

# Operation of monetary policy

by the Monetary Management Department

In the third quarter of 2009, the Hong Kong-dollar exchange rate stayed close to the strong-side Convertibility Undertaking (CU) level of HK\$7.75 despite a slowdown in capital inflows relative to the second quarter. The HKMA injected a total of HK\$90.7 billion into the banking system upon repeated triggering of the strong-side CU and issued a total of HK\$124.2 billion worth of additional Exchange Fund Bills to meet the strong demand from banks. As a result, the Aggregate Balance fell slightly to HK\$184.2 billion by the end of September. With ample liquidity, short-term local interest rates remained close to zero throughout the quarter, while long-term rates tracked closely those of US Treasuries to move slightly lower.

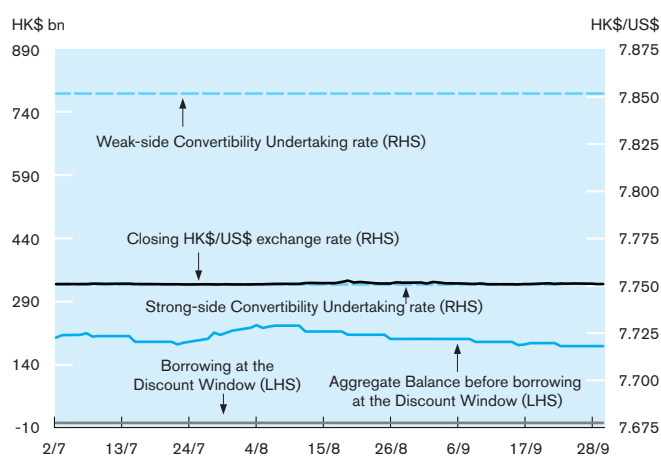
## Convertibility Undertaking and Aggregate Balance

The Hong Kong-dollar exchange rate stayed close to the strong-side CU level of 7.75 throughout the quarter (Chart 1). Equity-related inflows, albeit at a slower pace, continued to be the main driver for the strength of the Hong Kong dollar. The HKMA injected a total of HK\$90.7 billion into the banking system during the quarter upon repeated triggering of the strong-side CU, compared with HK\$131.3 billion in the second quarter. On the other hand, since there was continued strong demand for Exchange Fund Bills as manifested in the very low yields of the short-dated papers, an additional HK\$124.2 billion worth of such Bills were issued against the Aggregate Balance. As a result, the Aggregate Balance declined from HK\$217.7 billion at the beginning of the quarter to HK\$184.2 billion by the end of the quarter.

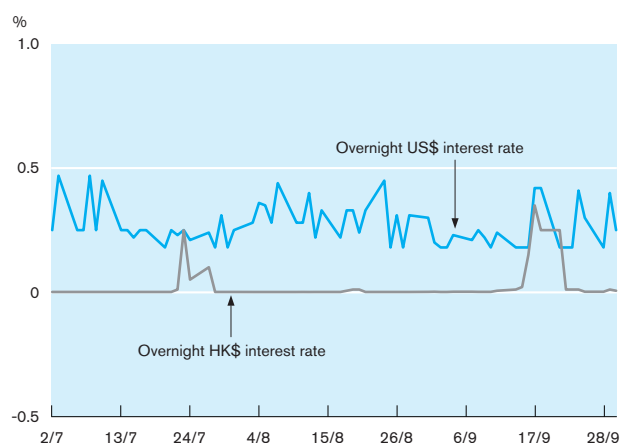
## Short-term Hong Kong-dollar interest rates

Short-term interbank interest rates remained close to zero throughout the quarter (Chart 2). Despite ample liquidity in the interbank market, overnight rates firmed occasionally in late July and mid-September amid increased funding demand owing to the strong response to a number of initial public offerings.

**CHART 1**  
Aggregate Balance, Discount Window activity and Hong Kong-dollar exchange rate



**CHART 2**  
Overnight Hong Kong-dollar and US-dollar interest rates



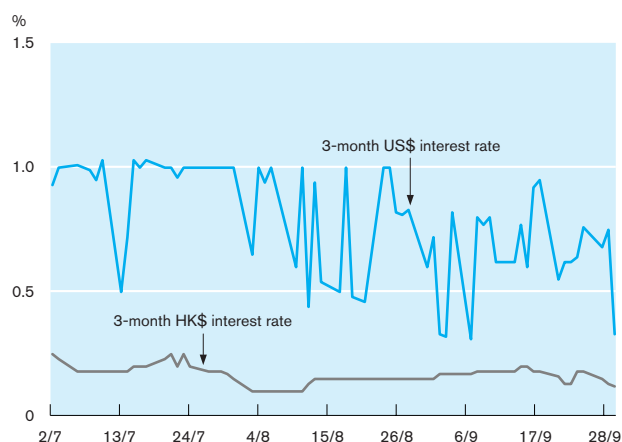
The three-month interest-rate spread between the US dollar and Hong Kong dollar tightened slightly towards the end of the quarter, as the US-dollar interest rates eased and Hong Kong-dollar interest rates remained close to zero (Chart 3). In line with the interest-rate movements, discounts of six-month and 12-month Hong Kong-dollar forward points narrowed modestly in the latter part of the quarter (Chart 4).

Separately, notwithstanding the expiry of the five temporary liquidity assistance measures at the end of March<sup>1</sup>, the functioning of interbank market remained smooth and orderly. The Base Rate also stayed steady at 0.5% throughout the quarter.

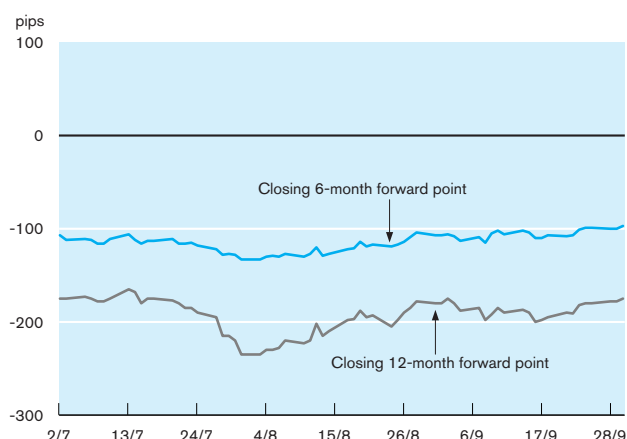
### Long-term Hong Kong-dollar interest rates

Long-term yields of Exchange Fund Notes tracked closely those of US Treasuries to move slightly lower during the quarter. The yield spreads between 10-year US Treasuries and 10-year Exchange Fund Notes widened to about -140 basis points in early August on better-than-expected economic outturns of the US, but closed the quarter at -96 basis points, the same level as at the beginning of the quarter (Chart 5).

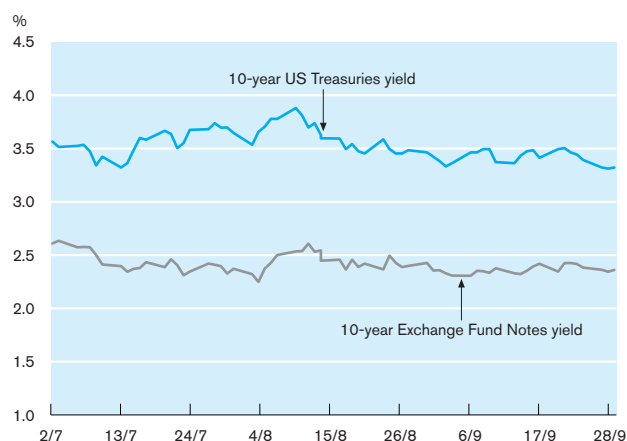
**CHART 3**  
Three-month Hong Kong-dollar and US-dollar interest rates



**CHART 4**  
Six-month and 12-month Hong Kong-dollar forward points



**CHART 5**  
Yields of 10-year Exchange Fund Notes and US Treasuries



<sup>1</sup> See the relevant HKMA press releases available on the HKMA website: (a) "HKMA to provide liquidity assistance to licensed banks in Hong Kong" (issued on 30 September 2008); (b) "HKMA to adjust the formula for determination of the base rate" (issued on 8 October 2008); (c) "Refinements to the measures for providing liquidity assistance to licensed banks in Hong Kong" (issued on 6 November 2008); and (d) "HKMA to continue the provision of liquidity assistance to banks" (issued on 26 March 2009).

## Hong Kong-dollar effective exchange rate

During the third quarter, the Hong Kong dollar trade-weighted nominal effective exchange-rate index (NEERI), which measures the nominal exchange value of the Hong Kong dollar against the currencies of major trading partners, continued to decline on a weakening US dollar. By the end of the quarter, the NEERI was 86.7, down 1.6% from a year earlier (Chart 6).

### CHART 6

#### Hong Kong-dollar/US-dollar exchange rate and Hong Kong-dollar nominal effective exchange-rate index

