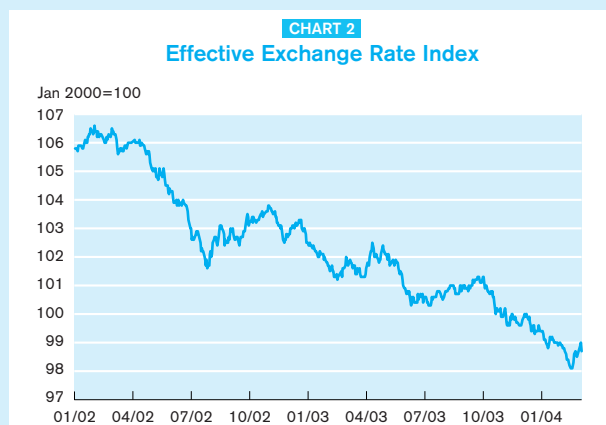
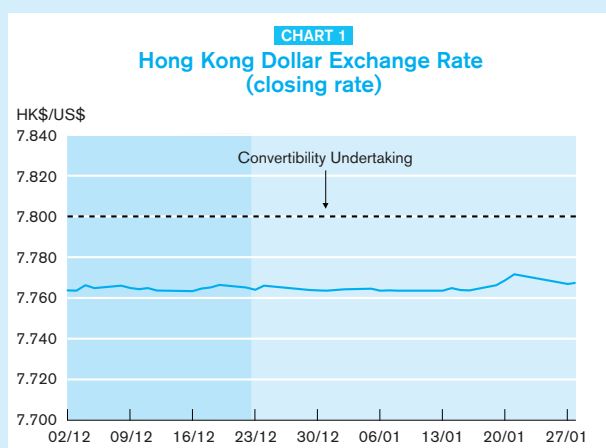


Report on Currency Board Operations (23 December 2003 – 28 January 2004)

The Hong Kong dollar exchange rate remained stable during the reporting period. Reflecting the strong demand for Hong Kong dollar assets, the HKMA sold a total of HK\$25.86 billion of Hong Kong dollars during the period, increasing the Aggregate Balance to HK\$52.25 billion. While short-term interbank interest rates remained close to zero, longer-term rates eased further below US dollar rates. The Monetary Base expanded notably from HK\$291.51 billion to HK\$329.77 billion during the period, mainly attributable to the expansion in the Aggregate Balance and an increase in the outstanding amount of Certificates of Indebtedness to meet the seasonal demand ahead of the Chinese New Year. In accordance with Currency Board principles, changes in the Monetary Base were fully matched by corresponding changes in foreign reserves.

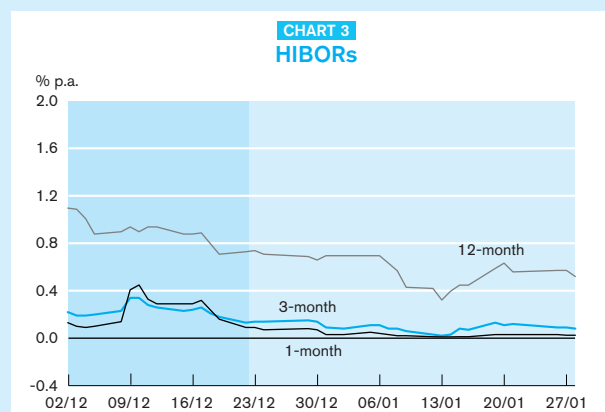
Hong Kong dollar exchange rate

Despite the strong demand for Hong Kong dollar assets, **the Hong Kong dollar exchange rate remained stable**. The exchange rate stayed within a range of 7.7631 to 7.7712 during the reporting period, and closed at 7.7669 (Charts 1 and 2). This in part reflected the sales of Hong Kong dollars by the HKMA in response to bank offers.

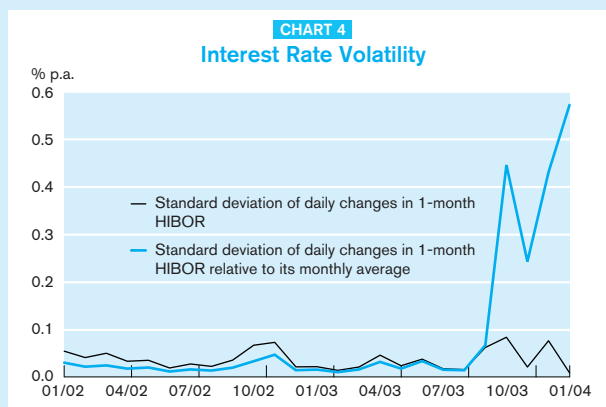


Interest rates

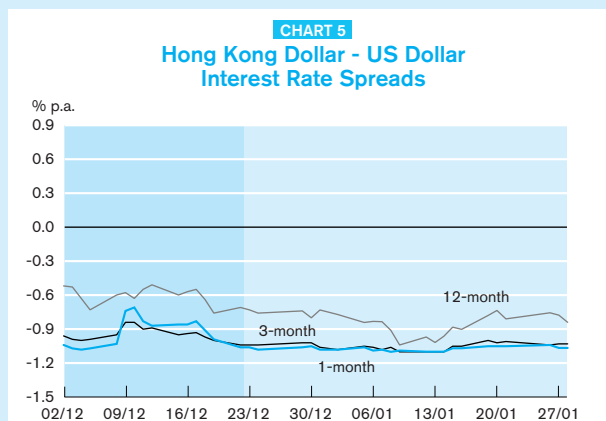
Alongside an expansion in interbank liquidity, **Hong Kong dollar interest rates eased further** during the reporting period, particularly for those with longer maturity. 12-month HIBOR fell by 22 bp to close at 0.51%. On the other hand, shorter-term interest rates remained close to zero, with 1-month and 3-month HIBORs closing at 0.02% and 0.07% respectively (Chart 3).



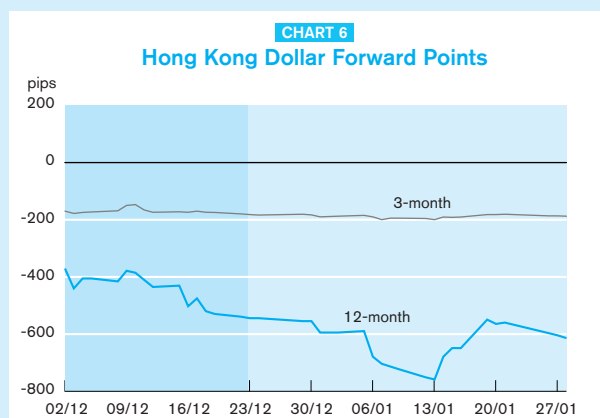
Interest rate volatility, as measured by the standard deviation of daily changes in 1-month HIBOR, **remained low**. Nevertheless, its ratio to the average level of 1-month HIBOR rose, as a result of the decline in the level of interest rates (Chart 4).¹



Hong Kong dollar interbank interest rates remained below US dollar rates. The 1-month and 3-month spreads were stable throughout the reporting period, closing at -107 bp and -103 bp respectively. Meanwhile, the 12-month spread dropped by 11 bp to close at -84 bp (Chart 5).



Reflecting the movements in interest rate spreads, **Hong Kong dollar 12-month forward points fell to a low of -765 pips on 13 January**, before rebounding somewhat to close at -620 pips. Meanwhile, 3-month forward points remained steady and closed at -191 pips (Chart 6).



Except for the short-end, **the yield curve of Exchange Fund paper shifted downwards** during the period (Chart 7). This largely reflected a fall in yield spreads over US Treasuries, with those for 5-year and 10-year paper dropping to -35 bp and -8 bp respectively at the end of the period (Table 1).

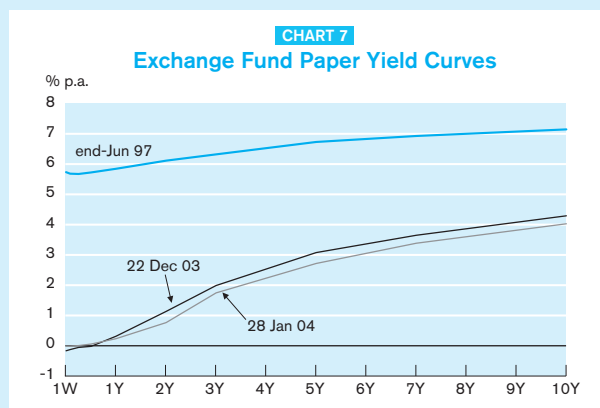
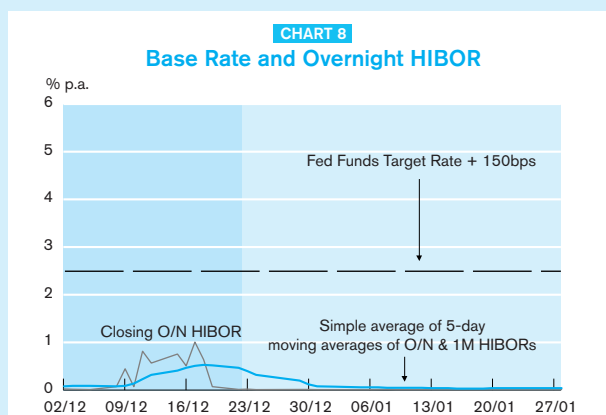


TABLE 1
Yield Spreads of Exchange Fund Paper over US Treasuries (basis points)

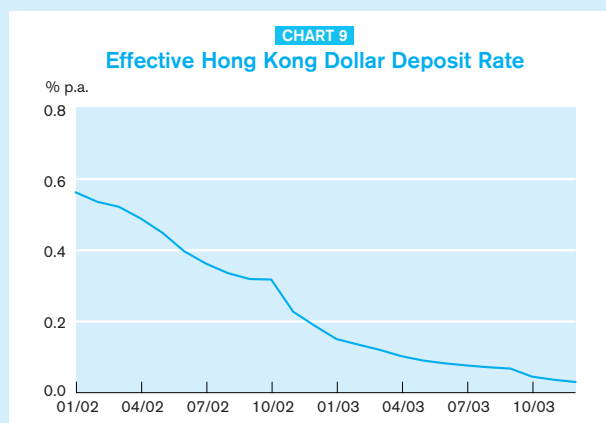
	27 Jun 97	22 Dec 03	28 Jan 03
3-month	56	-87	-90
1-year	21	-72	-89
3-year	3	-32	-37
5-year	27	-7	-35
10-year	54	11	-8

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 HKMA Base Rate remained at 2.50% (Chart 8). The banks also kept their Best Lending Rate unchanged at 5%.



The average rate offered by major authorized institutions for 1-month time deposits dropped to 0.004% during the period.² Meanwhile, the effective deposit rate declined marginally in December (Chart 9).³



Monetary Base

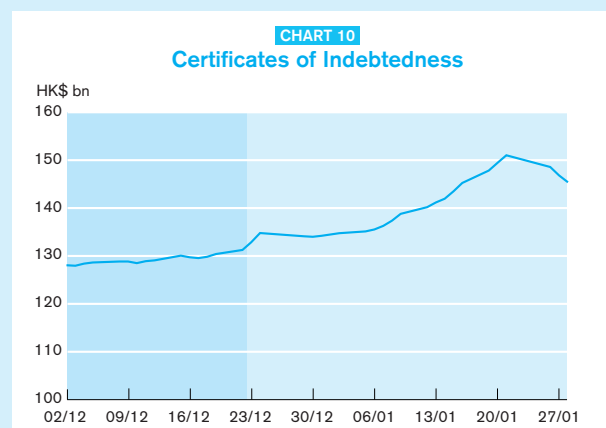
The **Monetary Base**, which comprises Certificates of Indebtedness (CIs), Government-issued currency notes and coins in circulation, the Aggregate Balance, and Exchange Fund Bills and Notes, **increased from HK\$291.51 billion to HK\$329.77 billion** during the reporting period (Table 2). This was mainly attributable to a notable expansion in the Aggregate Balance and, to a lesser extent, an increase in the outstanding amount of CIs. Movements in individual components are discussed below.

TABLE 2
Monetary Base

(HK\$ bn)	23 Dec 03	28 Jan 04
CIs	132.85	145.44
Government-issued Currency Notes and Coins in Circulation	6.36	7.56
Aggregate Balance	28.42	52.25
Outstanding EFBNs	123.89	124.53
Monetary Base	291.51	329.77

Certificates of Indebtedness

In response to increased public demand for banknotes ahead of the Chinese New Year holidays, **the outstanding amount of CIs increased from HK\$132.85 billion to HK\$145.44 billion** (Chart 10).

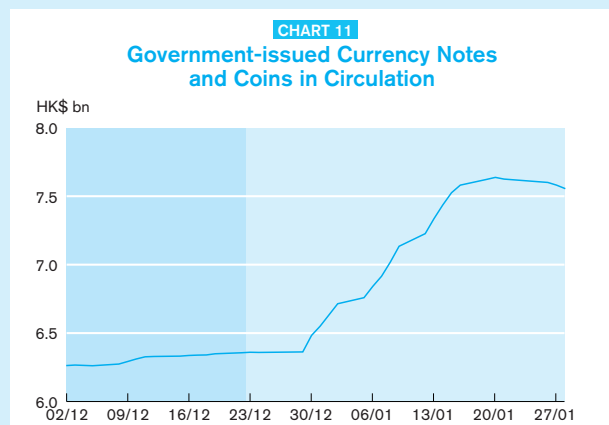


² The figures refer to the average of interest rates offered by the major authorized institutions for one-month time deposits of less than HK\$100,000.

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 demand for ten-dollar notes also rose before the Chinese New Year. Consequently, the total amount of **Government-issued currency notes and coins in circulation increased from HK\$6.36 billion to HK\$7.56 billion** during the reporting period (Chart 11).



Aggregate Balance

The HKMA sold a total of HK\$25.86 billion of Hong Kong dollars during the reporting period. As a result, **the Aggregate Balance increased to HK\$52.25 billion** at the end of the period (Chart 12 and Table 3).

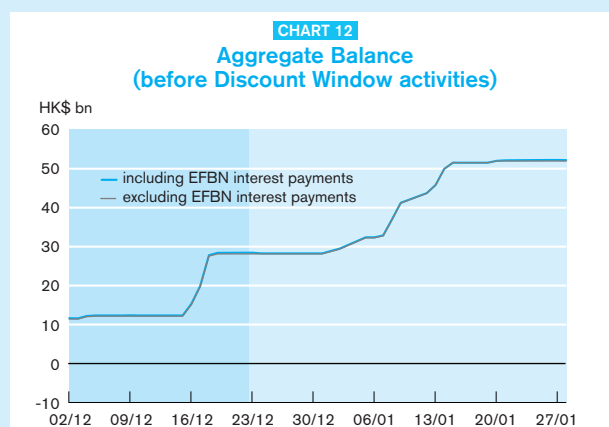
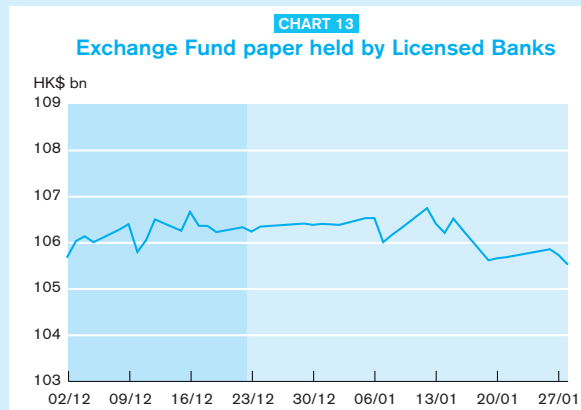


TABLE 3
HKMA HK\$/US\$ FX Transactions
(23 December 03 – 28 January 04)

Trade Date	Net HK\$ purchase (+) (HK\$m)
30 Dec 03	-1,227
31 Dec 03	-2,911
05 Jan 04	-505
06 Jan 04	-4,060
07 Jan 04	-4,332
08 Jan 04	-2,554
09 Jan 04	-2,127
12 Jan 04	-4,169
13 Jan 04	-1,591
15 Jan 04	-77
16 Jan 04	-365
27 Jan 04	-1,941
Total	-25,859

Outstanding Exchange Fund Bills and Notes

The market value of outstanding Exchange Fund Bills and Notes increased from HK\$123.89 billion to **HK\$124.53 billion**. Meanwhile, **holdings of Exchange Fund paper by the banking sector (before Discount Window activity) decreased slightly** from HK\$106.26 billion (85.77% of total) to HK\$105.55 billion (84.76% of total) (Chart 13).



During the period, **interest payments of HK\$3.41 billion were made on Exchange Fund paper**. Taking into account interest payments carried forward from the last reporting period, **an additional HK\$3.5 billion (in market value) of Exchange Fund paper was issued to absorb these interest payments**. All issues of Exchange Fund paper were well received by the market (Table 4).

TABLE 4

Issuance of Exchange Fund Bills and Notes (23 December 03 – 28 January 04)

	No. of issues launched	Over-subscription ratio
3-month EFB	6	3.52-7.01
6-month EFB	3	4.28-7.38
1-year EFB	1	5.37
3-year EFN	1	6.18

Discount Window activity

For the period as a whole, **three banks borrowed a total of HK\$0.3 billion from the Discount Window**, compared with HK\$5.17 billion in the preceding period (Chart 14). All of them used Exchange Fund paper as collateral (Table 5).

CHART 14

Discount Window Borrowing

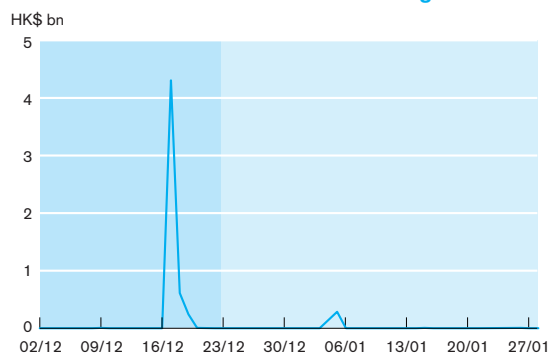


TABLE 5

Frequency of Individual Bank Access to the Discount Window (23 December 03 – 28 January 04)

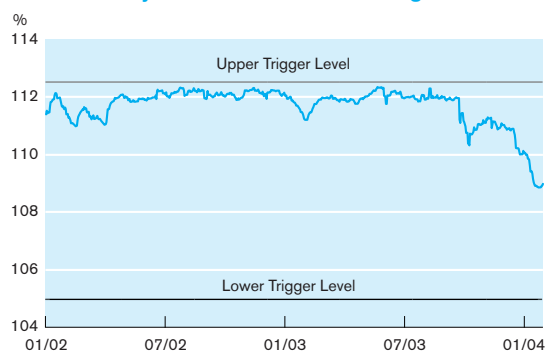
Frequency of using Discount Window	No. of banks
1	3
Total	3

Backing Portfolio

The Backing Assets increased during the period, mainly attributable to the corresponding rise in the outstanding amount of CIs and the Aggregate Balance in the Monetary Base, as well as interest income. While the increase in the Backing Assets exceeded that of the Monetary Base in magnitude, it was smaller in proportion. As a result, **the backing ratio decreased moderately from 110.09% on 23 December 2003 to 108.97% on 28 January 2004** (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 5 March 2004

(Approved for Issue by the Exchange Fund Advisory Committee on 25 March 2004)

Report on Currency Board Operations (29 January - 20 February 2004)

The Sub-Committee noted that the Hong Kong dollar had continued to be stable during the reporting period, and that the difference between the market rate of the dollar and the Linked rate had narrowed further since the reporting period. Interest rates had risen briefly in early February on concerns about avian influenza, but they had subsequently softened. The Aggregate Balance had remained largely flat, at around \$55 billion, following the substantial increases in January. Members observed that the Currency Board arrangements were working effectively.

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 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 growth in the US continued to gather momentum, and that Japan had shown exceptionally strong growth in the fourth quarter of 2003. Recent indicators showed that the recovery in Hong Kong was deepening, and Members noted that some private institutions had revised upwards their growth projections for 2004. The risks to Hong Kong's monetary system appeared to have declined, as the economy improved, the balance of payments continued to show a large surplus, and the Hong Kong dollar exchange rate remained on the strong side.

Issuance of Exchange Fund paper to reduce the Aggregate Balance

The Sub-Committee considered a paper examining the need, consistency with Currency Board principles, effectiveness, and technical considerations of issuing Exchange Fund paper to mop up interbank liquidity in the light of the substantial increase in the size of the Aggregate Balance in recent months. Members noted that such a measure could be undertaken in one of a number of possible scenarios under which the current strength of the Hong Kong dollar might unfold, that is, the size of the Aggregate Balance and the

associated loose monetary conditions became a matter of concern. Other scenarios included the Aggregate Balance increasing to a size where the total opportunity cost to the banking sector exceeded the perceived risk of the alternative (i.e. appreciation of the Hong Kong dollar), resulting in banks switching out of Hong Kong dollars; the imposition of charges on large balances maintained by banks in their clearing accounts held with the HKMA; and allowing low nominal and real interest rates to continue to play their role in facilitating economic recovery until, through the normal operation of the Currency Board system, equilibrium was gradually restored.

Members agreed that the issue of Exchange Fund paper to mop up interbank liquidity would be consistent with Currency Board principles: Exchange Fund paper was a component of the Monetary Base, and such a measure would involve no change in the size of the Monetary Base. Members noted, however, that there was a possibility that the measure might be perceived in the market as a form of sterilised intervention.

Members had doubts about whether there was a need, in present circumstances, to reduce the Aggregate Balance in this way. Members observed that under the Currency Board system low interest rates, resulting from inflow of funds, were the only monetary tool available for facilitating economic recovery, and that asset price increases were a legitimate channel through which monetary expansion could be transmitted to achieve economic recovery. Members observed that Hong Kong was currently experiencing economic recovery and a normalisation in asset prices. It was too early to conclude if there was an asset price bubble. A large Aggregate Balance was a symptom, rather than a cause, of current monetary conditions.

Members also had some doubts about the effectiveness of such a measure. While noting that the issue of additional Exchange Fund paper could provide a buffer in dealing with the monetary consequences of inflows of funds, Members noted the small scope of interest rate tightening and the limited effect of interest rates on asset prices. Members also expressed concerns that in certain circumstances the opposite might be achieved. By tightening interbank liquidity and putting upward pressure on Hong Kong dollar interest rates, the issue of Exchange Fund paper could lead to further inflows of funds.

The Sub-Committee advised that there was no need in present circumstances to issue additional Exchange Fund paper to mop up interbank liquidity.

Movements in the Backing Ratio

The Sub-Committee noted an information paper analysing the factors in the steady decline in the level of the Backing Ratio (i.e. the ratio of the Backing Assets to the Monetary Base) since September 2003. Members noted that in the first eight months of 2003 the Backing Ratio had been at around 112%, which was close to the upper trigger of 112.5% (at which assets would be transferred out of the backing portfolio to the investment portfolio of the Exchange Fund assets to bring the ratio to 110%). Since September the Backing Ratio had gradually declined to 109.2% on 13 February 2004.

Members noted the analysis in the paper that the main reason for the decline in the Backing Ratio was the increase in the Aggregate Balance. Even though the sales of Hong Kong dollars had led to matched increases in the Backing Assets and the Monetary Base, the fractional increase in the former was smaller owing to its being larger than the latter.

Sources of unemployment

The Sub-Committee noted an information paper examining the underlying sources of the relatively high rate of unemployment seen in Hong Kong in recent years. Consistent with research carried out for the Sub-Committee in 2001, the paper found that the main drivers of unemployment were cyclical, although there were signs that the natural rate of unemployment may have risen, from 2-3% in the late 1980s to $3\frac{1}{2}$ - $4\frac{1}{2}$ % in recent years, as a result of the considerable structural changes taking place in the economy.

Members noted that the 15-19 age group had a markedly higher rate of unemployment than other age groups and that the construction sector had suffered most from unemployment, while the services sector had fared better.

A simple measure of underlying inflation: Estimates for Hong Kong and the Mainland

The Sub-Committee noted an information paper on measures of underlying inflation for Hong Kong and Mainland China. The analysis in the paper used a simple measure made by means of a statistical model that decomposed the monthly change in the CPI into the underlying rate of inflation and changes due to price-level shocks. The paper found that, under this model, deflation in Hong Kong had ended in the second half of 2003 but that inflation had not yet taken hold, and that inflationary pressures were rising on the Mainland.

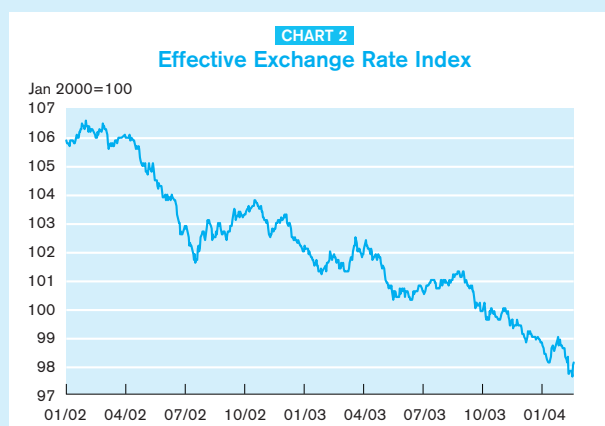
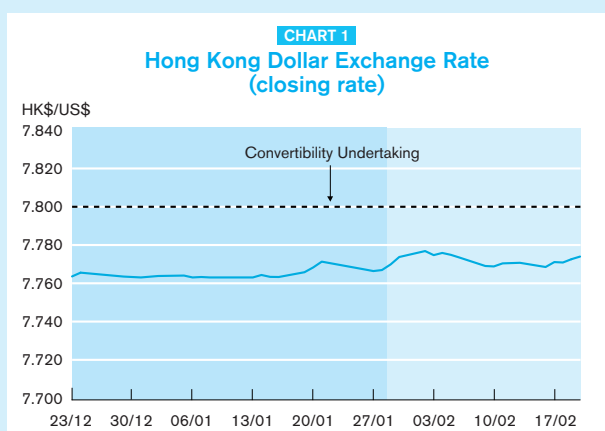
Annex

Report on Currency Board Operations (29 January — 20 February 2004)

The Hong Kong dollar exchange rate remained stable during the reporting period. Short-term interbank interest rates continued to stay close to zero while longer-term rates eased further below US dollar rates. The HKMA sold a total of HK\$0.54 billion during the period, increasing the Aggregate Balance to HK\$54.69 billion. Nevertheless, the Monetary Base fell from HK\$330.89 billion to HK\$323.35 billion, owing to a decline in the outstanding amount of Certificates of Indebtedness and the Government-issued currency notes as the public demand for cash dropped after the Chinese New Year. In accordance with the Currency Board principles, changes in the Monetary Base were fully matched by corresponding changes in foreign reserves.

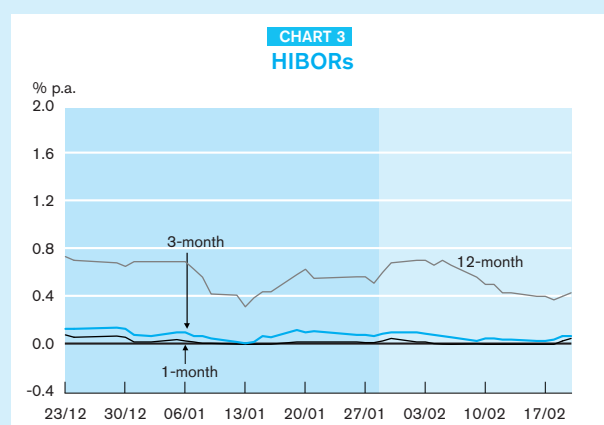
Hong Kong dollar exchange rate

The Hong Kong dollar exchange rate was stable. It stayed in a range between 7.7685 and 7.7767 during the reporting period, and closed at 7.7738 (Chart 1). In effective terms, the Hong Kong dollar depreciated by 0.7% during the period, reflecting the weakness of the US dollar (Chart 2).

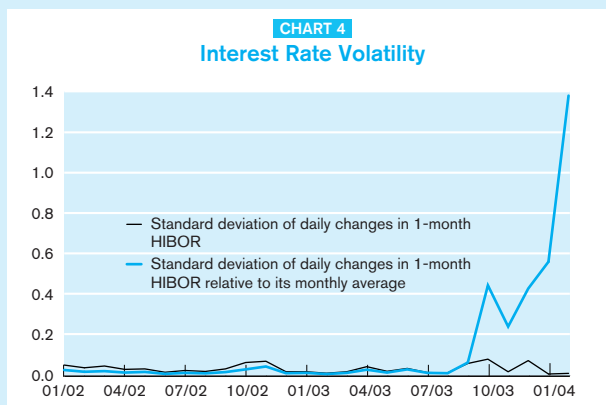


Interest rates

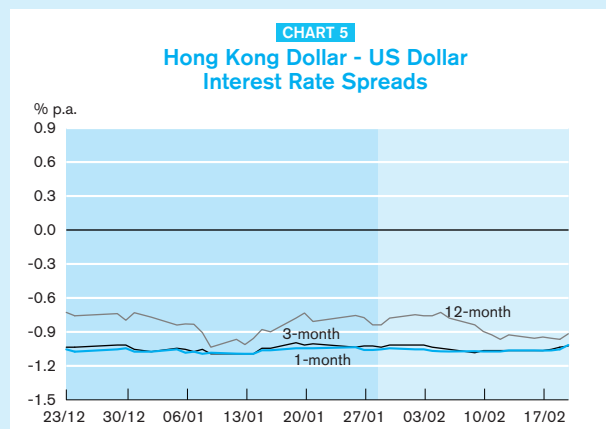
Short-term Hong Kong dollar interest rates stayed close to zero, and longer-term rates eased during the reporting period. Interest rates increased briefly in the early part of the period upon concerns about the spread of avian flu in the region, but softened subsequently. Towards the end of the reporting period, interest rates edged up again in the light of increased liquidity demand associated with new share subscriptions. For the period as a whole, 1-month and 3-month HIBORs were little changed and closed at 0.05% and 0.07% respectively. 12-month HIBOR eased by 17 bp to close at 0.43% (Chart 3).



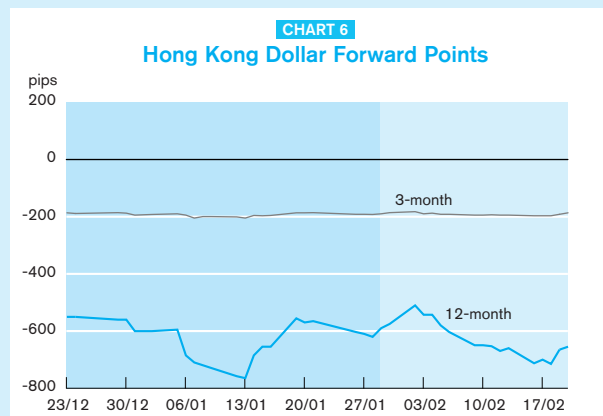
Interest rate volatility, as measured by the standard deviation of daily changes in 1-month HIBOR, **remained low**. Nevertheless, its ratio to the average level of 1-month HIBOR was boosted by a small decline in the latter (Chart 4).¹



Hong Kong dollar interbank interest rates remained below US dollar rates. For the period as a whole, the 1-month and 3-month spreads against US dollar rates increased by 4 bp and 1 bp respectively to -102 bp and -103 bp. The 12-month spread declined by 8 bp to close at -92 bp (Chart 5).



In line with the movements in interest rate spreads, **Hong Kong dollar 12-month forward discount fell to 510 pips in early February but increased thereafter**, to 655 pips at the end of the period. Meanwhile, 3-month forward points remained steady and closed at -185 pips (Chart 6).



The yield curve of Exchange Fund paper generally shifted downwards, particularly for paper with maturity of three years and above (Chart 7). This largely reflected a fall in yield spreads over US Treasuries, with those for 5-year and 10-year paper dropping to -41 bp and -13 bp respectively at the end of the period (Table 1).

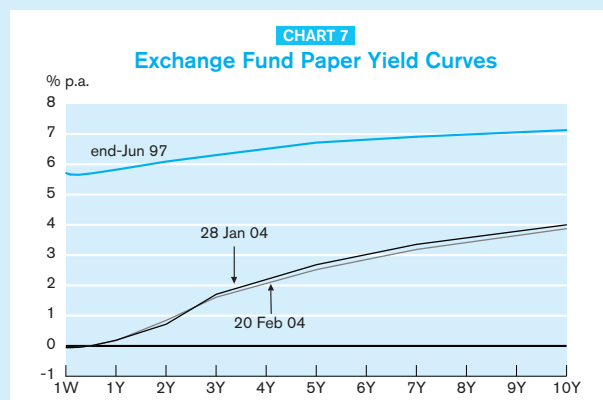
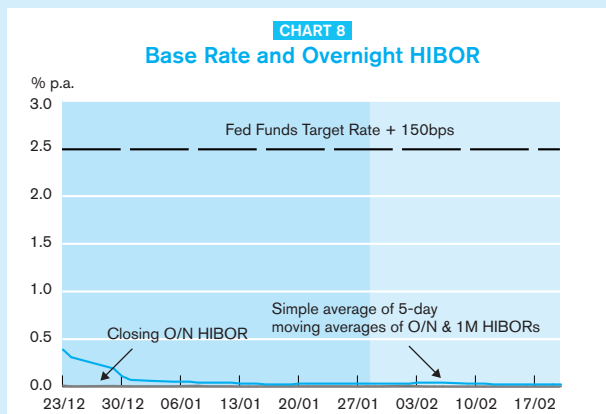


TABLE 1
Yield Spreads of Exchange Fund Paper over US Treasuries (basis points)

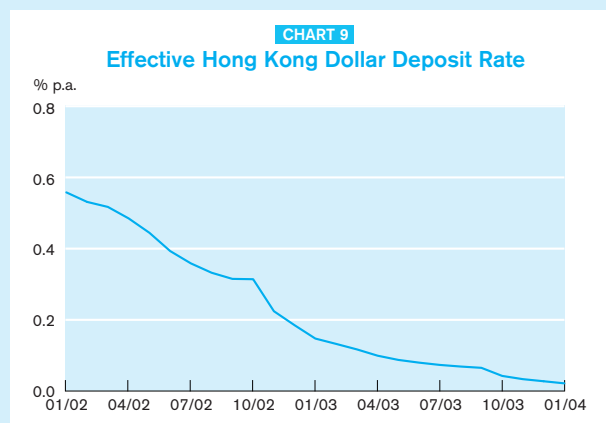
	27 Jun 97	28 Jan 04	20 Feb 04
3-month	56	-90	-90
1-year	21	-89	-86
3-year	3	-37	-49
5-year	27	-35	-41
10-year	54	-8	-13

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 HKMA Base Rate remained at 2.50% (Chart 8). The banks also kept their Best Lending Rate unchanged at 5%.



The average rate offered by major authorized institutions for 1-month time deposits was generally unchanged at 0.004% during the period.² Meanwhile, the effective deposit rate declined marginally in January (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

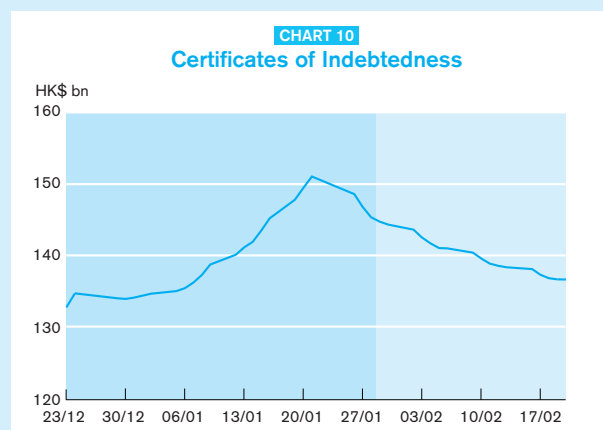
The **Monetary Base**, which comprises Certificates of Indebtedness (CIs), Government-issued currency notes and coins in circulation, the Aggregate Balance, and Exchange Fund Bills and Notes, **fell from HK\$330.89 billion to HK\$323.35 billion** during the reporting period (Table 2). This was mainly attributable to a notable decline in the outstanding amount of CIs and the Government-issued notes. Movements in individual components are discussed below.

TABLE 2
Monetary Base

(HK\$ bn)	29 Jan 04	20 Feb 04
CIs	144.84	136.76
Government-issued Currency Notes and Coins in Circulation	7.53	7.14
Aggregate Balance	54.21	54.69
Outstanding EFBNs	124.32	124.76
Monetary Base	330.89	323.35

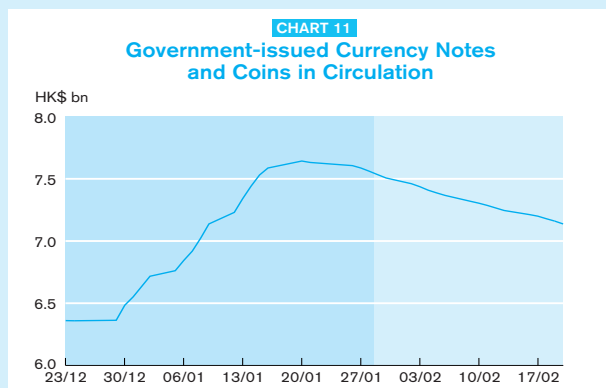
Certificates of Indebtedness

Owing to a decline in public demand for cash after the Chinese New Year, the three note-issuing banks redeemed from the HKMA a total of HK\$8.08 billion of CIs in exchange for US\$1.04 billion during the period. As a result, **the outstanding amount of CIs declined from HK\$144.84 billion to HK\$136.76 billion** (Chart 10).



Government-issued currency notes and coins in circulation

The demand for ten-dollar notes also decreased after the Chinese New Year. Consequently, the total amount of **Government-issued currency notes and coins in circulation dropped from HK\$7.53 billion to HK\$7.14 billion** during the reporting period (Chart 11).



Aggregate Balance

The HKMA sold a total of HK\$0.54 billion during the reporting period. As a result, **the Aggregate Balance increased to HK\$54.69 billion** at the end of the period (Chart 12 and Table 3).

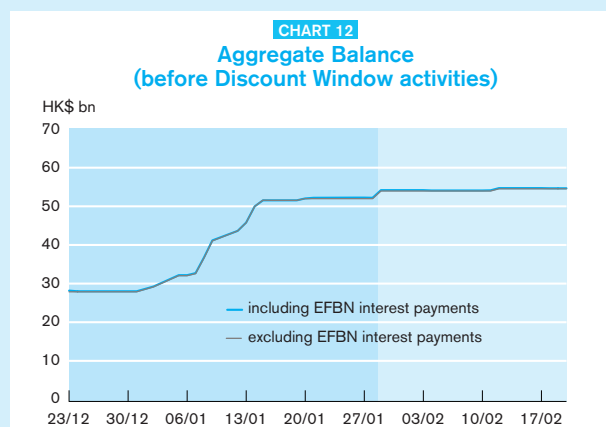
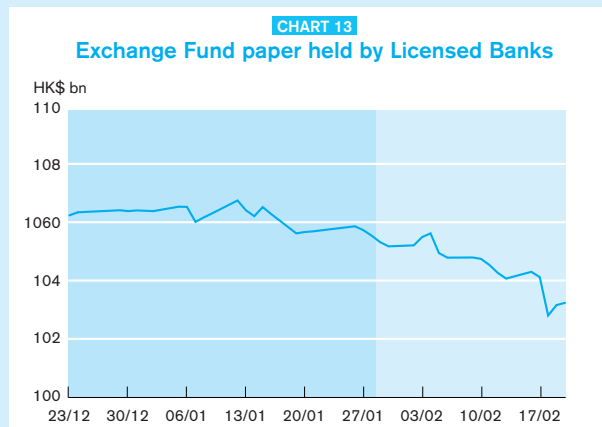


TABLE 3
HKMA HK\$/US\$ FX Transactions
(29 January — 20 February 04)

Trade Date	Net HK\$ purchase (+) (HK\$m)
10 Feb 04	-544

Outstanding Exchange Fund Bills and Notes

The market value of outstanding Exchange Fund Bills and Notes increased from HK\$124.32 billion to **HK\$124.76 billion**. Meanwhile, **holdings of Exchange Fund paper by the banking sector (before Discount Window activity) decreased moderately** from HK\$105.33 billion (84.73% of total) to HK\$103.24 billion (82.75% of total) (Chart 13).



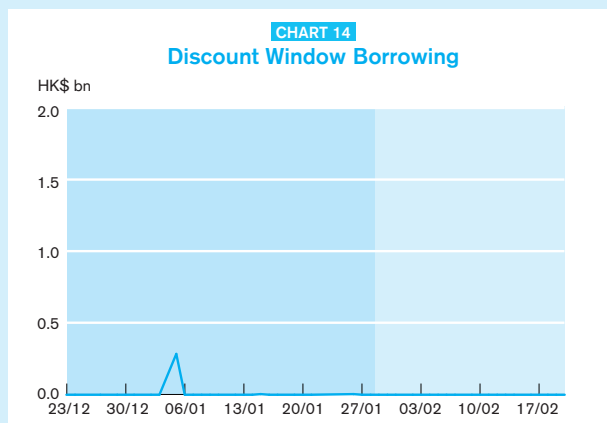
During the period, **interest payments of HK\$0.09 billion were made on Exchange Fund paper**. Taking into account interest payments carried forward from the last reporting period, **an additional HK\$0.13 billion (in market value) of Exchange Fund paper was issued to absorb these interest payments**. All issues of Exchange Fund paper were well received by the market (Table 4).

TABLE 4
Issuance of Exchange Fund Bills and Notes
(29 January — 20 February 04)

	No. of issues launched	Over-subscription ratio
3-month EFB	3	5.95-7.61
6-month EFB	2	5.95-7.87
1-year EFB	1	7.21
2-year EFN	1	5.16

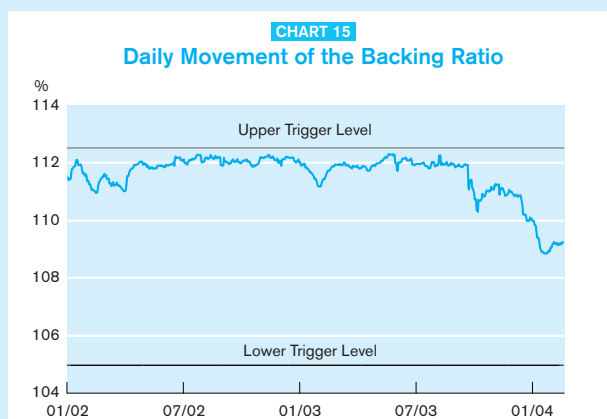
Discount Window activity

For the period as a whole, **no banks borrowed from the Discount Window**, compared with borrowings of HK\$0.3 billion in the preceding period (Chart 14). This reflected mainly the abundant liquidity in the interbank market.



Backing Portfolio

The Backing Assets decreased during the period, mainly attributable to the decline in the outstanding amount of CIs and the Government-issued currency notes. The Monetary Base also decreased, but proportionately more than the Backing Assets, leading to a higher Backing Ratio. **The Ratio increased moderately from 108.93% on 29 January to 109.32% on 20 February** (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.

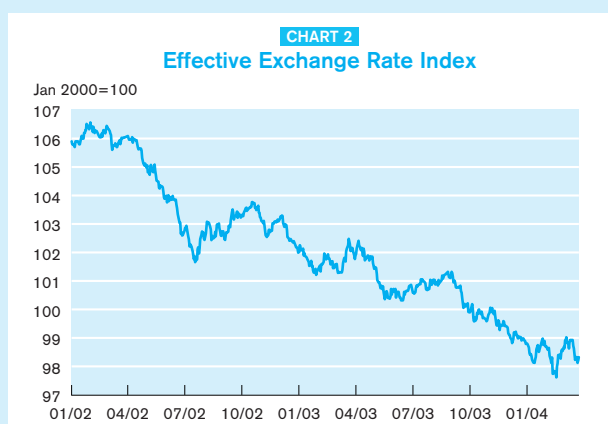
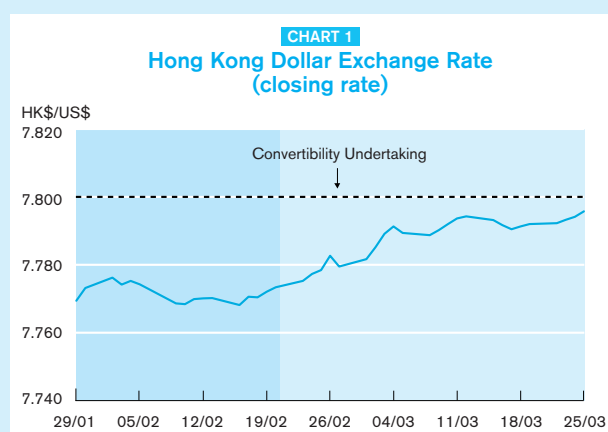


Report on Currency Board Operations (21 February - 25 March 2004)

The Hong Kong dollar exchange rate depreciated closer to the linked rate during the reporting period. Short-term interbank interest rates remained close to zero, while longer-term rates firmed slightly against US dollar rates. The Monetary Base fell modestly from HK\$322.91 billion to HK\$321.30 billion during the period, owing to a decline 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.

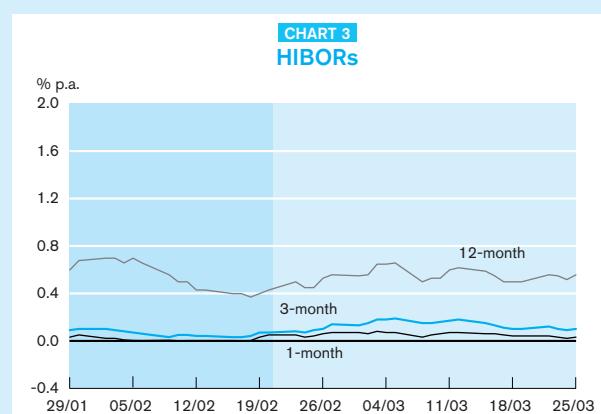
Hong Kong dollar exchange rate

The Hong Kong dollar exchange rate depreciated from 7.7757 to 7.7964 during the reporting period (Chart 1). The gap between the market exchange rate and the linked rate of 7.8 narrowed, alongside a consolidation in the local stock market. Meanwhile, the effective exchange rate of the Hong Kong dollar was little changed (Chart 2).

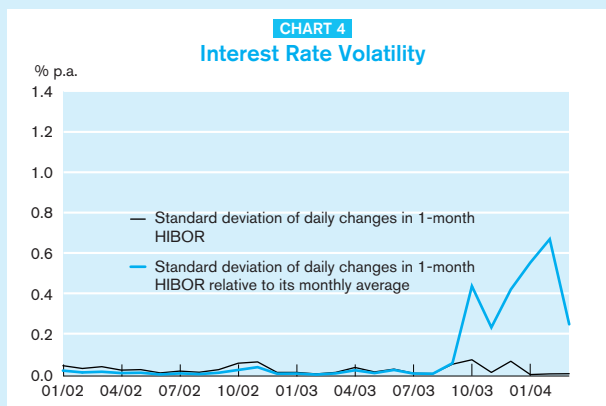


Interest rates

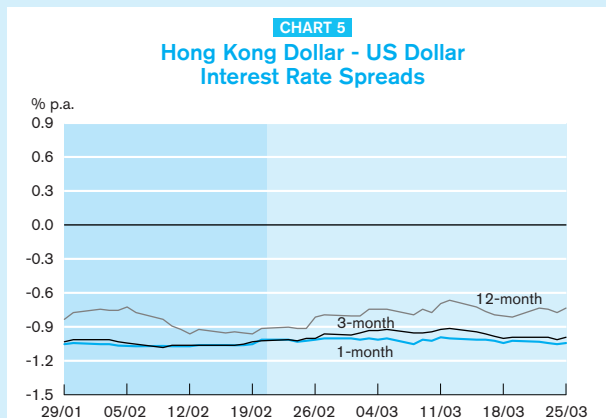
Short-term Hong Kong dollar interest rates remained low, although they rose temporarily in early to mid-March because of the liquidity demand associated with a number of equity IPOs. For the period as a whole, one-month HIBOR dropped by 2 bp to close at 0.03%, while three-month and 12-month HIBORs edged up by 2 bp and 6 bp to close at 0.10% and 0.56% respectively (Chart 3).



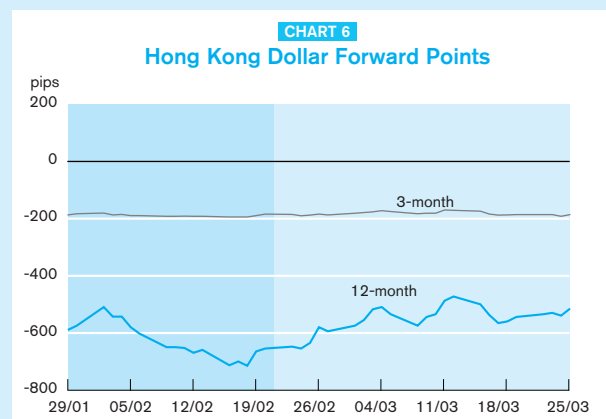
Interest rate volatility, as measured by the standard deviation of daily changes in one-month HIBOR, **remained low**. As a ratio to the average level of one-month HIBOR, it decreased in March, attributable to an increase in the latter (Chart 4).¹



Hong Kong dollar interbank interest rates remained below US dollar rates, although the negative spread for 12-month rates narrowed slightly. The one-month and three-month spreads against US dollar rates were -105 bp and -100 bp respectively, close to the levels at the beginning of the period. The 12-month spreads increased by 17 bp to close at -74 bp (Chart 5).



Reflecting the movements in interest rate spreads, **Hong Kong dollar 12-month forward discount narrowed to 515 pips** at the end of the reporting period. Meanwhile, three-month forward points remained stable and closed at -187 pips (Chart 6).



In part tracking the movements of US counterparts, **the yield curve of Exchange Fund paper flattened during the period**. Short-term yields increased, while those on long-term paper declined (Chart 7). The negative yield spread for five-year paper narrowed to -20 bp, while that for 10-year paper was unchanged at the end of the period (Table 1).

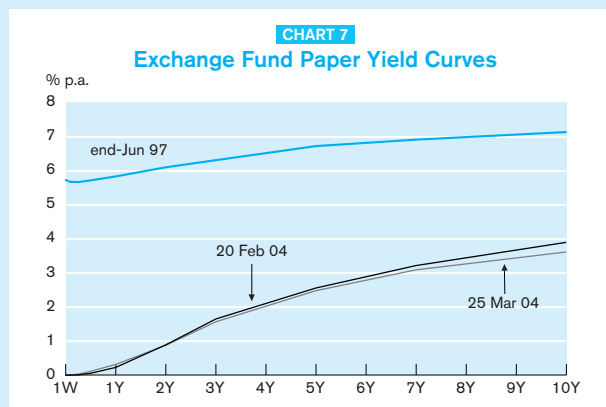
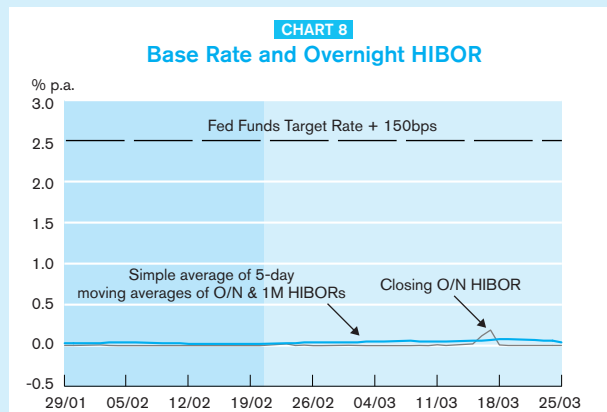


TABLE 1
Yield Spreads of Exchange Fund Paper over US Treasuries (basis points)

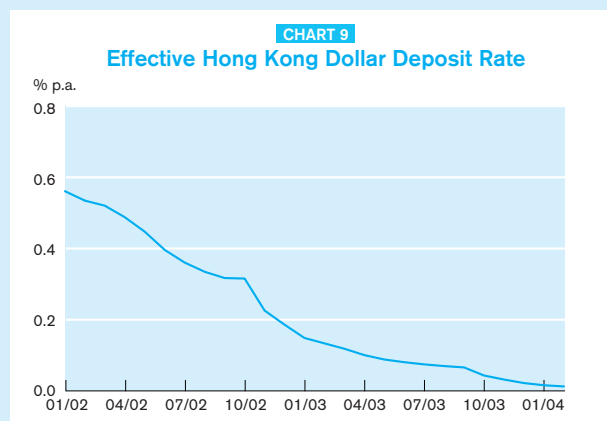
	27 Jun 97	20 Feb 04	25 Mar 04
3-month	56	-90	-88
1-year	21	-86	-71
3-year	3	-49	-29
5-year	27	-41	-20
10-year	54	-13	-13

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 HKMA Base Rate remained at 2.50% (Chart 8). The banks also kept their Best Lending Rate unchanged at 5%.



The average rate offered by major authorized institutions for one-month time deposits was virtually unchanged at 0.004% during the period.² Meanwhile, the effective deposit rate declined marginally in February (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

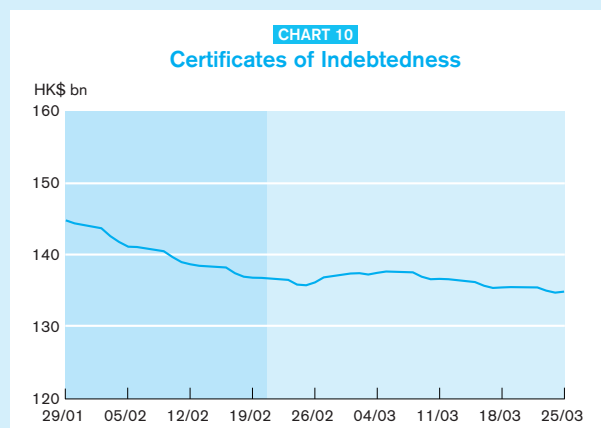
The Monetary Base, which comprises Certificates of Indebtedness (CIs), Government-issued currency notes and coins in circulation, the Aggregate Balance, and Exchange Fund Bills and Notes, fell slightly from HK\$322.91 billion to HK\$321.30 billion during the reporting period (Table 2). Movements in individual components are discussed below.

TABLE 2
Monetary Base

(HK\$ bn)	23 Feb 04	25 Mar 04
CIs	136.49	134.83
Government-issued Currency Notes and Coins in Circulation	7.12	6.85
Aggregate Balance	54.69	54.69
Outstanding EFBNs	124.61	124.93
Monetary Base	322.91	321.30

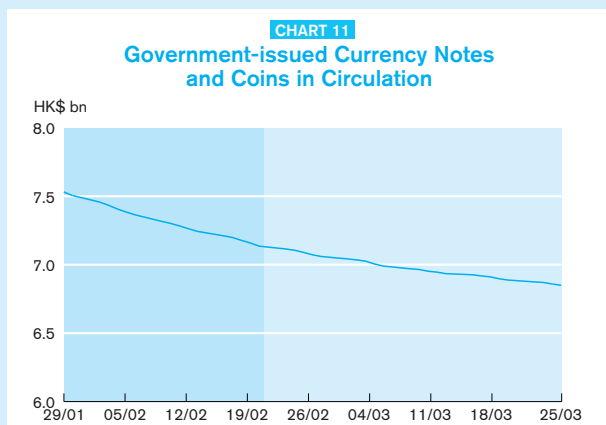
Certificates of Indebtedness

During the reporting period, the three note-issuing banks redeemed from the HKMA a total of HK\$1.66 billion of CIs in exchange for US\$0.21 billion. As a result, the outstanding amount of CIs declined from HK\$136.49 billion to HK\$134.83 billion (Chart 10).



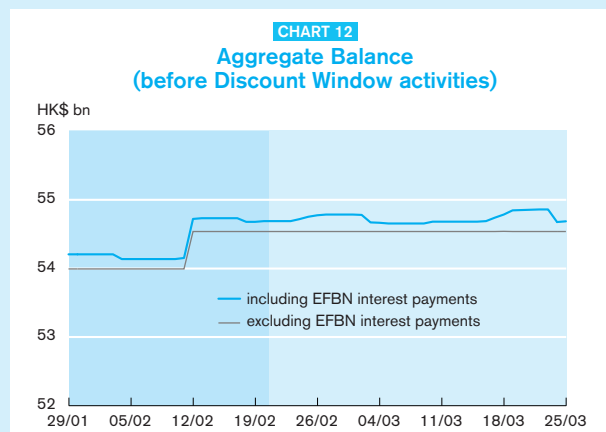
Government-issued currency notes and coins in circulation

The total amount of **Government-issued currency notes and coins in circulation** dropped from **HK\$7.12 billion** to **HK\$6.85 billion** during the reporting period (Chart 11).



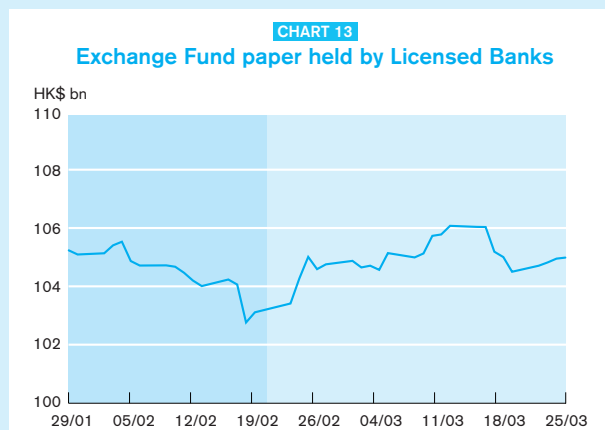
Aggregate Balance

The **Aggregate Balance** remained unchanged at **HK\$54.69 billion** at the end of the period, with small fluctuations due to interest payments and new issues of Exchange Fund paper during the period (Chart 12).



Outstanding Exchange Fund Bills and Notes

The market value of outstanding **Exchange Fund Bills and Notes** increased slightly from **HK\$124.61 billion** to **HK\$124.93 billion**. Meanwhile, **holdings of Exchange Fund paper by the banking sector (before Discount Window activity) increased** from **HK\$103.48 billion** (83.04% of total) to **HK\$105.07 billion** (84.10% of total) (Chart 13).



During the period, **interest payments of HK\$0.36 billion were made on Exchange Fund paper. An additional HK\$0.33 billion (in market value) of Exchange Fund paper was issued to absorb these interest payments.** All issues of Exchange Fund paper were well received by the market (Table 3). The remaining amount was carried forward in the Aggregate Balance.

TABLE 3
Issuance of Exchange Fund Bills and Notes (21 February – 25 March 04)

	No. of issues launched	Over-subscription ratio
1-month EFB	1	30.92
3-month EFB	5	6.88-7.12
6-month EFB	2	6.19-6.81
1-year EFB	1	5.64
5-year EFN	1	4.60
7-year EFN	1	2.67

Discount Window activity

Same as the preceding period, **no banks borrowed from the Discount Window** during the reporting period. This primarily reflected ample liquidity in the interbank market.

Backing Portfolio

The Backing Assets decreased during the period, mainly attributable to the decline in the outstanding amount of CIs, which was partly offset by investment income and valuation gains. Its decrease was thus smaller than that in the Monetary Base. As a result, **the Backing Ratio increased from 109.32% on 22 February to 109.85% on 25 March** (Chart 14). 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.

