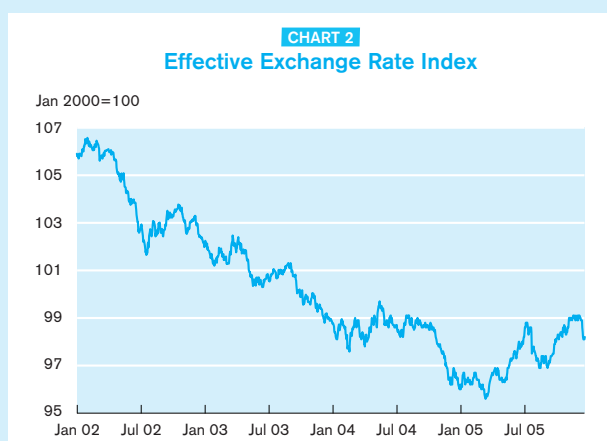
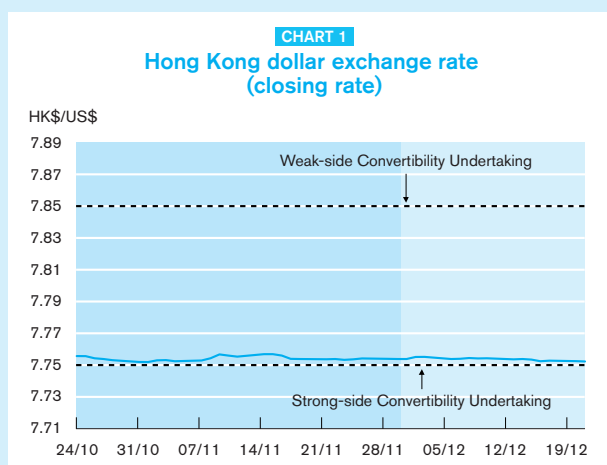


## Annex Report on Currency Board Operations (30 November – 20 December 2005)

The Hong Kong dollar exchange rate strengthened modestly during the reporting period. Interbank interest rates eased. The Monetary Base rose from HK\$277.09 billion to HK\$280.06 billion, largely due to increases 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

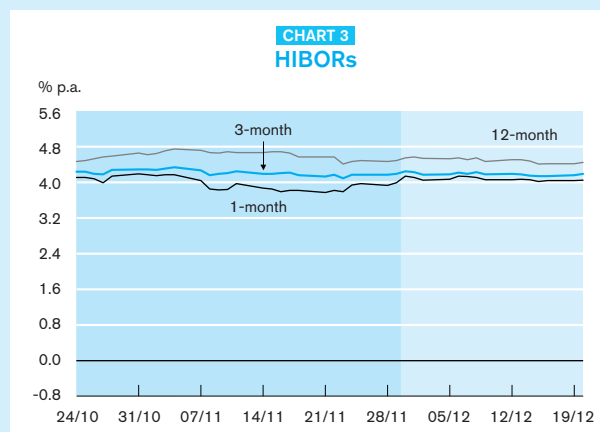
The Hong Kong dollar exchange rate strengthened slightly to close at 7.7525 at the end of the reporting period, reportedly attributable to increased demand for Hong Kong dollars associated with equity initial public offerings (Chart 1). Separately, the effective exchange rate of the Hong Kong dollar softened moderately, reflecting weakness in the US dollar against major currencies (Chart 2).



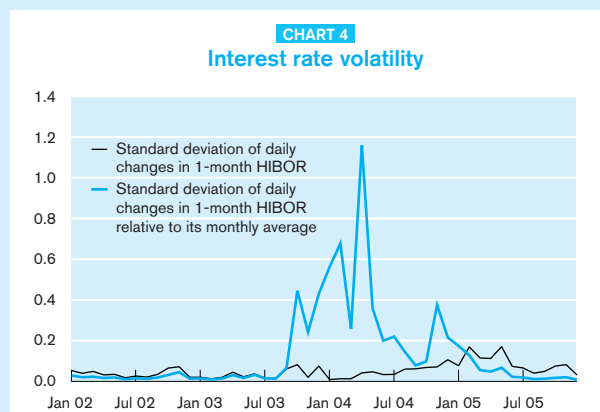
<sup>1</sup> The ratio of the standard deviation of daily changes in the 1-month HIBOR to its monthly average measures the extent of interest rate fluctuations relative to the average level of interest rates.

### Interest rates

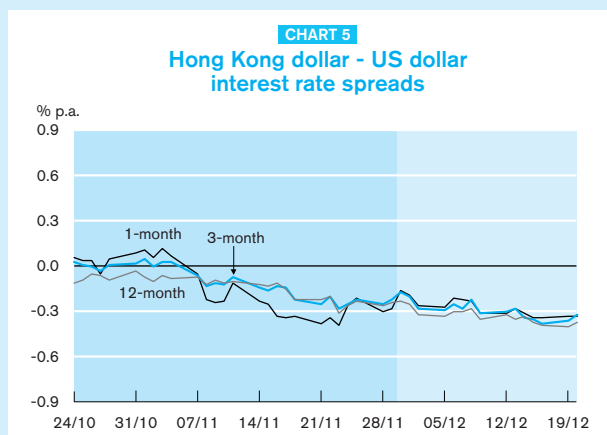
Hong Kong dollar interbank interest rates eased slightly during the reporting period. The one-month and three-month HIBORs dropped by 9 basis points and 6 basis points to close at 4.06% and 4.20% respectively. The 12-month HIBOR decreased by 10 basis points to close at 4.46% (Chart 3).



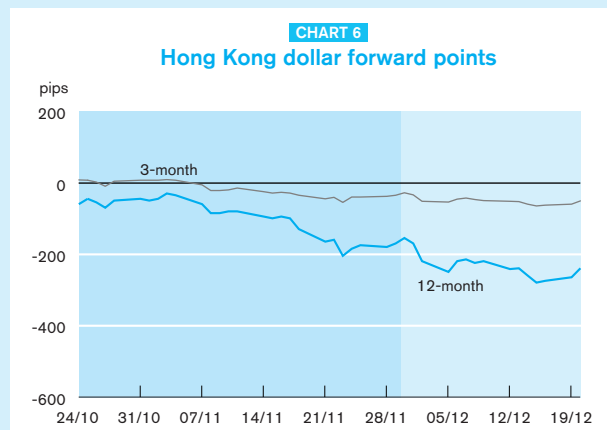
Interest rate volatility, as measured by the standard deviation of daily changes in one-month HIBOR, decreased in December. The standard deviation as a ratio of the average level of one-month HIBOR also decreased (Chart 4).<sup>1</sup>



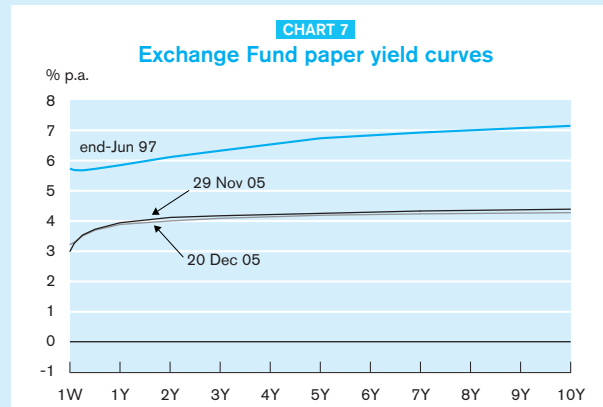
**Negative spreads of Hong Kong dollar interest rates over the US dollar counterparts widened** during the reporting period. The one-month and three-month spreads increased by 17 basis points and 15 basis points to -33 basis points and -32 basis points respectively. Meanwhile the 12-month spread rose by 14 basis points to close at -37 basis points (Chart 5).



In line with the movements in interest rate spreads, the **Hong Kong dollar 12-month forward discount widened by 85 pips to close at 240 pips**, while the three-month forward discount increased by 23 pips to close at 51 pips (Chart 6).



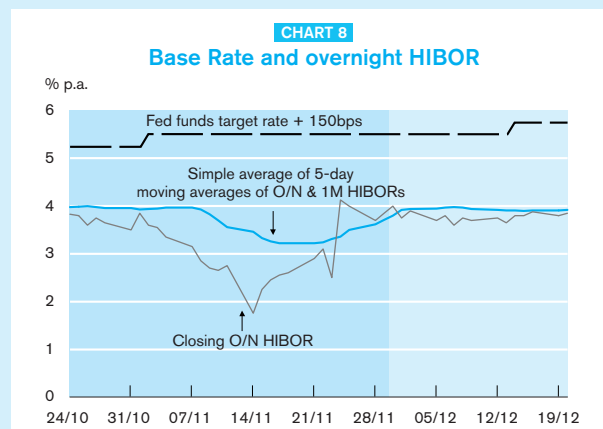
**Yields of Exchange Fund paper decreased across the board during the period** (Chart 7). The negative yield spreads against US Treasuries widened. In particular, the five-year and 10-year spreads increased to -19 basis points and -20 basis points respectively at the end of the period (Table 1).



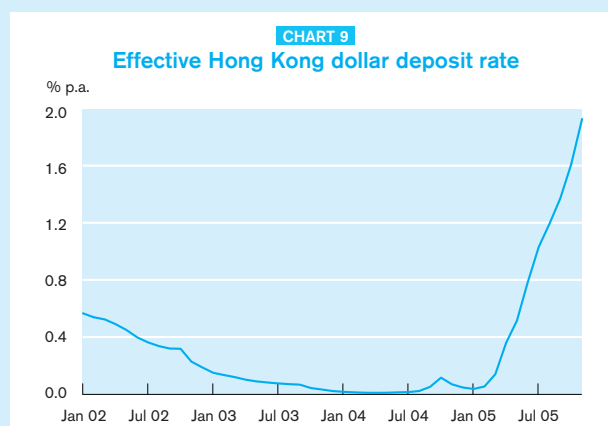
**TABLE 1**  
Yield spreads of Exchange Fund paper over US Treasuries (basis points)

	27 Jun 97	29 Nov 05	20 Dec 05
3-month	56	-47	-49
1-year	21	-40	-54
3-year	3	-18	-31
5-year	27	-11	-19
10-year	54	-7	-20

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 5.75% on 14 December 2005** according to the established formula (Chart 8). **Banks raised their Best Lending Rates by 25 basis points** as well.



The average one-month time deposit rate offered by major authorized institutions rose from 2.593% to 2.671% during the period.<sup>2</sup> The effective deposit rate rose from 1.61% to 1.93% in November (Chart 9).<sup>3</sup>



## 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, **expanded from HK\$277.09 billion to HK\$280.06 billion** during the reporting period (Table 2). Movements in the individual components are discussed below.

**TABLE 2**  
Monetary Base

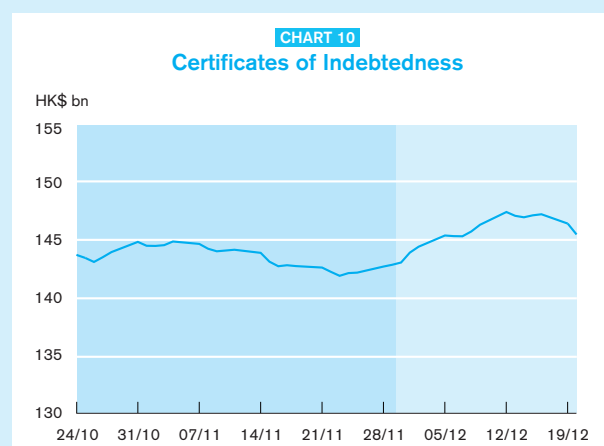
(HK\$ bn)	30 Nov 05	20 Dec 05
CIs	143.09	145.52
Government-issued Currency Notes and Coins in Circulation	6.76	6.80
Aggregate Balance	1.25	1.57
Outstanding EFBNs	126.00	126.18
<b>Monetary Base</b>	<b>277.09</b>	<b>280.06</b>

<sup>2</sup> 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.

<sup>3</sup> 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.

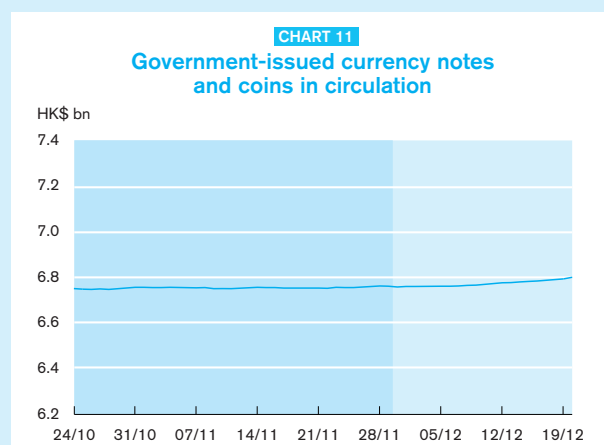
## Certificates of Indebtedness

The three note-issuing banks submitted US\$0.31 billion to the HKMA in exchange for HK\$2.43 billion worth of CIs during the period. As a result, **the outstanding amount of CIs increased from HK\$143.09 billion to HK\$145.52 billion** (Chart 10).



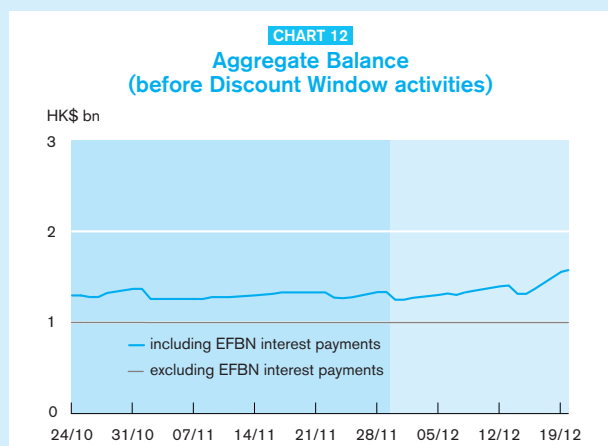
## Government-issued currency notes and coins in circulation

The total amount of **government-issued currency notes and coins in circulation increased slightly to HK\$6.80 billion** during the reporting period (Chart 11).



## Aggregate Balance

The Aggregate Balance was little changed to close at around HK\$1.6 billion during the reporting period, with small fluctuations due to interest payments on Exchange Fund paper (Chart 12).



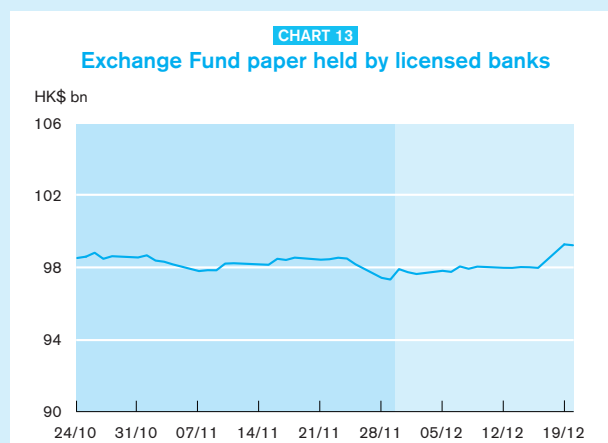
During the period, a total of HK\$602.86 million of interest payments on Exchange Fund paper were made. An additional HK\$346.96 million (in market value) of Exchange Fund paper was issued to absorb these interest payments. The remaining amount was carried forward in the Aggregate Balance. All issues of Exchange Fund paper were well received by the market (Table 3).

**TABLE 3**  
Issuance of Exchange Fund Bills and Notes  
(30 Nov – 20 Dec 05)

	No. of issues launched	Over-subscription ratio
3-month EFB	3	1.99-2.65
6-month EFB	1	2.83
1-year EFB	1	1.96
3-year EFN	1	3.74
5-year EFN	1	2.57
10-year EFN	1	1.96

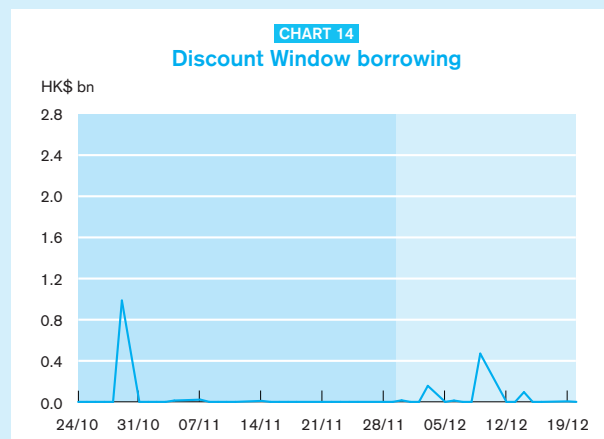
## Outstanding Exchange Fund Bills and Notes

The market value of outstanding Exchange Fund Bills and Notes rose slightly from HK\$126.00 billion to HK\$126.18 billion. Holdings of Exchange Fund paper by the banking sector (before Discount Window activities) increased from HK\$97.89 billion (77.69% of total) to HK\$99.22 billion (78.64% of total) (Chart 13).



## Discount Window activities

During the period, ten banks borrowed a total of HK\$757 million from the Discount Window, compared with HK\$1.03 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  
(30 Nov – 20 Dec 05)

Frequency of using Discount Window	No. of banks
1	10
Total	10

## Backing Portfolio

Backing Assets rose during the period, largely due to increases in Certificates of Indebtedness. As the Backing Assets increased proportionally less than the Monetary Base, **the Backing Ratio decreased marginally from 111.60% on 30 November to 111.59% on 20 December 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.

