

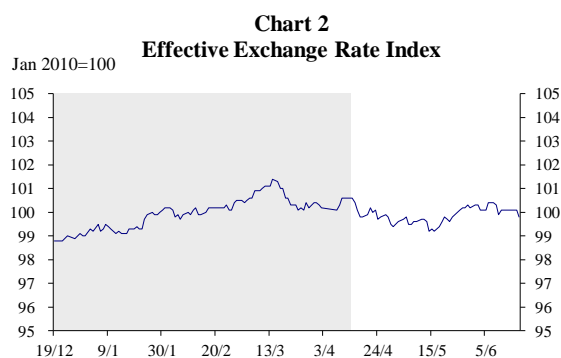
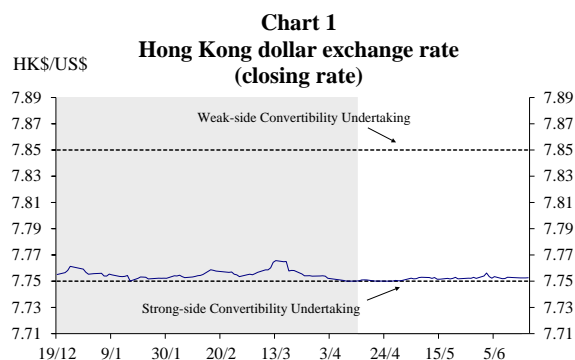
EXCHANGE FUND ADVISORY COMMITTEE
Currency Board Sub-Committee

Report on Currency Board Operations
(14 April – 18 June 2015)

During the review period, the Hong Kong dollar traded within a narrow range of 7.7500 – 7.7562 against the US dollar, while the Hong Kong dollar interbank interest rates remained at low levels. The strong-side Convertibility Undertaking (CU) was triggered between 20 and 24 April 2015 amid strong equity-related and commercial demand. As a result of the triggering, the Aggregate Balance expanded and the Monetary Base increased to HK\$1,420.94 billion. All changes in the Monetary Base were fully matched by changes in foreign reserves in accordance with the Currency Board principles.

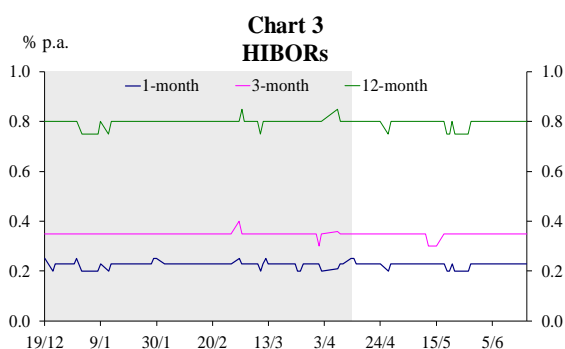
Hong Kong dollar exchange rate

1. For the review period as a whole, the Hong Kong dollar traded within a narrow range of 7.7500 to 7.7562 against the US dollar (Chart 1). In the early part of the review period, the Hong Kong dollar exchange rate continued to hover very close to 7.75. In particular, the **strong-side Convertibility Undertaking (CU)** was triggered between 20 and 24 April amid strong equity-related and commercial demand for the Hong Kong dollar, prompting the HKMA to purchase a total of US\$4.9 billion from banks in exchange for HK\$37.7 billion. The Hong Kong dollar exchange rate then softened slightly along with local stock market consolidation, closing at 7.7526 at the end of the review period. **The nominal effective exchange rate index of the Hong Kong dollar edged down** during the review period, reflecting a slight weakening of the US dollar against other major currencies (Chart 2).

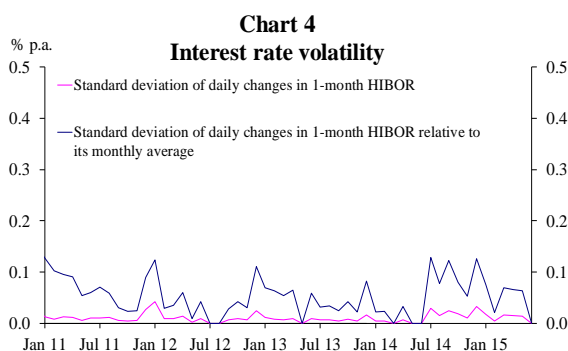


Interest rates

2. During the review period, the Hong Kong dollar interbank interest rates remained stable at low levels (Chart 3). Overall, the one-month, three-month and 12-month HIBORs averaged 0.23%, 0.35% and 0.79% respectively.

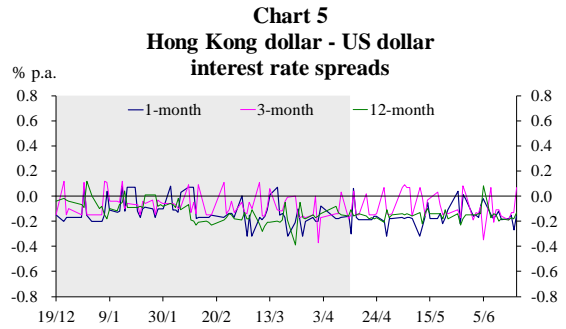


3. **Interest rate volatility**, measured by the standard deviation of daily changes in the one-month HIBOR, **decreased slightly** to 1.1 basis points in May and early June, compared with 1.5 basis points in April (Chart 4). The standard deviation as a ratio of the average one-month HIBOR also followed similar movement.¹

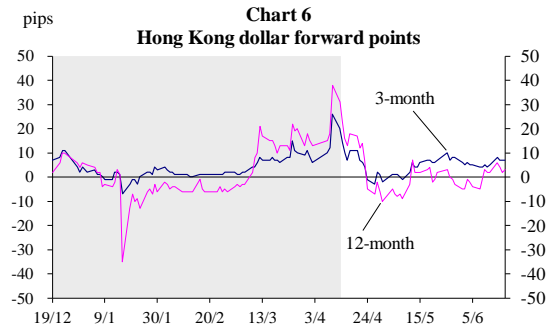


¹ The ratio of the standard deviation of daily changes in the one-month HIBOR to its monthly average measures the extent of interest rate fluctuations relative to the average level of interest rates.

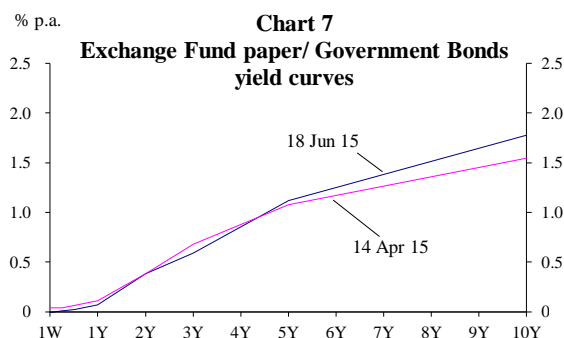
4. The spreads of Hong Kong dollar interest rates against their US dollar counterparts were roughly stable during the review period (Chart 5). For the whole period, the one-month, three-month and 12-month spreads averaged -16, -8 and -15 basis points respectively.



5. During the review period, the Hong Kong dollar forward premium narrowed along with decreased funding demand for equity trading activities (Chart 6). At the end of the review period, the three-month and the 12-month forward points closed at +7 pips and +3 pips respectively.

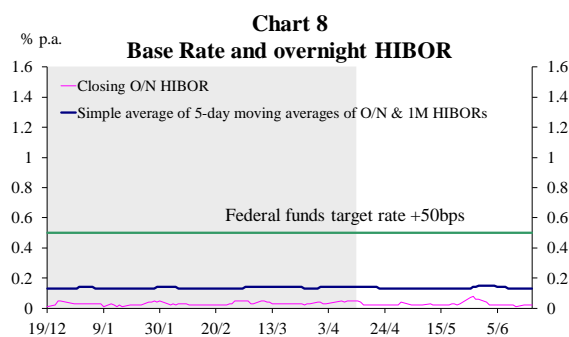


6. Both the US dollar yield curve and the Hong Kong dollar yield curve steepened during the review period (Chart 7). But due to a smaller increase in the Hong Kong dollar yields, the negative spreads over the US dollar yields widened (Table 1). For the Hong Kong dollar Government Bonds, the 10-year yield picked up by 24 basis points to 1.78%, while the 3-year yield edged down by 9 basis points to 0.59%.

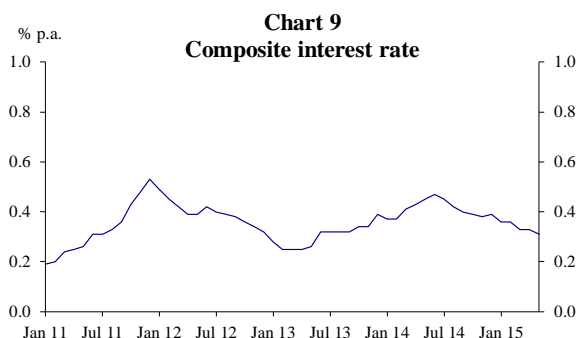


	14 Apr 15	18 Jun 15
3-month EFB	2	0
12-month EFB	-12	-19
3-year HKGB	-17	-44
5-year HKGB	-27	-53
10-year HKGB	-36	-57

7. At the April and June meetings, the US Federal Open Market Committee (FOMC) decided to keep the current range of the Federal Funds Target Rate (FFTR) unchanged at 0 – 0.25%. **The HKMA Base Rate remained unchanged at 0.5%** (Chart 8). It continued to be set at 50 basis points above the lower boundary of the FFTR target range in accordance with the revised Base Rate formula announced on 26 March 2009.



8. Banks kept their Best Lending Rates unchanged, in line with the stable US FFTR. There continued to be two Best Lending Rates of 5.00% and 5.25% at the end of the review period. The average one-month Hong Kong dollar time deposit rate offered by retail banks remained stable at 0.01%.² **The composite interest rate³**, which indicates the average cost of funds for retail banks, **edged down to 0.31% in May** from 0.33% in March (Chart 9). On the lending side, the average mortgage interest rates for newly approved mortgage loans continued to stay at a low level.



² The figure refers to the average interest rate offered by major authorized institutions for one-month time deposits of less than HK\$100,000.

³ This is a weighted average interest rate of all Hong Kong dollar interest bearing liabilities, which include deposits from customers, amounts due to banks, negotiable certificates of deposit and other debt instruments, and Hong Kong dollar non-interest bearing demand deposits on the books of banks. Data from retail banks, which account for about 90% of the total customers' deposits in the banking sector, are used in the calculation.

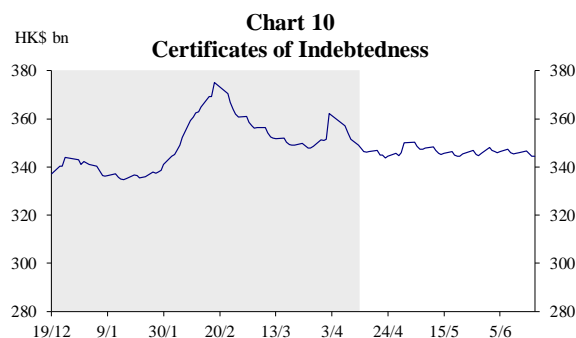
Monetary Base

9. **The Monetary Base**, which consists of Certificates of Indebtedness (CIs), government-issued currency notes and coins in circulation, the Aggregate Balance and Exchange Fund Bills and Notes, **increased to HK\$1,420.94 billion on 18 June from HK\$1,380.68 billion on 14 April** (Table 2). Movements in the individual components are discussed below.

(HK\$bn)	14 Apr 15	18 Jun 15
CIs	347.62	344.39
Government-issued Currency Notes and Coins in Circulation	11.72	11.60
Aggregate Balance	266.78	310.69
Outstanding EFBNs	754.56	754.27
Monetary Base	1380.68	1420.94

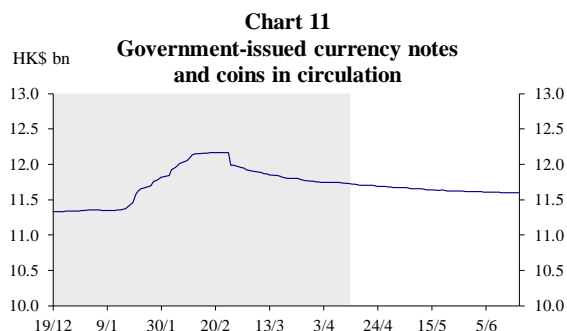
Certificates of Indebtedness

10. During the review period, the three note-issuing banks redeemed HK\$3.23 billion worth of CIs to the HKMA in exchange for US\$414 million. As a result, **the outstanding CIs decreased to HK\$344.39 billion on 18 June** (Chart 10).



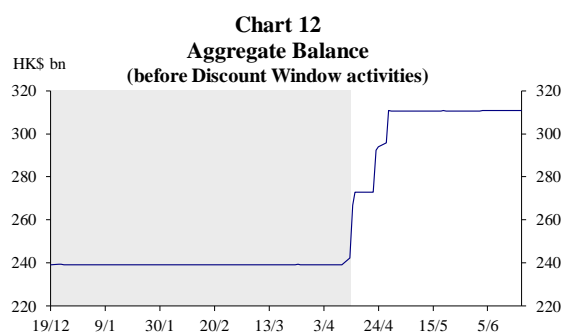
Government-issued currency notes and coins in circulation

11. During the review period, the amount of **government-issued currency notes and coins in circulation** decreased to HK\$11.60 billion on 18 June from HK\$11.72 billion on 14 April (Chart 11).



Aggregate Balance

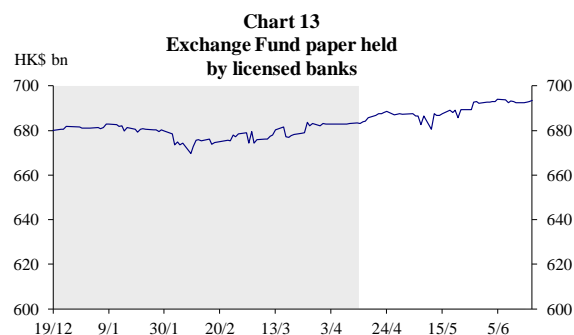
12. **The Aggregate Balance expanded to HK\$310.69 billion on 18 June from HK\$266.78 billion on 14 April** (Chart 12), due to triggering of the strong-side CU between 20 and 24 April (Table 3).



Trade Date	Net sale of HK\$ (HK\$mn)
20-Apr-15	11,586.25
21-Apr-15	7,750.00
22-Apr-15	1,550.00
23-Apr-15	1,937.50
24-Apr-15	14,880.00
Total	37,703.75

Outstanding Exchange Fund Bills and Notes

13. The market value of outstanding Exchange Fund Bills and Notes edged down to HK\$754.27 billion from HK\$754.56 billion during the review period. Holdings of Exchange Fund paper by the banking sector (before Discount Window activities) increased to HK\$693.37 billion (91.9% of total) from HK\$683.19 billion (90.5% of total) (Chart 13).

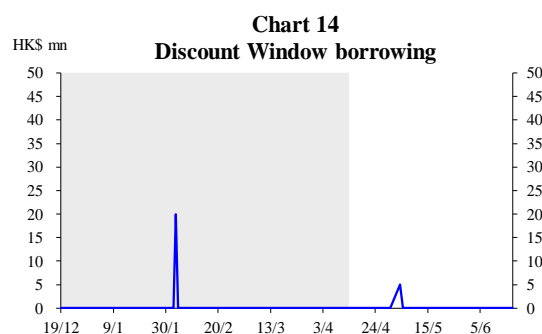


14. During the review period, HK\$230.71 million of interest payments on Exchange Fund paper were made. An additional HK\$134.99 million (in market value) of Exchange Fund paper was issued to absorb these interest payments. The remaining amount was carried forward in the Aggregate Balance. The Exchange Fund paper issued during the review period was well received by the market (Table 4).

	No. of issues launched	Over-subscription ratio
1-month EFB	1	13.42
3-month EFB	10	2.24 – 7.34
6-month EFB	10	1.96 – 10.32
12-month EFB	3	5.33 – 6.03
2-year EFN	1	3.30

Discount Window activities

15. During the review period, **a bank borrowed HK\$5 million from the Discount Window**, compared with HK\$20 million in the preceding period (Chart 14 and Table 5).



Backing Portfolio

16. The Backing Assets expanded during the review period, to HK\$1,520.04 billion on 18 June mainly reflecting an increase in the Aggregate Balance driven by the triggering of the strong-side CU. As the Backing Assets increased proportionally less than Monetary Base, **the Backing Ratio edged down to 107.05% from 107.24% during the review period** (Chart15). Under the Linked Exchange Rate system, while specific Exchange Fund assets have been designated for the Backing Portfolio, all Exchange Fund assets are available to support the Hong Kong dollar exchange rate.

Frequency of using Discount Window	No. of banks
1	1

