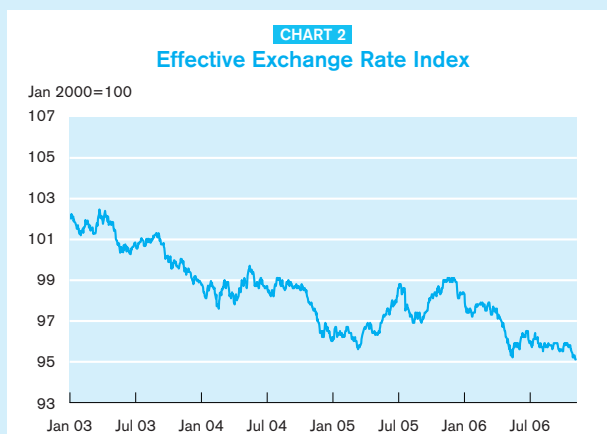
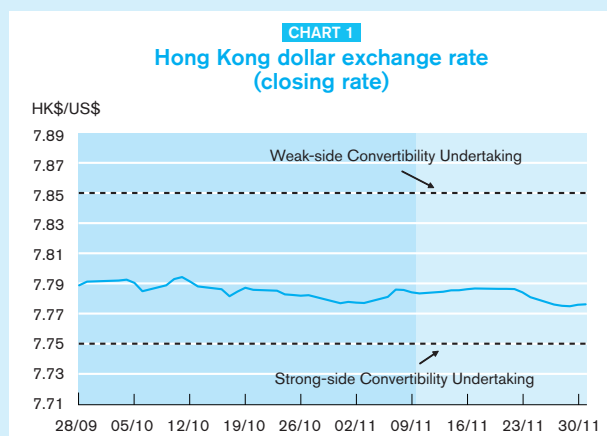


Report on Currency Board Operations (10 November – 1 December 2006)

The Hong Kong dollar exchange rate strengthened during the reporting period. Movements in interbank interest rates showed a mixed pattern, while their negative spreads against US dollar interest rates narrowed. The Monetary Base rose slightly from HK\$292.39 billion to HK\$293.27 billion. In accordance with Currency Board principles, changes in the Monetary Base were fully matched by the corresponding changes in foreign reserves.

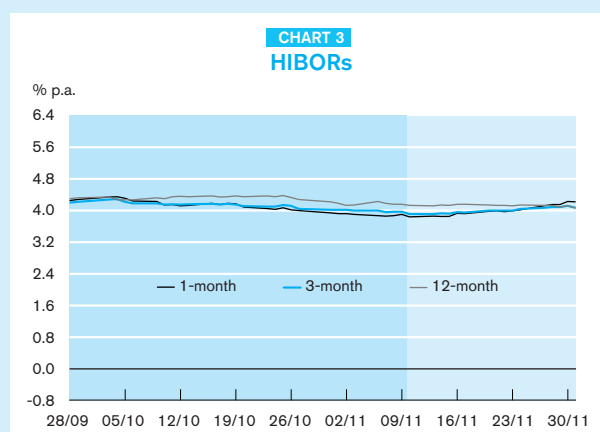
Hong Kong dollar exchange rate

During the reporting period, **the Hong Kong dollar exchange rate strengthened** from 7.7838 to 7.7766 (Chart 1), partly under the influence of equity-related inflows ahead of a number of equity initial public offerings. Meanwhile, the effective exchange rate index of the Hong Kong dollar fell from 95.0 to 94.1, as the US dollar weakened against other major currencies (Chart 2).

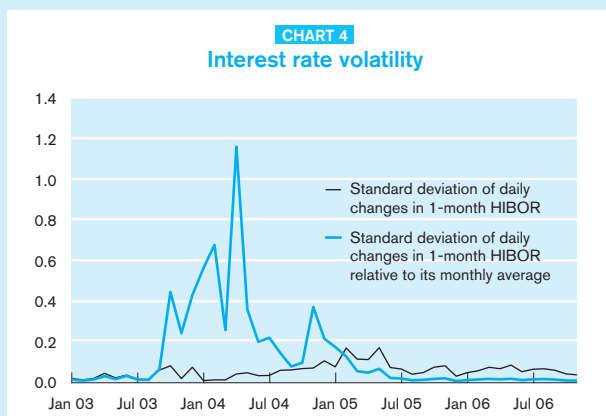


Interest rates

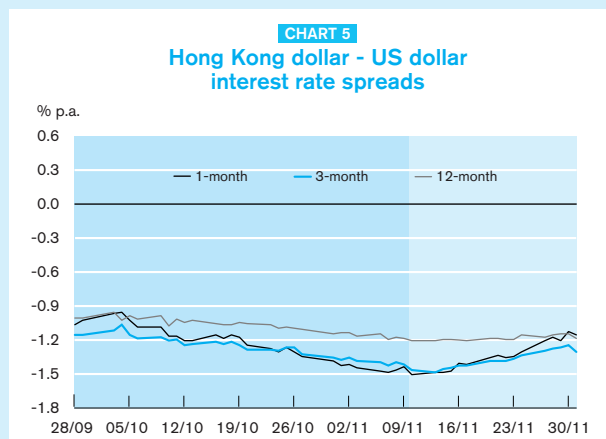
Hong Kong dollar interbank interest rates showed a mixed pattern during the reporting period. The one-month and three-month HIBORs rose by 38 and 16 basis points to close at 4.22% and 4.07% respectively. On the other hand, the 12-month HIBOR decreased slightly to close at 4.06% (Chart 3).



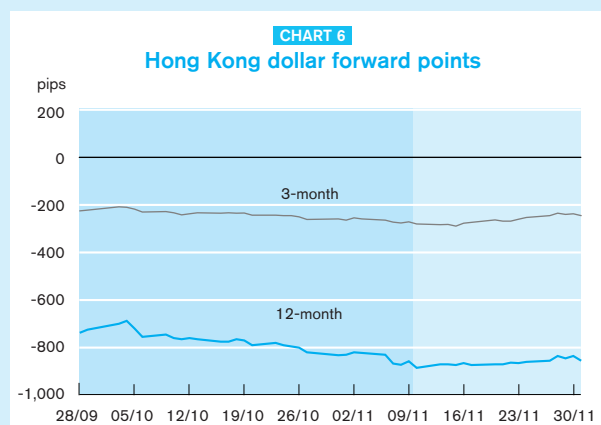
Interest rate volatility, measured by the standard deviation of daily changes in one-month HIBOR, **decreased** in November. However, the standard deviation as a ratio of the average level of one-month HIBOR remained unchanged (Chart 4).¹



Negative spreads of Hong Kong dollar interest rates against their US dollar counterparts narrowed. The one-month and three-month negative interest rate spreads decreased by 35 and 16 basis points to -115 and -130 basis points respectively. Meanwhile, the 12-month negative spread decreased by two basis points to -118 basis points (Chart 5).



Reflecting the movements in the interest rate spreads, the **Hong Kong dollar three-month and 12-month forward discounts decreased** by 35 and 30 pips to close at 247 and 855 pips respectively (Chart 6).



Yields of Exchange Fund paper decreased during the period except for the one-week and three-month tenors (Chart 7). The negative yield spreads against US Treasuries narrowed. The three-month negative spread fell to 154 basis points, while the five-year and 10-year negative spreads declined to 71 and 70 basis points respectively at the end of the period (Table 1).

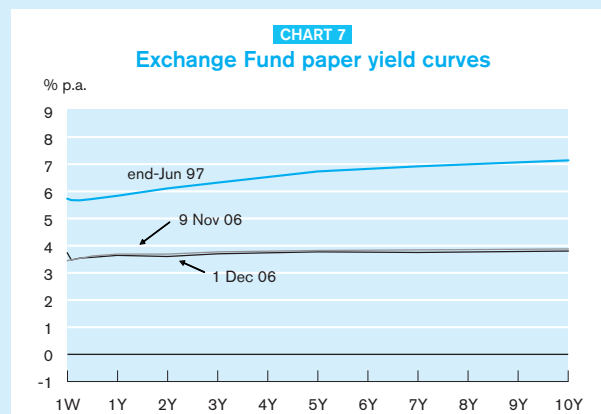
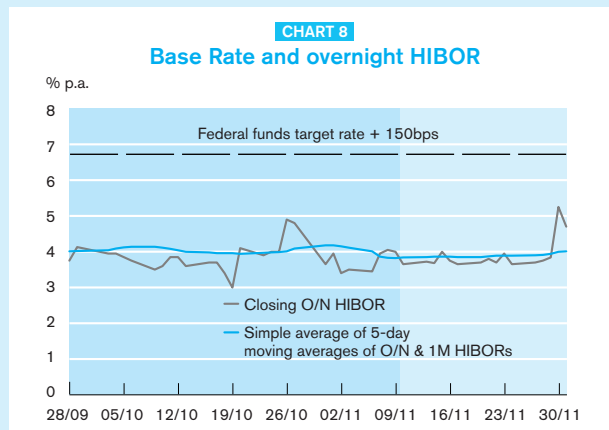


TABLE 1
Yield spreads of Exchange Fund paper over US Treasuries (basis points)

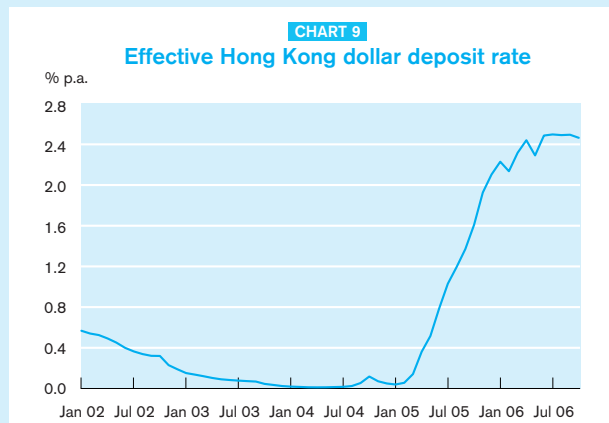
	27 Jun 97	9 Nov 06	1 Dec 06
3-month	56	-161	-154
1-year	21	-128	-128
3-year	3	-93	-84
5-year	27	-83	-71
10-year	54	-80	-70

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.

The HKMA Base Rate remained unchanged at 6.75% throughout the period (Chart 8). Banks kept their Best Lending Rates unchanged. There continued to be two Best Lending Rates at 7.75% and 8% at the end of the reporting period.



The average one-month time deposit rate offered by major authorized institutions remained unchanged at 2.519% during the period.² The effective deposit rate decreased slightly from 2.50% in September to 2.47% in October (Chart 9).³ The composite interest rate, which reflects the average cost of funds of banks, also declined modestly from 3.06% at the end of September to 3.03% at the end of October.⁴



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.

Monetary Base

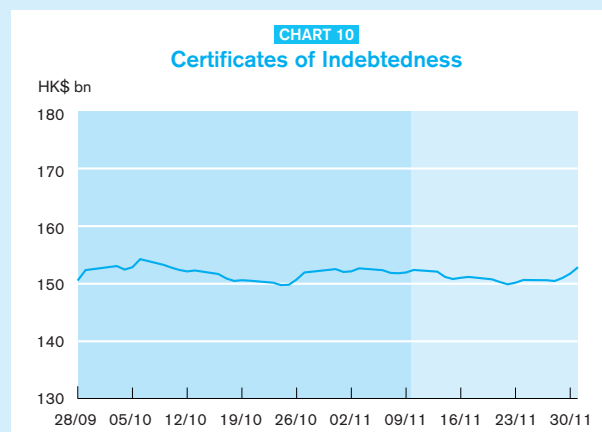
The Monetary Base, which consists of Certificates of Indebtedness (CIs), government-issued currency notes and coins in circulation, the Aggregate Balance and Exchange Fund Bills and Notes, increased from HK\$292.39 billion to HK\$293.27 billion during the reporting period (Table 2). Movements in the individual components are discussed below.

TABLE 2
Monetary Base

(HK\$ bn)	10 Nov 06	1 Dec 06
CIs	152.44	152.92
Government-issued Currency Notes and Coins in Circulation	7.06	7.07
Aggregate Balance	1.27	1.28
Outstanding EFBNs	131.62	132.01
Monetary Base	292.39	293.27

Certificates of Indebtedness

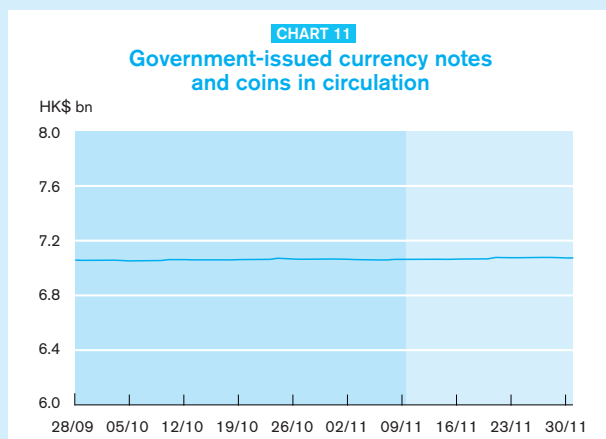
During the reporting period, the three note-issuing banks submitted a total of US\$61.54 million to the HKMA in exchange for HK\$480 million worth of CIs. As a result, the outstanding CIs rose modestly from HK\$152.44 billion to HK\$152.92 billion (Chart 10).



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.

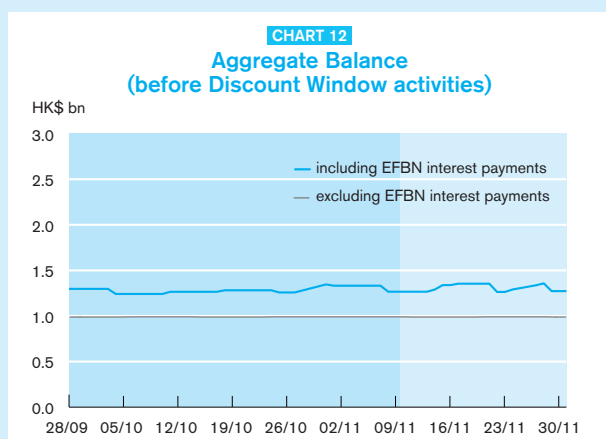
Government-issued currency notes and coins in circulation

The total of **government-issued currency notes and coins in circulation remained stable at HK\$7.07 billion** during the reporting period (Chart 11).



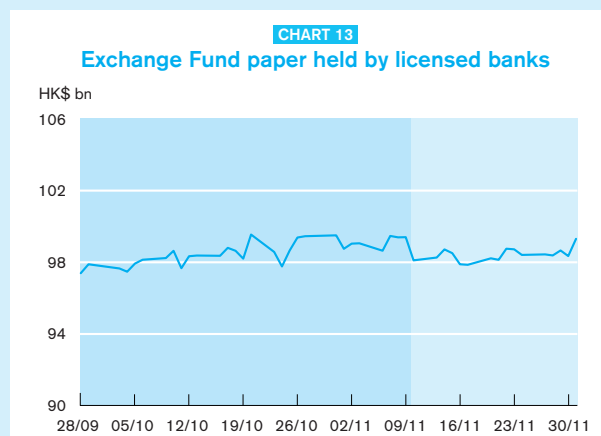
Aggregate Balance

The **Aggregate Balance was little changed to close at around HK\$1.30 billion** during the reporting period, 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 rose from **HK\$131.62 billion to HK\$132.01 billion**. Holdings of Exchange Fund paper by the banking sector (before Discount Window activities) **increased** from HK\$98.12 billion (74.55% of total) to HK\$99.32 billion (75.24% of total) (Chart 13).



During the period, a total of **HK\$304.05 million of interest payments on Exchange Fund paper were made**. An **additional HK\$297.37 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 (10 Nov 06 – 1 Dec 06)

	No. of issues launched	Over-subscription ratio
1-month EFB	1	18
3-month EFB	3	0.92-3.53
6-month EFB	1	2.81
12-month EFB	1	2.78
2-year EFN	1	1.85
7-year EFN	1	1.30

Discount Window activities

During the period, **10 banks borrowed a total of HK\$2.03 billion from the Discount Window**, compared with a total of HK\$931 million in the preceding period (Chart 14 and Table 4). The borrowing used Exchange Fund paper as collateral.

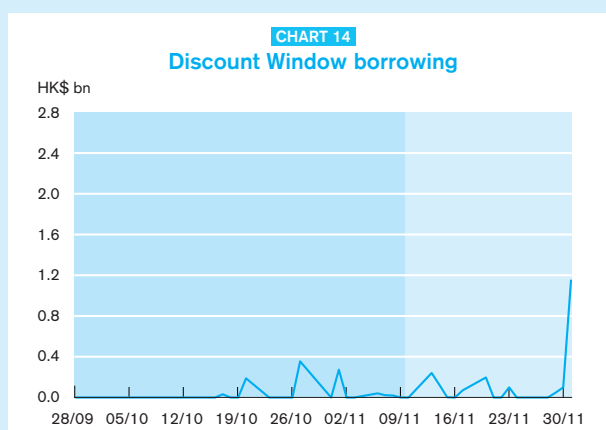


TABLE 4
Frequency of individual bank's access to the Discount Window (10 Nov 06 – 1 Dec 06)

Frequency of using Discount Window	No. of banks
1	9
2	1
Total	10

Backing Portfolio

Backing Assets rose during the period, reflecting an increase in the Monetary Base and valuation gains. As the Backing Assets increased proportionally more than the Monetary Base, **the Backing Ratio rose slightly from 111.71% on 10 November to 112.12% on 1 December** (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.

