

# Hong Kong's 2026-27 Budget and the Exchange Fund

by John Greenwood

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## Introduction and Overview

- In his recent Budget Speech on February 25, Hong Kong's Financial Secretary Paul Chan announced that he would seek to transfer HK\$ 150 billion from the Hong Kong Monetary Authority (HKMA) to the Hong Kong Treasury, primarily in connection with new capital expenditure projects such as the Northern Metropolis (NM).
- Coming after several years when the Hong Kong government's budgetary position has been adversely affected by the Covid pandemic and more recently by the start of some major capital expenditure projects, this proposal aroused a storm of commentary in Hong Kong.
- The questions to be answered are: (1) whether the underlying fiscal position of the government can bear this expenditure without any threat to the monetary and financial stability of Hong Kong, (2) whether the monetary reserves are adequate, and (3) whether the governance systems are adequate to prevent an unwarranted run-down of Hong Kong's reserves in future.
- As background, I will set out the balance sheet of the HKMA and explain some of its operating procedures.
- First, from as far back as 1976 the HKMA (or the Exchange Fund as it was then known), was given the responsibility for managing the foreign currency assets which constituted the bulk of the fiscal reserves of the government.
- Second, I will consider whether the HKMA's combined assets – monetary and fiscal – are adequate to back the currency and the government's fiscal plans.
- Finally, I will consider whether Hong Kong's governance system – or guardrails – are strong enough to preserve that Hong Kong's long-term monetary and fiscal integrity.

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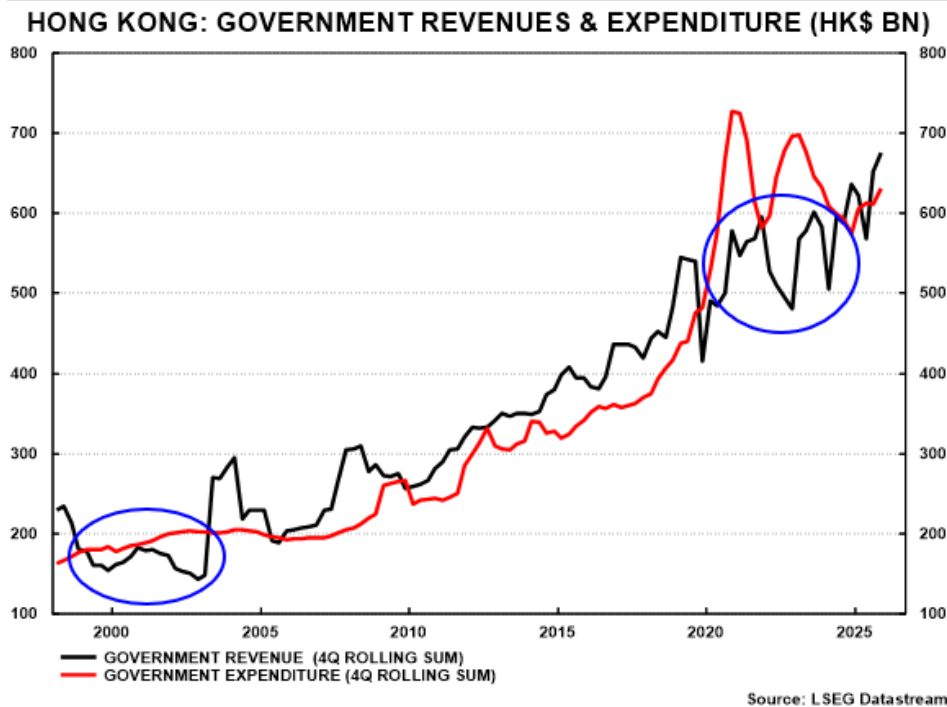
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### **The Fiscal Background**

In his recent Budget Speech on February 25, Hong Kong’s Financial Secretary Paul Chan announced the continuation of efforts to strengthen the public sector’s fiscal position following the budget deficits of recent years. As in many other economies, the Covid pandemic of 2020-22 pushed the government into the red (on a recurrent basis) as revenues declined and expenditures soared (see Figure 1).

**Figure 1.**



As shown in Figures 1 & 2, the Hong Kong government has generally run budget surpluses (on a current account basis – i.e. comparing recurrent revenues with recurrent expenditures). The two main exceptions were the period after the Asian Financial Crisis and the period after the Covid pandemic (both circled in blue). The GFC in 2008-09 did not affect Hong Kong severely enough to cause a sustained budget deficit.

However, it should be noted that when the economy is strong and government revenues are buoyant, the authorities tend to place substantial sums aside for capital expenditures, as in the period 2017-20. Such transfers and investments are reflected in the consolidated government accounts (the red line in Figure 2), but do not feature in the simple balance of recurrent revenue and expenditure.

To restore economic growth and cooperate positively with the Mainland, the government has committed to substantial capital expenditures associated with the development of a “Northern Metropolis” (NM) and other capital works. To fund these projects, not only has the government increased bond issues (see Table 1), but it has also decided to draw on the substantial reserves it maintains with the Hong Kong Monetary Authority (HKMA).

**Figure 2.**  
**HONG KONG: BUDGET BALANCE (HK\$ BN)**

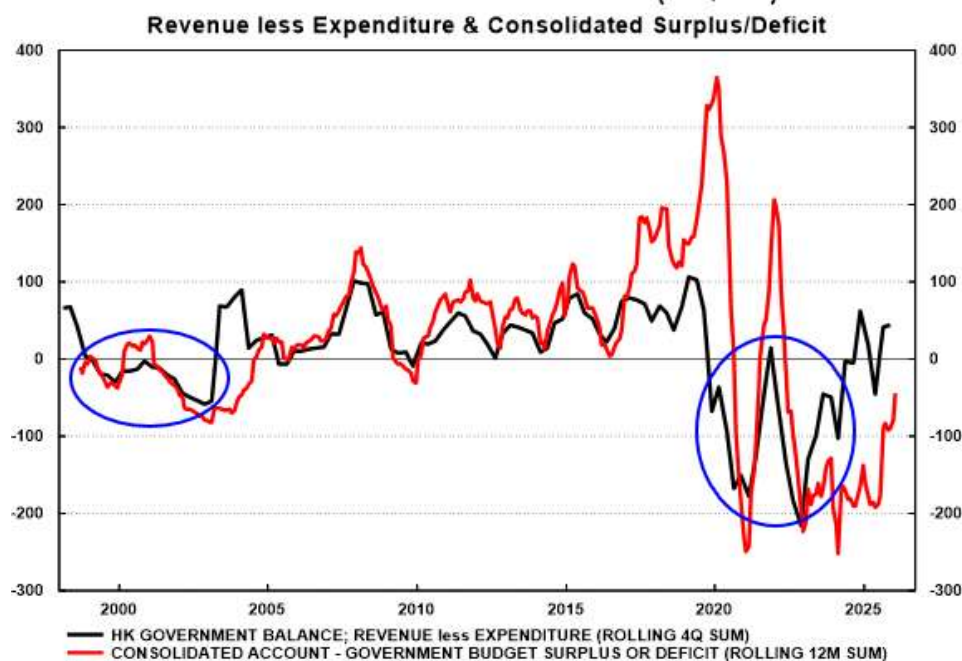


Table 1 presents a fiscal-year summary of the Hong Kong SAR Government's (HKSARG) recent and expected outcomes for its revenue and expenditure on current account, before and after bond issuance and repayment. In addition, HKSARG also maintains eight Funds for capital projects, disaster relief, innovation and technology, etc. (not shown).

**Table 1. Consolidated Summary of Government Accounts (HK\$ mn)**

	Actual				Revised Estimate	Estimate
	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
Revenue	693,576	622,147	549,406	564,909	688,762	<b>765,234</b>
Expenditure	693,339	810,477	721,301	753,220	789,171	<b>843,416</b>
Surplus/Deficit (Before bond issuance and repayment)	237	(188,330)	(171,895)	(188,311)	(100,409)	<b>(78,182)</b>
Bond Issue Proceeds	9,124	65,992	72,490	130,036	155,000	160,000
Repayment of Govt Bonds	—	—	800	21,993	51,686	59,708
Surplus/Deficit (After bond issuance and repayment)	9,361	(122,338)	(100,205)	(80,268)	2,905	22,110
Consolidated Fiscal Reserves (After bond issuance and repayment)	957,128	834,790	734,585	654,317	657,222	679,332

The charts and estimates above show that while the recurrent accounts have been improving (returning to surplus), the consolidated statement which includes capital spending (red line in Figure 2) is taking longer to return to a surplus.

The proposal to draw down funds from the HKMA has raised a storm of comments in Hong Kong concerning the safety and integrity of the funds managed by the HKMA and its implications for the currency. To understand the situation fully we need some perspective on the Exchange Fund, the entity which holds the foreign currency reserves of the HKSARG.

### **The Monetary Consequences**

The Exchange Fund was set up by the Currency Ordinance of 1935 (later renamed the Exchange Fund Ordinance). Prior to this, the three commercial banks having charters authorising them to issue banknotes in Hong Kong had mainly held silver dollar coins and silver bullion as backing for their note issues. However, as a result of the steep rise in the price of silver (due to the US Silver Purchase Act of 1934), Hong Kong's exchange rate saw a steep appreciation which threatened to devastate trade and economic activity in the midst of the Great Depression.

Accordingly, it was decided to shift from the silver standard to a sterling standard. Henceforth the banks would be required to issue banknotes against sterling (instead of silver) at a fixed rate which properly reflected Hong Kong's competitiveness. Also, in future the government would hold the reserves. The banks' existing stocks of silver reserves were therefore taken over by the government, sold on world markets, and replaced with UK government securities (gilts) to be held by the Exchange Fund. The banks were issued with Certificates of Indebtedness (CIs) in recognition of the transfer, and from then onwards they were to pay pounds sterling at the fixed rate to the Exchange Fund in exchange for CIs whenever they wished to issue additional banknotes. Conversely, the Exchange Fund would pay out sterling at the fixed rate if the banks wished to redeem HK\$ banknotes. The principle of two-way convertibility at a fixed price continues to the present day as the core of the Linked Exchange Rate System.

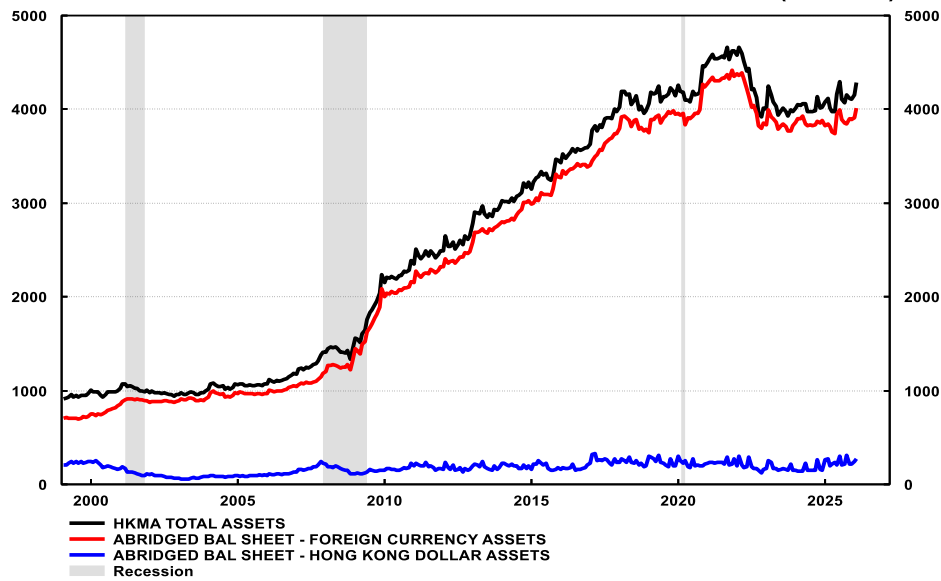
Moving to the present, the first point to note is that the Exchange Fund manages not only the monetary reserves of Hong Kong but also a substantial portion of the fiscal reserves of the Government. As far back as 1976 the majority of the foreign currency assets held in the Government's General Revenue Account were transferred to the Exchange Fund for management. Today, the total fund, amounting to HK\$ 4,285.6 billion at 31 January 2026, therefore consists of both monetary reserves and fiscal reserves (Figures 3 & 4).

<https://www.hkma.gov.hk/eng/key-functions/reserves-management/history/>

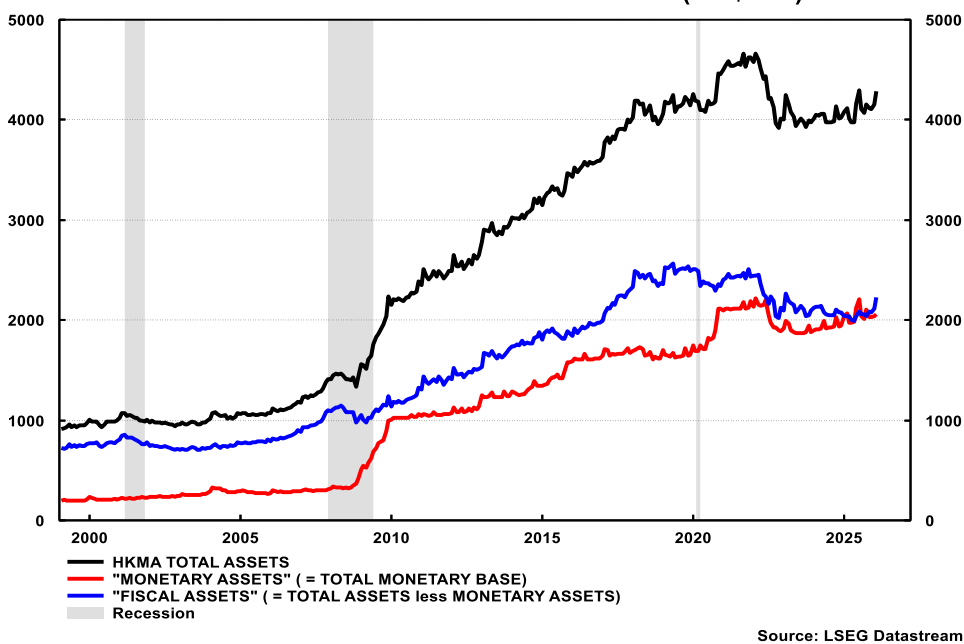
The monetary component of the HKMA's assets is designated the Backing Portfolio (BP) and is maintained in short-term US\$ instruments. The remainder of the portfolio is invested in three sub-portfolios: the Investment Portfolio (IP), a Long-Term Growth Portfolio, and a Strategic Portfolio.

The proposed amount of the transfer (two tranches of HK\$75 billion over two years) amounts to 3.5% of the total fund and will come from the HKMA’s “fiscal” assets. This implies no risk to the monetary reserves which are more than adequate to cover the monetary base (Certificates of Indebtedness – equal to the note issues by three note-issuing banks – plus government-issued notes and coins plus the aggregate balance of the commercial banks at the HKMA, plus the total of Exchange Fund Bills and Notes issued). See Figure 5.

**Figure 3. Total Assets of the HKMA, by Currency**  
HONG KONG: HKMA TOTAL ASSETS & COMPONENTS (HK\$ BN)



**Figure 4. Monetary and Fiscal Reserves Held by the HKMA**  
HONG KONG: HKMA TOTAL ASSETS (HK\$ BN)



In addition, the Exchange Fund Ordinance has, since 1935, required the HKMA to hold, as backing for its monetary liabilities, foreign currency assets equal to not less than 105% of its liabilities. Sums in excess of 112.5% are generally transferred to the remainder (or fiscal reserve component) of the Exchange Fund’s assets.

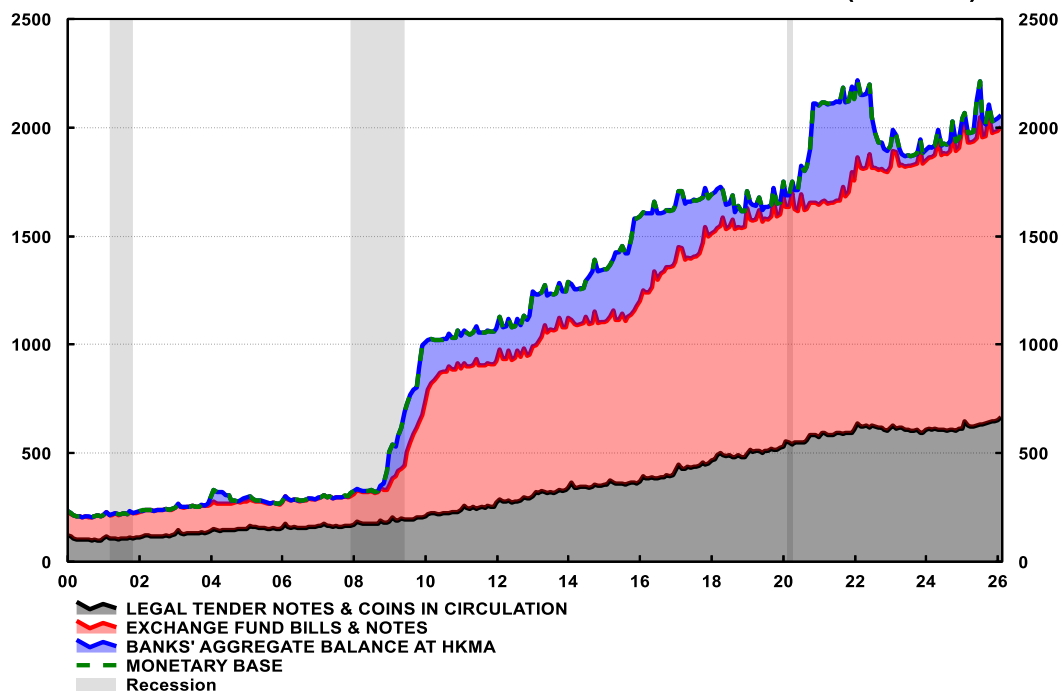
The monetary base at 31 January was HK\$ 2,058.7 billion, and the backing assets for the monetary base were HK\$ 2,279.8 billion, or 110.74% of the monetary base, but the remainder of the Exchange Fund’s assets (HK\$4,285.6 billion less HK\$ 2,279.8 billion equals HK\$ 2,005.8 billion) are available to support the Hong Kong dollar if required.

<https://www.hkma.gov.hk/eng/news-and-media/press-releases/2026/02/20260227-3/>

Given its small size and the fact that it does not impinge upon the monetary reserves of the HKMA, I do not believe this one-time, two-step transfer of HK\$150 billion from the HKMA to the Capital Works Reserve Fund poses any threat to Hong Kong’s financial stability or the strength of the backing for the HK\$ currency.

<https://www.hkma.gov.hk/eng/key-functions/reserves-management/history/>

**Figure 5. HKMA’s Monetary Liabilities**  
**HONG KONG: MONETARY BASE & COMPONENTS (HK\$ BN)**



Source: LSEG Datastream

Finally, it should be noted that, from a governance perspective, Section 8 of the Exchange Fund Ordinance empowers the Financial Secretary to effect transfers from the Fund and prescribes the relevant procedures. The primary condition is that the Financial Secretary must be satisfied that such transfer will not adversely affect the Fund’s core purposes—namely, maintaining Hong Kong dollar exchange rate stability and ensuring the stability and integrity of the local monetary and financial systems. Any such decision must be made following consultation with the Exchange

Fund Advisory Committee and be approved by the Executive Council. These guardrails are a strong protection against any possible erosion of the HKMA and its monetary reserves.

## **Conclusions**

- In his recent Budget Speech on February 25, Hong Kong’s Financial Secretary Paul Chan announced that he would seek to transfer HK\$ 150 billion from the Hong Kong Monetary Authority (HKMA) to the Treasury, primarily in connection with new capital expenditure projects such as the Northern Metropolis (NM).
- The fiscal accounts of the HKSARG (Table 1) show a fiscal reserve of HK\$ 657 billion at the end of March 2026, with the overall figures starting to recover from the deficits of recent years. (This is before any drawdown from the HKMA.)
- Rather than raise taxes or issue a greater volume of bonds and increase the government’s indebtedness, the Financial Secretary has chosen to fund some of its planned capital projects by utilising a portion of the government’s existing financial assets held at the HKMA. This seems entirely sensible.
- The HKMA’s total assets at 31 January 2026 amounted to HK\$ 4,285.6 billion, so the transfer of HK\$ 150 billion to the Capital Works Reserve Fund is equivalent to just 3.5% of total assets.
- Moreover, the HKMA’s assets are clearly divided into monetary assets and fiscal assets, with each comprising about 50% of the total. Since the drawdown will be from the fiscal side of the accounts, the monetary accounts (or the Backing Portfolio) will remain unaffected.
- It remains the case that all the assets of the HKMA are available to support the currency if required. With the HKMA’s foreign reserve assets (\$420 billion or HK\$ 3,276 billion) equal to 1.6 times the size of the monetary base (HK\$ 2,057 billion in January 2026), the HKMA’s local (HK\$) monetary liabilities are more than adequately backed by short-term US\$ assets.
- Finally, from a governance perspective, the safeguards – prior approval by the Executive Council and by the Exchange Fund Advisory Committee – are strong enough in my view to prevent any undermining of Hong Kong’s monetary and financial integrity.

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