

This article sets out very briefly some of the more important events in the history of the Exchange Fund. Many of the figures in the accompanying tables have not been published before, especially data for the years from 1945 to 1985. The article traces the evolution of the Exchange Fund from its origin as a reserve backing Hong Kong's note issue to its current role as Hong Kong's official foreign exchange reserves and major monetary policy tool.

The Establishment of the Exchange Fund

From the earliest days of British administration in Hong Kong, the Territory acted as an important entrepôt for trade with China. It was thus natural for Hong Kong to adopt a similar monetary standard to China, and since in the 19th century China's monetary system was based on the silver standard, this became de facto the basis for Hong Kong's currency as well. As the 19th century progressed, the world's currency systems were increasingly based on a gold standard, but despite this China, and Hong Kong, remained based on the silver standard well into the 20th century.

In 1920 the price of silver fell sharply, and throughout the following decade it fluctuated widely. While the low price of silver, and thus the Chinese currency, boosted Chinese exports, thereby bringing much prosperity to Hong Kong through the ensuing trade, it also led to much uncertainty in the exchange value of the currency. This led to the formation in 1930 of a UK Parliamentary Committee on Hong Kong's Currency, to consider the merits of continuing a silver-based currency system for Hong Kong versus the alternative of a sterling-based currency. The Government¹ submitted that "as long as China links her currency to silver, so long must it be advantageous for Hong Kong to do likewise", and the Parliamentary Committee's report, published in 1931, agreed. The report did however propose that silver holdings should be centralised and held by the Government, and also proposed that banks should hold silver certificates instead of bullion itself. These recommendations, though not acted upon at the time, were incorporated almost unchanged into the subsequent reforms in 1935.

The stock market crash on Wall Street in 1929, and the depression that gripped much of the developed world in the following years, put great strain on economies tied to the gold standard. The United Kingdom abandoned the gold standard in 1931, and the United States followed in 1933. In May 1934 the "Silver Purchase Act" was enacted in the US, under which the US Government undertook to purchase silver on the international bullion markets at a fixed rate. This rate was set at a comparatively high price compared to prevailing market levels, in an attempt to drive up the price of silver again, and it led to a very large outflow of silver from China and Hong Kong. As a result China was forced to abandon the silver standard on 4 November 1935, with Hong Kong immediately following suit.

Since the received wisdom of the time was that currencies should not be left unbacked, the Government was forced to consider alternative arrangements for backing the note issue in the Territory with some haste. In the circumstances they turned to the ideas proposed in the 1931 Parliamentary report, and only just over a month later, on 6 December 1935, the "Currency Ordinance" was enacted. This prohibited the circulation of silver coins in Hong Kong and set up a fund (the "Exchange Fund") to purchase silver from the public. The silver collected was to be sold in the London bullion market for sterling, with the intention being that the resulting sterling would be held in the Exchange Fund as a reserve backing the issue of bank notes; in other words, the Exchange Fund would act very much like the standard colonial currency board², with the only difference

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1 In general, "Government" means the Hong Kong Government throughout. The UK and other authorities are referred to as "the UK Government", etc.

2 For an introduction to currency boards, and more detail on Hong Kong's current arrangements, see the article "Hong Kong's Currency Board Arrangements" in this issue of the Quarterly Bulletin.

being that it would not issue notes itself but would authorise the note-issuing banks to do so. The Currency Ordinance, now renamed the Exchange Fund Ordinance, is still current and remains the legal basis for the operation of the Exchange Fund.

At the same time the “Bank Notes Issue Ordinance”, an ordinance dating back to 1895, was amended. Under this amendment only bank notes issued by Chartered Bank of India, Australia and China (now Standard Chartered Bank), The Hongkong and Shanghai Banking Corporation (HSBC) and Mercantile Bank of India (taken over by HSBC in 1959), were legal tender, and the three note-issuing banks had to deposit the silver reserve backing their existing note issues with the newly created Exchange Fund, receiving Certificates of Indebtedness (CIs) in exchange. This silver was also sold for sterling. The existing requirement on the note-issuing banks to repay holders of their notes in silver on demand was suspended.

From this date on, the Exchange Fund acted as the ultimate backing for the note issue of all three note-issuing banks, a role it retains to this day. Before the banks could make any further issues of bank notes, they had to deposit sterling with the Exchange Fund, receiving in exchange further CIs. These CIs were issued at the fixed rate of 1s 3d³ per HK dollar, equivalent to an exchange rate of £1 = HK\$16. The management of the Exchange Fund was in the hands of the Government’s Accountant General’s Office (part of the Treasury), under the ultimate control of the Colonial Treasurer⁴. Also from this date, the Exchange Fund Advisory Committee (EFAC) was established to advise the Colonial Treasurer in his management of the Fund, with membership drawn from the leading commercial bankers of the day.

Early operations

The early days of the Exchange Fund’s operations were dominated by the continuing surrender of silver coin and bullion to the Government by the public. This silver was shipped to Bombay for refining, and then on to London, and value in sterling was given for it at the London

branch of HSBC. This phase of the Exchange Fund’s operations was largely completed by the end of 1936. The accounts of 1936 show a small profit on this activity even after shipping and refining costs, arising from the small turn that the Fund took on all silver transactions.

From the very first meeting of EFAC, there appears to have been lively discussion as to how best to invest the assets of the Fund. Initially a very high proportion of the assets were held at call with the clearing banks in London, but EFAC was keen to diversify into securities, and by the end of 1936 over half the Fund was in holdings of British Government Stock. Other assets were in call deposits and short time deposits, with small amounts placed with the Crown Agents. All the assets, except working balances and silver in transit and awaiting shipment, were held in London, and as a result the accounts of the Fund were naturally drawn up in sterling. At the end of 1936, the first full year of the Fund’s existence, the accounts show assets of £10.45 mn (\$167 mn) and liabilities of £9.30 mn (\$149 mn), for an operating profit on the year of £1.15 mn (\$18 mn).

One early addition to the Fund’s expenses was a contribution to the note-issuing banks to cover some of the costs of their note issues. This first appears in the accounts in the latter half of 1937, and has been a regular part of the expenses borne by the Exchange Fund ever since.

The balance sheet of the Fund in the late 1930s was kept deliberately very liquid, with often over 80% of the liabilities covered by cash or short term securities. The Fund was profitable, mainly because the largest part of the liabilities, the CIs, were non-interest bearing, and right from the start the Fund’s assets more than covered its liabilities. The Fund’s balance sheet was published regularly in the Government Gazette.

The War years (1939-1945)

By 1939 the operation of the Fund had become largely routine. Very little silver was now being surrendered, and what there was, was mostly

3 1s 3d: 1 shilling and 3 pence in pre-decimal British money, or 15 pence.

4 This post was abolished in August 1946. The new post of Financial Secretary took over the duties of the Colonial Treasurer with respect to the Exchange Fund.

old and worn or clipped coin. The accounts for 1939 note that after refining such coins, the amounts raised by the sale of the silver often did not cover the amount paid out when shipping and refining costs were taken into account. But the scale of the operation was very small, and the rest of the Exchange Fund's operations remained profitable.

The first effects of the War on the Exchange Fund were a sharp increase in shipping and insurance costs for silver being shipped to London. Also in 1940, consideration was given to the transfer of funds to the UK Government, in line with similar contributions made by other colonies to the British Imperial war effort, though there is no surviving record of whether the payment was actually made. But in general the War appears to have had little effect on the Exchange Fund in 1939-41.

One factor however was to have far-reaching consequences, as by now the custody arrangements for the Fund's securities had been finalised, and all the securities, which now included Dominion and some Colonial Government stock as well as Gilts, were held at the Crown Agents in London. When the Japanese military forces occupied Hong Kong in December 1941, therefore, there were no significant assets of the Exchange Fund in the Territory for them to seize. The only loss suffered by the Fund was the stock of silver awaiting shipment to London, with total value only £17,500 (\$280,000).

During the years of occupation, the assets of the Fund were managed on a caretaker basis by the Crown Agents in London on behalf of the Colonial Office, and they were thus preserved intact when the British Administration returned to the Territory four years later. Income earned during these years amounted to £1.93 mn (\$31 mn), with the only call upon the Fund being the cost of financing the activities of the provisional Hong Kong Government in London.

In Hong Kong itself between 1941 and 1945, the previous arrangements for the issue of bank notes against CIs were suspended, and the banks were forced by the Japanese military authorities to issue notes from their stores without backing. When supplies of these were exhausted, the banks were forced to print more notes, and these too were issued unbacked. These issues were known

as "Duress notes", and one of the major problems facing the Government in September 1945 was how these notes were to be treated.

1945-1947: Recovery from the consequences of the War

Although the Exchange Fund had been preserved intact during the Occupation, and indeed had grown in net value due to the investment returns earned, the managers of the Fund faced three problems when peace was restored. The first of these was an asset of over \$33 mn owed to the Exchange Fund by the Government, under the heading "Chungking Account". This amount represented backing for notes stored in a vault in Chungking during the Occupation for immediate transfer back to Hong Kong and issue on the resumption of British Administration. By agreement with the War Office in London the debt was taken over by the British Military Administration, and was eventually settled in large part in early 1946, with the full amount finally settled in 1947.

A more serious issue facing the new Government was the question of the notes issued by the banks during the Occupation on the orders of the Japanese Military Administration (the "Duress notes" mentioned above). These were unbacked, yet it was deemed politically and economically impossible simply to cancel them as worthless. Not only would great hardship befall holders of the notes, but it was also difficult if not impossible for the public to determine which notes were legally issued before the occupation and which were issued under duress. The amounts involved were far from small, totalling \$119 mn from HSBC alone (over 60% of the total pre-war note issue). Of these, \$47 mn represented notes signed but unissued before the Occupation and \$72 mn represented notes printed and signed under duress. Some of the notes had been used by HSBC themselves to discharge their own liabilities, but most had been used in some form or other by the Japanese authorities to procure supplies and services.

Under Ordinance No 13 of 1946, CIs were immediately issued to the note-issuing banks to cover the Duress note issues, but the question remained as to how the backing for the CIs was to be funded. Under an agreement with HSBC reached in 1946, backing for those notes used by the bank to meet its own liabilities during the

occupation years was to be provided to the Exchange Fund by HSBC itself. Of the rest, some \$72 mn, a settlement was reached under which the cost of providing cover was split between the Exchange Fund and HSBC, with the Exchange Fund absorbing the bulk of the cost. This was put into effect through the Fund's accounts in 1946.

Similar arrangements were eventually reached with the other note-issuing banks, though in these cases the sums involved were considerably smaller. The net cost to the Fund of backing all the various Duress note issues was an increase in the Fund's liabilities of some \$56 mn in all, a sum large enough to turn what had been a healthy surplus at the end of 1945, with assets equal to 114% of liabilities, into a small deficit at the end of 1946, with asset cover only 96%. The accounts for 1946 note with concern that, with net income averaging only about 1% of the Fund's assets at the time, the Exchange Fund was likely to remain in deficit until 1950 at the earliest.

The third problem was that the reestablished Government was very short of revenue. Commercial activity in the Territory was very slow to restart, and the Government was faced with large fiscal deficits. Under the authority of a UK 1942 Order in Council, grants totalling over \$6 mn were made by the Exchange Fund to the Government in 1946, out of a total investment income return for the Fund (before allowance for the Duress notes) of only \$8 mn. (There was an additional revaluation profit for the Fund of another \$6 mn in 1946, as the price of gilt-edged stock had risen sharply during the year as interest rates fell in London, but under the cautious accounting practices of the time this was treated separately from the investment income).

As the more normal operation of the Exchange Fund resumed, the question of the investment policy once again became a subject of debate at EFAC. The Fund had grown in size from around \$200 mn in 1941 to nearly \$600 mn in 1947, with most of the excess being placed on deposit at first, earning about 1.4%, and although for practical reasons the day to day management of the investments of the Fund remained in London as it had been throughout the Occupation, EFAC increasingly wished to guide the investment policy being pursued. At the EFAC meeting in early 1946, the decision was taken to invest more funds in

securities, and the Fund's managers in London were duly asked to move assets into the securities markets. As a result some £13 mn, over one third of the Fund, was placed in 3 month sterling treasury bills. These earned just 0.5%, a very low figure even by the standards of the day, and the accounts for 1947 refer to "this disappointing return" being taken up with the managers in London. Although there is no mention of how this matter was resolved, in subsequent years a higher rate of return was obtained on the Fund's money market investments.

Return to normal operations

In the report and accounts for 1948 the annual report by the Secretary of EFAC advised that "most if not all of the unusual features arising out of the occupation of the Colony have now been settled". In addition, a good year in the gilt market enabled the Fund to show an investment return for the year of over \$16 mn and a profit after all expenses of \$12 mn, which almost completely covered the accumulated deficit. Thus the considerable task of providing for the cost of backing the Duress note issue had largely been accomplished in just three years, rather than the five or more foreseen in 1946.

Indeed, such was the recovery in the Fund that the note-issuing banks began to press the Government for CIs to be redeemed at the full rate of 1s 3d per HK dollar implied by the fixed rate of £1 = HK\$16. From its inception the Exchange Fund had charged a spread for CIs, requiring the banks to deposit sterling against CIs at the rate of 1s 3d per HK dollar of note issuance, but only returning less than this amount when redeeming the CIs. Initially the redemption rate had been 1s 2³/₄d (implying a spread for the Exchange Fund of 1/4d in 1s 3d, or 1.67%), though it had been changed twice before and once immediately after the War, and by 1946 the spread stood at 1/8d, with CIs redeemed at 1s 2⁷/₈d per HK dollar. However, this was still a discount to the full official rate, and the banks were keen to have full value for their CIs. Since increasing the rate would have been costly to the Exchange Fund, as revaluing the outstanding CIs upwards would have increased the Fund's liabilities, the Government declined to do so, quoting the need for caution in the face of the still precarious balance sheet of the Fund and the uncertainty in China at the time,

where Nationalist and Communist forces were already in conflict.

This same message was repeated in 1949, the year in which the Exchange Fund finally moved fully back into surplus. The more interesting feature of the accounts for 1949 however is the complete absence of any mention of the devaluation of sterling on 18 September that year, from £1 = US\$4.03 to £1 = US\$2.80. The HK dollar remained tied to sterling at the existing rate of £1 = HK\$16, and the effect on the Exchange Fund was therefore limited only to the fall in gilt prices which preceded the devaluation, but even so the omission reads strangely to modern eyes and the fact that the Hong Kong Government did not need to consider exchange rates against non-sterling currencies indicates the powerful role that sterling, and the Sterling Area, still played in the late 1940s.

In the 1950 accounts, mention is made of a direct transfer of \$2 mn of CIs from Chartered Bank of India, Australia and China to HSBC. This transfer, which was made with the approval of EFAC, appears to have been an attempt to remind the Government of the note-issuing banks' grievance at the sterling rate for redeeming CIs, as the transfer avoided the Fund's books and thus did not give rise to the Fund's "turn". The Government remained unmoved, however, and the innovation of transferable CIs was never repeated.

In 1951, the Exchange Fund showed its first operating loss (excluding the loss in 1946 arising from the resolution to the Duress note issue), as the increase in the UK Bank Rate that year to 4% depressed the price of the securities held in the Fund. The Fund stayed just in surplus, however, with assets 101% of liabilities. The gilt market recovered the next year, and the higher yields on money market securities, plus a more judicious mix between treasury bills and other assets, enabled the investment income of the Fund to grow handsomely. This enabled the Fund to move solidly into surplus, and despite a further loss recorded in 1955 the 1950s as a whole were years of comparative calm in which the accounts became very healthy, with assets equalling 125% of liabilities by 1959.

Throughout this period of growing net accumulated surpluses there was intermittent pressure on the Government to redeem CIs at the full rate, and also from the Government on EFAC to transfer some of the surplus to the General Revenue. There was considerable discussion over the appropriate level of surplus, and a working figure of 110% was suggested, but those members of EFAC drawn from the note-issuing banks appear to have been reluctant to accept attempts to deplete the Fund in this manner before their own grievance was resolved.

Another issue raised in the late 1950s was the degree of discretion enjoyed by the Crown Agents in the day to day management of the Fund's assets. At various meetings EFAC expressed a wish to direct the Fund's management more precisely, and in 1959 a more formal set of investment guidelines was drawn up and given to the Crown Agents. This new investment style was successful, as investment income increased sharply over the next few years and the ratio of assets to liabilities reached a high of 142% in 1963.

This unprecedented level of cover for the Exchange Fund's liabilities finally encouraged the Legislative Council and the Secretary of State to act on the matter of distributing some of the net accumulated surplus, and in January 1964 the Exchange Fund Ordinance was amended to allow transfers from the Fund to other Government accounts. A transfer of \$150 mn was duly made later that year to the Development Loan Fund, thus reducing the cover for the liabilities to 125%. Although a decision to make a further transfer to the Development Loan Fund was made two years later, this second transfer did not in the end take place, and apart from a one-off payment direct to the General Revenue in 1984⁵, the 1964 transfer remains the only time since the Exchange Fund was returned to normal peacetime operation that transfers from the Fund to other Government accounts have been made.

Times of turbulence: 1965-1974

In the first months of 1965 the Territory experienced runs on several local banks. The

5 This transfer was to compensate the General Revenue for the loss of revenue arising from the abolishment of interest withholding tax on HK dollar denominated deposits, as described below.

resulting demand for bank notes caused the note issues of the note-issuing banks to increase sharply, leading to more calls for the abolition of the $\frac{1}{8}$ d spread charged on CIs. The banks argued that the extra issue was not made for commercial reasons but to preserve the stability of the banking system, and as such they should not have to bear the extra cost of the spread. The Government accepted the strength of this argument, and agreed that CIs held against notes issued to cover abnormal demand for cash would be redeemed at 1s 3d. The issue of such CIs totalled \$354 mn in all before the demand for cash subsided.

At the same time there were fears that the supply of notes in the Territory might not prove sufficient, and as a precaution the Government decided to hold in reserve a supply of Bank of England notes. Notes for £20 mn were airfreighted to Hong Kong and made legal tender (at HK\$16 to the £1) under the Emergency (Bank Control) Regulations 1965, but the crisis was contained without their issue being necessary and they were returned to London. The physical cost of the exercise was nearly \$2 mn, with a further \$5 mn of interest foregone on the £20 mn withdrawn from the Exchange Fund's accounts in London.

In the EFAC meeting in 1967 the note-issuing banks again returned to the subject of the redemption value for CIs. The banks pointed out that the very high demand for bank notes at Chinese New Year imposed a great and growing burden on them, and they observed that their actions to minimise their losses by attempting to influence, within limits, the market rate for sterling either side of Chinese New Year were misunderstood by other banks and the community at large, and led to ill feeling. The Government again accepted the argument, and it was agreed that CIs issued after 1 December and redeemed within 30 days of the following Chinese New Year would be redeemed at the full rate of 1s 3d.

In the latter half of 1967 Hong Kong suffered major civil unrest, and the demand for bank notes again grew rapidly. Notes in circulation increased by \$688 mn, or over 42% of the circulation at end-1966. Again the note-issuing banks pressed for the corresponding CIs to be redeemed at full rate, and again the Government agreed.

In November 1967, sterling was devalued again against the US dollar by 14.3%, from £1 = US\$2.80 to £1 = US\$2.40. Unlike in 1949, the time of the previous sterling devaluation, the Government chose not to follow completely, and on 23 November 1967 the HK dollar was revalued upwards against sterling by 10%, from £1 = HK\$16 to £1 = HK\$14.55, though this still represented a 5.7% devaluation against the US dollar. As a result of the change in the sterling parity, CIs were now sold and redeemed at 1s $4\frac{1}{2}$ d and 1s $4\frac{3}{8}$ d respectively, and with the Exchange Fund's assets entirely in sterling at the time, this revaluation of the Fund's liabilities caused a large loss of \$189 mn to the 1967 accounts. There was no question, however, of abandoning sterling as the unit of account for the Fund.

A further cost to the Exchange Fund arose from an undertaking given by the Government to authorised exchange banks to compensate them for their net losses arising from the revaluation of the HK dollar. A large proportion of the assets of Hong Kong banks were held in sterling, and since no currency risk between the HK dollar and sterling had been foreseen, these assets were not hedged. The appreciation of the HK dollar therefore caused large losses to the banks, and on settlement of the various claims in 1968 and 1969 the compensation paid out by the Exchange Fund amounted to \$154 mn.

The Government was keen to protect the Exchange Fund against further sterling devaluations, which at that time looked likely, and in June 1968 entered into a temporary agreement with the UK Government that the Exchange Fund would buy \$900 mn of "British Government Bonds denominated in HK dollars". These bonds carried interest at $7\frac{1}{8}$ % and although they were non-marketable, they protected the assets of the Fund against a further change in the £/HK\$ parity rate. They mark the first time that the Exchange Fund had held any non-sterling assets other than silver.

The British Government Bonds in HK dollars were replaced in September 1968 with a more comprehensive Sterling Guarantee Agreement. Under this scheme the UK Government guaranteed the sterling value in terms of US dollars of the official balances eligible for guarantee, provided

that the Hong Kong Government maintained a minimum holding of the Exchange Fund in sterling. This scheme was revised in February 1969 and put on a more formal basis, with an agreement that it would be operative for at least 5 years.

Alongside this Agreement, the Government set up the "Sterling Exchange Guarantee Scheme" for banks in Hong Kong. Under this scheme, the Exchange Fund was credited with sterling deposits with participating banks and in return issued them with a debt certificate for the equivalent amount denominated in HK dollars. In the event of a change in the £/HK\$ parity rate, the banks' asset was thus denominated in HK dollars while the Exchange Fund's asset was in sterling. There was a small levy ($\frac{1}{16}$ d per dollar, or 0.4%) on the amount guaranteed. Banks were keen to use the Scheme, with \$2,575 mn exchanged with the Fund in the first three months of its operation. Eventually sums under the Scheme reached a high of \$7,000 mn before the arrangement was terminated.

There was a small further concession to the note-issuing banks under the Sterling Exchange Guarantee Scheme, whereby CIs and debt certificates under the scheme were considered interchangeable at par. Instead of redeeming CIs at 1s $4\frac{3}{8}$ d per HK dollar, therefore, the note-issuing

banks could receive debt certificates denominated in HK dollars, which were then exchangeable at the full rate of 1s $4\frac{1}{2}$ d to the HK dollar. This therefore marked the first time that CIs were generally issued and redeemed at the same rate.

In early 1972 pressure on sterling again began to increase, and the Government sought and obtained from London permission to hold the assets of the Exchange Fund in securities denominated in currencies other than sterling⁶. On 23 June 1972, as a result of severe pressure on the foreign exchange markets, the UK Government announced that sterling was to be allowed to float, and soon after, on 6 July 1972, the Government decided to break the traditional link with sterling and to fix the HK dollar to the US dollar instead, at a central rate of US\$1 = HK\$5.65 and with upper and lower IMF intervention points at $\pm 2\frac{1}{4}\%$. The US dollar was chosen as the new base currency because of the importance of the US dollar as the world's reserve currency and also because of the importance to Hong Kong of the United States as a trading partner, and the new rate represented a 5.2% appreciation against sterling. New arrangements were then made for CIs to be paid for and redeemed in HK dollars⁷, and the Government began to diversify the Exchange Fund

The Exchange Rate Regime for the HK dollar

Date	Exchange rate regime	Reference rate
Until 4 Nov 1935	Silver standard	—
6 Dec 1935	Pegged to Sterling	£1 = HK\$16
23 Nov 1967		£1 = HK\$14.55
6 July 1972	Fixed to US dollar with $\pm 2\frac{1}{4}\%$ intervention bands	US\$1 = HK\$5.65
14 Feb 1973	around a central rate	US\$1 = HK\$5.085
25 Nov 1974	Free float	—
17 Oct 1983	Link system to US dollar	US\$1 = HK\$7.80

6 The Exchange Fund always had the authority to hold assets in any currency; the original 1935 Ordinance specifically stated that the assets of the Fund could be held "in Hong Kong currency or in any other currency or in gold or in silver". But the Government clearly thought it prudent to receive clearance from London before actually moving assets out of sterling.

7 This change finally resolved the issue of the spread between the issuance and redemption rate for CIs, as with CIs denominated and paid for in HK dollars, there was no currency exchange involved. When the US dollar Link was established in 1983 and CIs were once again exchanged for foreign currency, it was agreed not to reintroduce the spread, both issuance and redemption of CIs being at the link rate of US\$1 = HK\$7.80.

out of sterling into other currencies. The share of sterling assets held by the Fund fell to 53.9% by end-1974 and was further down to 16.5% at end-1976. Despite this it was decided to maintain the accounts of the Exchange Fund in sterling still.

A minor run on the HK dollar developed within a month of the new arrangements, and the Government was forced for the first time to use the Exchange Fund to support the currency. After intervention of US\$20 mn and £4.8 mn the currency was stabilised by 8 August 1972 and returned to the parity rate.

The parity rate for the HK dollar against the US dollar was soon tested again, this time in the other direction. On 12 February 1973 the US dollar was devalued by 10%, and on 14 February 1973 the Government announced that the HK dollar would be revalued by 11.1% against the US dollar, thus restoring its exchange rate against other currencies. The central rate was lowered to US\$1 = HK\$5.085 and upper and lower intervention limits of HK\$4.9706 and HK\$5.1994 were established. Despite its devaluation, the general weakness of the US dollar continued, and in March 1973 most of the world's currencies decided to abandon fixed rates against the US dollar and float. The Government did not follow this course, however, and the HK dollar remained pegged to the US dollar.

The changed circumstances made the Sterling Exchange Guarantee Scheme redundant, and in September 1973 it was wound up. The total net cost to the Exchange Fund of the Scheme was some £68 mn, which was partially offset by receipts of £19 mn from the UK Government under the Sterling Guarantee Agreement. This loss, coupled with investment losses over the previous three years as worldwide interest rates and bond yields rose, and revaluation losses since 1967 as the HK dollar appreciated, all combined to reduce the Exchange Fund's surplus heavily, from a position where assets were 131% of liabilities at end-1966 to a level of only 82% by end-1973.

In October 1974 the HK dollar began to appreciate against the US dollar again, and by mid-November the rate came close to the intervention point of HK\$4.9706. Although intervention was made through direct purchases of US dollars, it failed to prevent the rate from continuing to rise,

and on 25 November 1974 the HK dollar was allowed to float on the foreign exchange markets. At the end of December 1974 the UK Government terminated the Sterling Guarantee Agreement, and in 1975 EFAC agreed that from henceforth the accounts of the Exchange Fund would be denominated in HK dollars. The Exchange Fund, and the HK dollar, had severed all links to other currencies.

Development of the Exchange Fund's role

From the earliest days of the Exchange Fund, its primary purpose was to regulate the value of Hong Kong's currency. Until the link with sterling was broken, the operation of the Fund was most akin to a currency board, albeit one that issued notes at one remove through the note-issuing banks and the CI mechanism. As such, the HK dollar automatically stabilised around the currency board rate, with little or no active involvement from the Exchange Fund. However, the move firstly to a pegged exchange rate system, from 6 July 1972 to 25 November 1974, and then to a floating currency, and the change to CIs being denominated and paid for in HK dollars, marked a major change and removed the automatic stabilisers inherent in a currency board system. From henceforth the main method by which the Exchange Fund could be used to affect the value of the HK dollar was as an intervention reserve fund.

This new use for the Fund led to a need for more assets in the Fund. From 1 April 1976, the Exchange Fund therefore became the home for virtually all of Hong Kong's official external assets. The bulk of the foreign exchange assets of the Government's General Revenue Account and all of the assets of the Coinage Security Fund (ie funds received against issue of coin) were transferred to the Exchange Fund and debt certificates were issued in exchange. Debt certificates issued to the General Revenue Account were interest bearing while those issued to the Coinage Security Fund which were held as cover for coin issued in Hong Kong were non-interest bearing. From that date, all coinage expenses were also borne by the Exchange Fund. Thus, the resources available to regulate the exchange value of the Hong Kong dollar were centralised in the Fund.

Although the driving force behind these transfers was the need to bolster the Exchange Fund, the transfers did have considerable logic as well. The Coinage Security Fund derived its assets from coins in circulation, and the assets that backed the coin issue therefore served the same monetary purpose as the assets in the Exchange Fund backing the note issue. In the case of the General Revenue Account, the rationale for the use of foreign currency assets was because repatriation of surpluses would put upward pressure on the exchange rate; again, this concern for the value of the currency overlapped considerably with the objectives and operation of the Exchange Fund. Two further factors behind the transfer of the foreign currency assets of the General Revenue to the Exchange Fund were a desire to insulate the Fiscal Reserves from exchange rate risk and the benefits of combining the management of the Government's foreign assets all in one place.

These developments, coupled with the greater currency diversification of the Fund's assets, much increased the magnitude and complexity of the management of the Fund, which at that time was simply an account maintained by the Treasury without dedicated staff of its own. In order to handle the extra responsibilities, a new Exchange Fund Division was formally set up in the Government Secretariat's Monetary Affairs Branch in April 1978, and work associated with the Exchange Fund, including responsibility for notes and coin, was progressively transferred to the Division, although the Treasury retained responsibility for the storage and issue of coins. The creation of this Division greatly strengthened the Government's ability to direct the management of the Fund itself, and while the UK Government retained overall statutory authority for the Fund, day to day discretionary management of the assets was now centred wholly in Hong Kong.

At the same time, the Government began to employ private sector fund managers to manage part of the assets of the Fund on a discretionary basis against agreed investment guidelines. The first of these was appointed in October 1976, with an initial portfolio of US\$20 mn. The custom of using external managers for a proportion of the assets of the Fund continues to this day.

In 1978 the Coinage Security Fund was wound up and merged with the Exchange Fund,

with its debt certificates being cancelled. The Government also started to transfer the accumulated HK dollar denominated surplus of the General Revenue Account to the Fund. By the end of the 1970s, therefore, the Exchange Fund had become the Government's general accumulated savings account and intervention reserve fund to protect and regulate the value of the HK dollar.

Experiences with a floating currency

The initial period after the float of the HK dollar was one of considerable prosperity in Hong Kong and for most of the time the monetary situation was not notably any less stable than in any other economy. Until late 1976, the HK dollar was generally subject to upward pressure. The pressure was particularly strong during the last three months of 1976 following an unusual surplus on the trade balance the preceding quarter. The effective (ie trade-weighted) exchange rate index (EERI) for the HK dollar rose to 114.4 at end-1976 (December 1971 = 100), mainly reflecting the devaluation of several foreign currencies that were important to Hong Kong's trade. As a result, exchange losses arising from the appreciation of the HK dollar amounted to \$521 mn in 1976 alone.

However, thereafter the floating rate system was not so benign. By removing the exchange rate anchor, monetary policy became discretionary, and although the Government mostly used the HK dollar receipts from the note issue to purchase foreign exchange as note backing, there was no formal obligation to do so, especially when the HK dollar was weak. Also, with no monetary authority able to influence the price or volume of liquidity in the banking system, and no clearly agreed monetary objectives, Hong Kong was at risk of being without an effective monetary policy.

From March 1977, the HK dollar was subject to downward pressure from both external and internal factors. Externally, the trade deficit was growing, while internally, the growth rate of domestic demand and the money supply (bank credit) remained high. Both these led to a continuing depreciation of the currency, and the EERI declined to 92.7 at end-1979 and 88.2 at end-1980, though one welcome side-effect of this depreciation was that from end-1977 assets of the Exchange Fund once more exceeded liabilities, for the first time since 1972.

The depreciation of the HK dollar and the lack of close control over the money supply led to double-digit inflation. Interest rates⁸ were raised on several occasions in 1978 and 1979 and were adjusted on eleven occasions during 1980, in attempts both to protect the exchange value of the HK dollar and to curb the rapid expansion in domestic credit, which was the largest single contributor to an excessively fast growth rate of the money supply. In addition, the Exchange Fund Ordinance was amended in May 1979 to require banks to hold 100% cover, in the form of specified liquid assets under the Banking Ordinance, against short-term deposits of the Exchange Fund. This 100% cover, against the previous 25% cover, was designed to prevent the proceeds of the note issue retained in HK dollars and the accumulated fiscal surplus from acting as a base for the creation of credit to the economy. After the introduction of this regulation, the Fund's short-term HK dollar balances, as a proportion of its total deposits with banks in Hong Kong, expanded substantially from 23% at end-1978 to 84% at end-1979 and remained high at 72% at end-1980.

Despite these measures, money supply growth continued to be strong, with M3 up 25% in 1979 and 40% in 1980. In an attempt to strengthen the authorities' influence over the interest rate mechanism as a means of controlling the growth of money supply and domestic credit on the one hand, and the movements of the exchange rate of the HK dollar on the other, a scheme was introduced in November 1981 to enable the Government through the Exchange Fund to influence the level of money market rates. Under this scheme the Exchange Fund bid for deposits at the short end of the money market. The money borrowed was held off the market by the commercial banks assisting in the scheme for varying periods and then when it was thought that market participants had come to accept that the tightness of the market was not a temporary aberration, the money was lent out at the longer end of the market.

In a further attempt to solve the problem of holding investments in HK dollars in a manner

which did not fuel credit growth, it was decided in 1981 to allow the Exchange Fund to hold equities. The first equity holding purchased was a stake in Cable and Wireless Ltd, and this was followed in September 1983 by a purchase for cash from the Development Loan Fund of the Government's holdings in Cross Harbour Tunnel Co Ltd, Hong Kong Air Cargo Terminals Ltd and Hong Kong Building and Loan Agency Ltd. Although these stakes were held for some time before their eventual sale, they were never added to.

During this period, the overall weakness of the HK dollar continued to have the effect of increasing the surplus of assets over liabilities. Exchange gains arising from the depreciation of the HK dollar contributed a significant share of the surplus each year from 1977 to 1982, amounting to over \$5,000 mn in 1981 and 1982 alone. As a result, assets were equal to 149% of liabilities by end-1982.

The currency crisis and the introduction of the Link system⁹

Despite the obvious role of the political situation in acting as the catalyst for the HK dollar currency crisis in 1983, the origins of the crisis in fact went deeper and beyond the uncertainties over Hong Kong's future. The credit explosion made possible by the lack of effective monetary management and loose supervisory environment had fuelled an asset price bubble that by 1981 was being kept alive largely by inflows on the capital account. When the economic fundamentals deteriorated sharply in 1982, the bubble burst, and the overlent position of the banking system to the property sector set the scene for a major liquidity squeeze. The political shock then came at the worst possible moment when the financial system was already very fragile and under pressure.

During 1982, the US dollar appreciated sharply and almost continuously. The HK dollar was comparatively steady during the first three quarters of 1982, with the EERI rising to 90.3, the highest level of the year, on 26 June 1982 from an end-1981 level of 85.9. This stability ended abruptly, however, when the uncertainty over the political

8 ie deposit rates, which were set by the Exchange Banks' Association. There was at the time no more formal way to influence interbank interest rates.

9 The report of the currency crisis in 1982-83 is of necessity very much abbreviated, and limited in this paper to its direct effect on the Exchange Fund.

future of Hong Kong surfaced towards the end of September 1982. The HK dollar fell to a year's low of HK\$6.95/US\$ on 26 October, though it recovered some of the ground to close the year at HK\$6.48, a depreciation of 12% against end-1981's level. The EERI closed 1982 at 80.1.

Anxiety over the political future of Hong Kong continued in 1983, and this, coupled with the strength of the US dollar on the world's exchanges, caused the currency to fall sharply despite regular increases in money market interest rates and repeated intervention by the Exchange Fund. At the same time, the liquidity squeeze in the banking system was coming to a head, and various local banks were under pressure. A factor adding to the pressure on the HK dollar and the local banking system was a decision in 1982 to remove interest withholding tax on foreign currency denominated deposits, while retaining it on those denominated in HK dollars. The currency moved steadily lower, with the EERI down to 78.3 at end-March and 73.8 at end-June.

Political tension was heightened in August by statements from China that sovereignty would be resumed regardless of the outcome of negotiations. On 16 September, by which time the exchange rate had reached HK\$7.89/US\$, the Financial Secretary made a statement which failed to reassure the markets, and the next weekend, amidst rumours that the talks in Beijing had ended in stalemate, the currency collapsed. In two days, and despite further intervention by the Exchange Fund, it fell by 13% to HK\$9.60/US\$, with the EERI touching a record low of 57.2 on 24 September. In the face of public lack of confidence in the currency and even in HK dollar banknotes, the Government announced that measures would be taken to stabilise the currency. Two days later Hang Lung Bank, a local bank which had suffered a bank run a year previously and had never really recovered, informed the Government that it could not meet its obligations. The Government guaranteed the bank overnight and enacted emergency legislation the next day to take it over, with the necessary funding provided by the Exchange Fund.

Permanent measures to stabilise the currency were introduced on 17 October 1983. The interest withholding tax on HK dollar-denominated deposits was abolished and arrangements for issuing and redeeming CIs against payment in foreign currency,

this time US dollars at the fixed rate of HK\$7.80/US\$, were reintroduced – a return to the modified currency board approach practised prior to 6 July 1972. These measures proved to be effective and the market exchange rate stabilised at around the Link rate of HK\$7.80/US\$ for the rest of 1983, a rate it has remained very close to ever since. Indeed, stability returned sufficiently quickly for interest rates to be reduced as early as 27 October, and the Exchange Fund was even able to recoup some of the US dollars used in earlier intervention.

In strict monetary terms, the cost to the Exchange Fund of the crisis was small. Total net sales of US dollars through intervention in the year amounted to US\$719 mn; as a proportion of this was at rates above HK\$7.80/US\$ it was profitable in accounting terms. The main costs were the cost of rescuing Hang Lung Bank, and a one-off payment to the general revenue of \$250 mn to cover the revenue foregone by the abolition of interest withholding tax on HK dollar denominated deposits. Both of these were dwarfed by the exchange gain through the HK dollar's depreciation over the year, which amounted to some \$7,650 mn and resulted in assets standing at the unprecedented level of 181% of liabilities at end-1983.

Bank crises in the 1980s

Although the introduction of the Linked exchange rate system had stabilised the currency, the banking system in Hong Kong was still fragile, and the Exchange Fund was involved in the rescue of several banks that became insolvent, either due to past mismanagement or in some cases fraud by the banks' management. This use of the Fund, which was still technically confined by the Exchange Fund Ordinance to the regulation of the value of the currency, was justified on the grounds that the collapse of a major local bank would have had unacceptable effects on the interbank market and the banking system as a whole, and hence on the exchange value of the HK dollar.

The first of these rescue operations took place in 1985, when Overseas Trust Bank Limited (OTB) advised the Government on 6 June that it was insolvent. The bank had been weak for some time, its problems being similar to those of Hang Lung Bank, and by June 1985 the management accepted that they could no longer keep the bank

going. An Ordinance was enacted for the takeover of OTB the next day, and the bank was able to reopen for business under Government ownership on 10 June, with funding again provided by the Exchange Fund. By the same Ordinance, the Hong Kong Industrial and Commercial Bank, another local bank and a subsidiary of OTB, also came under Government control. By December 1985, the capital reconstruction of OTB was complete, with the cancellation of the previous shares of the bank and the injection of fresh capital by the Exchange Fund.

Further assistance was given to four other banks in 1985 and 1986. In each of these cases, the Exchange Fund provided financial assistance to enable third parties to undertake the necessary restructuring.

With this episode complete, the banking system had broadly recovered from the weaknesses arising from the events of the early 1980s. However, a different problem arose as a consequence of the October 1987 crisis in world stock markets. The sharp fall in the price of shares on the Hong Kong Stock Exchange led to some brokers on the Hong Kong Futures Exchange experiencing difficulty in meeting their obligations. The Exchange Fund was again called upon, this time to provide two standby revolving credit facilities for the Hong Kong Futures Guarantee Corporation Limited to enable it to finance the settlements of its obligations to members of the Futures Exchange.

In 1991 Hong Kong suffered another bank crisis, as the collapse of the Bank of Credit and Commerce International caused a run on its locally incorporated subsidiary, Bank of Credit and Commerce Hong Kong Limited. By this time, however, the financial system was generally in a healthier position, and it was not deemed necessary, for the sake of the wider banking system, to use the Exchange Fund to rescue the bank and it was duly allowed to close.

By 1993, the last of the banks still in Government ownership, OTB, had been returned to health and the Government was able to complete its sale to the private sector in October of that year, thus largely concluding the successful operation to preserve the banking system from collapse. The proceeds of the sale were credited to the Exchange Fund, and following this sale the total

net cost to the Exchange Fund of the rescue operations during 1983-1993 in accounting terms was reduced to \$3,800 mn, a modest cost for ensuring the stability of Hong Kong's banking sector and the monetary system during a critical period. Despite this call upon the Fund the overall size of the Fund continued to grow sharply from 1985 onwards, with surpluses recorded for each of the last 10 years.

Strengthening of the Monetary Management mechanism

With the establishment of the Link to the US dollar, the primary objective of monetary policy became the maintenance of the stability of the exchange rate. Initially the methods open to the Government to achieve this were through operations to influence interbank liquidity and thus short-term interbank interest rates, and direct intervention on the foreign exchange markets.

With no direct control over interbank liquidity, other than through the placement or withdrawal of Exchange Fund deposits from the interbank market, the bulk of the Government's operations to hold the exchange rate in the first years of the Link were through direct intervention on the foreign exchange markets. Market confidence in both the Link and the Government's determination to defend it was essential, and the Government moved quickly to counteract even relatively minor deviations from the Link rate. These moves were successful; apart from one weekend in July 1984 when the rate briefly touched HK\$8.05/US\$ the market rate for the HK dollar stayed within 1% of the link rate throughout the mid-80s. But the level of intervention needed to ensure this was not small, especially as the US dollar weakened in 1986-87 and there was repeated speculation that the HK dollar would be revalued upwards. In 1987 purchases of US dollars reached the level of US\$2.7 bn gross, despite HK dollar interbank rates which were well below US dollar rates, and at times close to zero.

Large scale intervention continued in 1988, with a further US\$3.1 bn gross purchased, and the Government decided that further reforms were needed to enable them to exercise more effective influence over liquidity and interest rates in the interbank market, and thus reduce the reliance on direct intervention. To this end the Accounting

Arrangements were introduced in July 1988. These Arrangements require HSBC, as the Management Bank of the Clearing House of the Hong Kong Association of Banks (HKAB), to open an Account with the Exchange Fund; the balance in the Account then represents the net amount of liquidity that can be advanced by HSBC to the clearing accounts of licensed banks. Under the Accounting Arrangements the balance of the Account can only be altered by the Government, and any excess liquidity in the banking system over the balance of the Account, created for example by HSBC extending extra credit to other banks' clearing accounts, is penalised by the Exchange Fund by the levy of a penal rate of interest.

With this arrangement the Government acquired control over the level of interbank liquidity, and the Exchange Fund effectively became the ultimate provider of liquidity to the banking system. This marked a significant change in official thinking, which hitherto had eschewed any significant central banking role for the Government or the Exchange Fund. Also at this time, the Government introduced legislative changes to remove the statutory ceiling (of 60%) on interest rates as set by the Moneylenders Ordinance, and to provide the mechanism for charging negative interest rates. These changes gave the Government total flexibility in raising or lowering interest rates in their defence of the exchange rate.

The Government next sought to extend its influence over the money markets beyond the very short overnight rate. The classic way for monetary authorities to influence interest rates is through open market operations, but in the case of Hong Kong, there were no official money market instruments or debt securities available for use as the Government had traditionally run a fiscal surplus. In order to remedy this the Government developed a programme of Exchange Fund Bills (from March 1990) and Notes (from May 1993). These programmes provide the banking system with a highly liquid asset, and provide the Exchange Fund with the necessary instruments to conduct open market operations.

The Exchange Fund Bills and Notes programmes have been very successful, and secondary market trading in the paper remains very active indeed. For the Government, their use for open market operations has advantages over

direct borrowing and lending in the interbank market. When reducing the level of interbank liquidity, the issuance of Exchange Fund paper is less costly to the Government than direct borrowing as the yield on the paper has in general been lower than the corresponding HK dollar interbank offer rate (HIBOR). When on the other hand the Government wishes to inject liquidity, buying back Exchange Fund paper, unlike placing deposits, does not involve any credit risk. In addition, the securities serve as benchmark issues for the debt securities market by providing a government yield curve which now extends to 5 years. The market's liquidity and attractiveness to the banking system has been enhanced by an efficient and robust clearing system, now operated by the Central Moneymarkets Unit of the HKMA.

Another milestone in monetary management was the introduction of the Liquidity Adjustment Facility (LAF) in June 1992. Through the LAF, banks can make late adjustments to their clearing accounts after the close of the interbank market, either by seeking funds overnight at the offer rate, in the form of Repurchase Agreements involving eligible securities, or by placing funds overnight with the Exchange Fund at the bid rate. These discounting and deposit facilities enable the Exchange Fund through the LAF to supply additional liquidity to or drain excess liquidity from the banking system, and the LAF bid and offer rates effectively set the floor and ceiling for overnight interbank interest rates. By varying the bid and offer rates of the LAF, the Government can influence short-term interest rates directly.

The Hong Kong Monetary Authority

The growing importance of Hong Kong as an international financial centre has placed added emphasis on monetary stability, the soundness and integrity of the financial system, and the efficiency and robustness of the market infrastructure of Hong Kong. The development of the central banking role of the Exchange Fund made it desirable to ensure that the Government's various activities in the monetary and banking fields were co-ordinated and performed with a high degree of professionalism and continuity in the lead up to 1997 and beyond. To this end, the Exchange Fund Ordinance was amended in December 1992, to provide for the appointment of a Monetary

Authority, whose duties combine those of the Office of the Exchange Fund with those of the Commissioner of Banking, and to empower the Financial Secretary to use the Exchange Fund to maintain the stability and integrity of the monetary and financial systems of Hong Kong, in addition to its primary use which remains regulating the exchange rate. The Exchange Fund (Amendment) Ordinance came into operation on 1 April 1993, and on that date the Hong Kong Monetary Authority was established.

The establishment of the HKMA has enabled the Government to continue the modernisation and development of central banking operations in Hong Kong. The mode of open market operations has been refined, with the HKMA now targeting the level of interbank interest rates rather than the level of interbank liquidity. Under this revised mode, introduced in March 1994, the level of interbank liquidity is adjusted more frequently in response to changes in demand to keep overnight HIBOR within the range set by the LAF bid and offer rates. The new approach has been successful in reducing unnecessary volatility in the interbank market, and since March 1994 there have been very few occasions of noticeable deviation between overnight HIBOR and the LAF Offer Rate.

On the settlement side, links have been established between the HKMA's CMU service and the Euroclear and CEDEL clearing systems. The link with Euroclear, which became operational in December 1994, was the first of its kind between an international and a domestic debt clearing system in East Asia, and facilitates trading by overseas investors in HK dollar debt instruments. Plans to strengthen the efficiency and integrity of the interbank payment and settlement system are also well in hand, with the HKMA and HKAB jointly developing a real time gross settlement system (RTGS) with final settlement across accounts at the HKMA. This move will mark a further development of the central banking role of the Exchange Fund, and is intended to make the interbank payment system more robust and secure,

and will also make the HKMA's money market operations more effective as the payment system would become more efficient in transmitting the impact of the operations.

For the Exchange Fund itself, the establishment of the HKMA has also enabled the Government to undertake a major upgrading of its investment management capabilities. From being held merely as reserve backing for the note issue when it was first established, the Fund has developed in both size and scope to play a major part in Hong Kong's financial system, and to represent a very considerable accumulation of assets. In the last decade, this growth has been particularly marked, with real per capita net assets more than doubling and real per capita gross assets more than trebling since the end of 1984, to a point where Hong Kong now enjoys the second highest gross reserves per capita in the world. Reflecting this growth, there is now a greater emphasis on the Fund as a store of value for future generations of the people of Hong Kong, and the assets are managed actively by the HKMA for profit and extra return.

Nevertheless, the core purpose of the Exchange Fund remains, as it always has been, to regulate the value of the currency. As Hong Kong undergoes economic and political transition, the need for stability in the financial sector remains paramount. No system is without its critics, but the Government remains firmly committed to the Link system, which has the full support of both the UK and the Chinese authorities. The monetary reform measures introduced over the last 12 years, the development of the Government's monetary management and supervisory capabilities, and the much increased transparency of the actions of the authorities in recent years (including the publication of the accounts of the Exchange Fund in 1992, after a period of over 50 years of secrecy) have helped to strengthen Hong Kong's capability to deliver monetary and financial stability in a way that commands confidence both locally and overseas. ☉

EXCHANGE FUND BALANCE SHEET 1936-1994

HK\$ mn	1936	1937	1938	1939	1940	1945	1946	1947	1948	1949	1950	1951	1952	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970	1971					
As at 31 December						#																															
ASSETS																																					
HK Dollar Assets																																					
US Dollar Assets																																					
Sterling Assets																																					
Other Foreign Currency Assets																																					
LIABILITIES																																					
Certificates of Indebtedness																																					
Fiscal Reserves Accounts																																					
Coins in Circulation																																					
Exchange Fund Bills and Notes																																					
Balance of Banking System																																					
Other Liabilities																																					
NET ASSETS																																					
	149	178	186	174	180	235	397	595	709	730	733	736	736	736	660	660	660	683	700	763	839	877	970	1,065	1,223	1,547	1,638	2,069	4,452	4,842	5,796	7,562					
	18	19	22	25	29	34	(14)	(14)	(2)	3	14	6	21	53	79	54	74	92	152	191	189	242	385	451	301	390	507	351	200	263	400	1,060					
REPRESENTED BY																																					
Accumulated Surplus/(Deficit) b/f		18	19	22	25	29	34	(14)	(14)	(2)	3	14	6	21	53	79	54	74	92	152	191	189	242	385	451	301	390	507	351	200	263	400					
Surplus/(Deficit) for the year		18	1	3	3	4	5	(48)	0	12	5	11	(8)	15	32	26	(25)	20	18	60	39	(2)	53	143	66	(150)	89	117	(156)	(151)	63	137	660				
ACCUMULATED SURPLUS/(DEFICIT) C/F		18	19	22	25	29	34	(14)	(14)	(2)	3	14	6	21	53	79	54	74	92	152	191	189	242	385	451	301	390	507	351	200	263	400	1,060				
Asset/Liabilities Ratio		112%	111%	112%	114%	116%	114%	96%	100%	100%	102%	101%	103%	107%	112%	108%	111%	113%	122%	125%	123%	128%	140%	142%	125%	125%	131%	117%	104%	105%	107%	114%					

1941-1944 detailed accounts not available

EXCHANGE FUND BALANCE SHEET 1936-1994

HK\$ mn

As at 31 December	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994 (unaudited)	
ASSETS																								
HK Dollar Assets	296	189	163	42	708	988	3,849	2,951	3,667	6,256	5,749	9,851	3,384	2,081	3,876	5,746	5,962	9,625	3,874	10,788	12,546	12,987	24,126	
US Dollar Assets	238	406	508	1,195	2,413	2,875	3,864	6,251	13,981	18,975	27,517	29,510	33,703	41,557	50,668	64,128	79,116	100,628	136,309	164,880	214,416	257,634	298,900	
Sterling Assets	8,587	2,025	1,480	1,390	1,076	1,012	1,062	1,399	3,054	2,516	2,522	2,499	1,944	3,862	3,872	10,304	11,033	11,191	10,970	7,213	5,717	9,880	10,284	
Other Foreign Currency Assets	167	117	596	1,080	2,344	3,505	5,338	6,610	8,493	10,121	11,529	13,678	14,943	22,774	30,175	38,657	36,940	37,333	45,044	53,240	54,815	67,985	75,175	
	9,288	2,737	2,747	3,707	6,541	8,380	14,113	17,211	29,195	37,868	47,317	55,538	53,974	70,274	88,591	118,835	133,051	158,777	196,197	236,121	287,494	348,466	408,465	
LIABILITIES																								
Certificates of Indebtedness	3,059	3,356	3,481	3,978	4,664	5,666	6,896	7,826	9,291	10,971	12,511	13,841	14,150	17,871	20,531	26,831	31,731	37,191	40,791	46,410	58,130	68,801	74,301	
Fiscal Reserves Accounts				1,900	1,496	4,573	5,521	14,033	17,087	17,761	14,198	13,692	19,007	23,359	32,359	32,557	38,269	52,546	63,226	69,802	96,145	115,683	131,240	
Coins in Circulation				386	539	708	708	750	901	1,012	1,049	1,161	1,102	1,197	1,441	1,470	1,890	2,012	2,003	2,299	2,559	2,604	3,372	
Exchange Fund Bills and Notes																			6,671	13,624	19,324	25,157	46,140	
Balance of Banking System					22	19	86	149	402	877	438	1,534	314	765	4,103	4,463	2,554	1,603	391	4,834	3,220	7,314	22,614	
Other Liabilities	5,675	2															860	978	480	500	1,480	1,385	2,208	
	8,734	3,358	3,481	3,978	6,972	7,720	12,263	14,246	24,627	29,947	31,799	30,734	29,258	38,840	49,434	65,311	75,304	94,330	113,562	137,469	180,858	220,944	279,875	
NET ASSETS	554	(621)	(734)	(271)	(431)	660	1,850	2,965	4,568	7,921	15,518	24,804	24,716	31,434	39,157	53,524	57,747	64,447	82,635	98,652	106,636	127,542	128,610	
REPRESENTED BY																								
Accumulated Surplus/(Deficit) b/f	1,060	554	(621)	(734)	(271)	(431)	660	1,850	2,965	4,568	7,921	15,518	24,804	24,716	31,434	39,157	53,524	57,747	64,447	82,635	98,652	106,636	127,542	
Surplus/(Deficit) for the year	(906)	(1,175)	(113)	463	(160)	1,091	1,190	1,115	1,603	3,353	7,597	9,286	(88)	6,718	7,723	14,367	4,223	6,700	18,188	16,017	7,984	20,906	1,068	
ACCUMULATED SURPLUS/(DEFICIT) CIF	554	(621)	(734)	(271)	(431)	660	1,850	2,965	4,568	7,921	15,518	24,804	24,716	31,434	39,157	53,524	57,747	64,447	82,635	98,652	106,636	127,542	128,610	
Asset/Liabilities Ratio	106%	82%	79%	93%	94%	109%	115%	121%	119%	126%	149%	181%	184%	181%	179%	182%	177%	168%	173%	172%	159%	158%	146%	

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Chart 1
Assets and Liabilities of the Exchange Fund

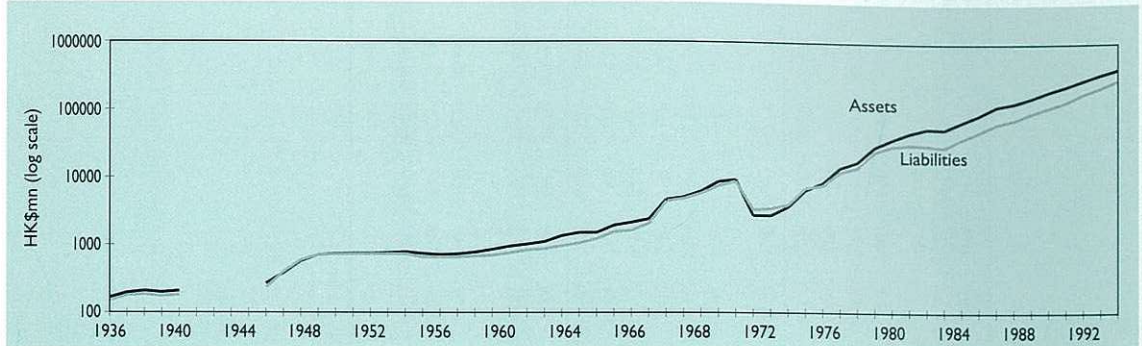


Chart 2
Assets as % of Liabilities

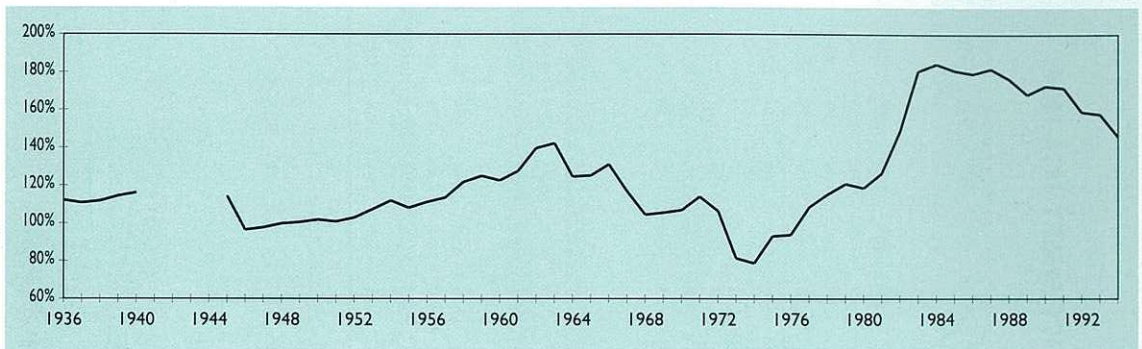


Chart 3
Exchange Fund (in constant price per capita terms)

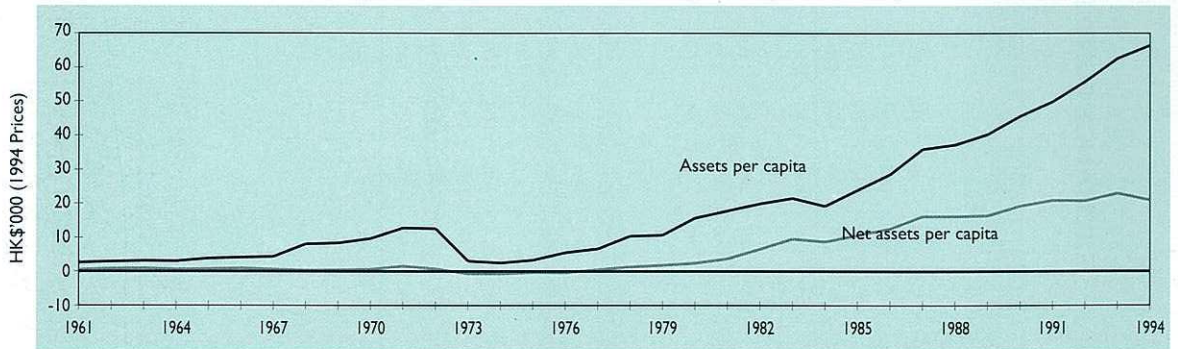


Chart 4
Currency Distribution %

