

# Record of Discussion of the Exchange Fund Advisory Committee Currency Board Sub-Committee on 4 November 2005

(Approved for Issue by the Exchange Fund Advisory Committee on 24 November 2005)

## Report on Currency Board Operations (1 October – 21 October 2005)

The Sub-Committee noted that the Hong Kong dollar exchange rate had strengthened modestly to close at 7.7567 at the end of the reporting period. Hong Kong dollar interbank rates had increased. The Monetary Base had decreased from HK\$280.26 billion to HK\$277.66 billion, largely reflecting a decline in Certificates of Indebtedness.

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

Members noted that the global economy had been resilient to recent shocks. The US economy had maintained strong growth despite damage from two severe hurricanes and high oil prices. Europe and Japan had shown signs of recovery. Concerns over inflation had increased and central banks, notably the US Federal Reserve, were expected to tighten monetary policy further. Growth of the Mainland economy had remained strong while inflation declined further. In Hong Kong, recent data suggested that economic growth had moderated in the third quarter of 2005. Headline inflation had increased modestly. The rise in interest rates had had a dampening effect on the property market.

Members noted that conditions in the housing market in August 2005 remained benign compared with 1997. However, the risk of an over-extension could not be ruled out. The direction of US interest-rate movements would be a key factor affecting the property market.

## Stress Testing Hong Kong's Macroeconomic Resilience Against Mainland Shocks

The Sub-Committee noted an analysis, using a quantitative model developed by Oxford Economic Forecasting, of the likely effects on Hong Kong of a number of hypothetical economic shocks on the Mainland. The analysis suggested, within the limits of the model, that Hong Kong is able to withstand shocks of considerable magnitudes.

## Revisiting External Demand for Hong Kong Dollar Currency

The Sub-Committee noted a study of the sources of demand for Hong Kong dollar currency from outside Hong Kong. The study noted that external demand for Hong Kong dollar currency, as a percentage of the total amount in circulation, has grown substantially over the past two decades. The Mainland plays a significant role in this demand in view of the increasing integration of the Mainland and Hong Kong economies.