

# EFAC SUB-COMMITTEE ON CURRENCY BOARD OPERATIONS REPORT ON CURRENCY BOARD OPERATIONS (22 JUNE – 29 JULY 2002)

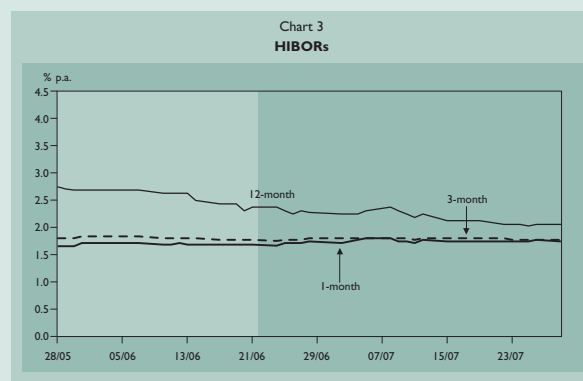
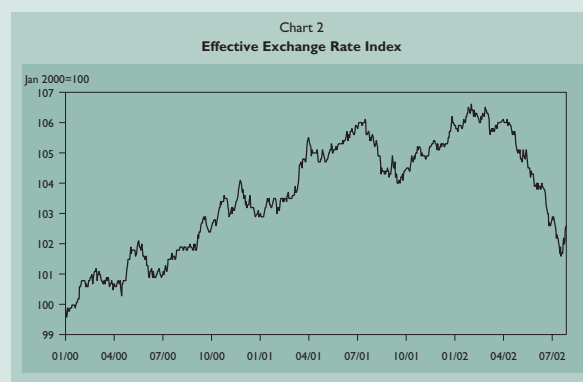
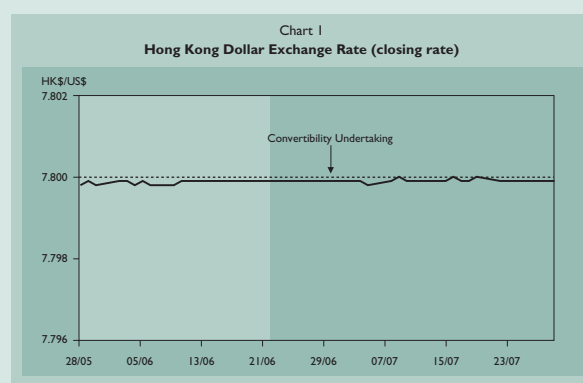
*The Hong Kong dollar and money markets were stable during the reporting period. Inter-bank interest rates remained soft, with short-term rates staying below their US dollar counterparts. The Monetary Base increased from HK\$236.19 billion to HK\$237.29 billion, mainly reflecting an increase in the outstanding amount of Certificates of Indebtedness and Exchange Fund Bills and Notes. In accordance with Currency Board principles, changes in the Monetary Base were fully matched by corresponding changes in foreign reserves.*

## Hong Kong Dollar Exchange Rate

The Hong Kong dollar exchange rate stayed within a narrow range of 7.7998 and 7.8000 throughout the reporting period. Despite corrections in the stock market, money market conditions remained calm (Charts 1 and 2).

## Interest Rates

Hong Kong dollar interest rates, particularly those of shorter term, were little changed. The 1-month and 3-month HIBOR closed at 1.75% and 1.78% respectively. Nevertheless, the 12-month HIBOR eased by 32bp to close at 2.06% (Chart 3).

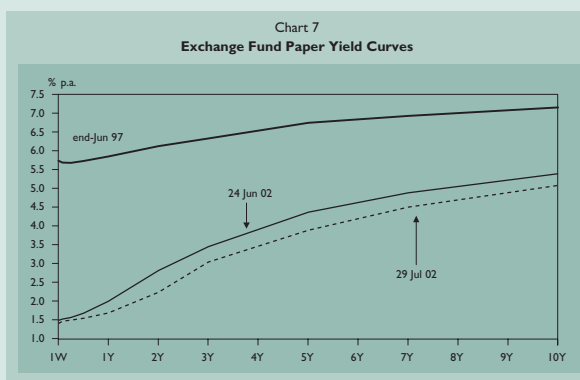
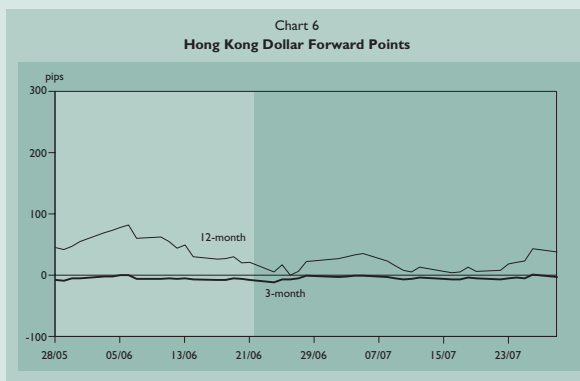
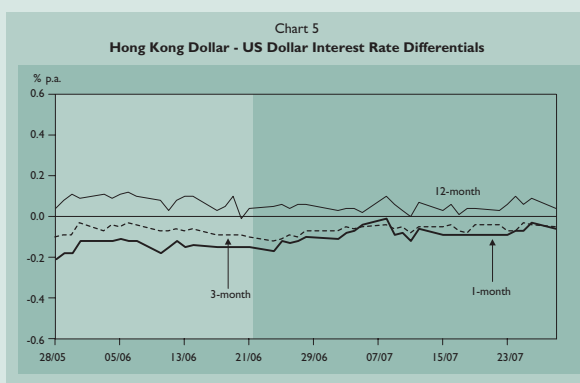
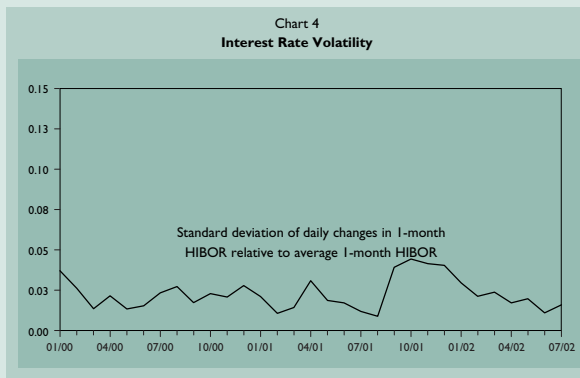


**Interest rate volatility**, measured by the ratio of standard deviation of daily changes in the 1-month HIBOR to the average 1-month HIBOR, **remained low** (Chart 4).<sup>1</sup>

**The Hong Kong dollar interbank interest rates in terms of one-month and three-month money stayed below their US dollar counterparts, although their negative spreads narrowed slightly to close at -6bp and -5bp respectively** (Chart 5). The interest rate spread for the 12-month money was generally stable and closed at 4bp.

Hong Kong dollar 3-month forward remained at a small discount during the period and closed at -3 pips. **The 12-month forward points rose towards the end of the period.** It increased from 5 pips at the beginning of the period to 38 pips at period end (Chart 6).

In part tracking the US dollar yield curve, **yields on Exchange Fund paper declined for all maturities** (Chart 7). Nevertheless, the yield spreads between the 5-year and 10-year Exchange Fund papers



<sup>1</sup> The ratio of the standard deviation of daily changes in the 1-month HIBOR to its monthly average measures the extent of interest rate fluctuations relative to the average level of interest rates, which may vary over time.

and US Treasuries widened slightly by 12bp and 5bp, to 43bp and 63bp respectively (Table 1).

The **HKMA Base Rate** remained unchanged at **3.25%** (Chart 8). The banks' **Best Lending Rates** were also unchanged.

The average deposit rate offered by the major authorized institutions for 1-month time deposits increased from 0.28% on 22 June to 0.31% on 29 July.<sup>2</sup> Meanwhile, the effective deposit rate was little changed in June (Chart 9).<sup>3</sup>

### Monetary Base

The **Monetary Base**, which comprises the outstanding amount of Certificates of Indebtedness (CIs), coins in circulation, the Aggregate Balance, and Exchange Fund Bills and Notes, increased from **HK\$236.19 billion** to **HK\$237.29 billion** during the reporting period (Table 2). Movements in individual components are discussed below.

Table 1  
Yield Spreads of Exchange Fund Paper over US Treasuries (basis points)

	27 Jun 97	24 Jun 02	29 Jul 02
3-month	56	-17	-20
1-year	21	21	-2
3-year	3	11	22
5-year	27	31	43
10-year	54	58	63

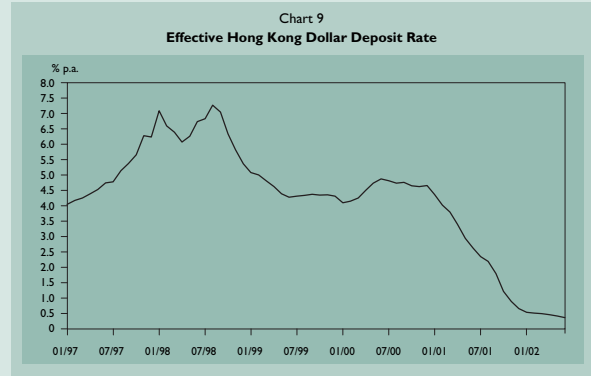
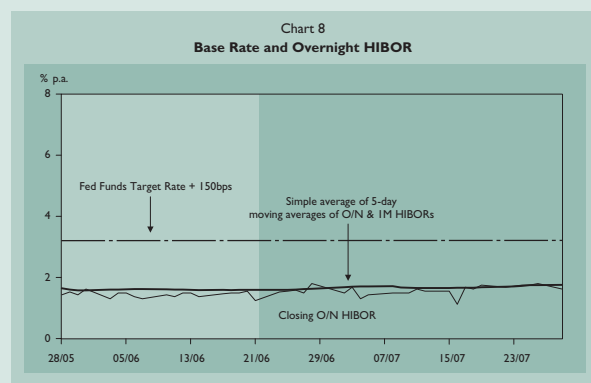


Table 2  
Monetary Base

(HK\$ billion)	24 Jun 02	29 Jul 02
CIs	110.59	110.90
Coins in Circulation	5.84	5.80
Aggregate Balance	1.11	1.21
Outstanding EFBNs	118.65	119.39
Monetary Base	236.19	237.29

2 The quoted figures refer to the average of interest rates offered by the major authorized institutions for one-month time deposits of amount less than HK\$100,000.

3 This is the average of the interest rates on demand, savings and time deposits. As the banking statistics classify deposits by remaining maturities, we have used certain assumptions regarding the maturity distribution to compute the effective deposit rate.

### Certificates of Indebtedness

During the period, the three note-issuing banks submitted to the HKMA a total of US\$0.04 billion in exchange for HK\$0.31 billion worth of Certificates of Indebtedness. As a result, the **outstanding amount of CIs increased marginally from HK\$110.59 billion to HK\$110.90 billion** (Chart 10).

### Coins

The total amount of **coins in circulation decreased slightly** from HK\$5.84 billion to HK\$5.80 billion during the period (Chart 11).

### Aggregate Balance

In the absence of foreign exchange operations conducted for the Currency Board, **the Aggregate Balance remained stable** at around HK\$1.1 billion during the reporting period, with small fluctuations reflecting interest payments of Exchange Fund paper (Chart 12).

During the period, **a total of HK\$0.33 billion of interest payments on Exchange Fund paper were made. An additional HK\$0.24 billion (in market value) of Exchange Fund paper was issued to absorb these interest payments.** The remaining amount was carried forward in the Aggregate Balance.

### Outstanding Exchange Fund Bills and Notes

**The market value of outstanding Exchange Fund paper increased slightly from HK\$118.65 billion to HK\$119.39 billion.** The increase was mainly a result of additional net issues (see paragraph above). All issues of Exchange Fund Bills and Notes were well received by the market (Table 3). **Holdings of Exchange Fund paper by the banking sector (before Discount Window activity) decreased**

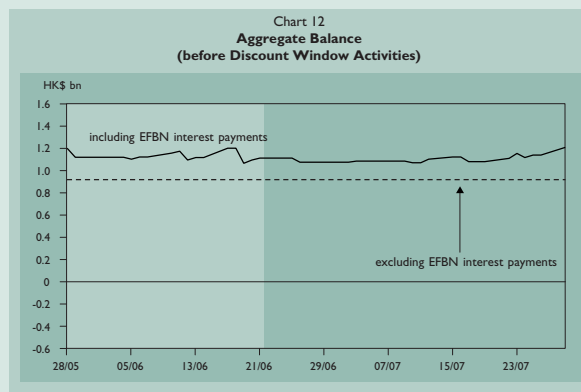
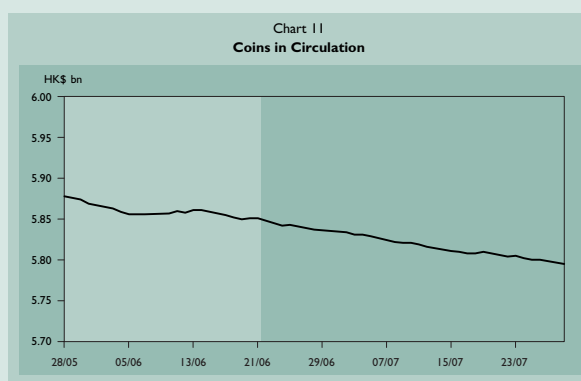
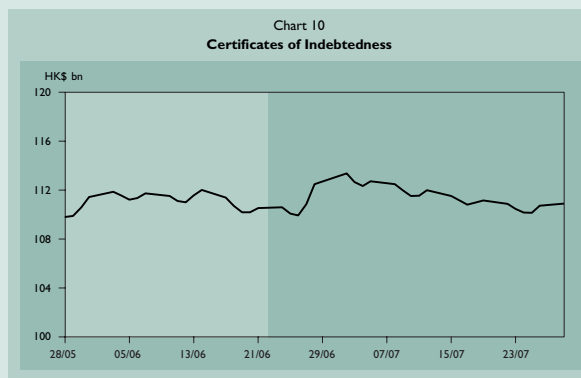


Table 3  
Issuance of Exchange Fund paper and notes  
(22 June – 29 July 02)


	No. of Issues Launched	Over-subscription Ratio
1-month EFB	1	13.92
3-month EFB	5	4.03–9.05
6-month EFB	3	5.92–6.42
1-year EFB	1	4.58
3-year EFN	1	5.12

marginally from HK\$107.68 billion (90.75% of total) to HK\$107.30 billion (89.88% of total) during the period (Chart 13).

### Discount Window Activity

For the period as a whole, **13 banks borrowed a total of HK\$0.78 billion from the Discount Window**, compared with HK\$1.96 billion in the preceding period (Chart 14). All borrowings used Exchange Fund paper as collateral. The banks used the Discount Window facility infrequently (Table 4).

### Backing Portfolio

Backing assets increased during the period mainly due to rises in the outstanding amount of CIs and investment income. **As a result, the backing ratio increased slightly from 112.20% on 23 June to 112.30% on 29 July** (Chart 15). 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. 

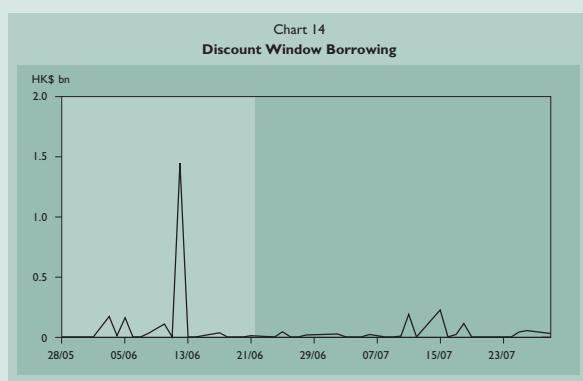
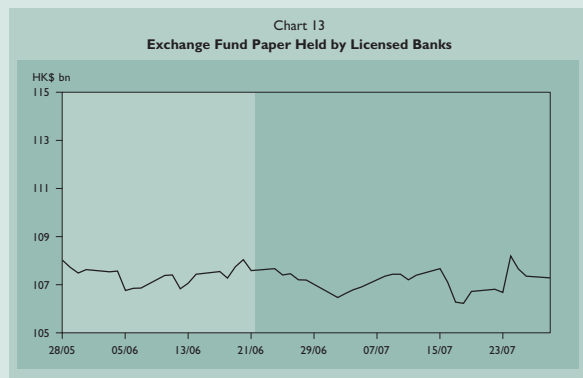
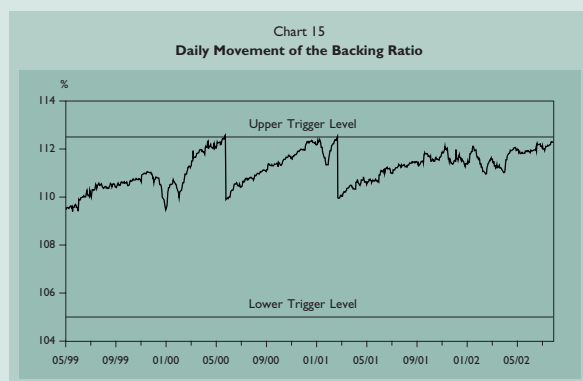


Table 4  
Frequency of Individual Bank  
Access to the Discount Window  
(22 June – 29 July 02)

Frequency of Using Discount Window	No. of Banks
1	9
2	3
3	0
4	1
<b>Total</b>	<b>13</b>



# EFAC SUB-COMMITTEE ON CURRENCY BOARD OPERATIONS REPORT ON CURRENCY BOARD OPERATIONS (30 JULY – 23 AUGUST 2002)

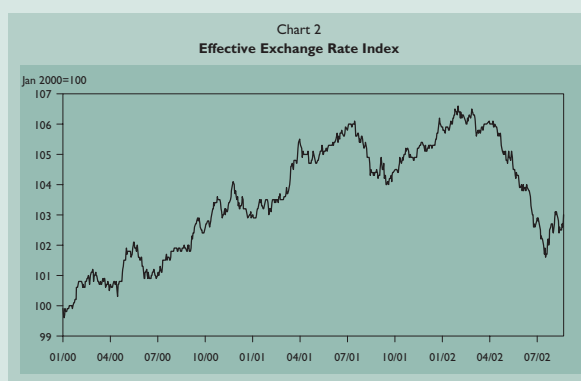
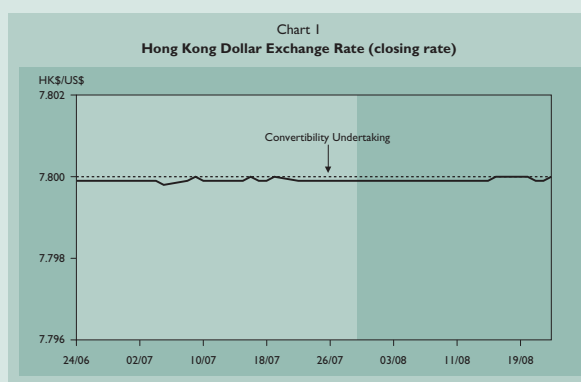
The Hong Kong dollar exchange and money markets were stable during the reporting period, notwithstanding the volatility of the Japanese yen and concerns about heightened cross-strait tensions. Inter-bank interest rates remained soft, with short-term rates staying below their US dollar counterparts. The Monetary Base increased from HK\$237.26 billion to HK\$238.05 billion, reflecting an increase in the outstanding amount of Certificates of Indebtedness and Exchange Fund Bills and Notes. In accordance with Currency Board principles, changes in the Monetary Base were fully matched by corresponding changes in foreign reserves.

## Hong Kong Dollar Exchange Rate

The Hong Kong dollar exchange rate stayed within a narrow range of 7.7999 and 7.8000 throughout the reporting period (Charts 1 and 2), despite volatility in the Japanese yen, stock market fluctuations and heightened cross-strait tensions in early August.

## Interest Rates

Hong Kong dollar interest rates, particularly those of shorter term, were little changed. The 1-month and 3-month HIBORs both closed at 1.73%. However, the 12-month HIBOR eased by 12bp to close at 1.94% (Chart 3).

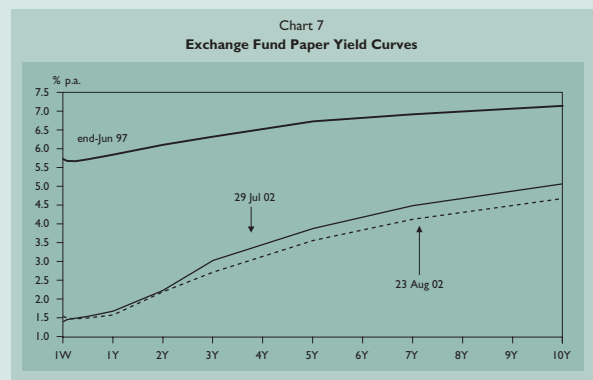
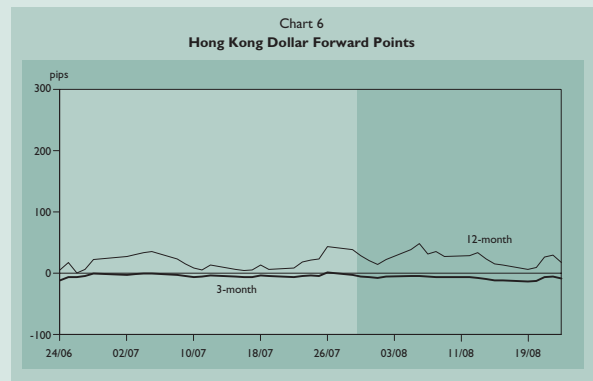
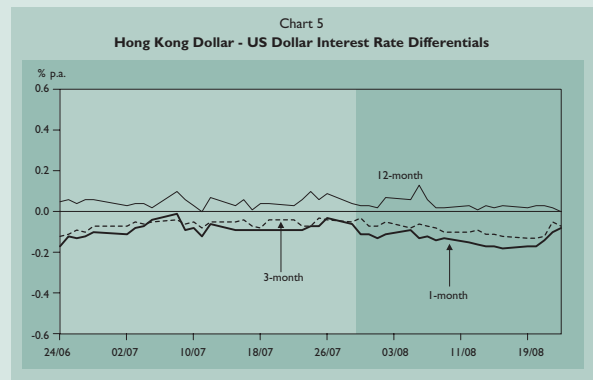
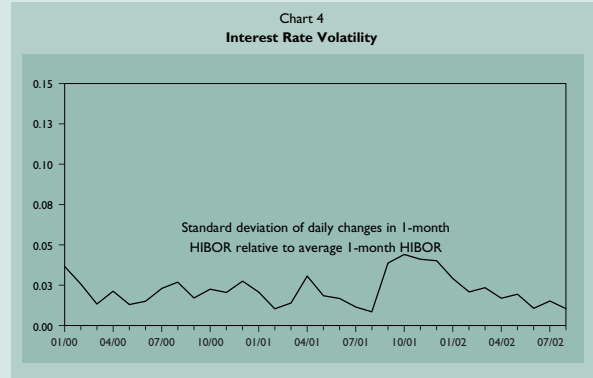


**Interest rate volatility**, measured by the ratio of standard deviation of daily changes in the 1-month HIBOR to its average, **remained low** (Chart 4).<sup>1</sup>

**The Hong Kong dollar interbank interest rates in terms of one-month and three-month money stayed below their US dollar counterparts.** Their spreads ended at -8bp and -7bp respectively (Chart 5). The 12-month spread rose in early part of the period on a temporary setback in cross-strait relations. As these tensions eased, the spread declined to zero at the end of the period.

Mirroring the movements of interest rate differentials against the US dollar, the Hong Kong dollar 3-month forward points remained at a small discount during the period and closed at -9 pips. **The 12-month forward points rose to a peak of 48 pips in the first half of the period before easing to close at 17 pips** (Chart 6).

In part tracking the US dollar yield curve, **yields on Exchange Fund paper declined for all maturities, except for short-term paper** (Chart 7). The yield spreads of 5-year and 10-year Exchange Fund



<sup>1</sup> The ratio of the standard deviation of daily changes in the 1-month HIBOR to its monthly average measures the extent of interest rate fluctuations relative to the average level of interest rates, which may vary over time.

paper over their US counterparts dropped by 25bp and 27bp, to 18bp and 36bp respectively (Table 1).

The **HKMA Base Rate** remained unchanged at **3.25%** (Chart 8). The banks' **Best Lending Rates** were also unchanged.

The average deposit rate offered by the major authorized institutions for 1-month time deposits remained stable at 0.33% during the period.<sup>2</sup> Meanwhile, the effective deposit rate was little changed in July (Chart 9).<sup>3</sup>

### Monetary Base

The **Monetary Base**, which comprises the outstanding amount of Certificates of Indebtedness (CIs), coins in circulation, the Aggregate Balance, and Exchange Fund Bills and Notes, increased from **HK\$237.26 billion** to **HK\$238.05 billion** during the reporting period (Table 2). Movements in individual components are discussed below.

Table 1  
Yield Spreads of Exchange Fund Paper over US Treasuries (basis points)

	27 Jun 97	29 Jul 02	23 Aug 02
3-month	56	-20	-19
1-year	21	-2	-12
3-year	3	22	4
5-year	27	43	18
10-year	54	63	36

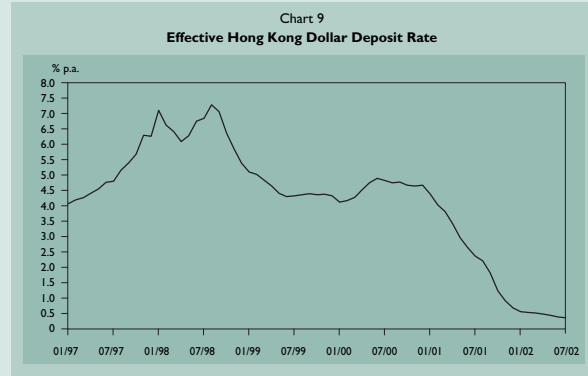
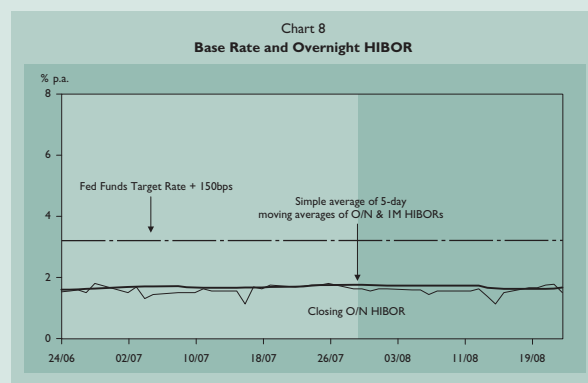


Table 2  
Monetary Base

(HK\$ billion)	30 Jul 02	23 Aug 02
CIs	110.97	111.17
Coins in Circulation	5.79	5.77
Aggregate Balance	1.21	1.09
Outstanding EFBNs	119.29	120.02
Monetary Base	237.26	238.05

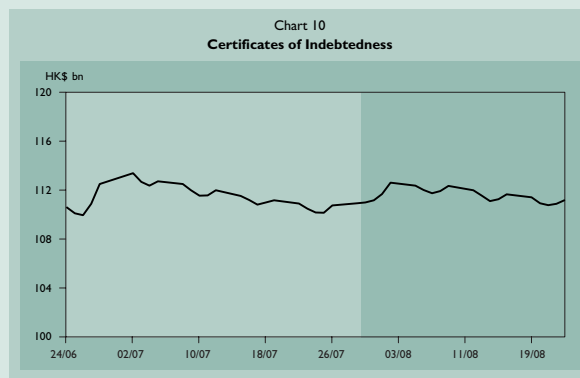
2 The quoted figures refer to the average of interest rates offered by the major authorized institutions for one-month time deposits of amount less than HK\$100,000.

3 This is the average of the interest rates on demand, savings and time deposits. As the banking statistics classify deposits by remaining maturities, we have used certain assumptions regarding the maturity distribution to compute the effective deposit rate.



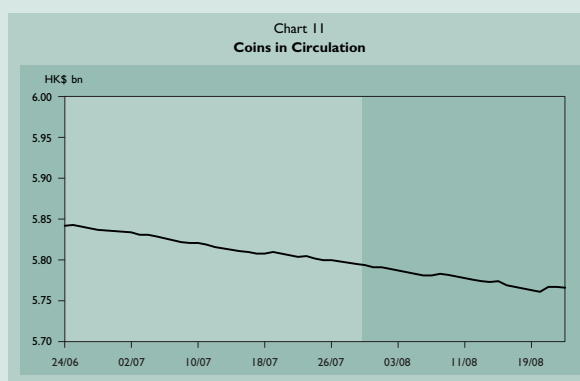
### Certificates of Indebtedness

During the period, the three note-issuing banks submitted to the HKMA a total of US\$0.026 billion in exchange for HK\$0.20 billion worth of Certificates of Indebtedness. As a result, the **outstanding amount of CIs increased marginally from HK\$110.97 billion to HK\$111.17 billion** (Chart 10).



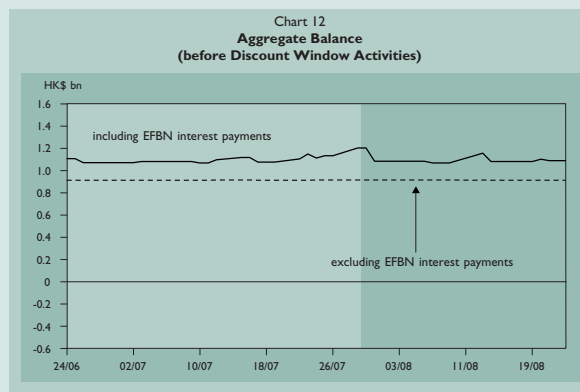
### Coins

The total amount of **coins in circulation decreased slightly** from HK\$5.79 billion to HK\$5.77 billion during the period (Chart 11).



### Aggregate Balance

In the absence of foreign exchange operations conducted for the Currency Board, **the Aggregate Balance remained stable** at around HK\$1.1 billion during the reporting period, with small fluctuations reflecting interest payments on Exchange Fund paper (Chart 12).



During the period, a **total of HK\$0.19 billion of interest payments on Exchange Fund paper were made**. Taking into account interest payments carried forward from the last reporting period, **an additional HK\$0.31 billion (in market value) of Exchange Fund paper was issued to absorb these interest payments**.

### Outstanding Exchange Fund Bills and Notes

The market value of outstanding Exchange Fund paper increased slightly from HK\$119.29 billion to HK\$120.02 billion. The increase was mainly a result of additional net issues (see paragraph above). All issues of Exchange Fund Bills and Notes were well received by the market (Table 3). **Holdings of Exchange Fund paper by the banking sector (before Discount Window activity) decreased**

Table 3  
Issuance of Exchange Fund paper and notes  
(30 July – 23 August 02)


	No. of Issues Launched	Over-subscription Ratio
3-month EFB	4	3.10–4.67
6-month EFB	2	5.10–8.68
1-year EFB	1	3.83
2-year EFN	1	4.71

marginally from HK\$107.56 billion (90.17% of total) to HK\$105.97 billion (88.29% of total) during the period (Chart 13).

### Discount Window Activity

For the period as a whole, **9 banks borrowed a total of HK\$0.42 billion from the Discount Window**, compared with HK\$0.78 billion in the preceding period (Chart 14). All borrowings used Exchange Fund paper as collateral. The banks used the Discount Window facility infrequently (Table 4).

### Backing Portfolio

Alongside a rise in the Monetary Base, backing assets increased during the period, though by proportionately less. As a result, **the backing ratio decreased slightly from 112.22% on 30 July to 112.19% on 23 August** (Chart 15). 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. 

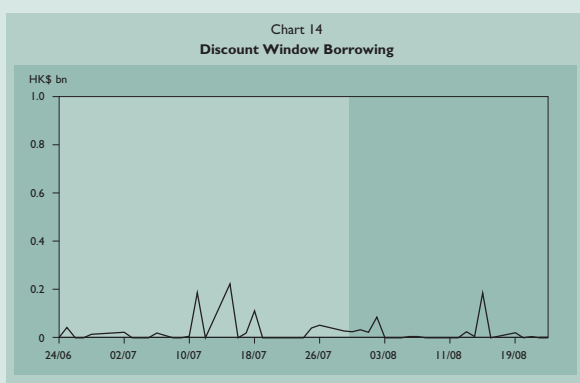
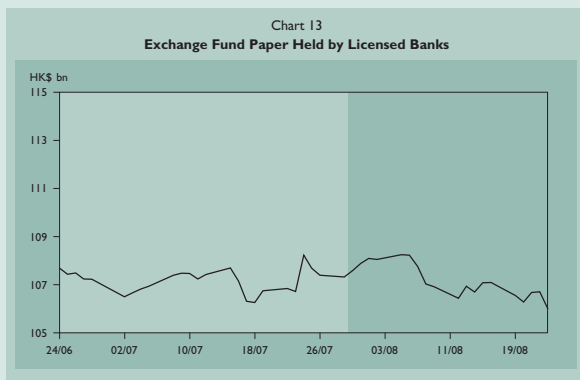
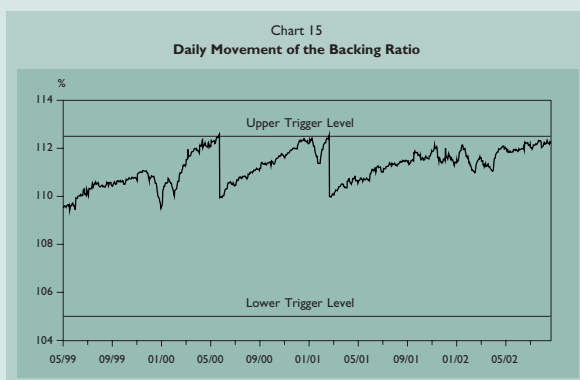


Table 4  
Frequency of Individual Bank  
Access to the Discount Window  
(30 July – 23 August 02)

Frequency of Using Discount Window	No. of Banks
1	7
2	0
3	2
<b>Total</b>	<b>9</b>

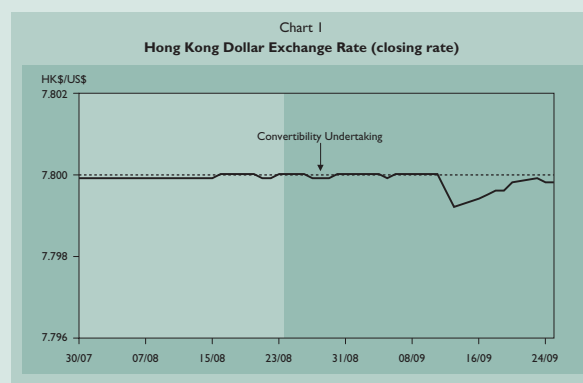


# EFAC SUB-COMMITTEE ON CURRENCY BOARD OPERATIONS REPORT ON CURRENCY BOARD OPERATIONS (24 AUGUST – 25 SEPTEMBER 2002)

*The Hong Kong dollar exchange rate stayed mostly at the linked rate until the triggering of the Convertibility Undertaking on 12 September, which led to a reduction in the Aggregate Balance and a strengthening in the Hong Kong dollar. Interbank interest rates rose to levels slightly above their US dollar counterparts, partly triggered by a brokerage report speculating about a change in the Link and a proposed (but later cancelled) study on the Link by Legislators. During the period, the Monetary Base increased from HK\$237.85 billion to HK\$238.32 billion, attributable to an increase in the outstanding amounts of Certificates of Indebtedness and Exchange Fund Bills and Notes. In accordance with Currency Board principles, changes in the Monetary Base were fully matched by corresponding changes in foreign reserves.*

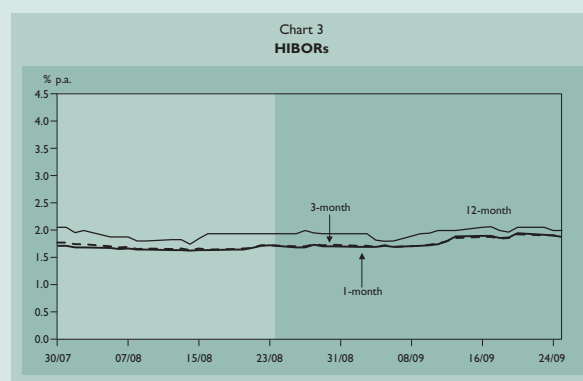
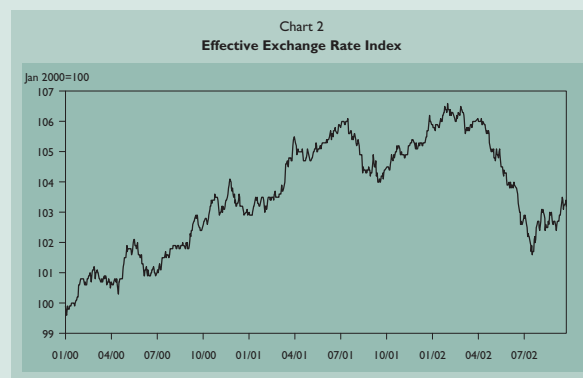
## Hong Kong Dollar Exchange Rate

The Hong Kong dollar exchange rate stayed mostly at the linked rate during the first half of the reporting period, before the Convertibility Undertaking was triggered on 12 September. The subsequent shrinkage in interbank liquidity led to a brief strengthening of the Hong Kong dollar to 7.7992. As the effect gradually subsided, the exchange rate weakened to close at 7.7998 at the end of the period (Charts 1 and 2).



## Interest Rates

Hong Kong dollar interest rates, particularly those of shorter term, rose slightly during the period. This was partly because the market was disturbed by a brokerage report speculating about a change in the exchange rate regime and a proposed (but later cancelled) study on the Link by the Financial Affairs Panel of the Legislative Council. The 1-month and 3-month HIBORs rose by 19bp and 16bp to 1.88% and 1.87% respectively. The 12-month HIBOR dipped initially, before rising modestly in the latter half of the period. It closed at 2.00%, compared with 1.94% at the beginning of the period (Chart 3).

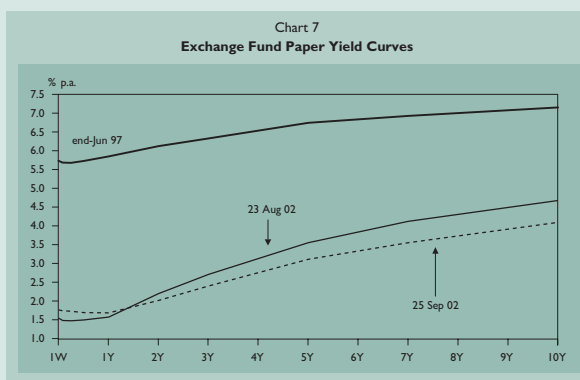
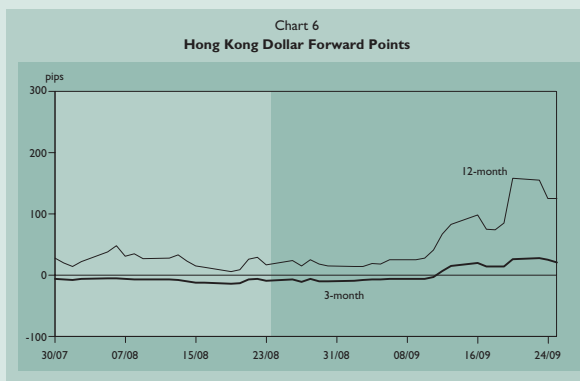
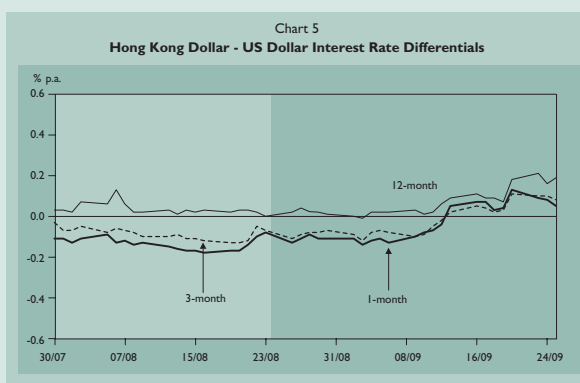
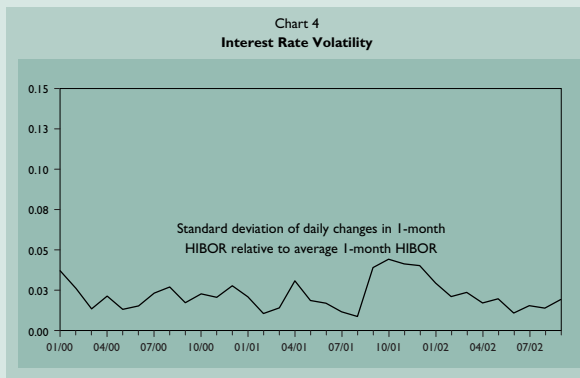


**Interest rate volatility**, measured by the ratio of standard deviation of daily changes in the 1-month HIBOR to its average, **rose slightly during the reporting period** (Chart 4).<sup>1</sup>

**Hong Kong dollar interbank interest rates rose to levels slightly above their US dollar counterparts in the second half of the period.** In terms of one-month and three-month money their spreads ended at 5bp and 8bp respectively. The interest rate spread for the 12-month money widened to close at 19bp (Chart 5).

Reflecting the rise in interest rate differentials against the US dollar, the Hong Kong dollar 3-month forward discount turned into a premium of 21 pips at the end of the period. **The 12-month forward points rose to a peak of 158 pips before easing to close at 125 pips** (Chart 6).

**Yields on Exchange Fund paper, except those at the short-end, decreased during the period**, in part reflecting the movements of the US Treasury yield curve (Chart 7). The yield spreads of 5-year and 10-year Exchange Fund paper over their US



<sup>1</sup> The ratio of the standard deviation of daily changes in the 1-month HIBOR to its monthly average measures the extent of interest rate fluctuations relative to the average level of interest rates, which may vary over time.

counterparts widened by 24bp and 7bp, to 42bp and 43bp respectively (Table 1).

The HKMA Base Rate remained unchanged at 3.25% (Chart 8). The banks' Best Lending Rates were also unchanged.

The average deposit rate offered by the major authorized institutions for 1-month time deposits rose marginally from 0.33% to 0.34% during the period.<sup>2</sup> Meanwhile, the effective deposit rate was little changed in August (Chart 9).<sup>3</sup>

### Monetary Base

The Monetary Base, which comprises the outstanding amount of Certificates of Indebtedness (CIs), Government-issued currency notes and coins in circulation, the Aggregate Balance, and Exchange Fund Bills and Notes, increased from HK\$237.85 billion to HK\$238.32 billion during the reporting period (Table 2). Movements in individual components are discussed below.

Table 1  
Yield Spreads of Exchange Fund Paper over US Treasuries (basis points)

	27 Jun 97	23 Aug 02	25 Sep 02
3-month	56	-19	8
1-year	21	-12	9
3-year	3	4	26
5-year	27	18	42
10-year	54	36	43

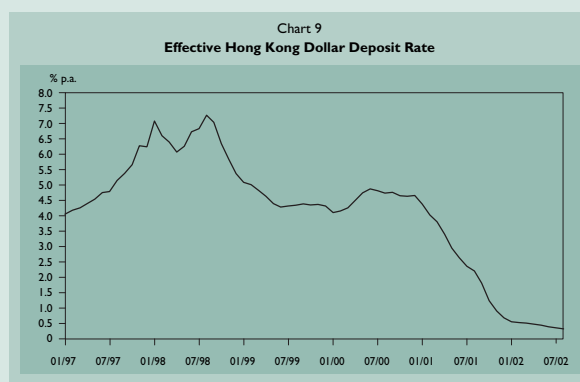
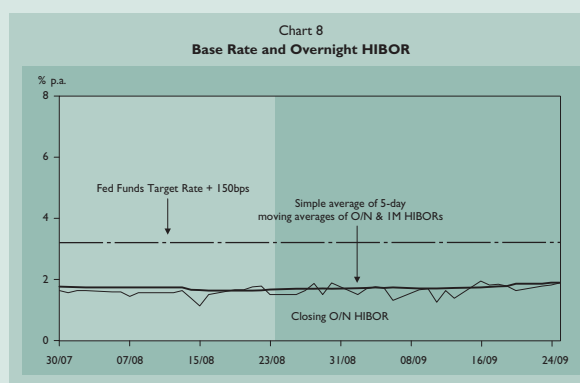


Table 2  
Monetary Base

(HK\$ billion)	26 Aug 02	25 Sep 02
CIs	110.93	111.35
Government-issued Currency Notes and Coins in Circulation	5.76	6.07
Aggregate Balance	1.19	0.31
Outstanding EFBNs	119.98	120.60
Monetary Base	237.85	238.32

- The quoted figures refer to the average of interest rates offered by the major authorized institutions for one-month time deposits of amount less than HK\$100,000.
- This is the average of the interest rates on demand, savings and time deposits. As the banking statistics classify deposits by remaining maturities, we have used certain assumptions regarding the maturity distribution to compute the effective deposit rate.

### Certificates of Indebtedness

During the period, the three note-issuing banks submitted to the HKMA a total of US\$0.05 billion in exchange for HK\$0.42 billion worth of Certificates of Indebtedness. As a result, the **outstanding amount of CIs increased marginally from HK\$110.93 billion to HK\$111.35 billion** (Chart 10).

### Government-issued currency notes and coins in circulation

After the new ten-dollar notes were put into circulation on 10 September, the total amount of Government-issued currency notes and coins in circulation increased from HK\$5.76 billion to HK\$6.07 billion during the period (Chart 11). The backing arrangement for the ten-dollar notes is the same as that for coins, which are also issued by the Government.

### Aggregate Balance

The Aggregate Balance stayed at around HK\$1.1 billion during the first half of the period. **Following the purchase of Hong Kong dollars amounting to HK\$0.78 billion by the HKMA under the Convertibility Undertaking on 12 September, the Aggregate Balance shrank to a level of around HK\$0.3 billion** (Chart 12 and Table 3).

During the period, **a total of HK\$0.37 billion of interest payments on Exchange Fund paper were made. An additional HK\$0.36 billion (in market value) of Exchange Fund paper was issued to absorb these interest payments.** The remaining balance was carried forward to the next period.

### Outstanding Exchange Fund Bills and Notes

**The market value of outstanding Exchange Fund paper increased slightly from HK\$119.98 billion to HK\$120.60 billion.** The increase was mainly a result of additional net issues (see paragraph above). All issues of Exchange Fund Bills and Notes were well received by the market (Table 4). **Holdings of Exchange Fund paper by the banking sector**

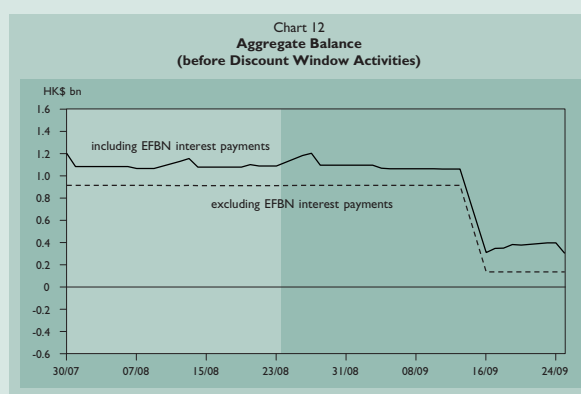
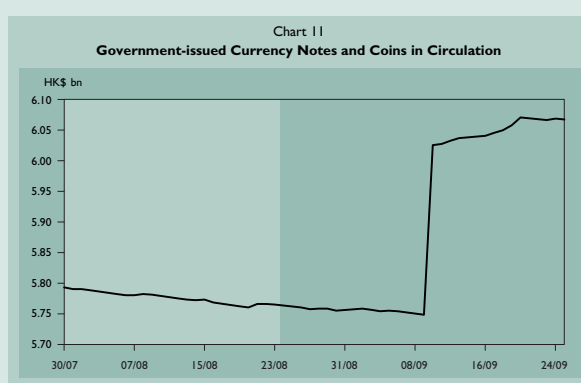
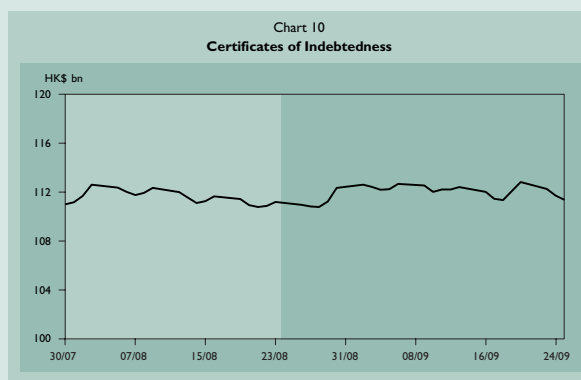


Table 3  
HKMA HK\$/US\$ FX Transaction  
(24 Aug – 25 Sep 02)

Trade Date	Net HK\$ purchase (+) (HK\$ mn)
12 Sep	+780

Table 4  
Issuance of Exchange Fund paper and notes  
(24 August – 25 September 02)


	No. of Issues Launched	Over-subscription Ratio
1-month EFB	1	16.42
3-month EFB	5	2.95–5.80
6-month EFB	2	5.65–5.86
1-year EFB	2	5.16–5.53
5-year EFN	1	7.27

(before Discount Window activity) decreased marginally from HK\$106.31 billion (88.61% of total) to HK\$105.43 billion (87.42% of total) during the period (Chart 13).

### Discount Window Activity

For the period as a whole, 11 banks borrowed a total of HK\$0.73 billion from the Discount Window, compared with HK\$0.42 billion in the preceding period (Chart 14). All borrowings used Exchange Fund paper as collateral. The banks used the Discount Window facility infrequently (Table 5).

### Backing Portfolio

Backing assets increased during the period mainly as a result of increases in the outstanding amounts of Exchange Fund paper and CIs. Nevertheless, as the Monetary Base rose proportionately more than the backing assets, the backing ratio decreased slightly from 112.20% on 25 August to 112.16% on 25 September (Chart 15). 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. 

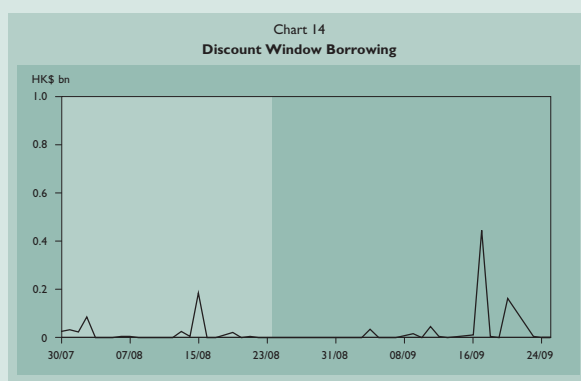
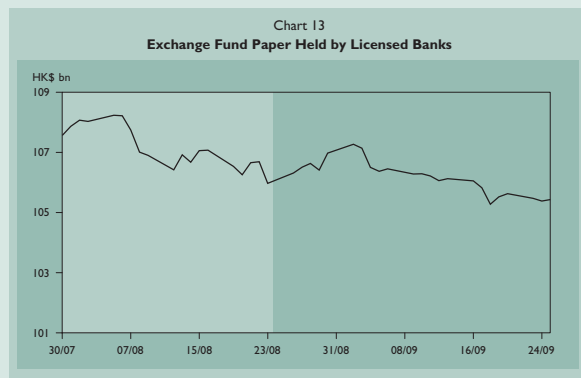


Table 5  
Frequency of Individual Bank  
Access to the Discount Window  
(24 August – 25 September 02)

Frequency of Using Discount Window	No. of Banks
1	10
2	1
<b>Total</b>	<b>11</b>

