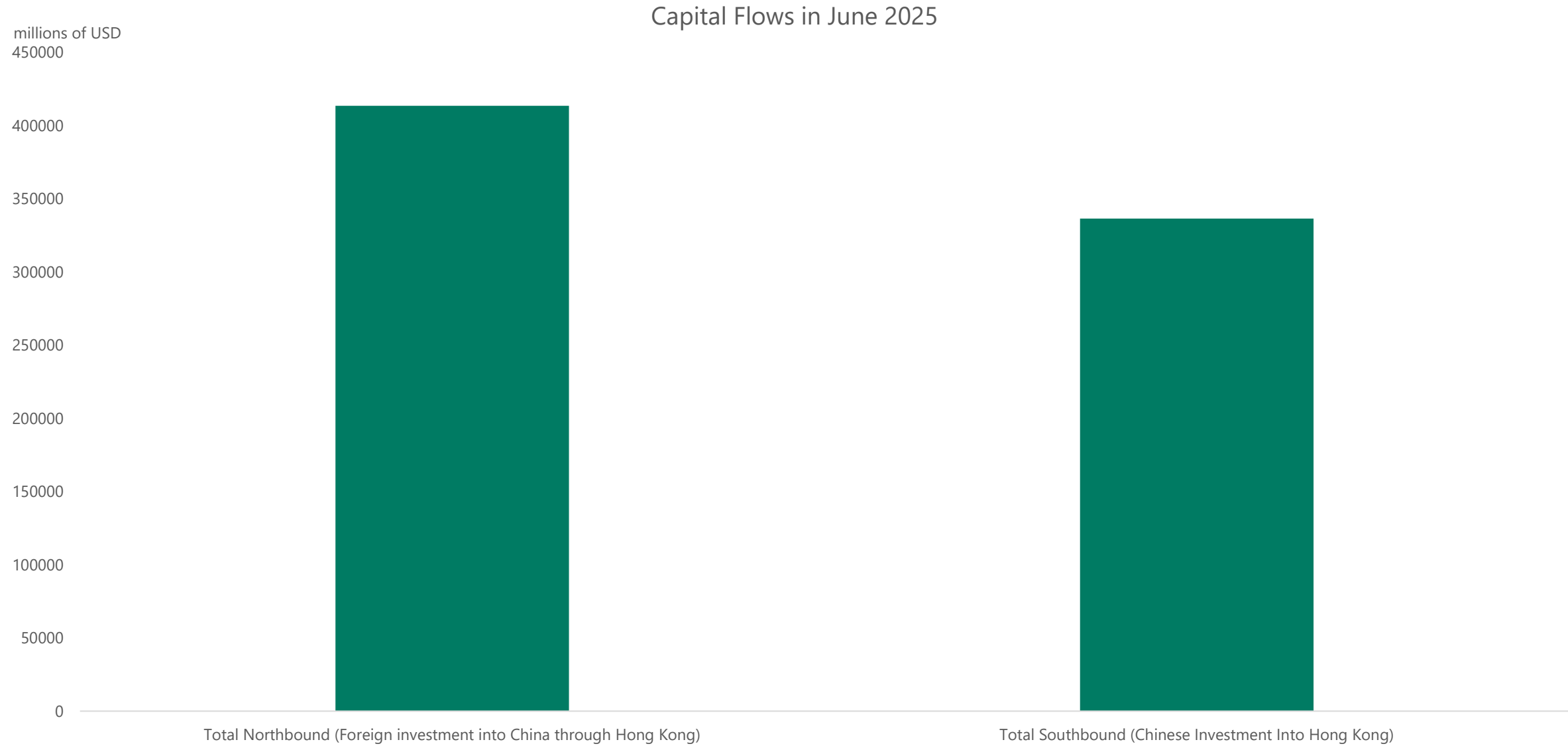
- Over 50% of Hong Kong's international trade is with China and financial agreements have linked the two markets. The two jurisdictions are increasingly economic and politically integrated.
- However, pegging to a currency with convertibility constraints and a different exchange rate regime than the HKMA could reduce investor confidence in the HKD. There are also political ramifications.
- Currently, Hong Kong does not have monetary independence but can have a fixed exchange rate and free capital mobility. Switching to a yuan peg would impose PBoC policy instead of the Federal Reserve and possibly come with restrictions on capital mobility.
- Pegging to a basket of currencies is also difficult and a large departure from the rules based, transparent LERS system.

Hong Kong’s economic indicators are increasingly linked to China



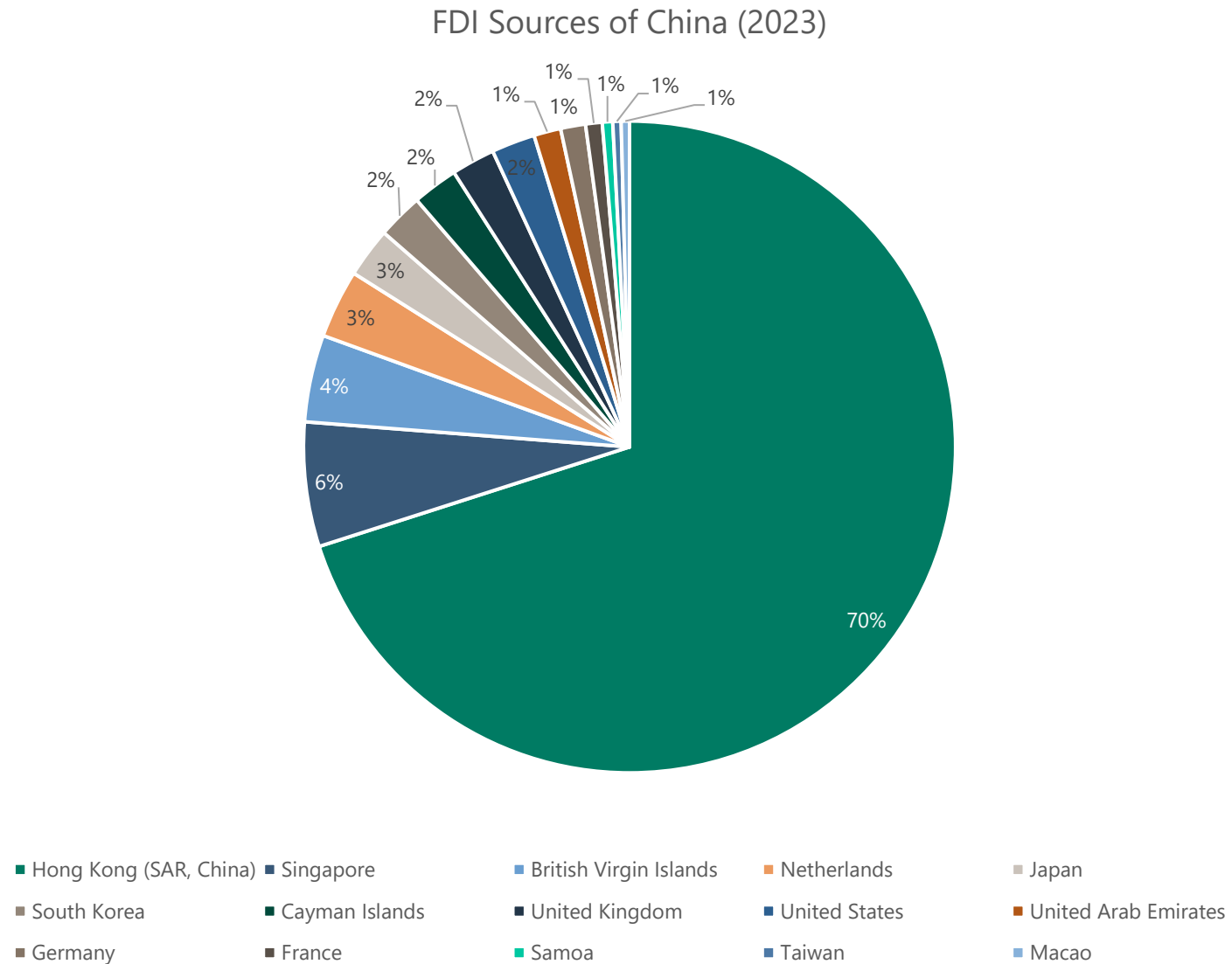
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There are large capital flows between Hong Kong and China



Source: Hong Kong Stock Exchange

Most of China's Foreign Direct Investment comes through Hong Kong



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Torsten Slok joined Apollo in August 2020 as Chief Economist and he leads Apollo's macroeconomic and market analysis across the platform.

Prior to joining, Mr. Slok worked for 15 years as Chief Economist at Deutsche Bank where his team was top ranked in the annual Institutional Investor survey for a decade. Prior to joining Deutsche Bank Mr. Slok worked at the IMF in Washington, DC and at the OECD in Paris.

Mr. Slok has a Ph.D in Economics and has studied at the University of Copenhagen and Princeton University.