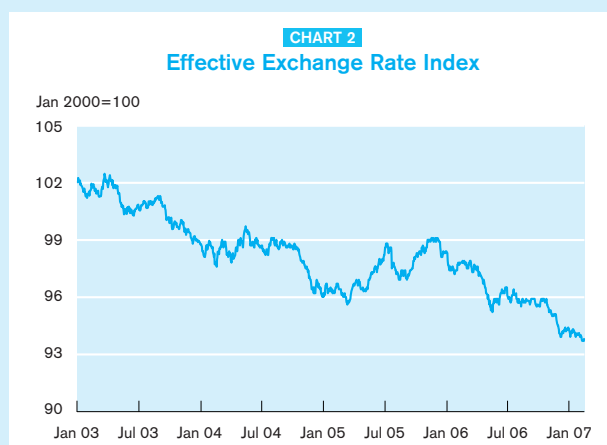
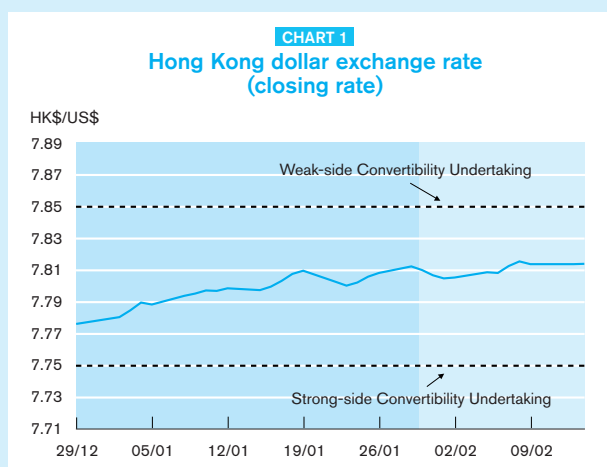


## Annex Report on Currency Board Operations (30 January – 14 February 2007)

The Hong Kong dollar exchange rate was generally stable during the reporting period. Interbank interest rates rose, while their negative spreads against US dollar interest rates narrowed. The Monetary Base increased from HK\$299.06 billion to HK\$314.14 billion. In accordance with Currency Board principles, changes in the Monetary Base were fully matched by corresponding changes in foreign reserves.

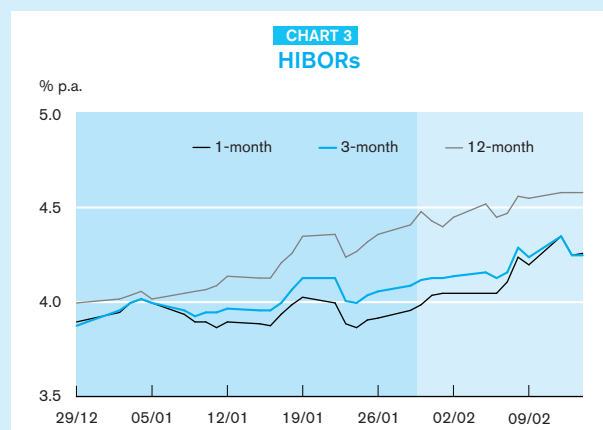
### Hong Kong dollar exchange rate

The Hong Kong dollar exchange rate was generally stable during the review period (Chart 1). It moved within a narrow range and closed at 7.8140 on 14 February. Meanwhile, the effective exchange rate index of the Hong Kong dollar decreased from 94.1 to 93.6, as the US dollar weakened against other major currencies (Chart 2).

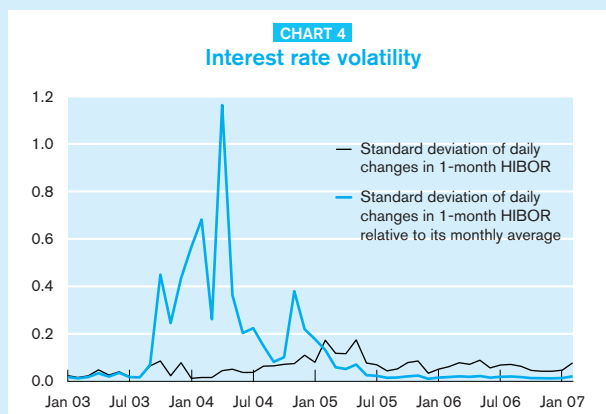


### Interest rates

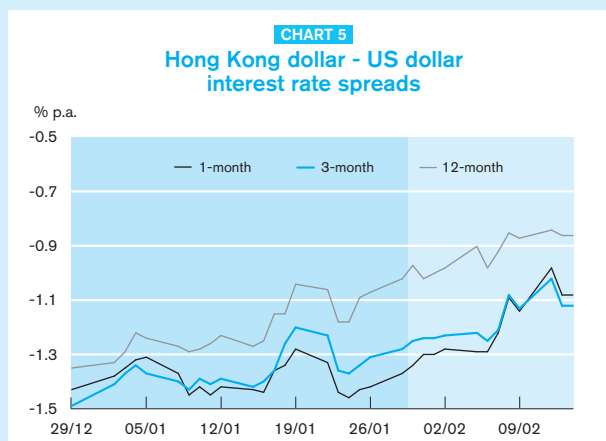
Hong Kong dollar interbank interest rates increased during the reporting period. The one-month and three-month HIBORs increased by 27 and 13 basis points to close at 4.26% and 4.25% respectively. The 12-month HIBOR rose by 10 basis points to close at 4.58% (Chart 3).



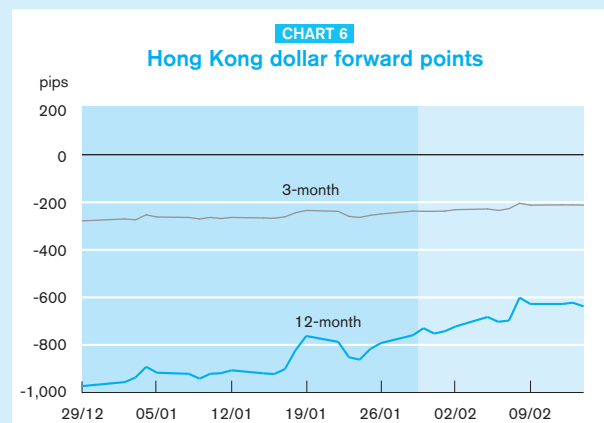
**Interest rate volatility**, measured by the standard deviation of daily changes in one-month HIBOR, **rose** in February. The standard deviation as a ratio of the average level of one-month HIBOR also increased slightly (Chart 4).<sup>1</sup>



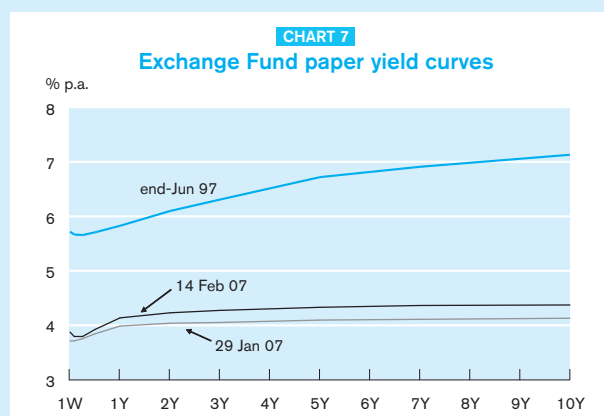
**Negative spreads of Hong Kong dollar interest rates against their US dollar counterparts narrowed.** The one-month and three-month negative interest rate spreads declined by 26 and 13 basis points to -108 and -112 basis points respectively, while the 12-month negative spread decreased by 11 basis points to -86 basis points (Chart 5).



Reflecting the movements in the interest rate spreads, the **Hong Kong dollar three-month and 12-month forward discounts declined** by 26 and 92 pips to close at 213 and 640 pips respectively (Chart 6).



**Yields of Exchange Fund paper increased during the period** (Chart 7). The negative yield spreads against US Treasuries narrowed across the board. In particular, the one-year negative spreads narrowed by 23 basis points to -95 basis points, while the three-year and 10-year negative spreads decreased by 34 and 30 basis points to -62 and -49 basis points respectively at the end of the period (Table 1).

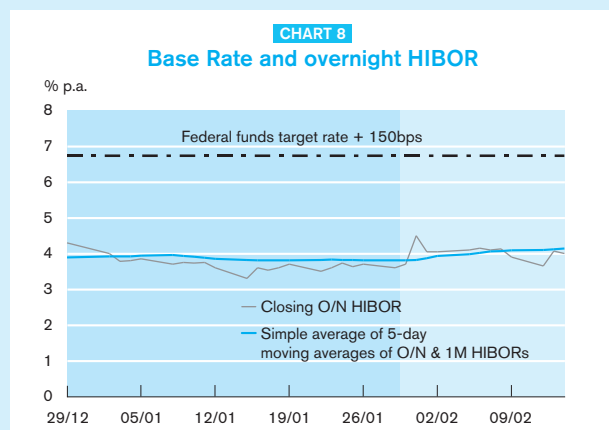


**TABLE 1**  
Yield spreads of Exchange Fund paper over US Treasuries (basis points)

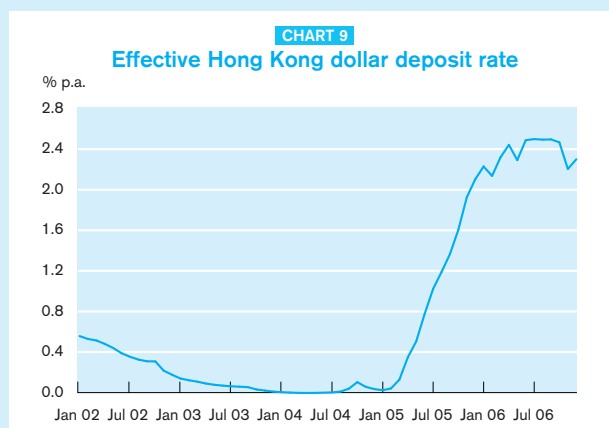
	27 Jun 97	29 Jan 07	14 Feb 07
3-month	56	-144	-141
1-year	21	-118	-95
3-year	3	-96	-62
5-year	27	-81	-53
10-year	54	-79	-49

<sup>1</sup> The ratio of the standard deviation of daily changes in the one-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 of 7.75% and 8% at the end of the reporting period.



The average one-month time deposit rate offered by major authorized institutions declined slightly from 2.530% to 2.519% during the period.<sup>2</sup> The effective deposit rate increased from 2.21% in November to 2.30% in December (Chart 9).<sup>3</sup> The composite interest rate, which reflects the average cost of funds of banks, was steady at 2.86% at the end of January 2007, the same as that of December 2006.



<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.

## Monetary Base

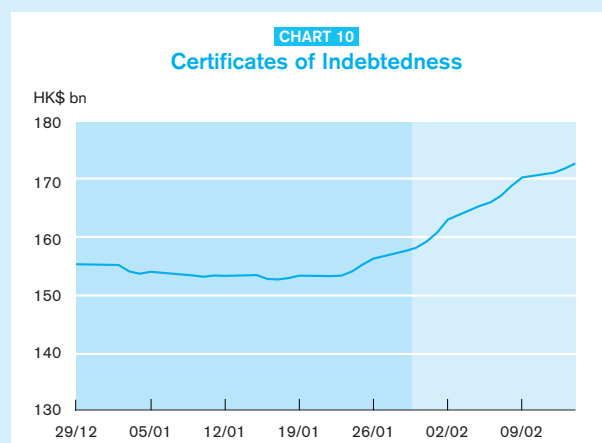
The Monetary Base, which consists of Certificates of Indebtedness (CIs), government-issued currency notes and coins in circulation, the Aggregate Balance and Exchange Fund Bills and Notes, increased from HK\$299.06 billion to HK\$314.14 billion during the reporting period (Table 2). Movements in the individual components are discussed below.

**TABLE 2**  
Monetary Base

(HK\$ bn)	30 Jan 07	14 Feb 07
CIs	158.24	172.90
Government-issued Currency Notes and Coins in Circulation	7.54	8.04
Aggregate Balance	1.31	1.33
Outstanding EFBNs	131.98	131.88
<b>Monetary Base</b>	<b>299.06</b>	<b>314.14</b>

## Certificates of Indebtedness

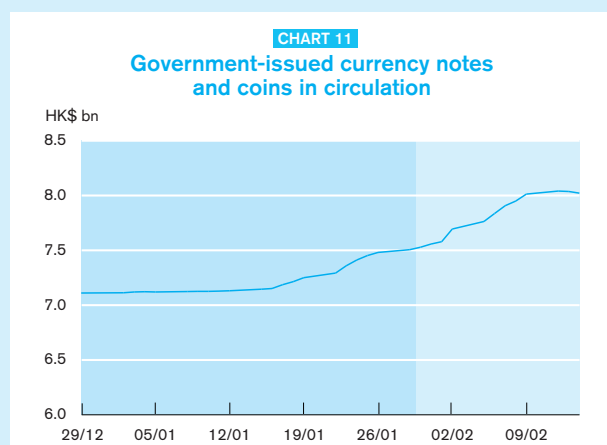
Reflecting increased public demand for banknotes ahead of the Chinese New Year festival, the three note-issuing banks submitted a total of US\$1.88 billion to the HKMA in exchange for HK\$14.66 billion worth of CIs. As a result, the outstanding CIs rose from HK\$158.24 billion to HK\$172.90 billion (Chart 10).



<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.

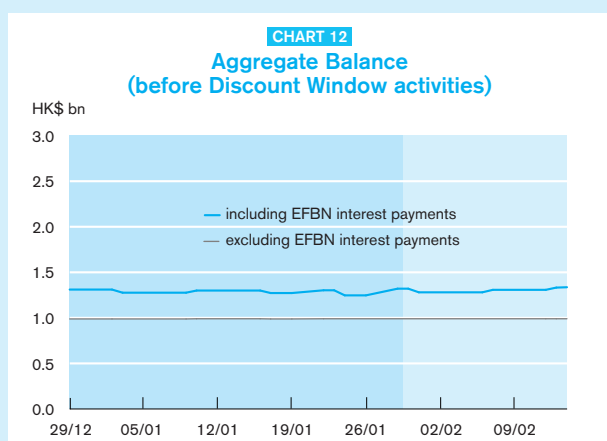
### Government-issued currency notes and coins in circulation

Alongside the increase in CIs, the total of **government-issued currency notes and coins in circulation increased from HK\$7.54 billion to HK\$8.04 billion** during the reporting period (Chart 11).



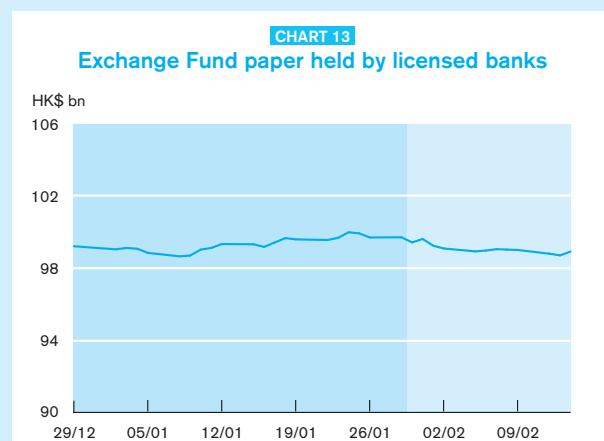
### Aggregate Balance

In the reporting period, **the Aggregate Balance remained stable at around HK\$1.3 billion**, with small fluctuations in between 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 declined slightly from **HK\$131.98 billion to HK\$131.88 billion**. Holdings of Exchange Fund paper by the banking sector (before Discount Window activities) decreased moderately from **HK\$99.47 billion (75.37% of total) to HK\$98.96 billion (75.04% of total)** (Chart 13).



During the period, **a total of HK\$226.85 million of interest payments on Exchange Fund paper were made. An additional HK\$211.01 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. The Exchange Fund papers issued were well received by the market (Table 3).

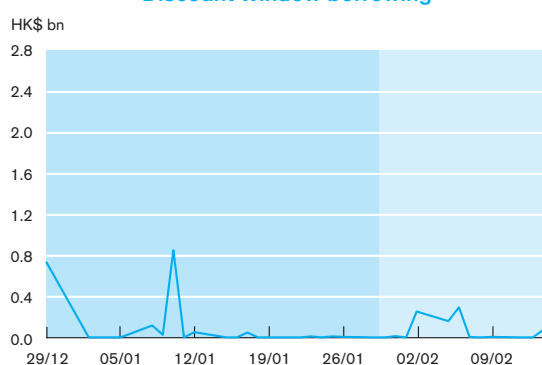
**TABLE 3**  
Issuance of Exchange Fund Bills and Notes (30 Jan 07 – 14 Feb 07)

	No. of issues launched	Over-subscription ratio
3-month EFB	3	2.12-4.07
6-month EFB	2	2.72-3.19
12-month EFB	1	6.51
2-year EFN	1	9.43

## Discount Window activities

During the period, **eight banks borrowed a total of HK\$800 million from the Discount Window**, compared with a total of HK\$1.84 billion in the preceding period (Chart 14 and Table 4). There was one occasion on which a bank borrowed an amount exceeding 50% of its holdings of Exchange Fund paper. The borrowing, amounting to HK\$129 million, was charged at the penal rate, currently equal to the Base Rate plus five per cent. All borrowings used Exchange Fund paper as collateral.

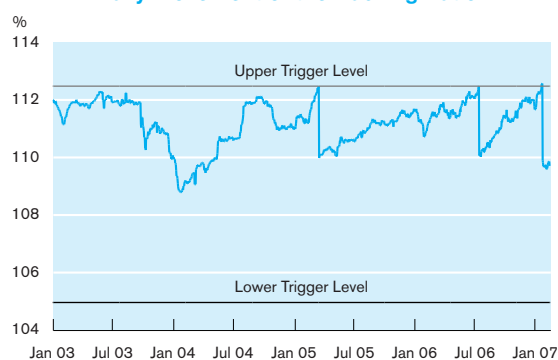
**CHART 14**  
Discount Window borrowing



## Backing Portfolio

Backing Assets rose during the reporting period, largely due to increases in Certificates of Indebtedness. As the Backing Assets increased proportionally less than the Monetary Base, **the Backing Ratio declined slightly from 109.77% on 30 January to 109.71% on 14 February** (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.

**CHART 15**  
Daily movement of the Backing Ratio



**TABLE 4**  
Frequency of individual bank's  
access to the Discount Window  
(30 Jan 07 – 14 Feb 07)

Frequency of using Discount Window	No. of banks
1	7
3	1
Total	8