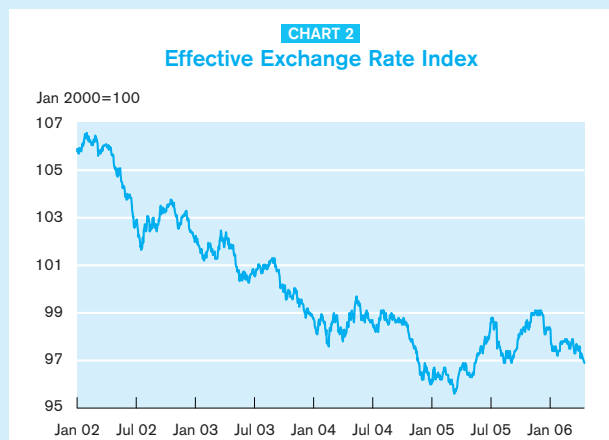
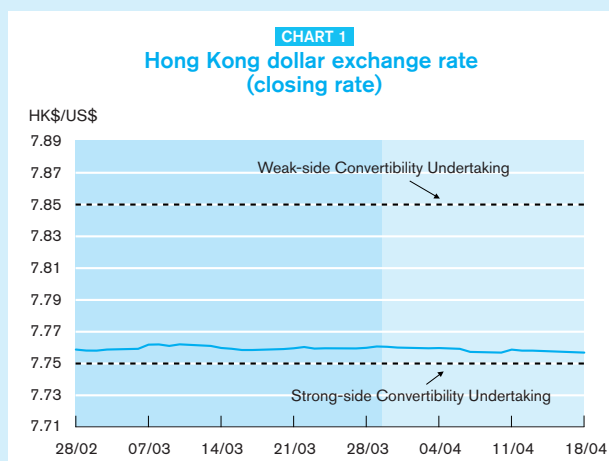


Annex Report on Currency Board Operations (30 March – 18 April 2006)

The Hong Kong dollar exchange rate strengthened moderately during the reporting period. Interbank interest rates rose. The Monetary Base increased from HK\$285.93 billion to HK\$288.52 billion, largely due to expansion 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

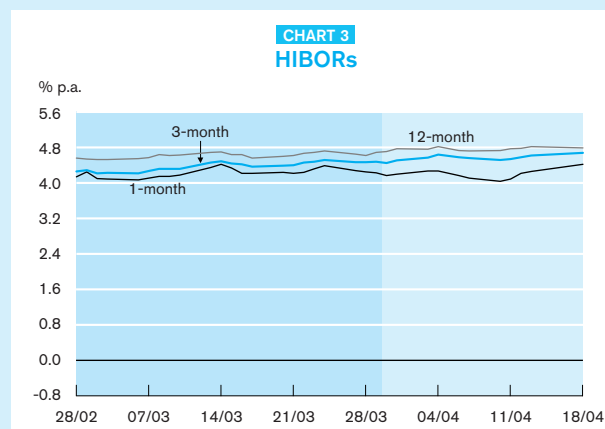
The Hong Kong dollar exchange rate strengthened slightly to close at 7.7569 at the end of the reporting period, reportedly associated with equity-related inflows (Chart 1). Meanwhile, the effective exchange rate of the Hong Kong dollar eased modestly, reflecting weakness in the US dollar (Chart 2).



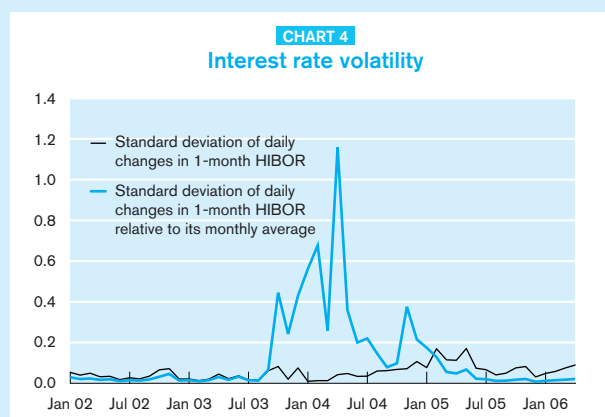
¹ The ratio of the standard deviation of daily changes in the 1-month HIBOR to its monthly average measures the extent of interest rate fluctuations relative to the average level of interest rates.

Interest rates

Hong Kong dollar interbank interest rates increased during the reporting period. The one-month and three-month HIBORs rose by 25 basis points and 23 basis points to close at 4.40% and 4.66% respectively. The 12-month HIBOR rose by eight basis points to close at 4.77% (Chart 3).

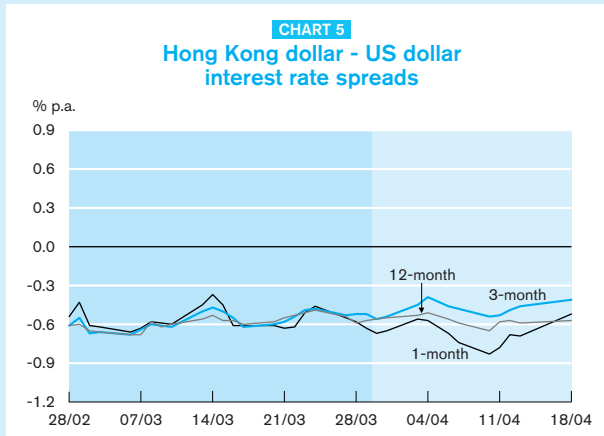


Interest rate volatility, measured by the standard deviation of daily changes in one-month HIBOR, **increased** in April. The standard deviation as a ratio of the average level of one-month HIBOR also rose slightly (Chart 4).¹



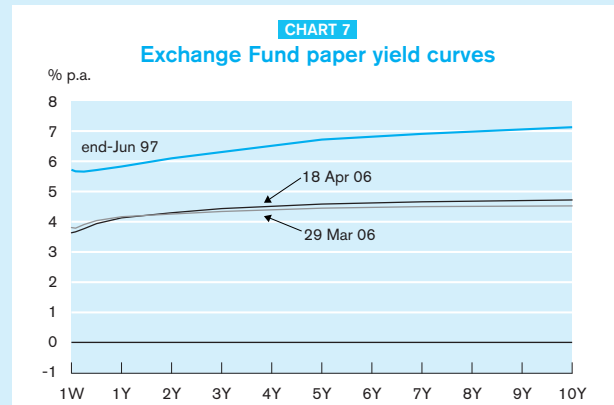
Hong Kong dollar interbank interest rates stayed below US dollar rates.

The short-term negative interest rate spreads narrowed during the period, with the one-month and three-month spreads decreasing by 15 basis points to close at -52 basis points and -41 basis points respectively (Chart 5). The 12-month spreads was little changed to close at -57 basis points.



Yield curve of Exchange Fund paper steepened during the period (Chart 7).

The negative yield spreads against US Treasuries widened at the short end, but narrowed in the intermediate end. In particular, the three-month spread increased to -97 basis points and the five-year spreads decreased to -38 basis points at the end of the period. The 10-year spread remained unchanged at -34 basis points (Table 1).



Reflecting the movements in interest rate spreads, the **Hong Kong dollar 12-month forward discount narrowed by 13 pips to close at 415 pips**, while the three-month forward discount decreased by 25 pips to close at 85 pips (Chart 6).

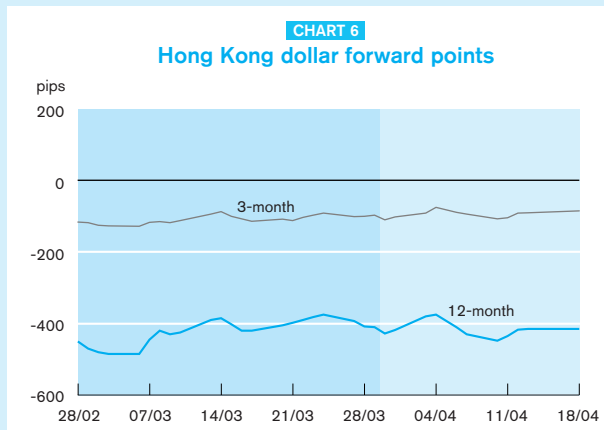
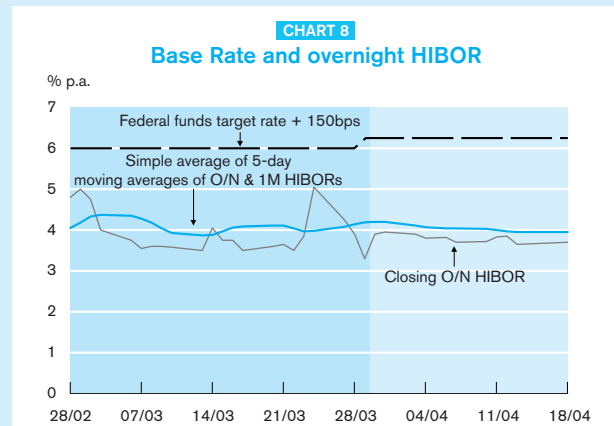


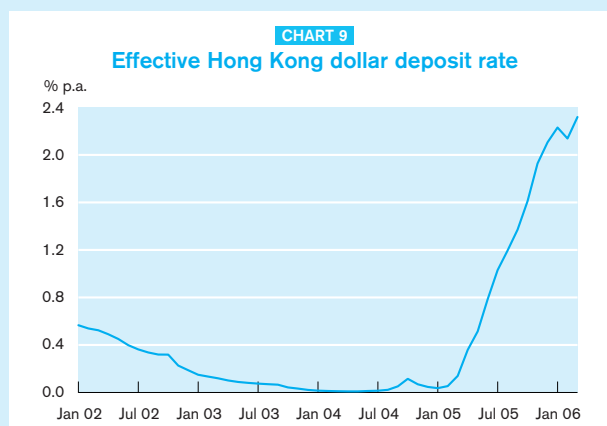
TABLE 1
Yield spreads of Exchange Fund paper over US Treasuries (basis points)

	27 Jun 97	29 Mar 06	18 Apr 06
3-month	56	-74	-97
1-year	21	-75	-82
3-year	3	-55	-47
5-year	27	-42	-38
10-year	54	-34	-34

In the absence of policy rate changes in the US, **the HKMA Base Rate was unchanged at 6.25%** during the reporting period (Chart 8). Meanwhile, **banks kept their Best Lending Rates unchanged.**

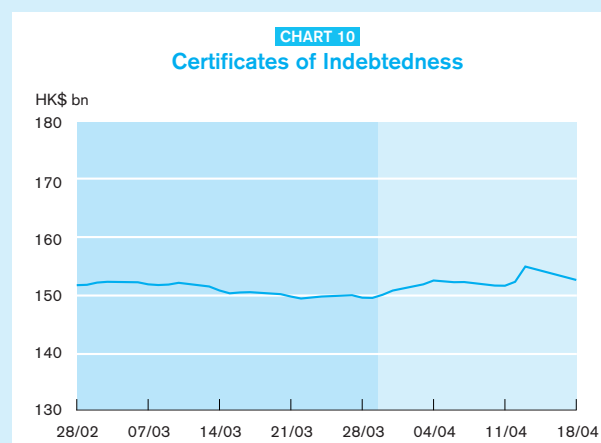


The average one-month time deposit rate offered by major authorized institutions rose from 2.731% to 2.769% during the period.² Meanwhile, the effective deposit rate rose from 2.14% to 2.32% in March (Chart 9).³ The composite interest rate, which reflects the average cost of funds of banks, increased from 2.94% at the end of February 2006 to 3.00% at the end of March 2006.⁴



Certificates of Indebtedness

The three note-issuing banks submitted US\$0.33 billion to the HKMA in exchange for HK\$2.57 billion worth of CIs during the period. As a result, the outstanding amount of CIs increased from HK\$150.07 billion to HK\$152.64 billion (Chart 10).



Monetary Base

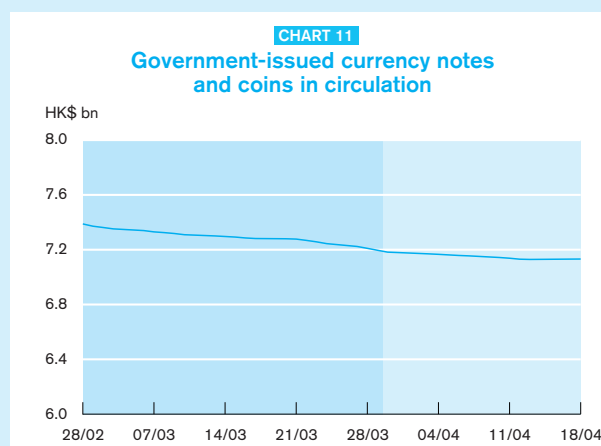
The Monetary Base, which consists of Certificates of Indebtedness (CIs), government-issued currency notes and coins in circulation, the Aggregate Balance and Exchange Fund Bills and Notes, increased from HK\$285.93 billion to HK\$288.52 billion during the reporting period (Table 2). Movements in the individual components are discussed below.

TABLE 2
Monetary Base

(HK\$ bn)	30 Mar 06	18 Apr 06
CIs	150.07	152.64
Government-issued Currency Notes and Coins in Circulation	7.18	7.13
Aggregate Balance	1.29	1.27
Outstanding EFBNs	127.39	127.48
Monetary Base	285.93	288.52

Government-issued currency notes and coins in circulation

The total amount of government-issued currency notes and coins in circulation dropped slightly from HK\$7.18 billion to HK\$7.13 billion during the reporting period (Chart 11).



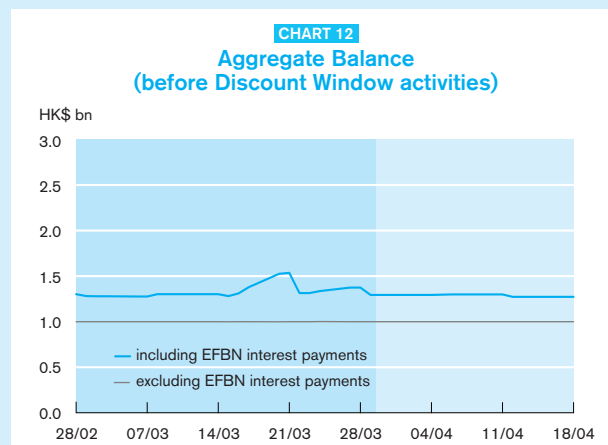
² The figures refer to the average of interest rates offered by the major authorized institutions for one-month time deposits of less than HK\$100,000.

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.

⁴ This is a weighted average interest rate of all Hong Kong dollar interest bearing liabilities, which include deposits from customers, amounts due to banks, negotiable certificates of deposit and other debt instruments, and Hong Kong dollar non-interest bearing demand deposits on the books of banks. Data from retail banks, which account for about 90% of the total customers' deposits in the banking sector, are used in the calculation.

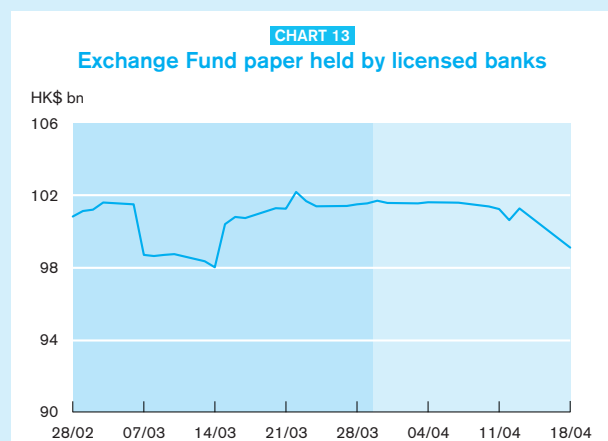
Aggregate Balance

The Aggregate Balance was little changed during the reporting period to close at around HK\$1.3 billion, with small fluctuations due to interest payments on Exchange Fund paper (Chart 12).



Outstanding Exchange Fund Bills and Notes

The market value of outstanding Exchange Fund Bills and Notes increased moderately from HK\$127.39 billion to HK\$127.48 billion. Holdings of Exchange Fund paper by the banking sector (before Discount Window activities) decreased from HK\$101.71 billion (79.84% of total) to HK\$99.11 billion (77.74% of total) (Chart 13).



During the period, a total of HK\$121.21 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\$142.66 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 3).

TABLE 3
Issuance of Exchange Fund Bills and Notes
(30 Mar 06 – 18 Apr 06)

	No. of issues launched	Over-subscription ratio
3-month EFB	2	3.41-4.09
6-month EFB	1	2.62
1-year EFB	1	1.75

Discount Window activities

During the period, four banks borrowed a total of HK\$461 million from the Discount Window, compared with HK\$1.88 billion in the preceding period (Chart 14). All borrowings used Exchange Fund paper as collateral (Table 4).

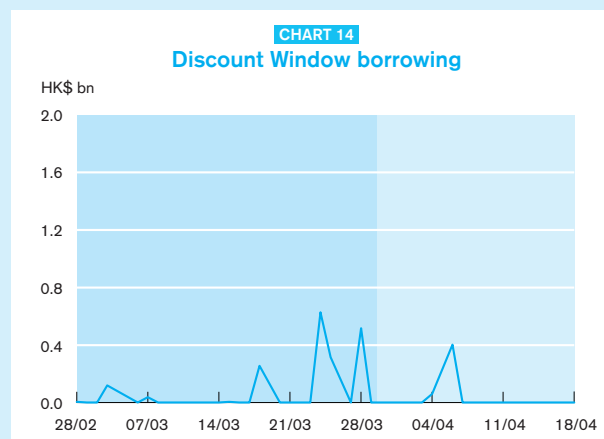


TABLE 4
Frequency of individual bank's access to the Discount Window
(30 Mar 06 – 18 Apr 06)

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

Backing Portfolio

Backing Assets increased during the period, mainly due to expansion in Certificates of Indebtedness. As the Backing Assets increased proportionally less than the Monetary Base, **the Backing Ratio decreased from 111.74% on 30 March 2006 to 111.52% on 18 April 2006** (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.

