

Operation of monetary policy

by the Monetary Management Department

The Hong Kong-dollar exchange rate weakened in the first quarter amid the political unrests in the Middle East and North Africa, natural disasters in Japan and sovereign debt problems in Europe. During the reporting period, the Aggregate Balance remained unchanged at HK\$148 billion. With ample liquidity in the interbank market, short-term interest rates stayed close to zero throughout the quarter, while the long-term rates moved in a narrow range tracking closely the long-term US Treasury yields. The Base Rate remained unchanged at 0.5%.

Convertibility Undertaking and Aggregate Balance

During the quarter, investors' risk appetite was dampened by the adverse developments in different regions around the globe including the political unrests in the Middle East and North Africa, the earthquake and tsunami in Japan and sovereign debt problems in Europe. As a result, the Hong Kong-dollar exchange rate eased from HK\$7.7715 against the US dollar at the beginning of the quarter to HK\$7.782 at the end of the quarter (Chart 1). The Aggregate Balance and the Base Rate remained unchanged at HK\$148 billion and 0.5% respectively.

Short-term Hong Kong-dollar interest rates

The overnight Hong Kong-dollar interest rate remained close to zero during the reporting period, reflecting ample liquidity in the interbank market (Chart 2). The three-month Hong Kong-dollar interest rates moved in a narrow range alongside the relatively more stable US-dollar interest rates (Chart 3).

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

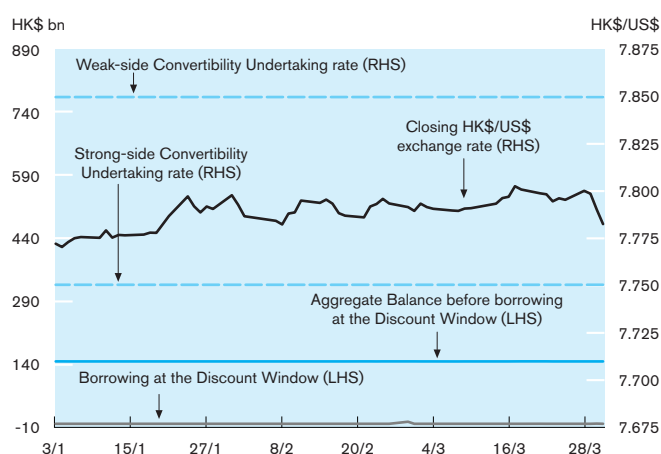
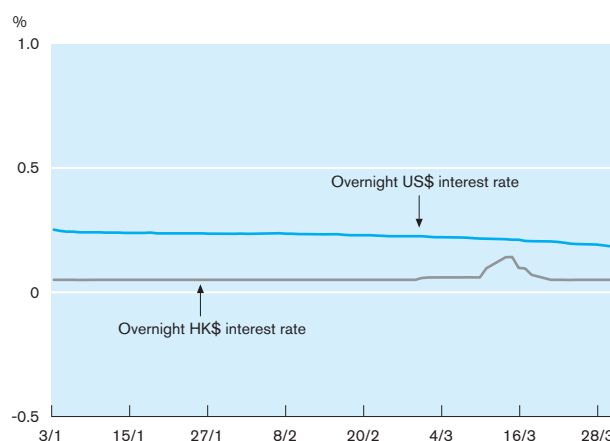


CHART 2
Overnight Hong Kong-dollar and US-dollar interest rates



The forward discounts narrowed across the spectrum in mid-March on the back of risk aversion amid uncertainty over events in Japan. Towards the end of the quarter, amid increasing signs of progress in containing the nuclear crisis in Japan, the forward discounts widened again (Chart 4).

Long-term Hong Kong-dollar interest rates

The yields of 10-year Exchange Fund Notes and US Treasuries were largely range-bound during the quarter, but the yield spreads between the two widened from -49 basis points at the beginning of the quarter to -69 basis points at the end of the quarter (Chart 5).

CHART 3

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

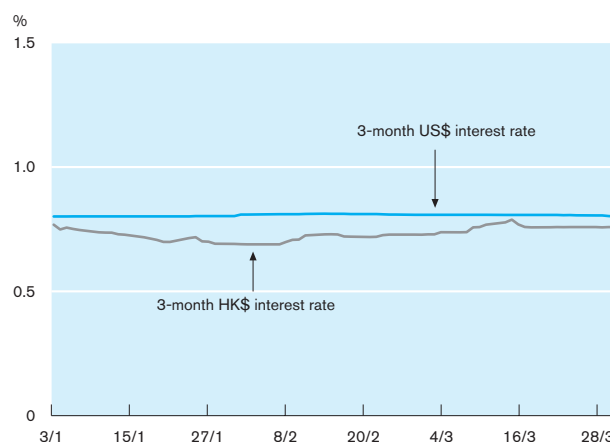


CHART 4

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

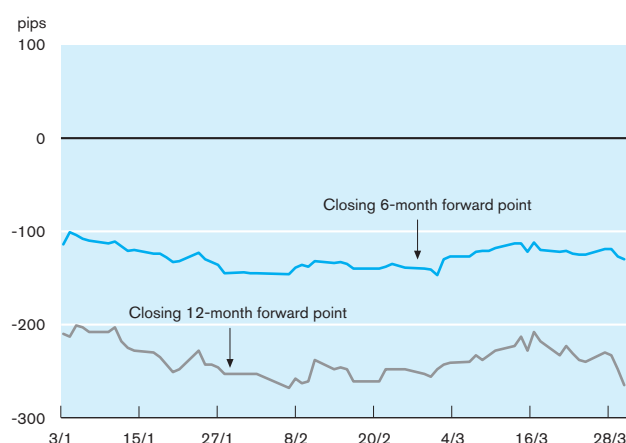
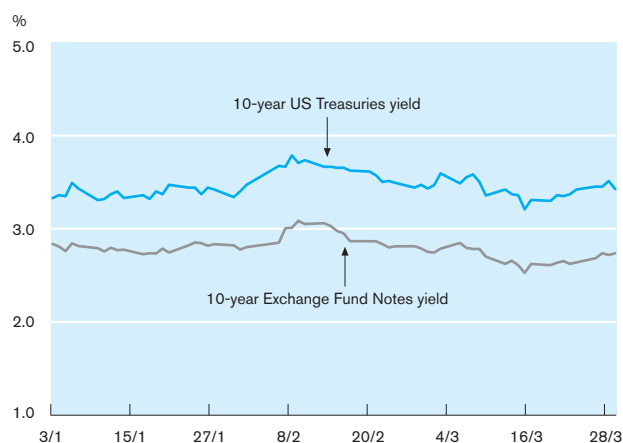


CHART 5

Yield 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 82.7 on 31 March compared with 83.7 on 3 January (Chart 6). The lower NEERI reflects the weakening of the US dollar, particularly against other major currencies.

CHART 6

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

