

Record of Discussion of the Exchange Fund Advisory Committee Currency Board Sub-Committee on 5 November 2004

(Approved for Issue by the Exchange Fund Advisory Committee on 16 November 2004)

Report on Currency Board Operations (29 September – 21 October 2004)

The Sub-Committee noted that the Hong Kong dollar had strengthened during the period under review, following a weakened US dollar and renewed talk about the renminbi exchange rate regime. Interbank interest rates had declined markedly. The Aggregate Balance, having dipped to HK\$3.23 bn near to the beginning of the period, closed the period at HK\$4.81 bn. Members noted that the Aggregate Balance had continued to expand after the period under review on the inflow of funds into the Hong Kong dollar, and was around HK\$12.5 bn at the time of the Sub-Committee's meeting. Members also noted that, during the period under review, the Monetary Base as a whole had decreased slightly, owing to a decline in the outstanding amount of Certificates of Indebtedness for banknotes in circulation.

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 economic growth, both in Hong Kong and worldwide, had generally slowed in the third quarter. The main exception had been the Mainland of China, where a rebound in the third quarter had prompted the People's Bank of China to increase benchmark interest rates on 28 October. Members were of the view that this measure should further help guide the economy to a soft landing, which would be conducive to monetary stability in Hong Kong. Members noted that, while the likelihood of a sharp rise in US interest rates appeared to have lessened, high oil prices had continued to contribute to volatility in financial markets.

HKMA Operations in the Foreign Exchange Market: September 2003-September 2004

The Sub-Committee considered a paper that reported on the pattern of foreign exchange market operations by the HKMA over the past year, a period the first half of which had seen a marked strengthening of the Hong Kong dollar. The analysis examined the causes of the strengthening and the reasons behind the slow return of the Hong Kong dollar to the Convertibility Undertaking rate of 7.8. The analysis found that, while domestic factors played a role, the strong inflows in September 2003 were mainly associated with a weakening of the US dollar and market speculation about a renminbi revaluation. The reasons for the slow return to the Convertibility Undertaking rate were, first, the time needed by some investors to unwind large short Hong Kong dollar positions; and, secondly, the limited interest rate differential, despite the sharp increase in the Aggregate Balance, reflecting low short-term US interest rates at around one per cent and the fact that Hong Kong dollar rates cannot fall below zero.

Members observed that the operations carried out by the HKMA in response to the strengthening of the Hong Kong dollar in September 2003, and subsequently, had been consistent with Currency Board principles and appropriate given that, in the absence of an explicit convertibility undertaking on the strong side, the HKMA had some limited technical discretion in determining at what level and in what circumstances it accepted offers from banks to purchase US dollars.

A Graphical Framework for Monitoring Property Market Developments in Hong Kong

Members considered a paper that presented a graphical framework for monitoring property market conditions and vulnerabilities in Hong Kong. The paper presented the evolution of five key indicators (property prices, property transaction volumes, new mortgages, the income-gearing ratio, and the buy-rent gap, which measures the funding cost of buying a property relative to its rental yield) in the form of a pentagon, to compare the current situation with the boom and bust cycles of the past decade or so. The analysis using this framework suggested that the risk of a property bubble was currently low, despite the sharp rebound in prices since the summer of 2003.

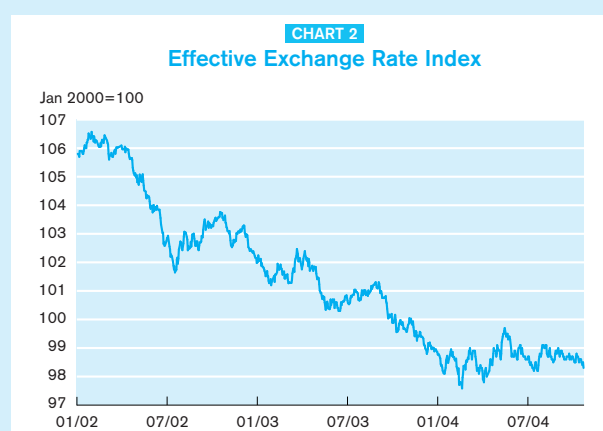
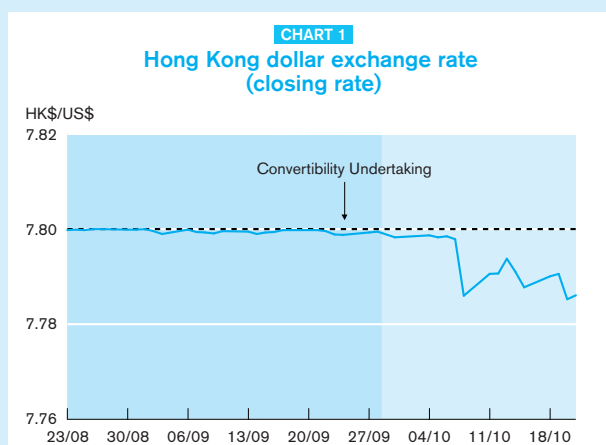
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Report on Currency Board Operations (29 September – 21 October 2004)

The Hong Kong dollar exchange rate strengthened markedly and closed at 7.7861 at the end of the reporting period. In response to banks' bids, the HKMA conducted two strong-side operations on 8 October and 20 October, selling a total of HK\$2.34 billion in the foreign exchange market. Interbank interest rates eased. The Monetary Base decreased from HK\$279.23 billion to HK\$278.99 billion during the period. In accordance with Currency Board principles, changes in the Monetary Base were fully matched by corresponding changes in foreign reserves.

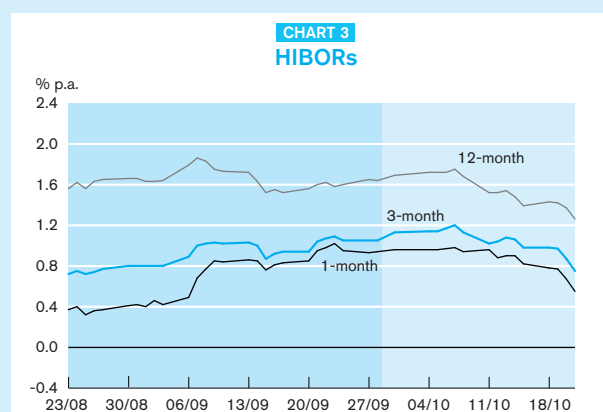
Hong Kong dollar exchange rate

The Hong Kong dollar exchange rate stayed close to the linked rate in the early part of the reporting period, but strengthened markedly to 7.7860 on 8 October (Chart 1). The movement was reportedly triggered by Sino-US discussion on the renminbi exchange rate regime and exacerbated by covering of Hong Kong dollar short positions. Thereafter, the Hong Kong dollar exchange rate weakened for a short period of time before strengthening again to **close at 7.7861 at the end of the period**. In response to banks' bids, the HKMA conducted two strong-side operations on 8 October and 20 October, selling a total of HK\$2.34 billion worth of Hong Kong dollar in the foreign exchange market. Meanwhile, the effective exchange rate of the Hong Kong dollar decreased slightly (Chart 2).

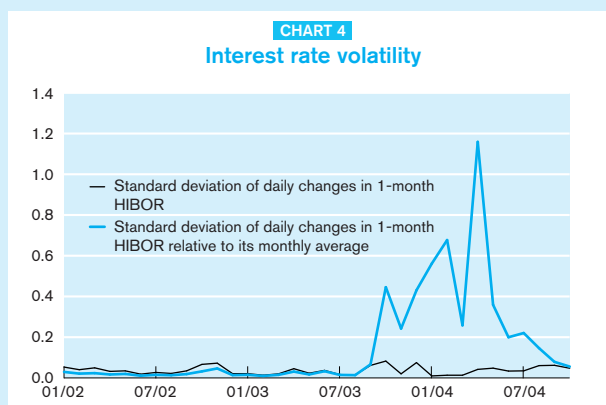


Interest rates

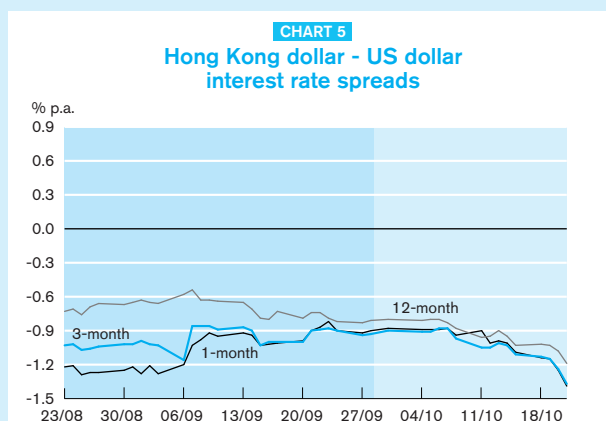
Hong Kong dollar interbank interest rates eased notably during the reporting period. Specifically, the one-month and three-month HIBORs decreased by 41 bp and 38 bp to close at 0.55% and 0.75% respectively. Meanwhile, 12-month HIBOR dropped by 43 bp to close at 1.26% (Chart 3).



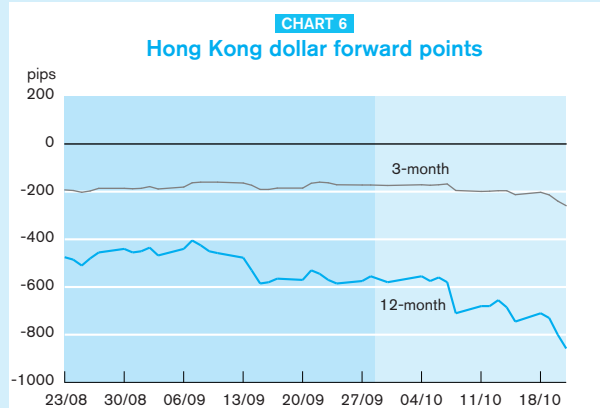
Interest rate volatility, as measured by the standard deviation of daily changes in one-month HIBOR, **remained low**. As a ratio to the average level of one-month HIBOR, it decreased in October (Chart 4).¹



Hong Kong dollar interbank interest rates remained below US dollar rates. The negative interest rate differentials widened during the period, with the one-month and three-month spreads closing at -139 bp and -137 bp respectively. Meanwhile, the 12-month spread widened by 39 bp to close at -119 bp (Chart 5).



Reflecting the movements in interest rate spreads, the **Hong Kong dollar 12-month forward discount increased by 278 pips to close at 858 pips**. Meanwhile, the three-month forward discount increased by 85 pips to close at 259 pips (Chart 6).



Yields of Exchange Fund paper decreased during the period (Chart 7). As a result, the negative yield spreads for five-year and 10-year paper expanded to -44 bp and -36 bp respectively at the end of the period (Table 1).

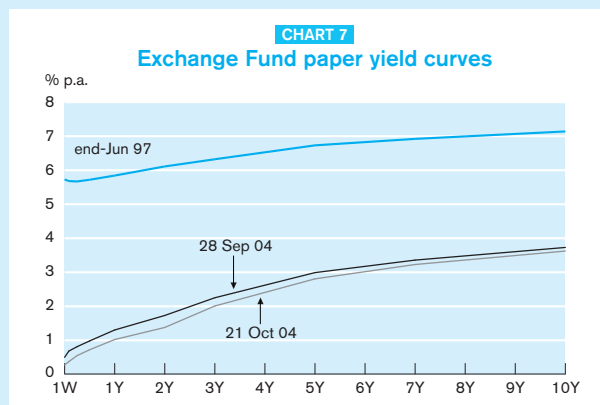
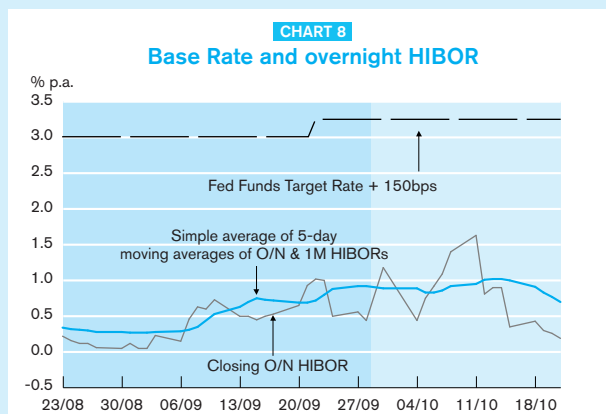


TABLE 1
Yield spreads of Exchange Fund paper over US Treasuries (basis points)

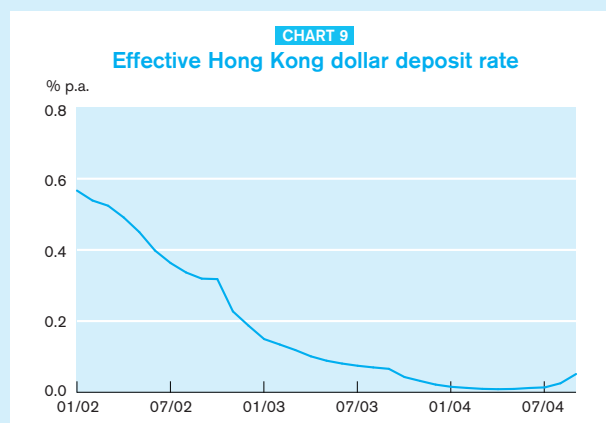
	27 Jun 97	28 Sep 04	21 Oct 04
3-month	56	-91	-120
1-year	21	-82	-102
3-year	3	-54	-58
5-year	27	-29	-44
10-year	54	-29	-36

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.

The HKMA Base Rate was unchanged at 3.25% (Chart 8). **Banks also kept their Best Lending Rates unchanged at 5.125%.**



The average one-month time deposit rate offered by major authorized institutions dropped from 0.17% to 0.15% during the period.² Meanwhile, the effective deposit rate increased from 0.02% to 0.05% in September (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 made certain assumptions regarding the maturity distribution in computing the effective deposit rate.

Monetary Base

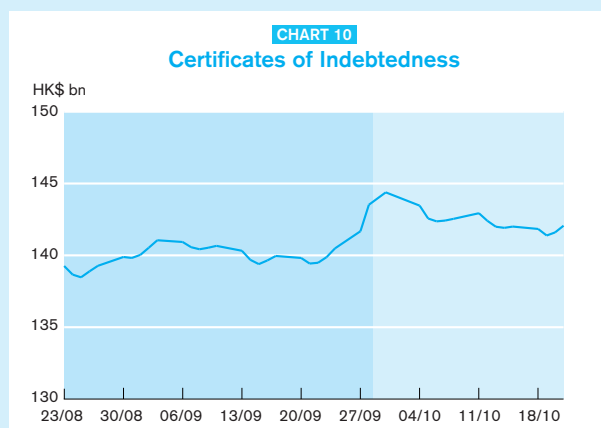
The Monetary Base, which comprises Certificates of Indebtedness (CIs), Government-issued currency notes and coins in circulation, the Aggregate Balance, and Exchange Fund Bills and Notes, **decreased from HK\$279.23 billion to HK\$278.99 billion** during the reporting period (Table 2). Movements in the individual components are discussed below.

TABLE 2
Monetary Base

(HK\$ bn)	30 Sep 04	21 Oct 04
CIs	144.39	142.07
Government-issued Currency Notes and Coins in Circulation	6.56	6.55
Aggregate Balance	3.23	4.81
Outstanding EFBNs	125.05	125.57
Monetary Base	279.23	278.99

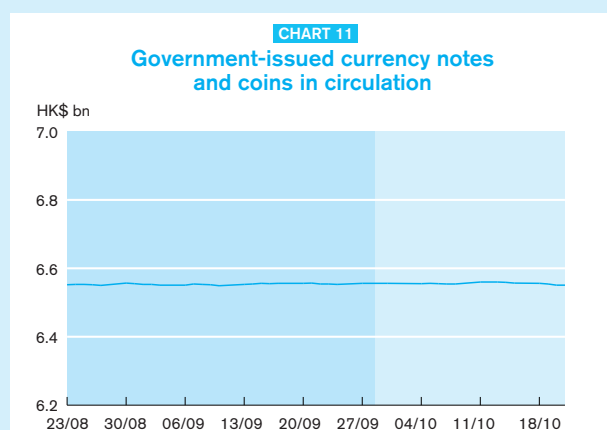
Certificates of Indebtedness

Reflecting decreases in public demand for banknotes after public holidays, the three note-issuing banks redeemed HK\$2.32 billion worth of Certificates of Indebtedness in exchange for US\$0.30 billion during the period. As a result, **the outstanding amount of CIs decreased from HK\$144.39 billion to HK\$142.07 billion** (Chart 10).



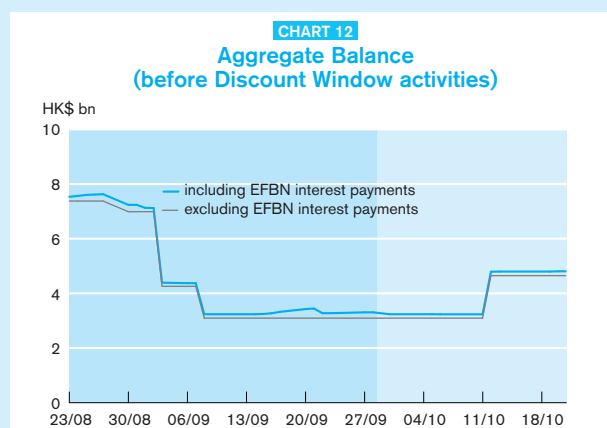
Government-issued currency notes and coins in circulation

The total amount of **Government-issued currency notes and coins in circulation was little changed at HK\$6.55 billion** at the end of the reporting period (Chart 11).



Aggregate Balance

Reflecting sales of Hong Kong dollars amounting to **HK\$1.56 billion by the HKMA in response to banks' bids on 8 October, the Aggregate Balance expanded** and closed at HK\$4.81 billion at the end of the period (Chart 12 and Table 3).⁴



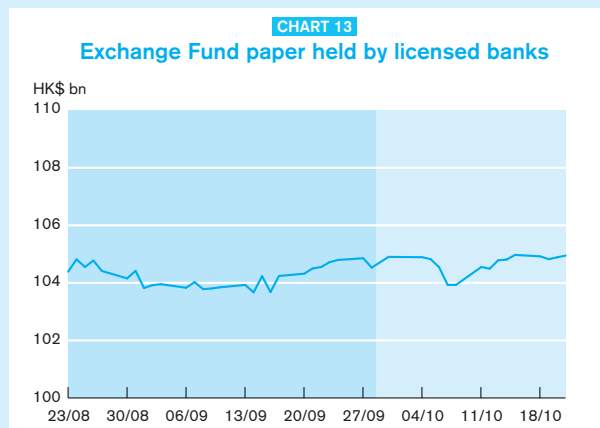
⁴ Sales of Hong Kong dollar of HK\$0.78 billion by the HKMA on 20 October was reflected in the Aggregate Balance on 25 October, which will be covered in the next reporting period.

TABLE 3
HKMA's foreign exchange transactions (29 September – 21 October 04)

Trade Date	Net Hong Kong dollar purchase (+) (HK\$mn)
8-Oct	-1,557
20-Oct	-778.5

Outstanding Exchange Fund Bills and Notes

The market value of outstanding Exchange Fund Bills and Notes increased from **HK\$125.05 billion to HK\$125.57 billion**. Meanwhile, **holdings of Exchange Fund paper by the banking sector (before Discount Window activities) increased slightly** from HK\$104.91 billion (83.89% of total) to HK\$104.95 billion (83.58% of total) (Chart 13).



During the period, **a total of HK\$44.6 million of interest payments on Exchange Fund paper were made.** Taking into account interest payments carried forward from the last reporting period, **an additional HK\$101.8 million (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 Sep – 21 Oct 04)

	No. of issues launched	Over-subscription ratio
3-month EFB	3	3.82-7.60
6-month EFB	1	3.99
12-month EFB	1	4.20

Discount Window activities

During the period, **eight banks borrowed a total of HK\$3.36 billion from the Discount Window**, compared with HK\$1.22 billion in the preceding period (Chart 14). All borrowings used Exchange Fund paper as collateral (Table 5).

CHART 14
Discount Window borrowing

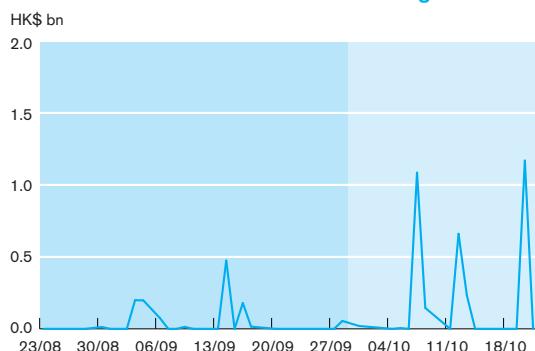


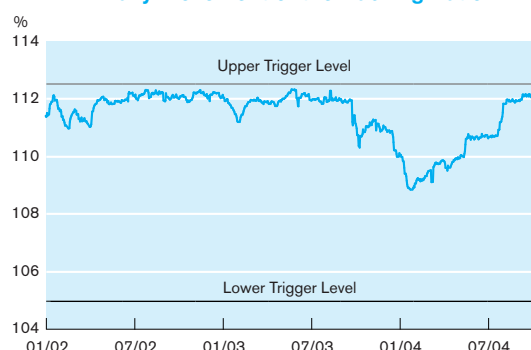
TABLE 5
Frequency of individual bank's access to the Discount Window
(29 Sep – 21 Oct 04)

Frequency of using Discount Window	No. of banks
1	7
3	1
Total	8

Backing Portfolio

Backing Assets decreased due to valuation losses during the period, which more than offset the expansion of the Aggregate Balance and accrual of interest income. Accordingly, **the Backing Ratio decreased from 111.99% on 29 September to 111.79% 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.

CHART 15
Daily movement of the Backing Ratio

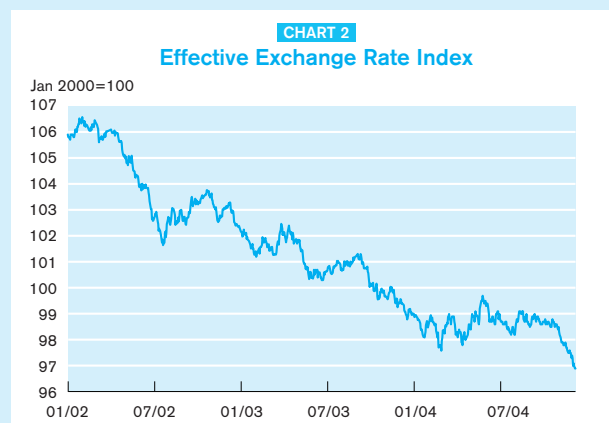
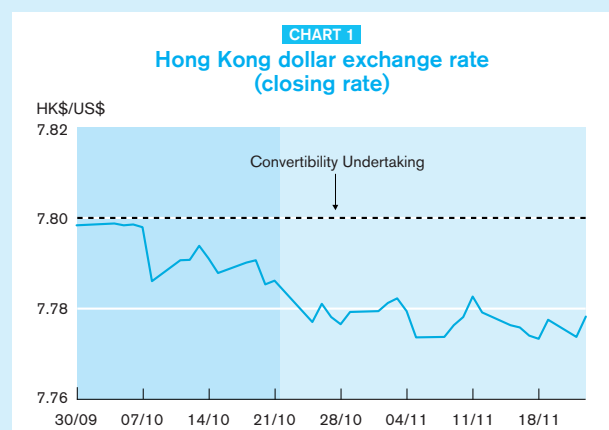


Report on Currency Board Operations (24 October – 23 November 2004)

The Hong Kong dollar exchange rate strengthened and closed at 7.7782 at the end of the reporting period. In response to banks' bids, the HKMA conducted a number of strong-side operations, selling a total of HK\$8.55 billion in the foreign exchange market. Short-term interbank interest rates eased markedly. The Monetary Base increased from HK\$279.29 billion to HK\$287.69 billion during the period. 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

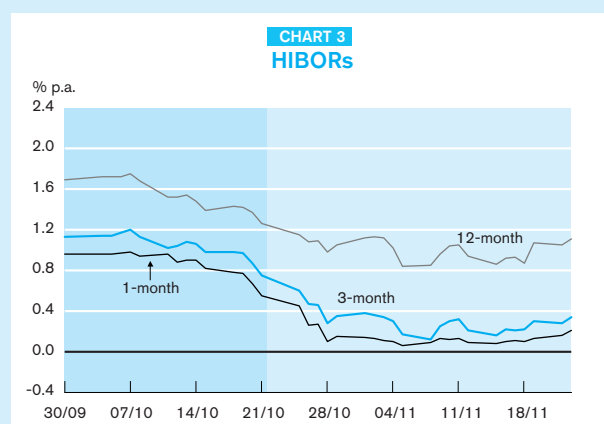
The Hong Kong dollar exchange rate continued to strengthen in the early part of the reporting period and **closed at 7.7782 at the end of the period** (Chart 1). The strength was associated with renewed speculation on renminbi revaluation and broad-based appreciation of Asian currencies. In response to banks' bids, the HKMA conducted several strong-side operations during the period. Meanwhile, the effective exchange rate of the Hong Kong dollar decreased, reflecting general weakness in the US dollar (Chart 2).



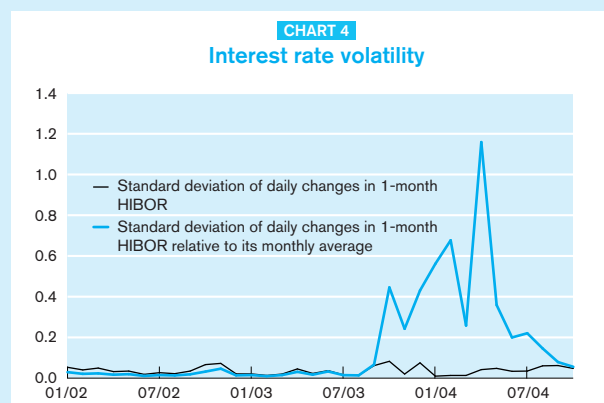
¹ The ratio of the standard deviation of daily changes in the 1-month HIBOR to its monthly average measures the extent of interest rate fluctuations relative to the average level of interest rates.

Interest rates

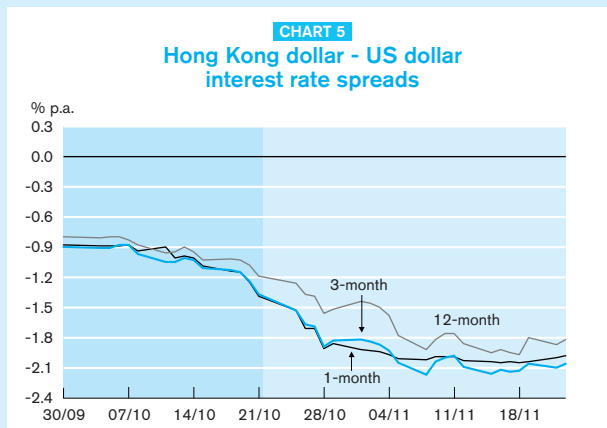
Short-term Hong Kong dollar interbank interest rates eased markedly during the reporting period. Specifically, the one-month and three-month HIBORs decreased by 24 bp and 26 bp to close at 0.21% and 0.34% respectively. Meanwhile, 12-month HIBOR declined by 4 bp to close at 1.11% (Chart 3).



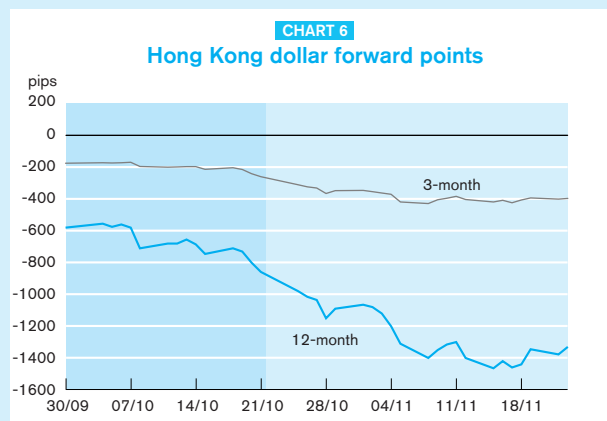
Interest rate volatility, measured by the standard deviation of daily changes in one-month HIBOR, **remained low**. As a ratio to the average level of one-month HIBOR, the volatility increased in November due to a decrease in the one-month HIBOR (Chart 4).¹



Hong Kong dollar interbank interest rates stayed below US dollar rates. The negative interest rate spreads widened during the period, with the one-month and three-month differentials closing at -198 bp and -206 bp respectively. Meanwhile, the 12-month spread widened by 56 bp to close at -182 bp (Chart 5).



In line with the movements in interest rate spreads, the **Hong Kong dollar 12-month forward discount increased by 350 pips to close at 1,330 pips.** Meanwhile, the three-month forward discount rose by 86 pips to close at 396 pips (Chart 6).



Yields of Exchange Fund paper generally decreased during the period (Chart 7). The negative yield spreads for five-year and 10-year paper over US counterparts expanded to -95 bp and -78 bp respectively at the end of the period (Table 1).

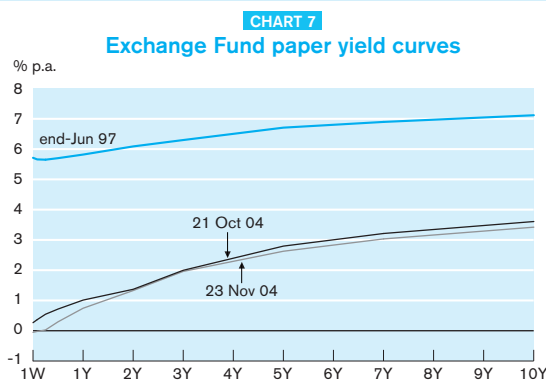
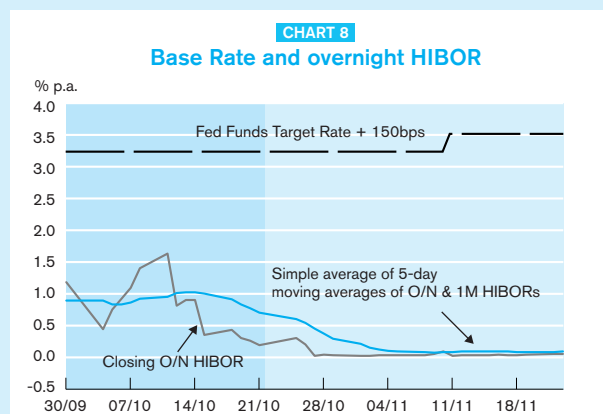


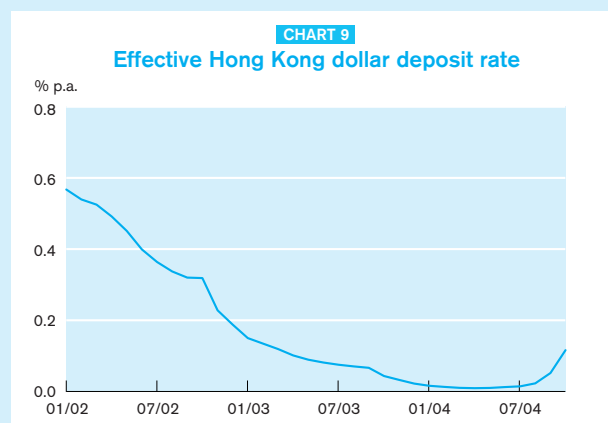
TABLE 1
Yield spreads of Exchange Fund paper over US Treasuries (basis points)

	27 Jun 97	21 Oct 04	23 Nov 04
3-month	56	-120	-218
1-year	21	-102	-188
3-year	3	-58	-122
5-year	27	-44	-95
10-year	54	-36	-78

Following a 25 bp increase in the US Federal funds target rate, **the HKMA Base Rate was adjusted upward to 3.50% on 11 November** according to the established formula (Chart 8). However, **most banks cut their Prime Rates by 12.5 bp only to 5.0% from 12 November onward**, in the light of ample liquidity in the banking system.



The average one-month time deposit rate offered by major authorized institutions dropped from 0.15% to 0.0125% during the period.² Meanwhile, the effective deposit rate increased from 0.05% to 0.12% in October (Chart 9).³



Monetary Base

The **Monetary Base**, which consists of Certificates of Indebtedness (CIs), Government-issued currency notes and coins in circulation, the Aggregate Balance, and Exchange Fund Bills and Notes, **increased from HK\$279.29 billion to HK\$287.69 billion** during the reporting period (Table 2). Movements in the individual components are discussed below.

TABLE 2
Monetary Base

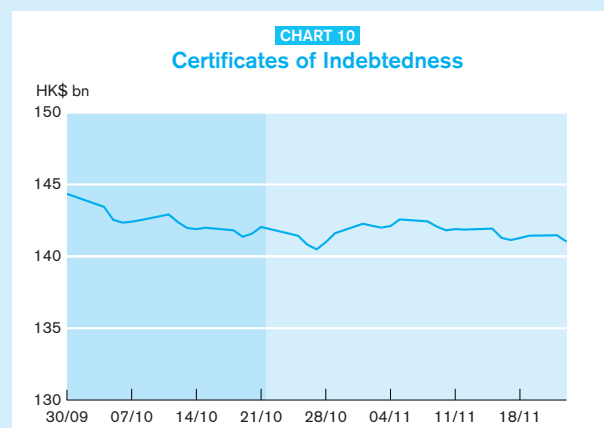
(HK\$ bn)	25 Oct 04	23 Nov 04
CIs	141.45	141.02
Government-issued Currency Notes and Coins in Circulation	6.56	6.55
Aggregate Balance	5.61	14.12
Outstanding EFBNs	125.68	126.00
Monetary Base	279.29	287.69

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 made certain assumptions regarding the maturity distribution in computing the effective deposit rate.

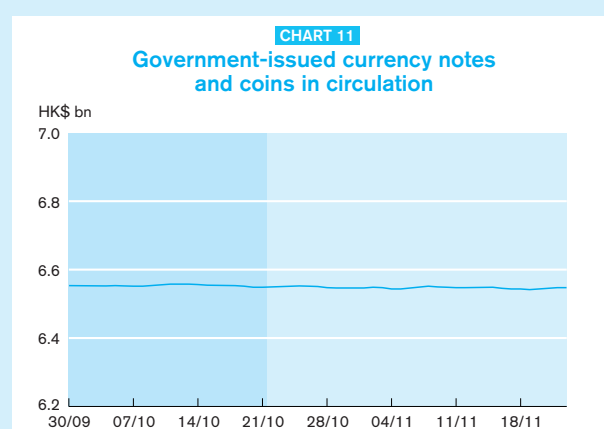
Certificates of Indebtedness

The three note-issuing banks redeemed HK\$0.43 billion worth of Certificates of Indebtedness in exchange for US\$55 million during the period. As a result, **the outstanding amount of CIs decreased from HK\$141.45 billion to HK\$141.02 billion** (Chart 10).



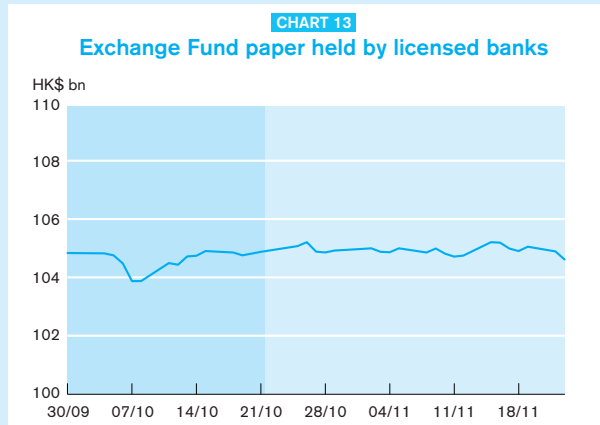
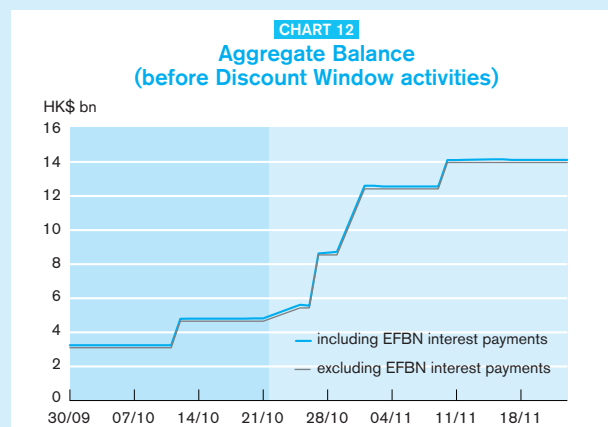
Government-issued currency notes and coins in circulation

The total amount of **Government-issued currency notes and coins in circulation was little changed at HK\$6.55 billion** at the end of the reporting period (Chart 11).



Aggregate Balance

Reflecting sales of Hong Kong dollars amounting to **HK\$8.55 billion** by the HKMA in response to banks' bids, the **Aggregate Balance expanded** and closed at **HK\$14.12 billion** at the end of the period (Chart 12 and Table 3).



During the period, a total of **HK\$116.97 million of interest payments on Exchange Fund paper were made**. Taking into account the interest payments carried forward from the last reporting period, **an additional HK\$130.97 million (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 3
HKMA's foreign exchange transactions
(24 October – 23 November 04)

Trade Date	Net Hong Kong dollar purchase (+) (HK\$m)
25-Oct	-3,112.5
28-Oct	-3,887.5
8-Nov	-1,554.0

TABLE 4
Issuance of Exchange Fund Bills and Notes
(24 Oct – 23 Nov 04)

	No. of issues launched	Over-subscription ratio
1-month EFB	1	18.70
3-month EFB	4	2.90-5.32
6-month EFB	2	4.19-10.79
1-year EFB	1	6.13
2-year EFN	1	3.73
3-year EFN	1	2.86

Outstanding Exchange Fund Bills and Notes

The market value of outstanding Exchange Fund Bills and Notes increased from **HK\$125.68 billion to HK\$126 billion**. Meanwhile, **holdings of Exchange Fund paper by the banking sector (before Discount Window activities) decreased** from **HK\$105.14 billion (83.66% of total)** to **HK\$104.68 billion (83.07% of total)** (Chart 13).

Discount Window activities

During the period, **two banks borrowed a total of HK\$130 million from the Discount Window**, compared with HK\$3.36 billion in the preceding period (Chart 14). All borrowings used Exchange Fund paper as collateral (Table 5).

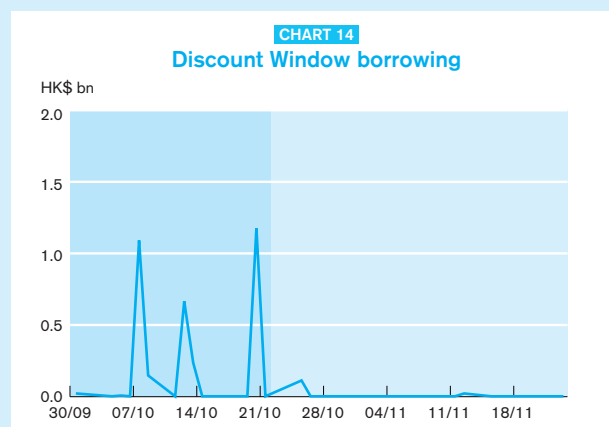
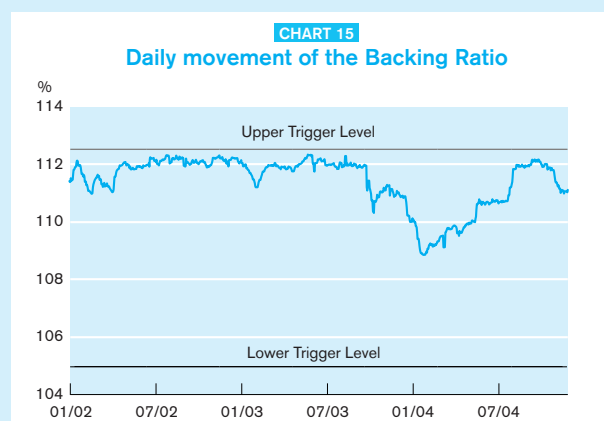


TABLE 5
Frequency of individual bank's access to the Discount Window (24 Oct – 23 Nov 04)

Frequency of using Discount Window	No. of banks
1	2
Total	2

Backing Portfolio

Backing Assets increased during the period, as the expansion of the Aggregate Balance more than offset valuation losses. However, as the Backing Assets rose proportionally less than the Monetary Base, **the Backing Ratio decreased from 111.80% on 24 October to 111.11% on 23 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.



Record of Discussion of the Exchange Fund Advisory Committee Currency Board Sub-Committee on 7 January 2005

(Approved for Issue by the Exchange Fund Advisory Committee on 20 January 2005)

Report on Currency Board Operations (24 November – 22 December 2004)

The Sub-Committee noted that the Hong Kong dollar exchange rate had strengthened in the middle of the period under review but had weakened towards the end of the period, closing at 7.7819. Since the end of the period the exchange rate had weakened further to below 7.79. Short-term Hong Kong dollar interbank interest rates had risen markedly in the middle of the period because of demand for liquidity associated with equity initial public offerings (IPOs). Members observed that the Currency Board system had accommodated the large IPO-related liquidity requirements without problems. In view of the ample liquidity in the system, banks had kept their Best Lending Rates unchanged at 5.0%, despite the 25-bp increase in the US fed funds target rate on 14 December.

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

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 and East Asian economies had continued to be solid, but it had been slower than expected in Japan and the euro area. Recent data suggested that growth on the Mainland was gradually decelerating. In Hong Kong, the latest indicators pointed to a slowdown in domestic demand growth but to continued robustness in external trade and inbound tourism.

Noting a general view among analysts that, given the size of the US current account deficit, the US dollar was likely to depreciate further against other major currencies, Members considered a special analysis of the risks for Hong Kong of a further decline in the US dollar. The analysis suggested that, with an orderly depreciation of the US dollar, growth in Hong Kong would probably be boosted by improved competitiveness and looser monetary conditions. Disorderly adjustment, on the other hand, could give rise to marked contractionary effects through financial channels in the short term, but this would probably be offset by positive trade effects over time.

A Monetary Conditions Index for Mainland China

Members considered a paper presenting an empirical framework for assessing monetary and financial conditions in Mainland China by estimating a monetary conditions index (MCI). The MCI consisted of a weighted sum of real interest rate, real exchange rate and real credit growth. Members noted that the estimated MCI suggested a sharp easing in monetary conditions in 2002-2003, reflecting a weaker US dollar, a relaxed credit stance among banks, and the easing of deflation, which reduced real interest rates. This had contributed to the acceleration in economic growth during that period. More recently, a rise in the MCI indicates a tightening of monetary conditions, reflecting primarily a sharp slowdown in credit growth.

While noting that the concept of an MCI was theoretically useful, there were caveats in its empirical implementation. Difficulties arose in measuring the real interest rate, the real effective exchange rate, and credit stance, as well as in estimating the relative weights of the component variables.

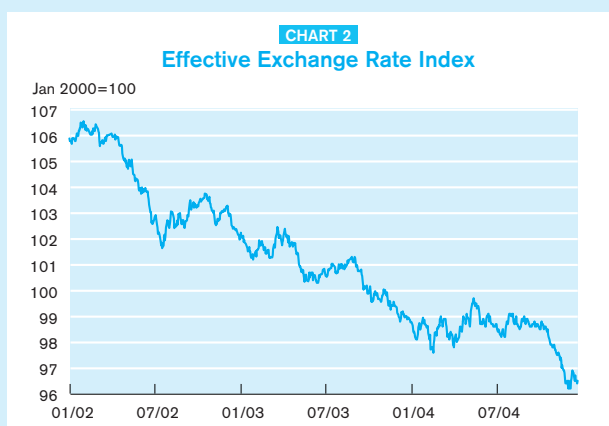
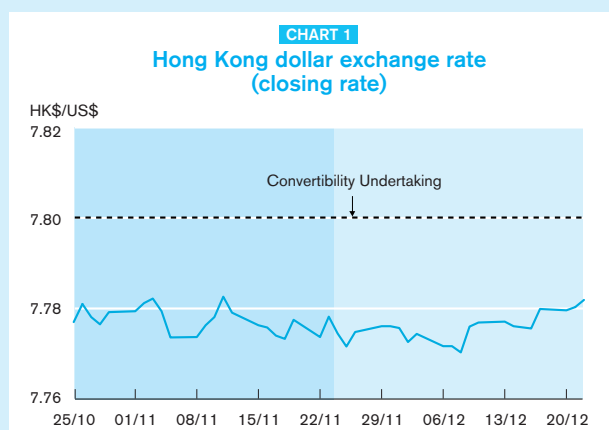
Annex

Report on Currency Board Operations (24 November – 22 December 2004)

The Hong Kong dollar exchange rate weakened and closed at 7.7819 at the end of the reporting period. In response to banks' bids, the HKMA conducted four strong-side operations, selling a total of HK\$1.67 billion in the foreign exchange market. The Monetary Base increased from HK\$287.45 billion to HK\$292.47 billion during the period. 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

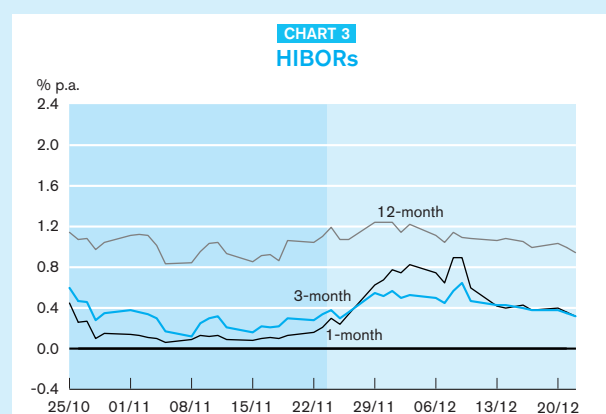
The Hong Kong dollar exchange rate strengthened in the middle of the reporting period, reaching 7.7703 on 8 December (Chart 1). In response to banks' bids, the HKMA conducted four strong-side operations on 6 and 8 December. Thereafter, the exchange rate **weakened to close at 7.7819 at the end of the period**, compared with 7.7782 at the closing of the last reporting period. Meanwhile, the effective exchange rate of the Hong Kong dollar decreased slightly (Chart 2).



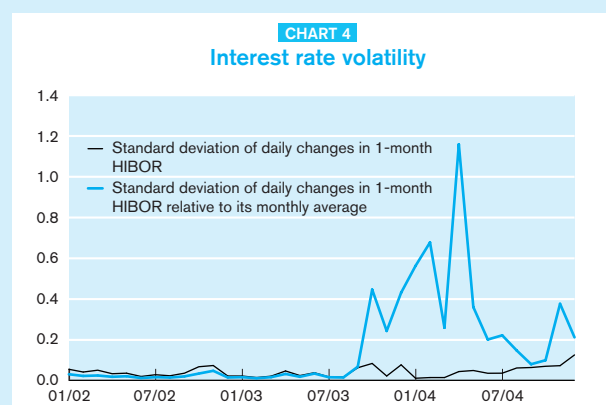
¹ The ratio of the standard deviation of daily changes in the one-month HIBOR to its monthly average measures the extent of interest rate fluctuations relative to the average level of interest rates.

Interest rates

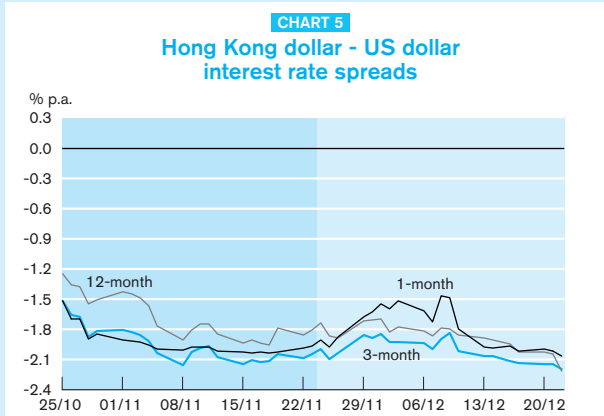
Short-term Hong Kong dollar interbank interest rates rose markedly in the middle of the reporting period, attributable to liquidity demand associated with equity IPOs. For the period as a whole, the one-month HIBOR increased by 2 bp to close at 0.32%, while the 3-month and 12-month HIBORs dropped by 6 bp and 25 bp to close at 0.32% and 0.95% respectively (Chart 3).



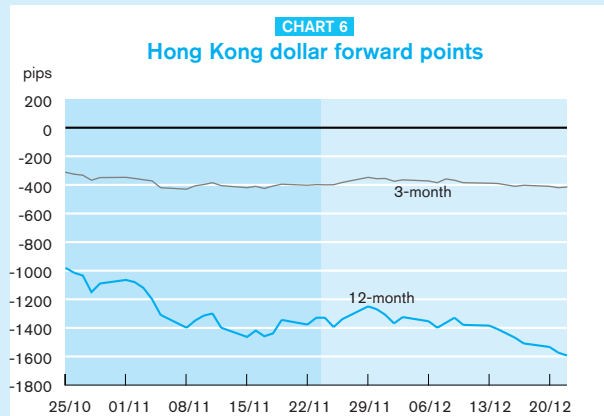
Interest rate volatility, as measured by the standard deviation of daily changes in one-month HIBOR, **remained low**. As a ratio to the average level of one-month HIBOR, it decreased in December, due to an increase in the average level (Chart 4).¹



Hong Kong dollar interbank interest rates stayed below US dollar rates. The negative interest rate spreads widened during the period, with the one-month and three-month differentials closing at -208 bp and -221 bp respectively. Meanwhile, the 12-month spread widened by 48 bp to close at -223 bp (Chart 5).



In line with the movements in interest rate spreads, the **Hong Kong dollar 12-month forward discount increased by 265 pips to close at 1,595 pips.** Meanwhile, the three-month forward discount rose by 15 pips to close at 413 pips (Chart 6).



Yields of Exchange Fund paper rose at the short end but eased at the long end during the period (Chart 7). Separately, the negative yield spreads for five-year and 10-year paper over US counterparts narrowed to -90 bp and -58 bp respectively at the end of the period (Table 1).

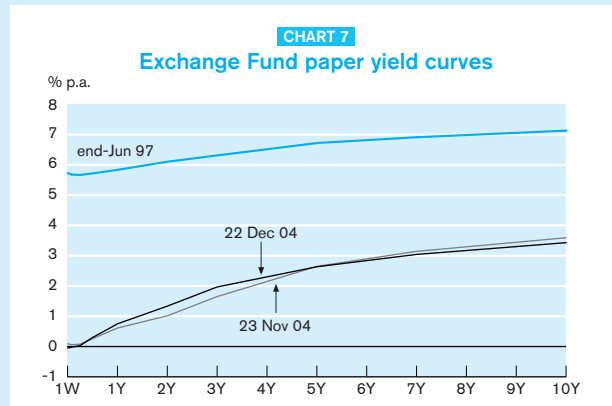
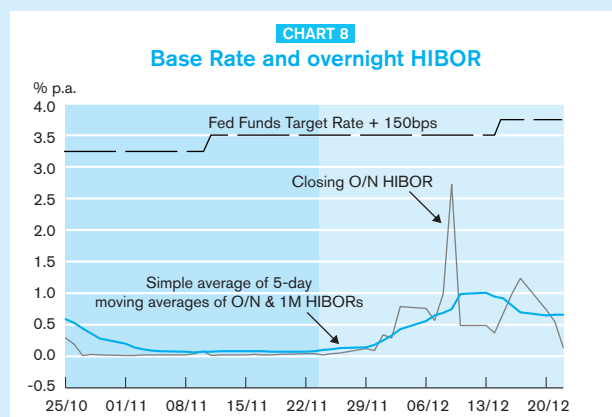


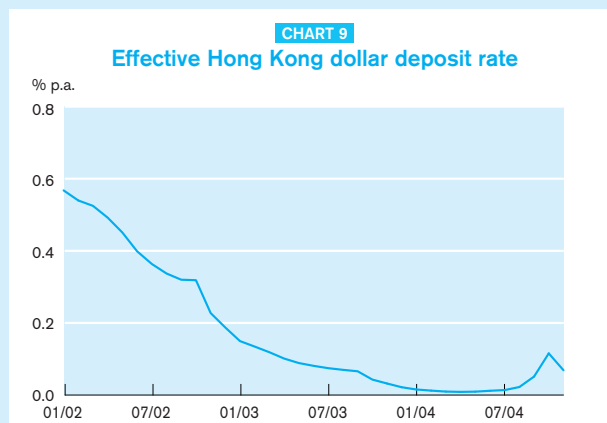
TABLE 1
Yield spreads of Exchange Fund paper over US Treasuries (basis points)

	27 Jun 97	23 Nov 04	22 Dec 04
3-month	56	-218	-213
1-year	21	-188	-206
3-year	3	-122	-152
5-year	27	-95	-90
10-year	54	-78	-58

Following a 25-bp hike in the US federal funds target rate, **the HKMA Base Rate was adjusted upward to 3.75% on 15 December** according to the established formula (Chart 8). However, **banks kept their Best Lending Rates unchanged at 5.0%**, in view of ample liquidity in the banking system.



The average one-month time deposit rate offered by major authorized institutions rose from 0.015% to 0.019% during the period.² Meanwhile, the effective deposit rate decreased from 0.12% to 0.07% in November (Chart 9).³



Monetary Base

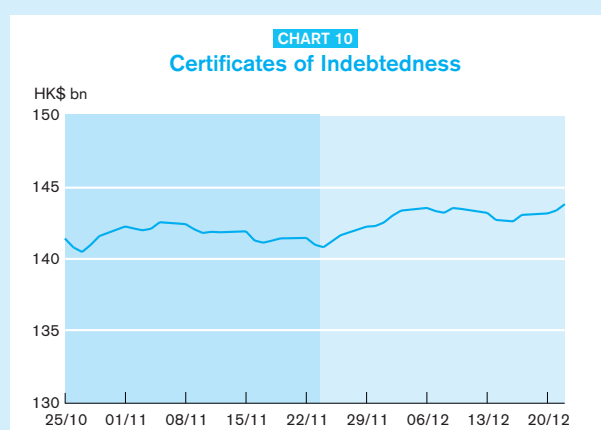
The **Monetary Base**, which consists of Certificates of Indebtedness (CIs), Government-issued currency notes and coins in circulation, the Aggregate Balance, and Exchange Fund Bills and Notes, **increased from HK\$287.45 billion to HK\$292.47 billion** during the reporting period (Table 2). Movements in the individual components are discussed below.

TABLE 2
Monetary Base

(HK\$ bn)	24 Nov 04	22 Dec 04
CIs	140.84	143.85
Government-issued Currency Notes and Coins in Circulation	6.55	6.60
Aggregate Balance	14.12	15.81
Outstanding EFBNs	125.95	126.22
Monetary Base	287.45	292.47

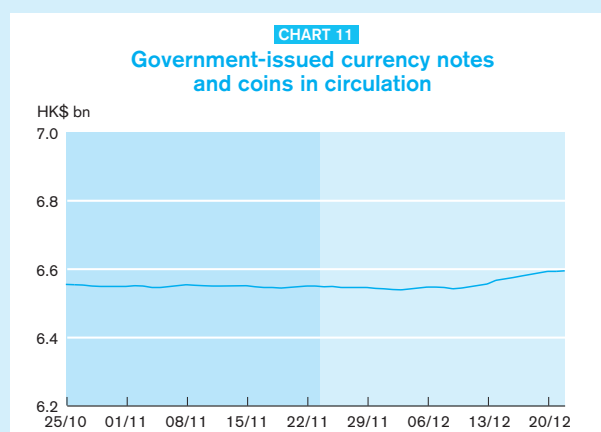
Certificates of Indebtedness

The three note-issuing banks submitted a total of US\$386 million to the HKMA in exchange for HK\$3.01 billion worth of CIs during the period. As a result, **the outstanding amount of CIs increased from HK\$140.84 billion to HK\$143.85 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 to HK\$6.60 billion** at the end of the reporting period (Chart 11).



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 made certain assumptions regarding the maturity distribution in computing the effective deposit rate.

Aggregate Balance

Reflecting sales of Hong Kong dollars of HK\$1.67 billion by the HKMA in response to banks' bids, the Aggregate Balance expanded and closed at HK\$15.81 billion at the end of the period (Chart 12 and Table 3).

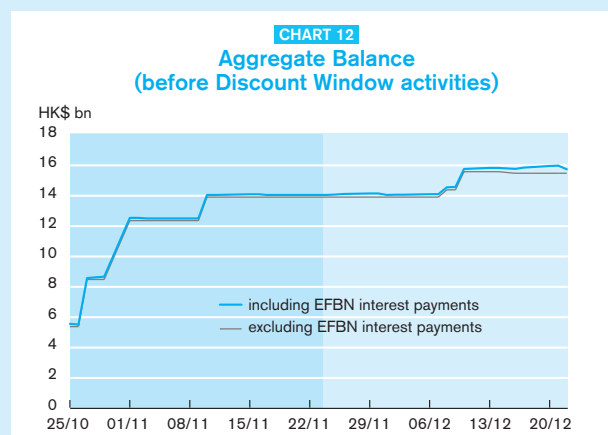
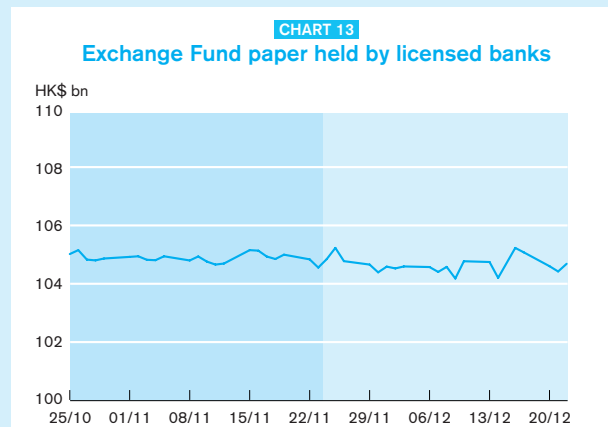


TABLE 3
HKMA's foreign exchange transactions
(24 November – 22 December 04)

Trade Date	Net Hong Kong dollar purchase (+) (HK\$m)
6-Dec	-481.74
8-Dec	-1,188.81

Outstanding Exchange Fund Bills and Notes

The market value of outstanding Exchange Fund Bills and Notes increased from HK\$125.95 billion to HK\$126.22 billion. Meanwhile, holdings of Exchange Fund paper by the banking sector (before Discount Window activities) decreased from HK\$104.97 billion (83.34% of total) to HK\$104.80 billion (83.03% of total) (Chart 13).



During the period, a total of HK\$562.44 million of interest payment on Exchange Fund paper was made. An additional HK\$507.90 million (in market value) of Exchange Fund paper was issued to absorb these interest payments. The remaining amount was carried forward in the Aggregate Balance. All issues of Exchange Fund paper were generally well received by the market (Table 4).

TABLE 4
Issuance of Exchange Fund Bills and Notes
(24 Nov – 22 Dec 04)

	No. of issues launched	Over-subscription ratio
3-month EFB	5	1.58-9.71
6-month EFB	3	4.14-5.65
1-year EFB	1	6.53
5-year EFN	1	1.16
7-year EFN	1	0.65
10-year EFN	1	1.72

Discount Window activities

During the period, seven banks borrowed a total of HK\$1.455 billion from the Discount Window, compared with HK\$130 million in the preceding period (Chart 14). All borrowings used Exchange Fund paper as collateral (Table 5).

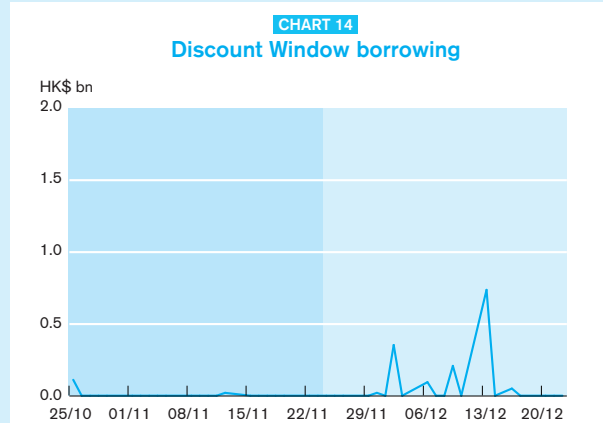


TABLE 5
Frequency of individual bank's access to the Discount Window
(24 Nov – 22 Dec 04)

Frequency of using Discount Window	No. of banks
1	6
2	1
Total	7

Backing Portfolio

Backing Assets increased during the period, attributable to valuation gains as well as increases in CI and the Aggregate Balance. As Backing Assets rose proportionally more than the Monetary Base, **the Backing Ratio rose from 111.16% on 24 November to 111.19% on 22 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.

