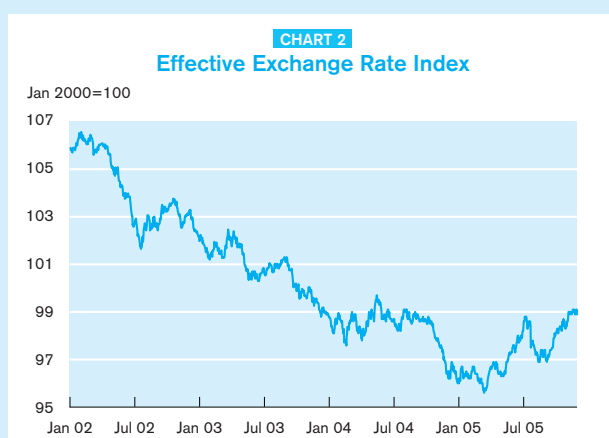
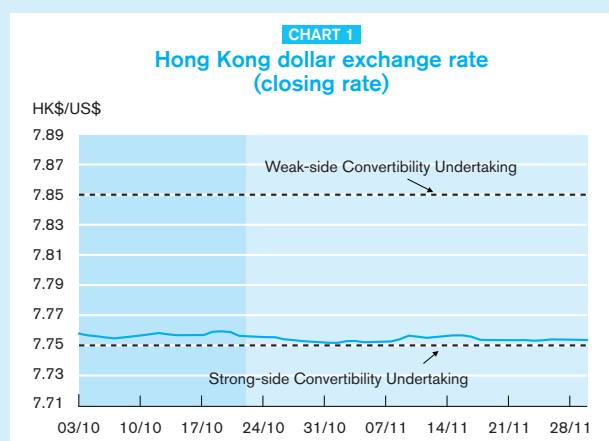


Report on Currency Board Operations (22 October – 29 November 2005)

The Hong Kong dollar exchange rate strengthened moderately during the reporting period. Interbank interest rates eased. The Monetary Base decreased from HK\$277.55 billion to HK\$277.00 billion, largely due to a decline in 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

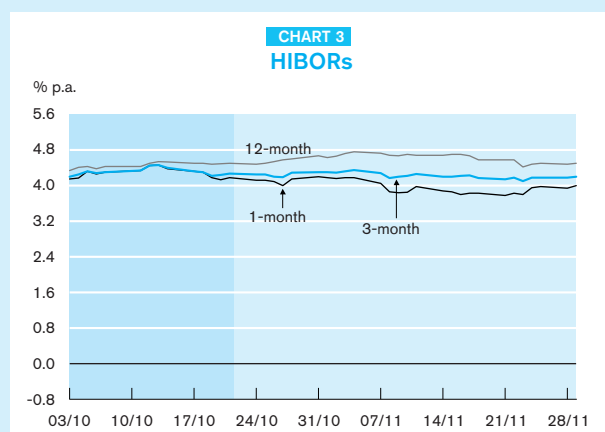
The Hong Kong dollar exchange rate strengthened modestly to close at 7.7540 at the end of the reporting period (Chart 1). The effective exchange rate of the Hong Kong dollar rose slightly, reflecting a strengthening of the US dollar against major currencies (Chart 2).



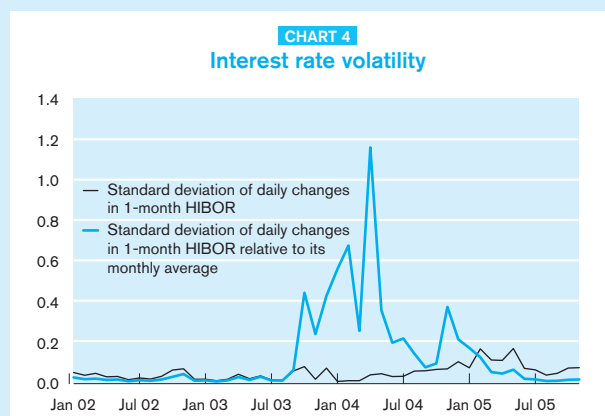
¹ The ratio of the standard deviation of daily changes in the 1-month HIBOR to its monthly average measures the extent of interest rate fluctuations relative to the average level of interest rates.

Interest rates

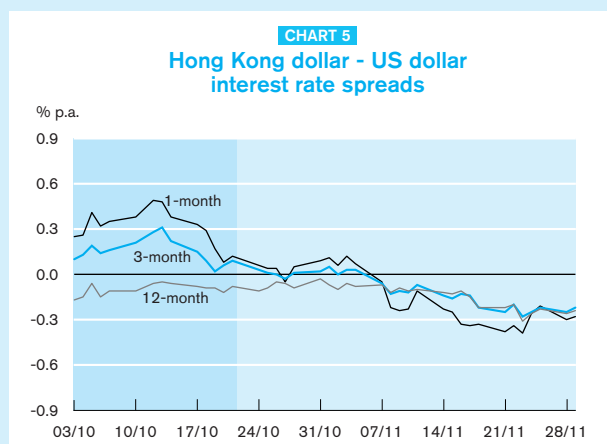
Hong Kong dollar interbank interest rates eased during the reporting period. The one-month and three-month HIBORs decreased by 12 basis points and 5 basis points to close at 4.00% and 4.20% respectively. The 12-month HIBOR rose marginally by 2 basis points to close at 4.50% (Chart 3).



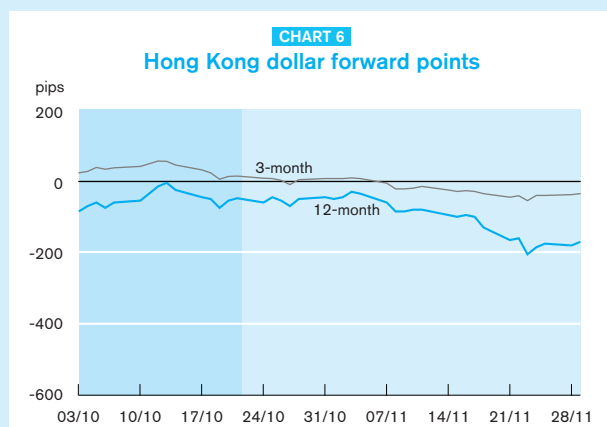
Interest rate volatility, as measured by the standard deviation of daily changes in one-month HIBOR, **increased** slightly in November. The standard deviation as a ratio to the average level of one-month HIBOR also increased (Chart 4).¹



Short-term interest rate spreads between the Hong Kong dollar and the US dollar declined and turned negative during the reporting period. The one-month and three-month spreads decreased by 34 basis points and 25 basis points to -28 basis points and -22 basis points respectively. Meanwhile the 12-month spread dropped by 13 basis points to close at -24 basis points (Chart 5).



In line with the movements in interest rate spreads, the **Hong Kong dollar 12-month forward discount widened by 110 pips to close at 170 pips**, while the three-month forward premium fell by 43 pips to close at a discount of 35 pips (Chart 6).



Yields of Exchange Fund paper rose across the board during the period (Chart 7). The negative yield spreads against US Treasuries narrowed as well, except for the one-year tenor. In particular, the five-year and 10-year spreads narrowed to -11 basis points and -7 basis points respectively at the end of the period (Table 1).

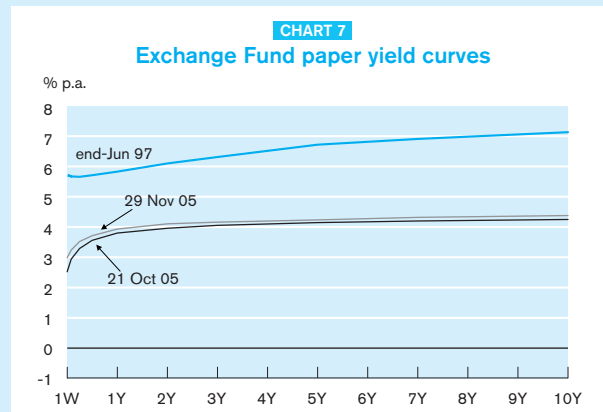
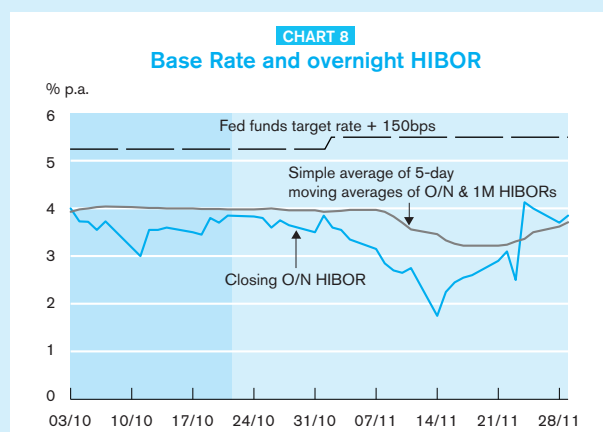


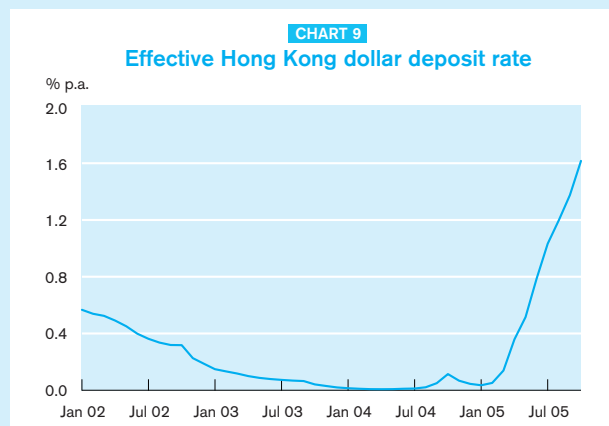
TABLE 1
Yield spreads of Exchange Fund paper over US Treasuries (basis points)

	27 Jun 97	21 Oct 05	29 Nov 05
3-month	56	-55	-47
1-year	21	-34	-40
3-year	3	-21	-18
5-year	27	-17	-11
10-year	54	-21	-7

Following a hike of 25 basis points in the US federal funds target rate, **the HKMA Base Rate was adjusted upward by 25 basis points to 5.50% on 2 November 2005** according to the established formula (Chart 8). Meanwhile, **banks generally raised their Best Lending Rates by 50 basis points.**



The average one-month time-deposit rate offered by major authorized institutions rose from 2.214% to 2.608% during the period.² The effective deposit rate rose from 1.37% to 1.61% in October (Chart 9).³



Monetary Base

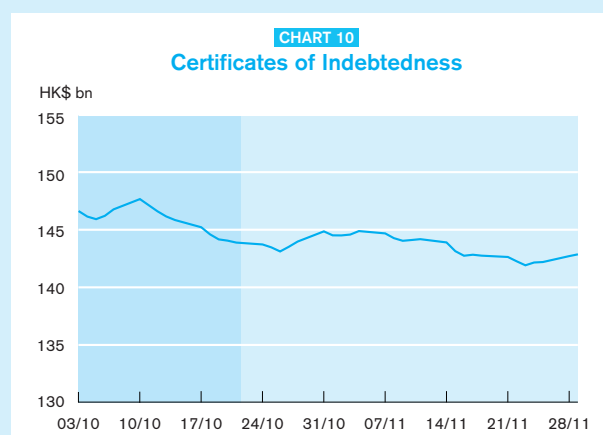
The **Monetary Base**, which consists of Certificates of Indebtedness (CIs), government-issued currency notes and coins in circulation, the Aggregate Balance, and Exchange Fund Bills and Notes, **decreased slightly from HK\$277.55 billion to HK\$277.00 billion** during the reporting period (Table 2). Movements in the individual components are discussed below.

TABLE 2
Monetary Base

(HK\$ bn)	24 Oct 05	29 Nov 05
CIs	143.75	142.89
Government-issued Currency Notes and Coins in Circulation	6.75	6.76
Aggregate Balance	1.29	1.33
Outstanding EFBNs	125.77	126.02
Monetary Base	277.55	277.00

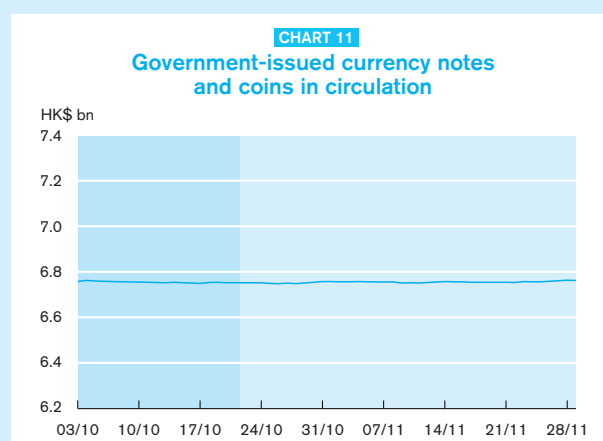
Certificates of Indebtedness

The three note-issuing banks redeemed HK\$0.86 billion of CIs to the HKMA in exchange for US\$0.11 billion during the period. As a result, **the outstanding amount of CIs decreased from HK\$143.75 billion to HK\$142.89 billion** (Chart 10).



Government-issued currency notes and coins in circulation

The total amount of **government-issued currency notes and coins in circulation was stable at around HK\$6.76 billion** during the reporting period (Chart 11).

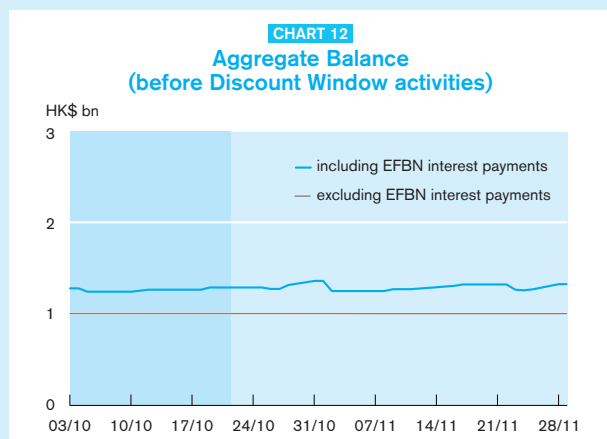


² The figures refer to the average of interest rates offered by the major authorized institutions for one-month time deposits of less than HK\$100,000.

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

The Aggregate Balance was little changed at around **HK\$1.33 billion** during the reporting period, with small fluctuations due to interest payments on Exchange Fund paper (Chart 12).



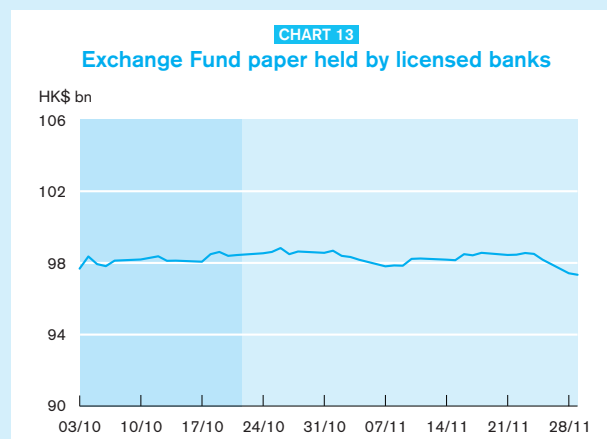
During the period, a total of **HK\$437.29 million** of interest payments on Exchange Fund paper were made. An additional **HK\$400.51 million** (in market value) of Exchange Fund paper was issued to absorb these interest payments. The remaining amount was carried forward in the Aggregate Balance. All issues of Exchange Fund paper were well received by the market (Table 3).

TABLE 3
Issuance of Exchange Fund Bills and Notes
(22 Oct – 29 Nov 05)

	No. of issues launched	Over-subscription ratio
1-month EFB	3	6.92-11.50
3-month EFB	5	1.84-3.84
6-month EFB	3	2.12-4.08
1-year EFB	1	3.54
2-year EFN	1	6.34
7-year EFN	1	3.18

Outstanding Exchange Fund Bills and Notes

The market value of outstanding Exchange Fund Bills and Notes rose slightly from **HK\$125.77 billion** to **HK\$126.02 billion**. Holdings of Exchange Fund paper by the banking sector (before Discount Window activities) decreased from **HK\$98.52 billion** (78.33% of total) to **HK\$97.32 billion** (77.22% of total) (Chart 13).



Discount Window activities

During the period, **four banks borrowed a total of HK\$1.03 billion** from the Discount Window, compared with **HK\$3.47 billion** in the preceding period (Chart 14). All borrowings used Exchange Fund paper as collateral (Table 4).

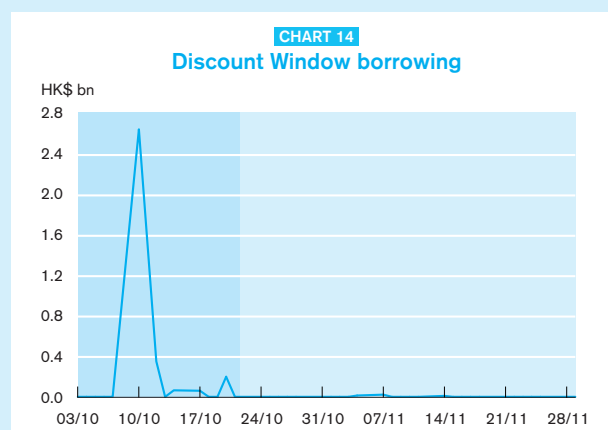


TABLE 4
Frequency of individual bank's access to the Discount Window
(22 Oct – 29 Nov 05)

Frequency of using Discount Window	No. of banks
1	4
Total	4

Backing Portfolio

Backing Assets increased during the period, largely due to interest income and valuation gains, which more than offset the decline in the Monetary Base. As a result, **the Backing Ratio increased from 111.33% on 23 October to 111.68% on 29 November 2005** (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.

