

EDITORIAL

Recent trends and events

Growth in Hong Kong's economy slowed in the second quarter, although growth in service exports and private consumption expenditure remained solid. Labour market conditions continued to improve, with the unemployment rate falling to 4.9% in the three months to the end of July. Inflation continued to rise but remained moderate, with the Composite Consumer Price Index increasing by 2.3% year on year in July.

After the seventeenth consecutive 25-basis-point increase in June, when the HKMA correspondingly raised the local Base Rate to 6.75%, the Federal Open Market Committee decided in August to keep its federal funds target rate unchanged at 5.25%. The Aggregate Balance stayed at around \$1.3 billion during the second quarter. The Hong Kong dollar exchange rate eased slightly to around HK\$7.76 per US dollar in the later part of the second quarter. The Hang Seng Index fell to around 15,200 in the middle of June before climbing to the 17,500 level in the middle of August. It closed at 17,392 at the end of August.

A Seminar on Financial Infrastructure jointly organised by the People's Bank of China and the HKMA was held in Beijing and Shanghai on 6 and 7 June respectively. The HKMA announced the formation of the Industry Working Group on Prevention of Money Laundering and Terrorist Financing on 13 June to help the banking sector prepare for challenges in these areas. On 4 September, banks in Hong Kong adopted a new five-day interbank clearing arrangement.

In this issue

This issue of the *Quarterly Bulletin* contains three feature articles. The first article is a research report on Hong Kong's business cycle synchronisation with Mainland China and the US. The research shows that business cycles in Hong Kong are more influenced by shocks from the US than Mainland China, suggesting that the US dollar should remain the anchor currency of Hong Kong's Linked Exchange Rate system. The second article, entitled the validation of internal rating systems for capital adequacy purposes, describes the main features of the validation standards the HKMA will use to determine whether authorized institutions are eligible to use their internal rating systems to calculate the supervisory capital requirements for credit risk. The last article describes an indicator approach to forecasting the non-rental component of the composite consumer price index (CCPI) inflation for Hong Kong.