

Record of Discussion of the Exchange Fund Advisory Committee Sub-Committee on Currency Board Operations on 1 November 2002

(Approved for Issue by the Exchange Fund Advisory Committee on 2 December 2002)

Currency Board Operations for the Period 26 September – 21 October 2002

The Sub-Committee noted that during the period under review the Hong Kong dollar exchange rate had remained stable and had strengthened slightly towards the end of the period, reflecting higher Hong Kong dollar interest rates. Interest rate spreads between the Hong Kong dollar and US dollar had widened significantly in the second half of the period and Hong Kong dollar 12-month forward points had risen to 368 pips in mid-October before easing to 295 pips at the end of the period. Members noted that these movements reflected renewed concerns about the budget deficit and generally nervous market sentiment. It was also observed that similar rises had taken place in the months leading up to the budget in previous years.

The Sub-Committee noted that, in accordance with Currency Board principles, changes in the Monetary Base during the reporting period had been fully matched by corresponding changes in the foreign reserves.

The report on Currency Board operations for the period under review is at [Annex](#).

Monitoring of Risks and Vulnerabilities

The Sub-Committee noted that there had been a slowdown in growth in the US and in Europe, although Asia, outside of Japan, had continued to record strong export growth. Concerns were growing about the sustainability of consumption growth in the US, with the sharp decline in consumer confidence, and about the weak labour market.

The Sub-Committee noted that some signs of recovery were emerging in Hong Kong. The unemployment rate had declined. Exports had continued to grow. Inbound tourism had increased strongly. There had been signs of some improvement in private investment. Private consumption, however, remained weak, and deflationary pressure had intensified.

External Circulation of Hong Kong Dollar Currency

The Sub-Committee considered a paper on the circulation of the Hong Kong dollar outside of Hong Kong. The paper estimated that some 15-25% of the total outstanding Hong

Kong dollar stock (around HK\$15-25 billion) was held outside of Hong Kong. Most of it was held in the southern parts of Mainland China, where the demand for Hong Kong dollars had grown in recent years, despite a stable renminbi. The demand was attributable to the increased economic integration of Hong Kong and the southern China region, the non-convertibility of the renminbi, and the relatively larger denominations of Hong Kong dollar banknotes.

Lithuania's Re-pegging from the US dollar to the euro

As part of its work in studying the operation of currency board systems in other economies, the Sub-Committee considered a paper on the re-pegging of the Lithuania litas from the US dollar to the euro in February 2002 under the currency board system employed by Lithuania. The decision to re-peg the litas was designed to facilitate the growing economic integration of Lithuania with the economies in the European Union. Members noted that the re-pegging had been carried out successfully in a transparent manner, with clear notice given, against a favourable economic environment, stable exchange rates and broad support from the public. Members also noted that there had been no devaluation of the litas during the re-pegging: the exchange rate to the euro had been determined by the market rate on the day prior to repegging.

Consumer Credit, Household Debt Service and Consumption

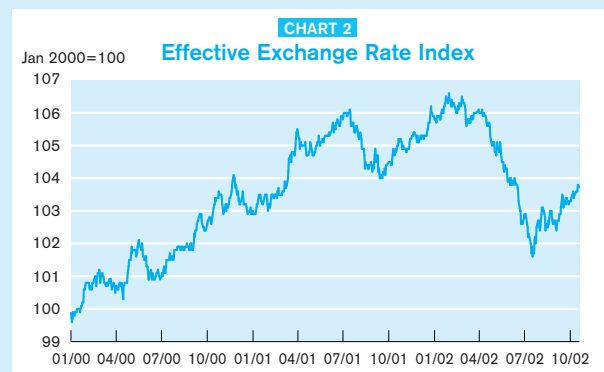
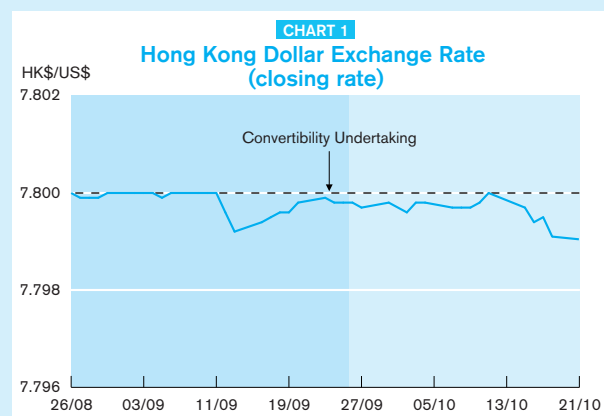
The Sub-Committee considered a paper on the relationship between consumer credit, household debt servicing, and consumption against the background of relatively strong external demand and relatively weak internal demand in the Hong Kong economy. The paper noted that, despite substantial growth in consumer credit, and an easing of the debt service burden over the past two years following interest rate cuts, private consumption remained subdued. The paper found that the main determinants of consumer spending appeared to be real income and wealth as captured by property prices. The paper further noted that shifts in credit conditions and debt service burden play a significant role in predicting consumption in the short term. But the availability of consumer credit did not appear to be statistically significant.

Annex Report on Currency Board Operations (26 September – 21 October 2002)

The Hong Kong dollar exchange rate strengthened in the latter part of the reporting period, reflecting in part higher Hong Kong dollar interest rates. Spreads against US interest rates widened, in the light of renewed concerns about the budget deficit and weakening of the Japanese yen. The Monetary Base increased from HK\$238.56 billion to HK\$238.89 billion, attributable to an increase in the outstanding amount of Certificates of Indebtedness. In accordance with Currency Board principles, changes in the Monetary Base were fully matched by corresponding changes in foreign reserves.

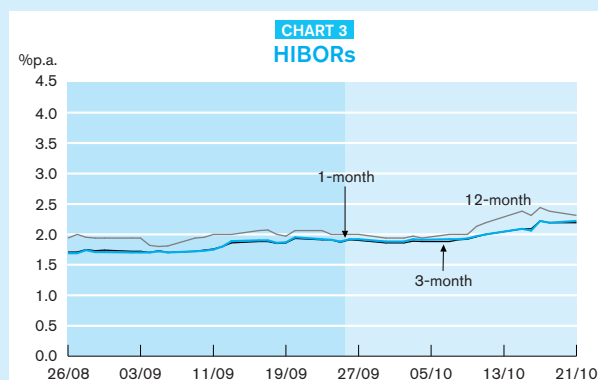
Hong Kong dollar Exchange Rate

The Hong Kong dollar exchange rate stayed close to the linked rate before strengthening slightly to close at 7.7990 at the end of the period, reflecting higher Hong Kong dollar interest rates (Charts 1 and 2).

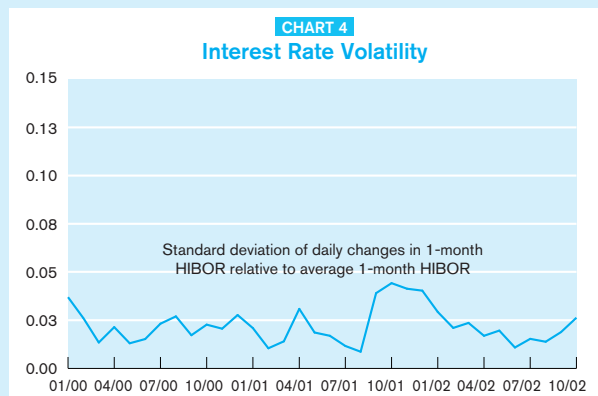


Interest Rates

Hong Kong dollar interest rates rose in the latter half of the period, reflecting renewed concerns about the budget deficit and weakening of the Japanese yen. The 1-month and 3-month HIBORs rose by 30bp and 28bp to 2.22% and 2.19% respectively. The 12-month HIBOR followed a similar pattern, rising by 31 bp to close at 2.31% (Chart 3).

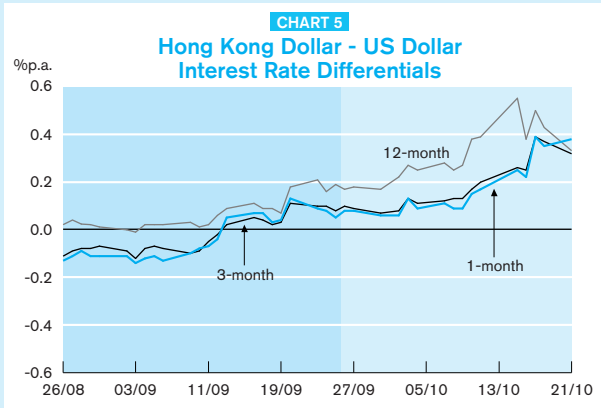


Interest rate volatility, measured by the ratio of standard deviation of daily changes in the 1-month HIBOR to its average, rose slightly (Chart 4).¹

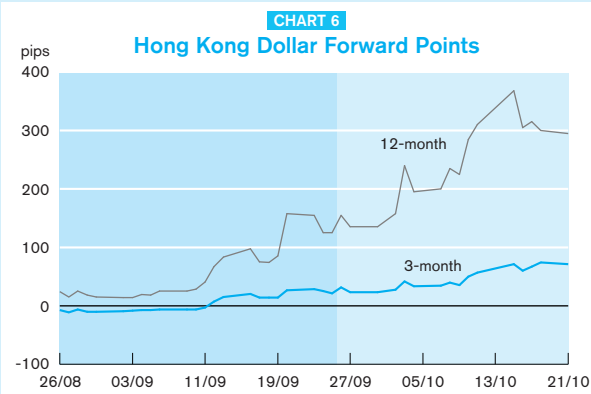


¹ The ratio of the standard deviation of daily changes in the 1-month HIBOR to its monthly average measures the extent of interest rate fluctuations relative to the average level of interest rates, which may vary over time.

Hong Kong dollar interbank interest rate spreads against the US dollar widened significantly in the second half of the period. One-month and three-month differentials ended at 38bp and 32bp respectively. The interest rate spread for the 12-month money widened to close at 33bp (Chart 5).



Mirroring the rise in interest rate differentials against the US dollar, the Hong Kong dollar 3-month forward premium increased to 71bp at the end of the period. **The 12-month forward points rose to a peak of 368 pips before easing to close at 295 pips** (Chart 6).



Yields on Exchange Fund paper increased 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 counterparts widened by 18bp and 14bp, to 60bp and 57bp respectively (Table 1).

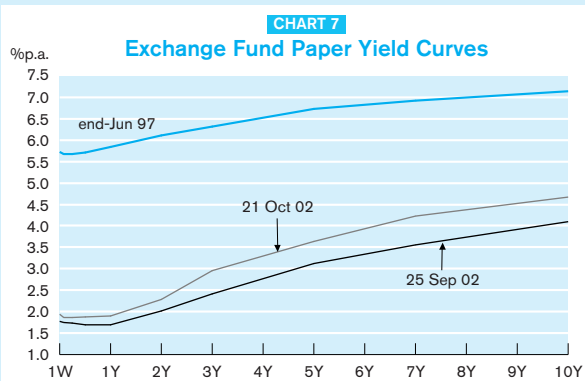
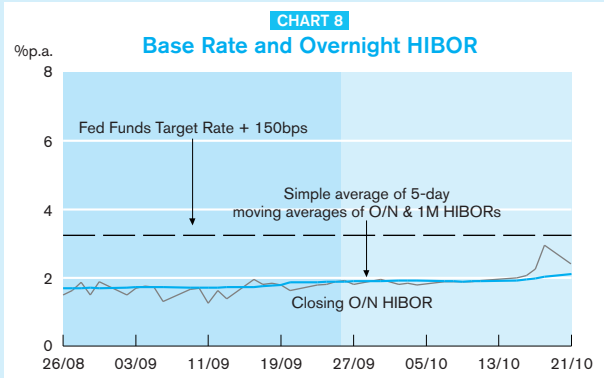


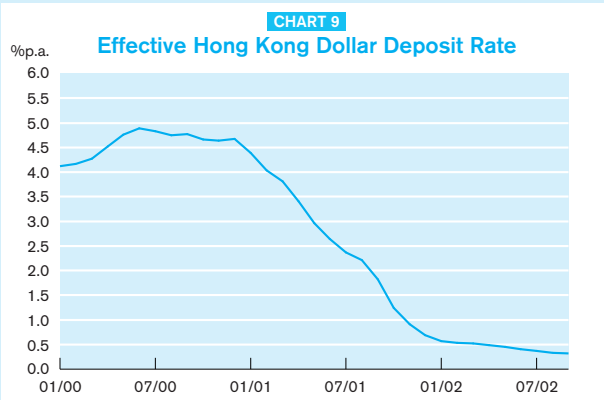
TABLE 1
Yield Spreads of Exchange Fund Paper over US Treasuries (basis points)

	27 Jun 97	25 Sep 02	21 Oct 02
3-month	56	8	20
1-year	21	9	24
3-year	3	26	50
5-year	27	42	60
10-year	54	43	57

The HKMA Base Rate remained unchanged at 3.25% (Chart 8). 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 0.34% to 0.41% during the period.² Meanwhile, the effective deposit rate was little changed in September (Chart 9).³



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.

Monetary Base

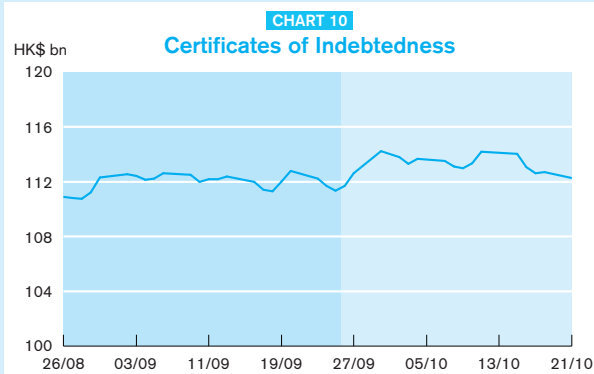
The **Monetary Base**, which comprises the outstanding amount of Certificates of Indebtedness (CIs), government-issued currency notes and coins in circulation, the Aggregate Balance, and Exchange Fund Bills and Notes, **increased from HK\$238.56 billion to HK\$238.89 billion during the reporting period** (Table 2). Movements in individual components are discussed below.

TABLE 2
Monetary Base

(HK\$ bn)	26 Sep 02	21 Oct 02
CIs	111.71	112.28
Government-issued Currency Notes and Coins in Circulation	6.07	6.09
Aggregate Balance	0.31	0.20
Outstanding EFBNs	120.47	120.32
Monetary Base	238.56	238.89

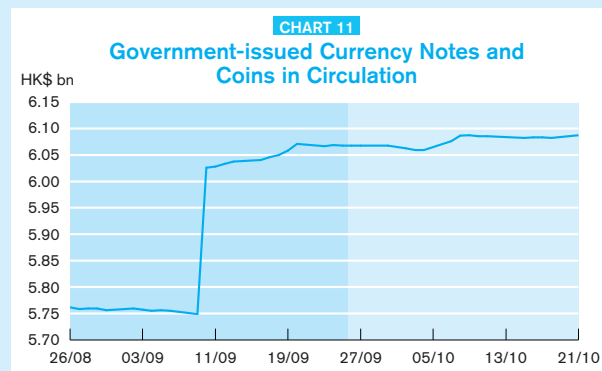
Certificates of Indebtedness

During the period, the three note-issuing banks submitted to the HKMA a total of US\$0.07 billion in exchange for HK\$0.57 billion worth of Certificates of Indebtedness. As a result, the **outstanding amount of CIs increased marginally from HK\$111.71 billion to HK\$112.28 billion** (Chart 10).



Government-issued currency notes and coins in circulation

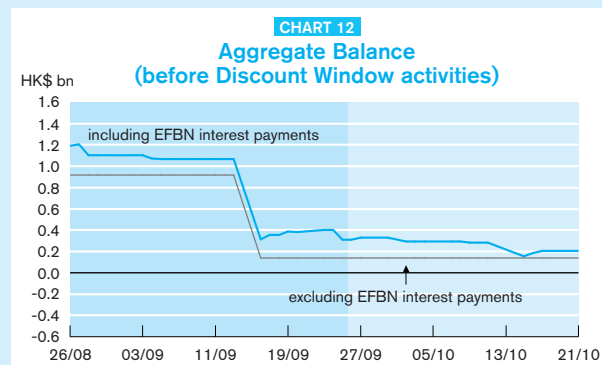
The total amount of Government-issued currency notes and coins in circulation increased slightly from HK\$6.07 billion to HK\$6.09 billion during the period (Chart 11).



Aggregate Balance

The **Aggregate Balance** stayed at around HK\$0.3 billion mostly during the period and **closed at HK\$0.2 billion** (Chart 12).

An additional HK\$0.08 billion (in market value) of Exchange Fund paper was issued to absorb interest payments for the current period as well as payments carried forward from the last one. Nevertheless, because some Exchange Fund Notes were issued at premium, **the net payment on Exchange Fund Paper** (i.e. coupon payments less (plus) any premium (discount) on new paper issued) **was HK\$ -0.02 billion**. This effect will be neutralised in the next period.

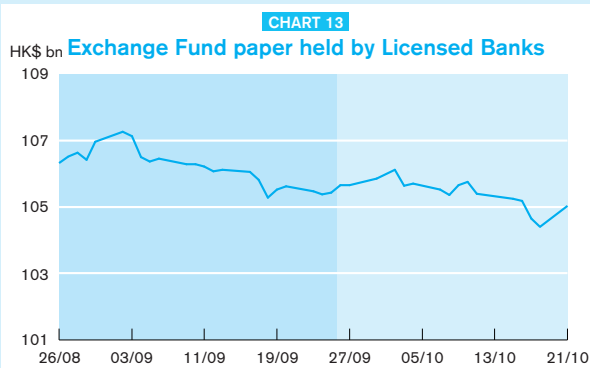


Outstanding Exchange Fund Bills and Notes

The market value of outstanding Exchange Fund paper decreased slightly from HK\$120.47 billion to HK\$120.32 billion. The decrease reflected mainly the valuation effect which more than offset the additional net issues. 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 marginally** from HK\$105.66 billion (87.71% of total) to HK\$105.02 billion (87.28% of total) during the period (Chart 13).

TABLE 3
Issuance of Exchange Fund bills and notes
(26 September – 21 October 02)

	No. of issues launched	Over-subscription ratio
3-month EFB	3	4.59-6.60
6-month EFB	2	4.71-5.18
3-year EFB	1	3.88



Discount Window Activity

For the period as a whole, **15 banks borrowed a total of HK\$3.10 billion from the Discount Window**, compared with HK\$0.73 billion in the preceding period (Chart 14). All borrowings used Exchange Fund paper as collateral (Table 4).

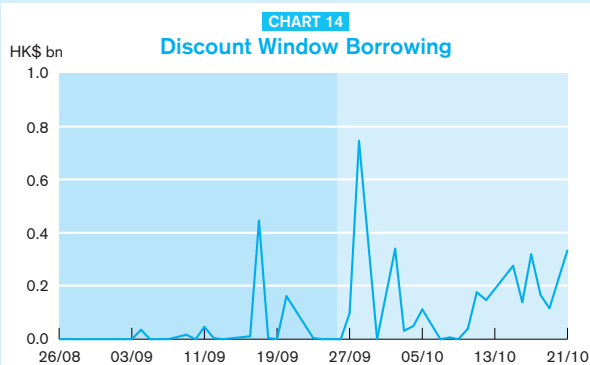
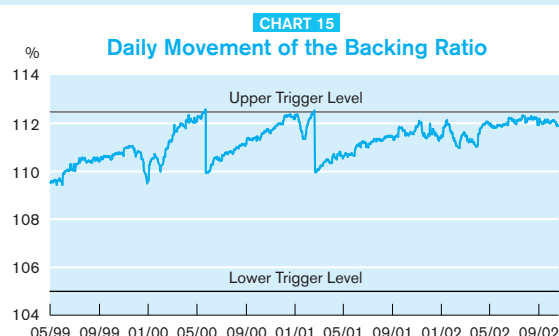


TABLE 4
Frequency of Individual Bank
Access to the Discount Window
(26 September – 21 October 02)

Frequency of using Discount Window	No. of banks
1	11
2	1
3	1
4	1
8	1
Total	15

Backing Portfolio

Backing assets increased during the period mainly due to increases in the outstanding amount of CIs. Nevertheless, as the Monetary Base rose proportionately more than the backing assets, **the backing ratio decreased slightly from 112.10% on 26 September to 111.95% on 21 October** (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.

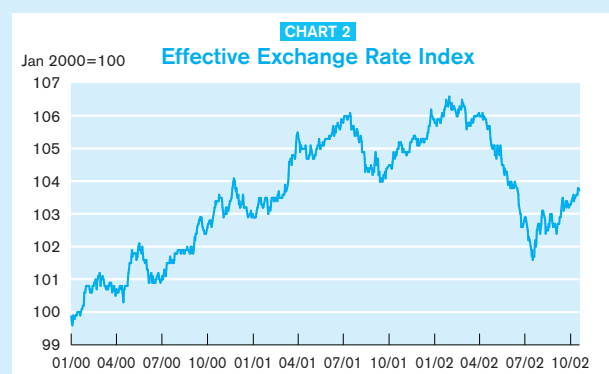
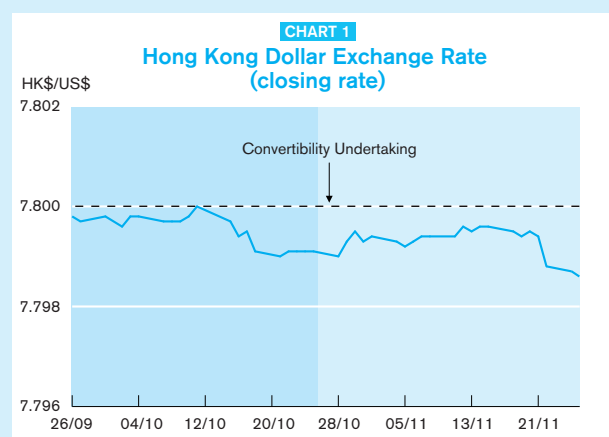


Report on Currency Board Operations (22 October — 26 November 2002)

The Hong Kong dollar exchange rate strengthened in the latter part of the reporting period, in part reflecting the subsiding speculation about the Link. The interest rate spreads against the US dollar also narrowed. Local interbank interest rates eased following the 50 bp cut in the US Fed Funds Target Rate on 6 November. The Monetary Base increased from HK\$238.41 billion to HK\$239.76 billion, attributable to an increase in the outstanding amount of Certificates of Indebtedness. In accordance with Currency Board principles, changes in the Monetary Base were fully matched by corresponding changes foreign reserves.

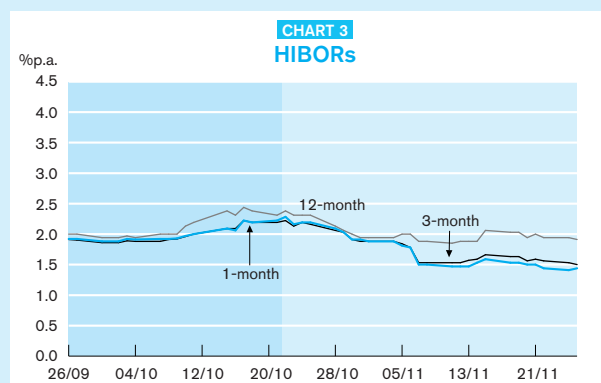
Hong Kong dollar Exchange Rate

The Hong Kong dollar exchange rate stayed mostly within a narrow range of 7.7990 and 7.7996 before strengthening slightly to close at 7.7985 at the end of the period (Charts 1 and 2).

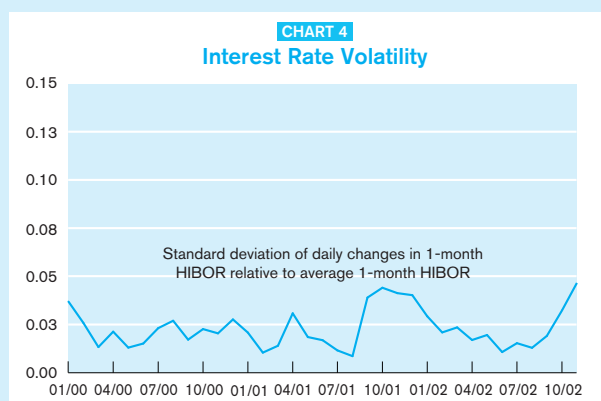


Interest Rates

Hong Kong dollar interest rates, particularly short-term rates, dropped moderately in the period, reflecting in part the 50 bp cut in the US Fed Funds Target Rate on 6 November. The 1-month and 3-month HIBORs fell by 84 bp and 72 bp to 1.44% and 1.50% respectively. The 12-month HIBOR followed a similar pattern, falling 47 bp to close at 1.91% (Chart 3).

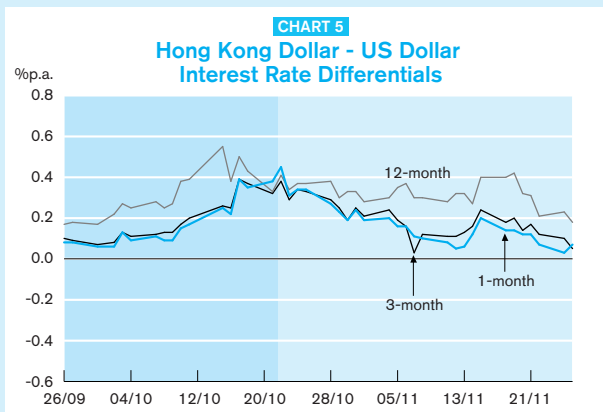


Interest rate volatility, measured by the ratio of standard deviation of daily changes in the 1-month HIBOR to its average, increased moderately (Chart 4).¹

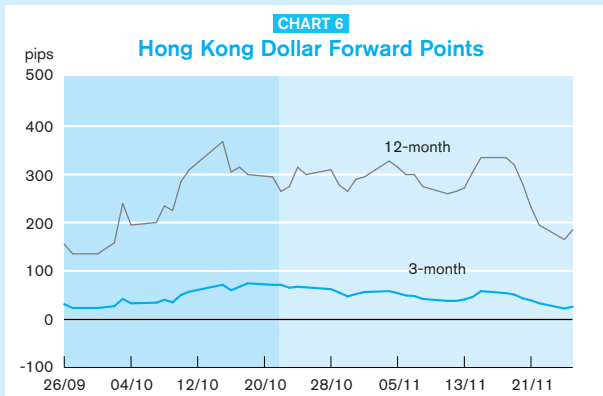


¹ The ratio of the standard deviation of daily changes in the 1-month HIBOR to its monthly average measures the extent of interest rate fluctuations relative to the average level of interest rates, which may vary over time.

The spreads of Hong Kong dollar interbank interest rates against the US dollar narrowed substantially in the period, as market rumours about the Link subsided. One-month and three-month differentials ended at 7 bp and 5 bp respectively. The interest rate spread for the 12-month money narrowed to close at 18 bp (Chart 5).



Echoing the movements in interest rate differentials against the US dollar, the Hong Kong dollar 3-month forward premium decreased in the period and closed at 26 pips. The 12-month forward points also eased to close at 185 pips (Chart 6).



Yields on Exchange Fund paper 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 counterparts narrowed by 43 bp and 32 bp, to 17 bp and 25 bp respectively (Table 1).

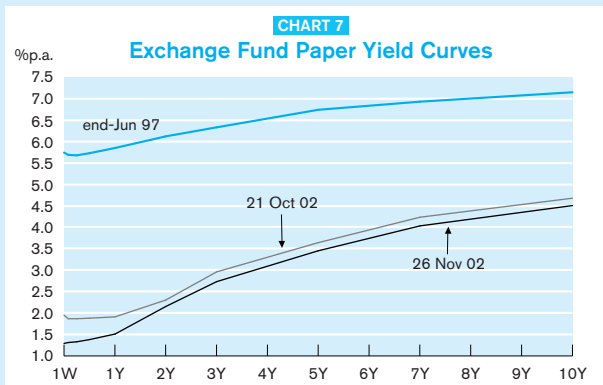
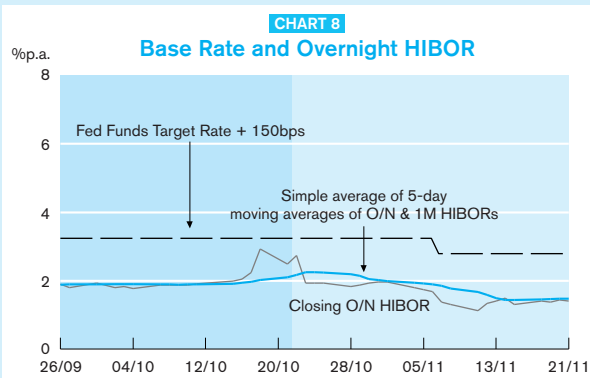


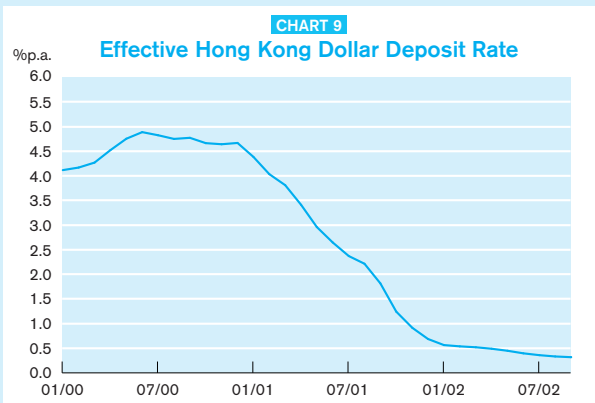
TABLE 1
Yield Spreads of Exchange Fund Paper over US Treasuries (basis points)

	27 Jun 97	21 Oct 02	26 Nov 02
3-month	56	20	6
1-year	21	24	19
3-year	3	50	16
5-year	27	60	17
10-year	54	57	25

Following the 50 bp cut in the US Fed Funds Target Rate on 6 November, the **Base Rate was adjusted downwards to 2.75% on 7 November** in accordance with the established formula (Chart 8). The **Best Lending Rate offered by major banks declined by 12.5 bp to 5%.**



The average deposit rate offered by the major authorized institutions for 1-month time deposits fell from 0.43% to 0.12% during the period.² Meanwhile, the effective deposit rate was little changed in October (Chart 9).³



² The figures refer to the average of interest rates offered by the major authorized institutions for one-month time deposits of 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.

Monetary Base

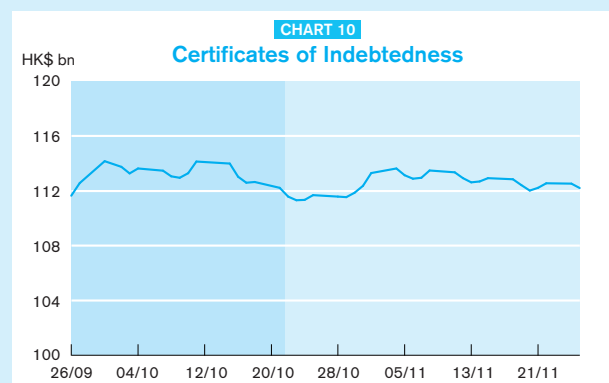
The **Monetary Base**, which comprises Certificates of Indebtedness (CIs), government-issued currency notes and coins in circulation, the Aggregate Balance, and Exchange Fund Bills and Notes, **increased from HK\$238.41 billion to HK\$239.76 billion during the reporting period** (Table 2). Movements in individual components are discussed below.

TABLE 2
Monetary Base

(HK\$ bn)	22 Oct 02	26 Nov 02
CIs	111.65	112.27
Government-issued Currency Notes and Coins in Circulation	6.10	6.14
Aggregate Balance	0.44	0.61
Outstanding EFBNs	120.23	120.75
Monetary Base	238.41	239.76

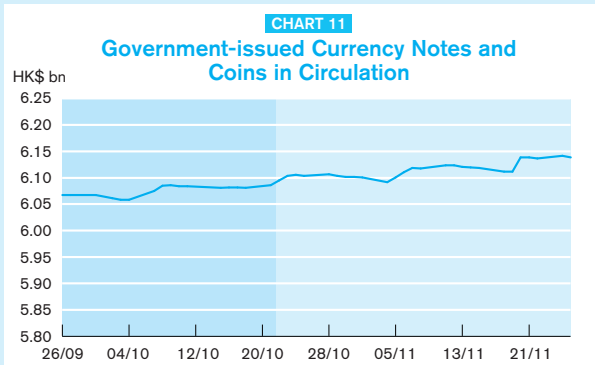
Certificates of Indebtedness

During the period, the three note-issuing banks submitted to the HKMA a total of US\$0.08 billion in exchange for HK\$0.62 billion worth of Certificates of Indebtedness. As a result, the **outstanding amount of CIs increased marginally from HK\$111.65 billion to HK\$112.27 billion** (Chart 10).



Government-issued currency notes and coins in circulation

The total amount of **Government-issued currency notes and coins in circulation increased slightly** from HK\$6.10 billion to HK\$6.14 billion during the period (Chart 11).



Aggregate Balance

The HKMA sold a total of HK\$0.23 billion of Hong Kong dollars in response to bank bids on 22 October. As a result, **the Aggregate Balance increased to around HK\$0.6 billion**. Thereafter, the Aggregate Balance remained stable, with small fluctuations reflecting interest payments of Exchange Fund paper (Chart 12 and Table 3).

During the period, **a total of HK\$0.44 billion of interest payments on Exchange Fund paper were made. An additional HK\$0.27 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.

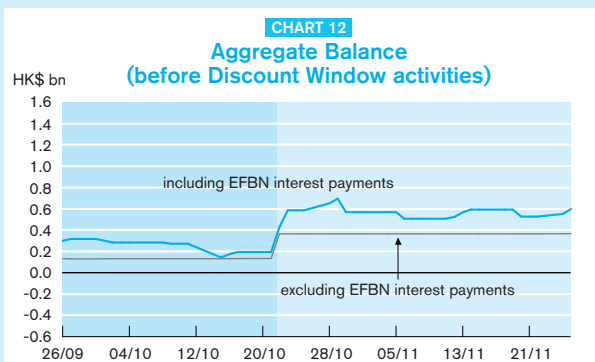


TABLE 3
HKMA HK\$/US\$ FX Transaction
(22 October — 26 November 02)

Trade Date	Net HK\$ purchase (+) (HK\$ mn)
22 Oct	-234

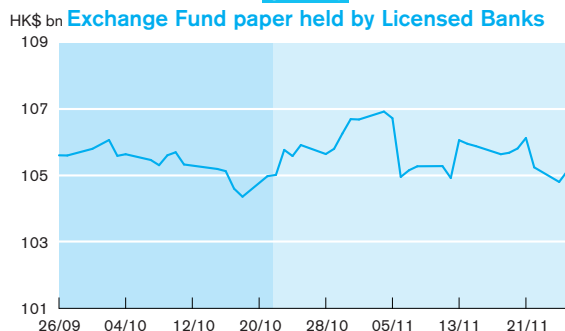
Outstanding Exchange Fund Bills and Notes

The market value of outstanding Exchange Fund paper increased slightly from HK\$120.23 billion to HK\$120.75 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 (before Discount Window activity) increased marginally from HK\$105.06 billion (87.38% of total) to HK\$105.19 billion (87.11% of total) during the period (Chart 13).

TABLE 4
Issuance of Exchange Fund bills and notes
(22 October – 26 November 02)

	No. of issues launched	Over-subscription ratio
3-month EFB	5	3.56-6.37
6-month EFB	2	6.51-7.35
1-year EFB	2	5.94-7.60
2-year EFN	1	5.98

CHART 13
Exchange Fund paper held by Licensed Banks



Discount Window Activity

For the period as a whole, **17 banks borrowed a total of HK\$1.90 billion from the Discount Window**, compared with HK\$3.10 billion in the preceding period (Chart 14), using Exchange Fund paper as collateral (Table 5).

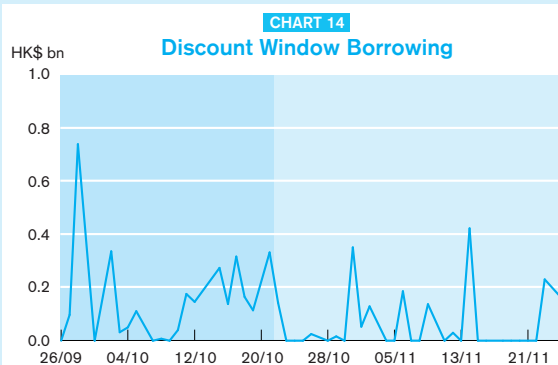


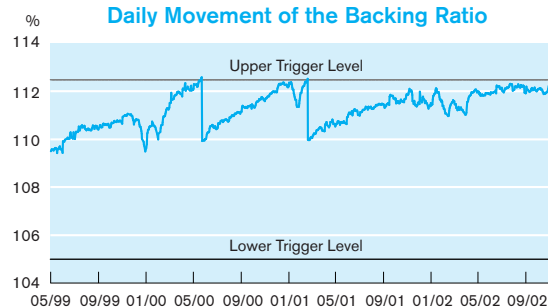
TABLE 5
Frequency of Individual Bank
Access to the Discount Window
(22 October – 26 November 02)

Frequency of using Discount Window	No. of banks
1	12
2	4
3	1
Total	17

Backing Portfolio

Backing assets increased during the period mainly due to rises in the outstanding amount of CIs and valuation changes. As a result, **the backing ratio increased slightly from 111.90% on 22 October to 112.13% on 26 November** (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.

CHART 15
Daily Movement of the Backing Ratio



Record of Discussion of the Exchange Fund Advisory Committee Sub-Committee on Currency Board Operations on 3 January 2003

(Approved for Issue by the Exchange Fund Advisory Committee on 30 January 2003)

Currency Board Operations for the Period 27 November – 19 December 2002

The Sub-Committee noted that the period under review had been a stable one marked by a mild strengthening of the Hong Kong dollar exchange rate and a slight firming of short-term interest rate spreads against US dollar rates. Following a somewhat volatile time in October and November, Hong Kong dollar 12-month forward points had remained largely stable during the period, easing slightly to close the period at 190 pips. The Monetary Base had expanded from HK\$239.78 billion to HK\$242.72 billion as a result of an increase in the outstanding amount of Certificates of Indebtedness, reflecting the seasonal increase in bank note issuance.

The Sub-Committee noted that, in accordance with Currency Board principles, changes in the Monetary Base during the reporting period had been fully matched by corresponding changes in the foreign reserves.

The report on Currency Board operations for the period under review is at [Annex](#).

Monitoring of Risks and Vulnerabilities

The Sub-Committee noted that there were mixed signals in the global economy. While Germany and Japan continued to show a weak performance, in the US the Institute for Supply Management's manufacturing index had increased sharply. Nevertheless, the sluggish labour market and the low household savings rate in the US were expected to continue to restrain consumption, and many other uncertainties remained. In Asia, export-driven growth had continued, leading to a boost in real GDP growth in Hong Kong in the third quarter. Domestic demand, however, remained weak.

The Sub-Committee noted the special analysis in the report addressing concerns about the danger that a Japanese-style deflationary spiral might develop in Hong Kong. The broad

conclusion of the research was that such a development was not taking place in Hong Kong, and was unlikely to take place. In contrast to Japan's, Hong Kong's economic performance was mainly determined by external demand: domestic price declines helped to boost external competitiveness, which would in turn bring benefits to Hong Kong in the form of growth and increased employment.

Export Performance in Hong Kong – Offshore Trade and Re-exports

The Sub-Committee noted a paper examining Hong Kong's export performance in the light of concerns about export growth in Hong Kong falling behind that of the Mainland and the growing tendency for Mainland exports to bypass Hong Kong. The main factors behind this process were the growth in direct shipment of goods between the Mainland and the rest of the world and the rapid growth as an industrial and trading centre of the Yangzi delta region, which was less integrated with Hong Kong than was the Pearl River delta region. The paper drew particular attention to the recent trend of rising offshore trade, reflecting Hong Kong's participation in the strong growth in direct trade between the Mainland and the rest of the world. Members noted that, since elasticity of employment was smaller for offshore trade than for domestic exports or re-exports, this change in the structure of exports had implications for employment in Hong Kong.

Alternative Measures of the Real Effective Exchange Rate

The Sub-Committee considered a paper exploring a number of alternative measures of the real effective exchange rate (REER) and comparing them with the REER series currently compiled and used by the HKMA. The conclusion of the paper was that the current HKMA REER series provided a good overall indicator of Hong Kong's competitiveness, although it could be supplemented by some of the alternative measures. The Sub-Committee recommended that the current REER index, in addition to its inclusion on a quarterly basis in the Government's *Economic Report*, should be published as a monthly series in the HKMA's *Monthly Statistical Bulletin*.

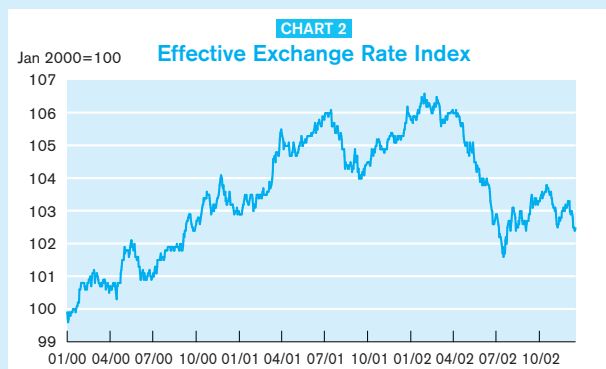
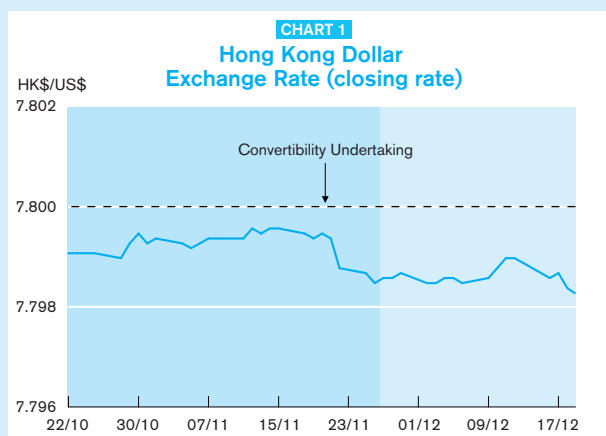
Annex

Report on Currency Board Operations (27 November – 19 December 2002)

The Hong Kong dollar exchange rate strengthened modestly towards the end of the reporting period. Alongside tighter liquidity conditions ahead of the year-end holidays, the short-term interest rate spreads against the US dollar also firmed slightly. Nevertheless, the 12-month interest rate differential narrowed. The Monetary Base increased from HK\$239.78 billion to HK\$242.72 billion, attributable to an increase in the outstanding amount of Certificates of Indebtedness. In accordance with Currency Board principles, changes in the Monetary Base were fully matched by corresponding changes in foreign reserves.

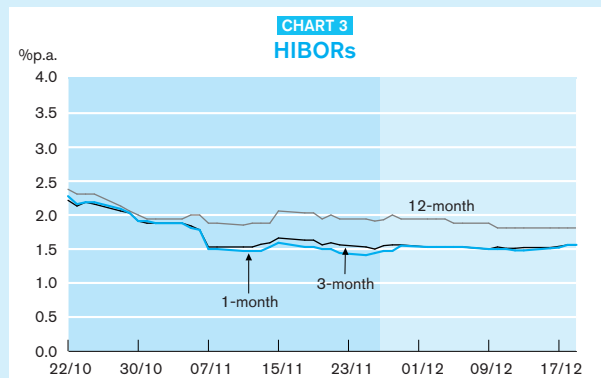
Hong Kong dollar Exchange Rate

During the reporting period, the Hong Kong dollar exchange rate stayed mostly around 7.7986. Towards the end of the period, it strengthened slightly to close at 7.7980, associated in part with tighter liquidity conditions ahead of the year-end holidays (Charts 1 and 2).

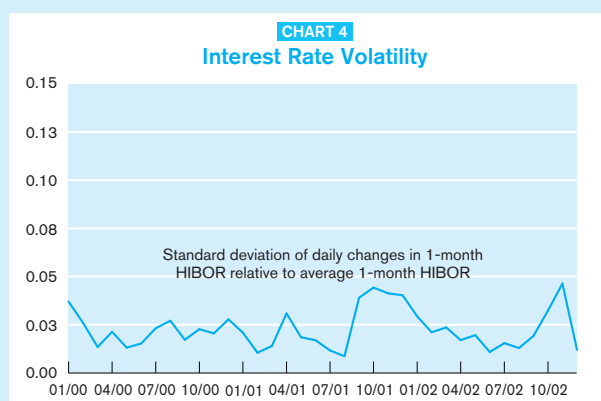


Interest Rates

Short-term Hong Kong dollar interest rates also firmed slightly during the period. The 1-month and 3-month HIBORs edged up by 9 bp and 1 bp to close at 1.56%. The 12-month HIBOR dropped by 12 bp to close at 1.81% (Chart 3).

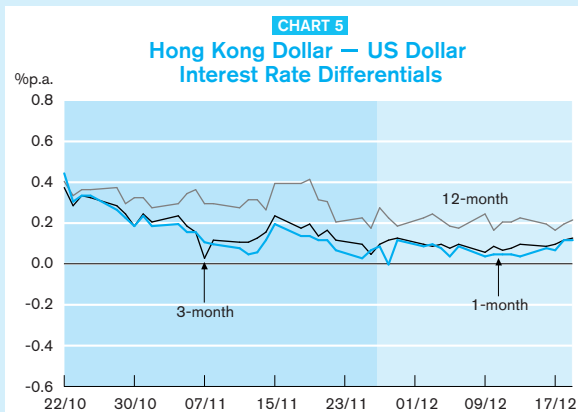


Interest rate volatility, as measured by the ratio of standard deviation of daily changes in the 1-month HIBOR to its average, **decreased moderately** for the period from end-November up to 19 December (Chart 4).¹

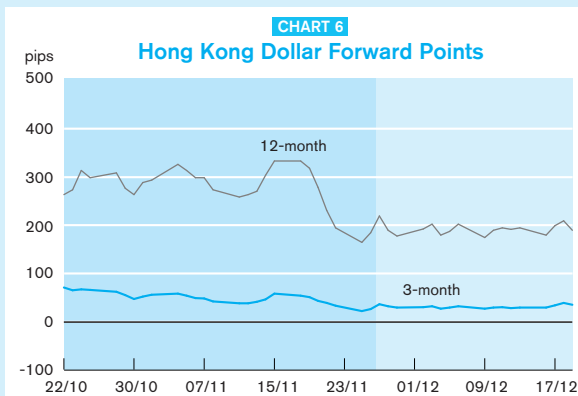


¹ The ratio of the standard deviation of daily changes in the 1-month HIBOR to its monthly average measures the extent of interest rate fluctuations relative to the average level of interest rates, which may vary over time.

The spreads of Hong Kong dollar one- and three-month interbank interest rates over the US dollar counterparts eased in the first half of the period. However, they rose modestly towards the end of the period to close at 13 bp and 12 bp respectively. In contrast, the interest rate spread for the 12-month money narrowed slightly to close at 22 bp (Chart 5).



The Hong Kong dollar 3-month forward premium was little changed in the period, staying at about 35 pips. The 12-month forward points eased slightly to close at 190 pips (Chart 6).



The yield curve of Exchange Fund paper steepened slightly during the period (Chart 7). Despite an across-the-board decline in yields of US Treasuries, yields on long-term Exchange Fund paper increased as their spreads over their US counterparts widened. The differentials in respect of 5-year and 10-year paper rose by 33 bp and 29 bp, to 50 bp and 54 bp respectively (Table 1).

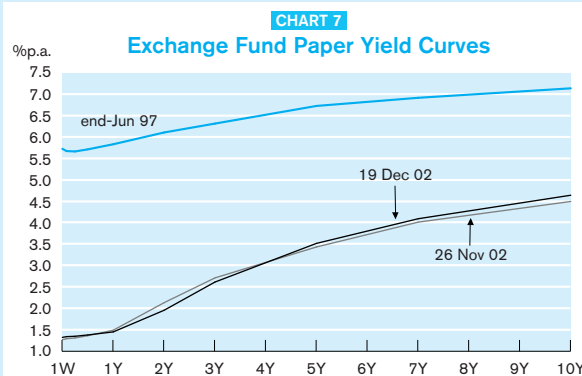
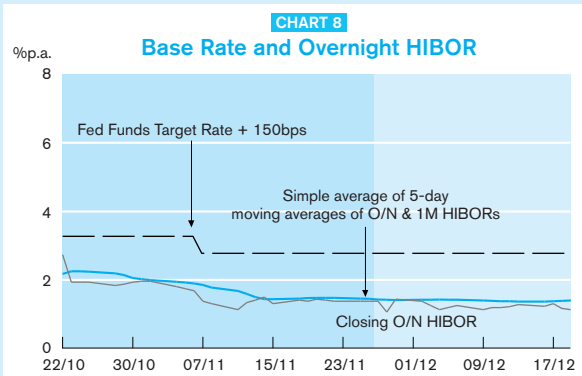


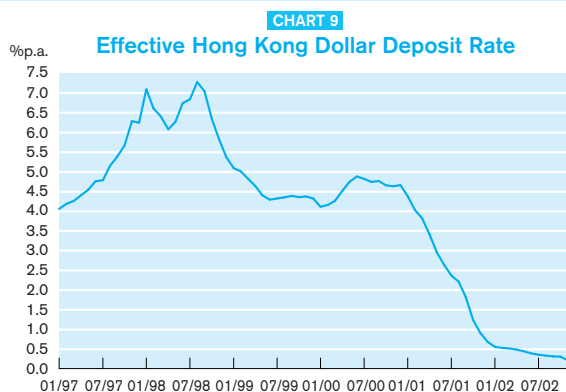
TABLE 1
Yield Spreads of Exchange Fund Paper over US Treasuries (basis points)

	27 Jun 97	26 Nov 02	19 Dec 02
3-month	56	6	13
1-year	21	19	14
3-year	3	16	38
5-year	27	17	50
10-year	54	25	54

The HKMA Base Rate remained unchanged at 2.75% (Chart 8). The Best Lending Rate offered by major banks was also unchanged at 5%.



The average rate offered by the major authorized institutions for 1-month time deposits rose slightly from 0.12% to 0.13% during the period.² Meanwhile, the effective deposit rate decreased modestly in November (Chart 9).³



Monetary Base

The **Monetary Base**, which comprises Certificates of Indebtedness (CIs), government-issued currency notes and coins in circulation, the Aggregate Balance, and Exchange Fund Bills and Notes, **increased from HK\$239.78 billion to HK\$242.72 billion during the reporting period** (Table 2). Movements in individual components are discussed below.

TABLE 2
Monetary Base

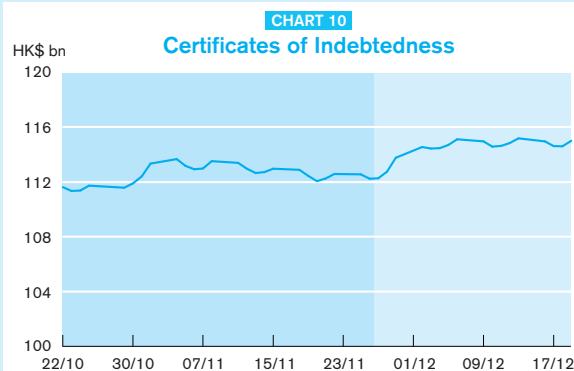
(HK\$ bn)	27 Nov 02	19 Dec 02
CIs	112.29	115.04
Government-issued Currency Notes and Coins in Circulation	6.14	6.13
Aggregate Balance	0.60	0.63
Outstanding EFBNs	120.77	120.92
Monetary Base	239.78	242.72

Certificates of Indebtedness

During the period, the three note-issuing banks submitted to the HKMA a total of US\$0.35 billion in exchange for HK\$2.75 billion worth of Certificates of Indebtedness. As a result, the **outstanding amount of CIs increased modestly from HK\$112.29 billion to HK\$115.04 billion** (Chart 10).

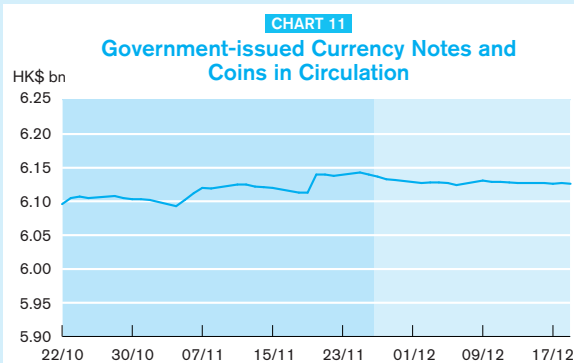
² The figures refer to the average of interest rates offered by the major authorized institutions for one-month time deposits of less than HK\$100,000.

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.



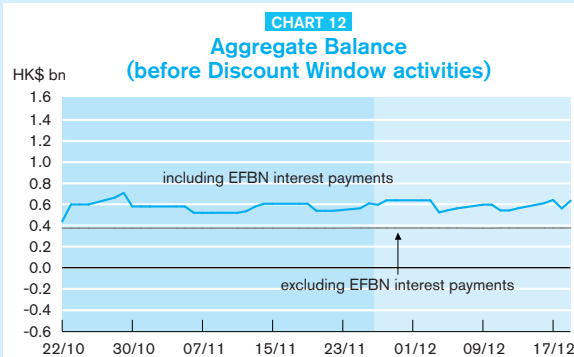
Government-issued currency notes and coins in circulation

The total amount of **Government-issued currency notes and coins in circulation decreased marginally from HK\$6.14 billion to HK\$6.13 billion during the period** (Chart 11).



Aggregate Balance

The **Aggregate Balance remained stable** at around HK\$0.60 billion during the period, with small fluctuations reflecting interest payments on Exchange Fund paper (Chart 12). It closed at HK\$0.63 billion.



During the period, a total of HK\$0.40 billion of interest payments on Exchange Fund paper was made. An additional HK\$0.38 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.

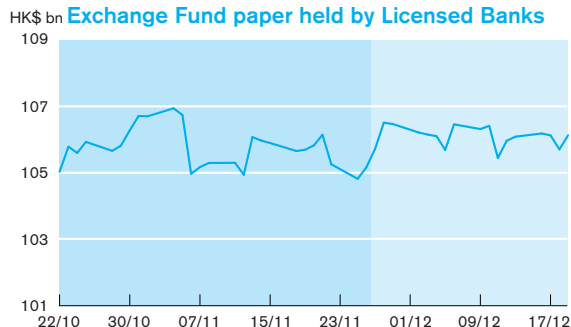
Outstanding Exchange Fund Bills and Notes

The market value of outstanding Exchange Fund paper increased slightly from HK\$120.77 billion to HK\$120.92 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) increased marginally from HK\$105.77 billion (87.58% of total) to HK\$106.17 billion (87.80% of total) during the period (Chart 13).

TABLE 3
Issuance of Exchange Fund bills and notes
(27 November – 19 December 02)

	No. of issues launched	Over-subscription ratio
1-month EFB	1	15.33
3-month EFB	4	3.82-5.85
6-month EFB	2	4.48-5.69
1-year EFB	1	4.11
5-year EFN	1	4.15
7-year EFN	1	3.12
10-year EFN	1	2.68

CHART 13
Exchange Fund paper held by Licensed Banks



Discount Window Activity

For the period as a whole, 9 banks borrowed a total of HK\$2.04 billion from the Discount Window, compared with HK\$1.90 billion in the preceding period (Chart 14). All of them used Exchange Fund paper as collateral (Table 4).

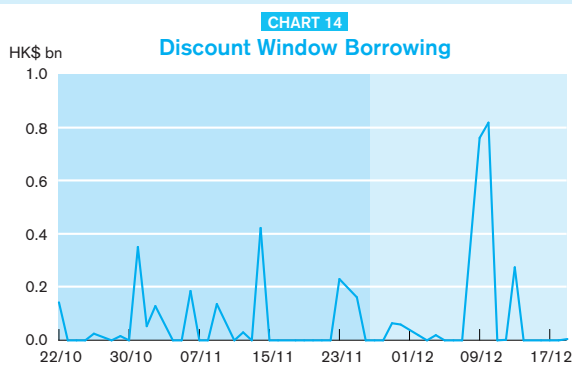


TABLE 4
Frequency of Individual Bank
Access to the Discount Window
(27 November – 19 December 02)

Frequency of using Discount Window	No. of banks
1	7
2	1
4	1
Total	9

Backing Portfolio

Backing assets increased during the period mainly due to rises in the outstanding amount of CIs and valuation changes. As a result, the backing ratio increased slightly from 112.18% on 27 November to 112.21% on 19 December (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.

CHART 15
Daily Movement of the Backing Ratio

