

Operation of monetary policy

by the Monetary Management Department

The Hong Kong-dollar exchange rate strengthened to near the strong-side Convertibility Undertaking level in the third quarter, amid a series of initial public offerings (IPOs) in the local stock market and the appreciation of the renminbi against the US dollar. The strong-side Convertibility Undertaking (CU) was not triggered and the Aggregate Balance stayed at HK\$148 billion. With ample liquidity in the interbank market, short-term interest rates remained low throughout the quarter, while the long-term rates tracked closely with their US counterparts to move lower. The Base Rate was unchanged at 0.5%.

Convertibility Undertaking and Aggregate Balance

During the quarter, the Hong Kong dollar gradually strengthened to near the strong-side CU level (Chart 1). Demand for Hong Kong-dollar funding increased alongside a large number of IPOs in the local stock market and the strengthening of the renminbi against the US dollar. The Hong Kong-dollar exchange rate ended the third quarter at HK\$7.7610 compared with HK\$7.7935 three months earlier. The strong-side CU was not triggered and the Aggregate Balance remained unchanged at HK\$148 billion.

Short-term Hong Kong-dollar interest rates

Tracking closely its US-dollar counterpart, the overnight Hong Kong-dollar interest rate stayed close to zero for most of the reporting period (Chart 2).

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

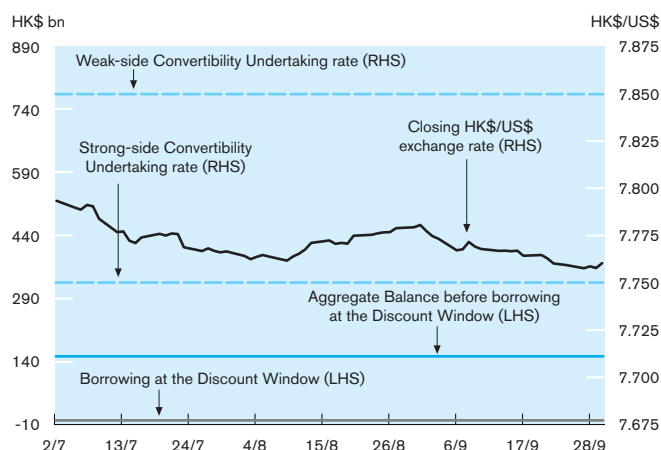
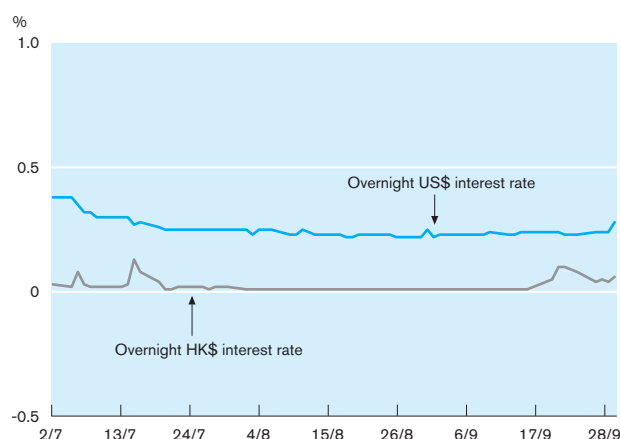


CHART 2
Overnight Hong Kong-dollar and US-dollar interest rates



While Hong Kong-dollar interest rates followed those of the US dollar to move lower during the quarter, the former declined at a slower pace. As a result, the negative interest-rate differential against the US dollar and forward points narrowed (Chart 3 and Chart 4).

Long-term Hong Kong-dollar interest rates

The long-term yields of Exchange Fund Notes tracked closely those of the US Treasuries to move lower but again at a slightly slower pace. Consequently, the yield spread between the 10-year Exchange Fund Notes and the 10-year US Treasuries narrowed from -67 basis points at the beginning of the quarter to -53 basis points by the end of the quarter (Chart 5).

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

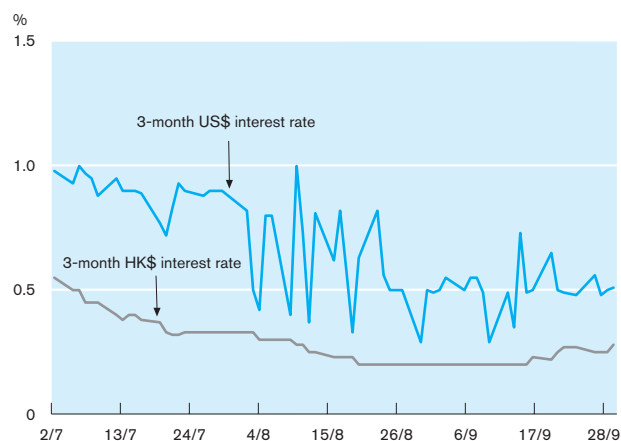


CHART 4
Six-month and 12-month Hong Kong-dollar forward points

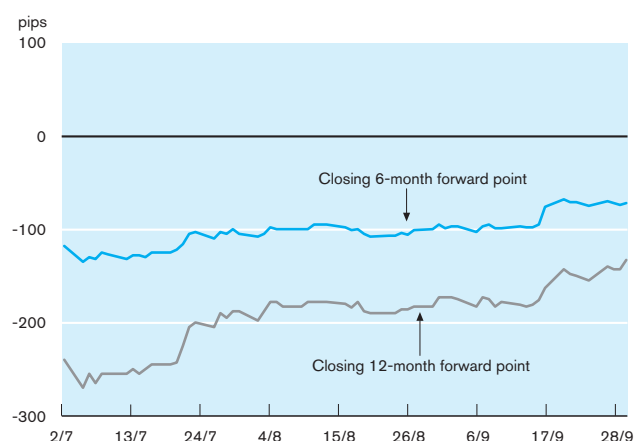
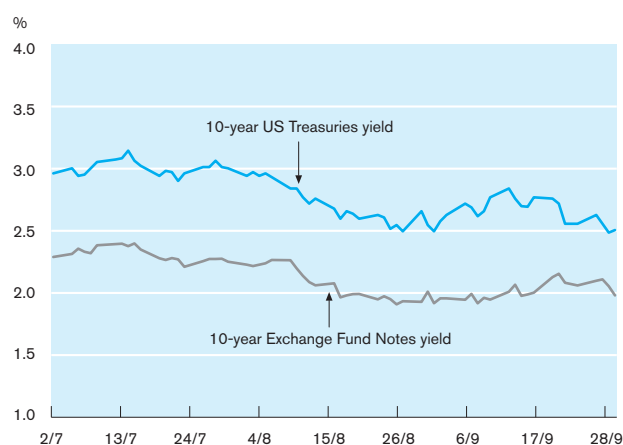


CHART 5
Yields of 10-year Exchange Fund Notes and US Treasuries



Hong Kong-dollar effective exchange rate

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, closed lower at 84.9 on 30 September compared with 87.1 on 2 July (Chart 6). The lower NEERI reflected the weakening of the US dollar against other major currencies.

CHART 6

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

