

The HKMA has further enhanced the transparency of its market activities by announcing the forecast change in the Aggregate Balance of the banking system due to its foreign exchange transactions. This has facilitated a more efficient and orderly adjustment in interest rates in response to the changes in interbank liquidity, as evidenced in the June episode when the Hong Kong dollar came under selling pressure again.

Aggregate Balance of the Banking System

Under the linked exchange rate system, the level of interbank liquidity, as represented by the balances in the clearing accounts maintained by banks with the HKMA (generally referred to as the Aggregate Balance) is determined by the flows of funds into or out of the Hong Kong dollar. Specifically, when there is capital outflow (or inflow) and the Hong Kong dollar exchange rate is under pressure, the HKMA stands ready to buy (or sell) Hong Kong dollars against US dollars in the foreign exchange market. In settling these foreign exchange transactions, the HKMA would debit (or credit) the clearing accounts of the banks selling (or buying) the Hong Kong dollars to (or from) it. The contraction (or expansion) of the Aggregate Balance would lead to a rise (or fall) in the interest rates, which would help to counteract the initial capital flows, maintaining exchange rate stability throughout.

The HKMA's foreign exchange transactions are mostly conducted on a spot basis which are settled two business days after the trade day. Prior to 11 June 1998, the effect of HKMA's foreign exchange transactions on the Aggregate Balance was known to the public only after the close of the settlement day (i.e. T+2 for spot transactions). With a view to further enhancing the transparency of its market activities, starting from 11 June, the HKMA has revised its page on various news services to provide the forecast change in the

Aggregate Balance resulting from HKMA's foreign exchange transactions as well as the projected levels of Aggregate Balance for "Today", "Next Business Day" and "After Next Business Day". The forecast is updated regularly during the day. The announcement of the forecast enables market participants to anticipate more accurately the changes in liquidity conditions in the interbank market. This in turn facilitates more efficient and orderly interest rate adjustments, hence further improving the robustness of the linked exchange rate system.

The HKMA page

The revised format of the HKMA page is shown at Exhibit 1. The following examines the various items on the HKMA page using the screen at the beginning of 3 August 1998 as an illustration.

Opening Aggregate Balance (OAB) — it represents the clearing balance of the banks at the start of the day and is equal to the Closing Aggregate Balance (CAB) carried forward from the previous day (i.e. 1 August 98 in our example).

Closing Aggregate Balance (CAB) — this item will be published at around 6:00 p.m. It represents the level of Aggregate Balance at the close of the day. The difference between the CAB and the OAB is attributable to the following activities:

Exhibit 1
Hong Kong Monetary Authority
Interbank Liquidity
03 Aug 1998

			Time	Aggregate Balance Of Settlement Accounts
Opening Aggregate Balance	428	MN	09:30HR	MN
Closing Aggregate Balance		MN	10:00HR	MN
Change Attributable To:			11:00HR	MN
Market Activities		MN	12:00HR	MN
LAF Reversal		MN	15:00HR	MN
LAF Today		MN	16:00HR	MN
Forecast Change in Aggregate Balance Attributable To FOREX Transactions				Forecast Aggregate Balance Before LAF
(As At 09.00HR On 03 Aug 98) :				
On 3 AUG 98	+0	MN		2,341 MN
On 4 AUG 98	-1,007	MN		1,334 MN
After 4 AUG 98	+0	MN		1,334 MN
LAF Rate 4. 00% BID/ 7. 00% Offer		TWI 138.8	*-0.1*	01.08.1998

- (a) **Market activities** — this item shows the impact on the Aggregate Balance due to foreign exchange and money market transactions conducted by the HKMA. As discussed above, under the currency board system, the level of Aggregate Balance is determined largely by the flows of funds into and out of the Hong Kong dollar. Only in exceptional circumstances such as Initial Public Offerings and other large scale Hong Kong dollar transactions which risk causing extreme conditions in the money market would the HKMA carry out money market operations to vary the clearing balance temporarily without a corresponding change in the Exchange Fund's holdings of US dollar assets².
- (b) **LAF Reversal** — it represents the net effect on the Aggregate Balance resulting from:
- (i) HKMA crediting the clearing accounts of those banks which placed deposits with the HKMA through LAF on the previous trading day; and
 - (ii) HKMA debiting the clearing accounts of those banks which borrowed from LAF on the previous trading day.
- A positive figure denotes there were net deposits with the HKMA through LAF on the previous day and a negative figure denotes net borrowing from the LAF.

¹ In all other activities conducted by the HKMA which may have the effect of varying the clearing balance of the banking system such as a transfer of fiscal reserves and the issue of Exchange Fund Bills and Notes, the HKMA ensures that such effect is neutralized as the case may be, by recycling or sterilizing Hong Kong dollar liquidity.

- (c) **LAF Today** — this item will be published at around 6:00 p.m. after the close of the LAF window. It shows the net effect of:
- (i) HKMA crediting the clearing accounts of those banks which borrowed from LAF today; and
 - (ii) HKMA debiting the clearing accounts of those banks which deposited with the HKMA through LAF today.

Aggregate Balance of Settlement Accounts — these figures depict the hourly movements of the Aggregate Balance, including changes arising from intraday Repos of Exchange Fund paper for the purpose of the Real Time Gross Settlement interbank payment system.

Forecast Change in Aggregate Balance attributable to Forex Transactions — (*New item*)

- (a) **ON TODAY** (i.e. 3 August 1998) — this is the forecast change in today's Aggregate Balance attributable to spot, tom/next or other foreign exchange transactions conducted earlier which are due for settlement today. The figure will be revised during the day in the event that the HKMA conducts some value-today foreign exchange transactions (where the deal is conducted and settled today).
- (b) **ON NEXT BUSINESS DAY** (i.e. 4 August 1998 in our example) — this is a forecast of the change in the Aggregate Balance based on the foreign exchange transactions due for settlement on the next business day. The forecast will be revised during the day in the event that the HKMA conducts some tom/next deals (where the deal is settled on the next business day following the trade day).
- (c) **AFTER NEXT BUSINESS DAY** — this is a forecast of the change in Aggregate Balance based on the foreign exchange transactions due for settlement after the next business day.

Forecast Aggregate Balance before LAF (*New item*) — the figures show the forecast on the levels of Aggregate Balance before LAF, taking into account the anticipated changes arising from the foreign exchange transactions conducted by the HKMA.

The June 1998 Episode

Events in mid June 1998 illustrate how the enhanced transparency of the HKMA market activities facilitates the interest rate adjustment mechanism. Selling pressure on the Hong Kong dollar emerged in the second week of June following a further weakening of the Japanese Yen. On 10 June, the HKMA passively bought a considerable amount of Hong Kong dollars for spot value (to be settled two business days later, i.e. 12 June). The forecast reduction in the Aggregate Balance arising from the foreign exchange transactions, to a tune of HK\$4,123 mn, was announced on 11 June when the revised HKMA page was first introduced. In other words, the Aggregate Balance was forecast to shrink to a negative level of HK\$479 mn on 12 June. In view of the impending shortage of interbank liquidity, some banks decided to switch from US dollars into Hong Kong dollars to meet their Hong Kong dollar payment needs. The HKMA started to pick up some US dollars, some of which were for value tomorrow. As a result, the forecast level of Aggregate Balance for 12 June rose to HK\$1,069 mn at the close of 11 June. However, selling pressure on the Hong Kong dollar resumed on 12 June. The HKMA continued to buy Hong Kong dollar passively in the foreign exchange market on spot basis to support the exchange rate. At the close of business on 12 June (Friday), the HKMA page indicated that the forecast level of Aggregate Balance two business days later (i.e. 16 June) would be reduced by HK\$7,262 mn to a negative level of HK\$6,620 mn. In response to the shrinkage in interbank liquidity, the overnight and 1-month interbank interest rates were driven up to the intraday high of around 17% and 20% respectively on 15 June (Monday). As in the previous occasion, some banks started to sell US dollars for Hong Kong dollars, counteracting the

initial outflow. By the close of 15 June, the forecast Aggregate Balance for 16 June returned to a positive figure HK\$269 mn. Overnight and 1-month interbank interest rates quickly eased to 7.5% and 9.25% respectively on 18 June.

Compared to the October 1997 episode when overnight and 1-month HIBOR surged to 280% and over 45%, the interest rate adjustment in the June round of selling pressure was much more moderate. While the selling pressure in the mid-June was smaller, the announcement of the forecasts on Aggregate Balance has also helped to bring about a more efficient and orderly interest rate adjustment. (2)

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