

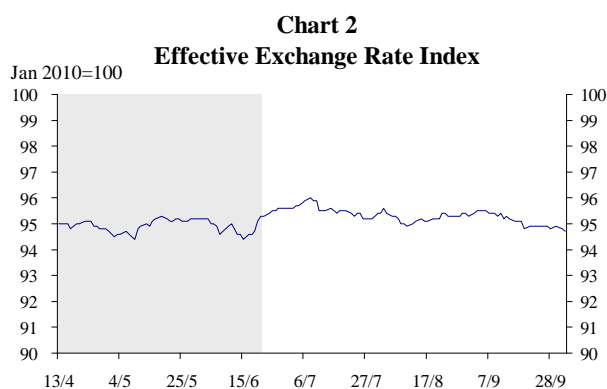
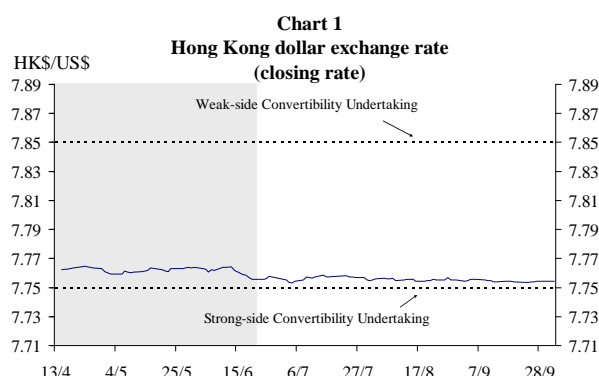
**EXCHANGE FUND ADVISORY COMMITTEE**  
**Currency Board Sub-Committee**

**Report on Currency Board Operations**  
**(22 June 2013 – 3 October 2013)**

During the review period, the Hong Kong dollar spot exchange rate continued to stay within a narrow range between 7.7533 and 7.7584. Despite sharp depreciation of some emerging market currencies and uncertainties arising from the US fiscal impasse, the Hong Kong dollar exchange market continued to trade in an orderly manner. Meanwhile, the Hong Kong dollar interbank interest rates remained steadily low, while the spreads against the US dollar counterparts turned slightly positive. The Monetary Base rose slightly, mainly due to an increase in Certificates of Indebtedness, and all changes in the Monetary Base were fully matched by changes in foreign reserves in accordance with Currency Board principles.

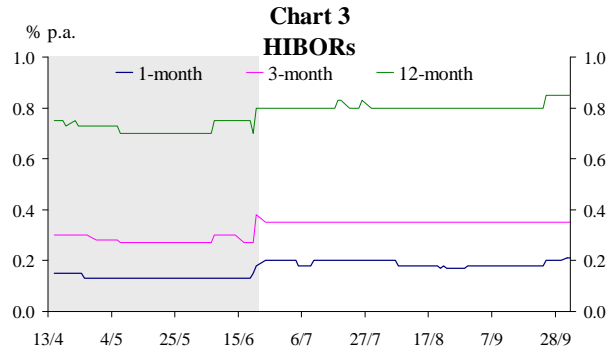
## Hong Kong dollar exchange rate

1. During the review period, the Hong Kong dollar exchange rate stayed within a narrow range between 7.7533 and 7.7584 (Chart 1). Although some emerging market currencies saw sharp depreciation amid weaker economic prospects and capital outflows, the Hong Kong dollar exchange rate had not experienced weakening pressure. Moreover, while the US fiscal impasse led to sell-offs in the global equity markets in early October, trading of the Hong Kong dollar continued in an orderly manner, with only limited fluctuations in the exchange rate. **During the review period, the nominal effective exchange rate index of the Hong Kong dollar eased marginally,** primarily reflecting the depreciation of US dollar against the Euro and Pound Sterling (Chart 2).

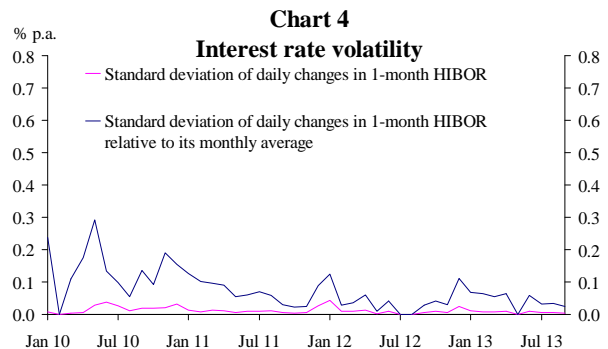


## Interest rates

2. **Hong Kong dollar interbank interest rates remained steadily low** during the review period. Towards the end of September, the interbank rates edged up amid a slight increase in banks' funding demand for quarter-end liquidity management and increased equity fund-raising activities (Chart 3). The one-month and 12-month HIBORs increased by 1 basis point and 5 basis points to 0.21% and 0.85% respectively, while the three-month HIBOR remained unchanged at 0.35%.

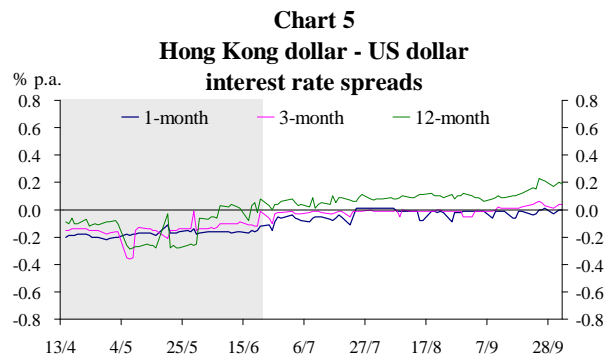


3. **Interest rate volatility remained low.** The standard deviation of daily changes in the one-month HIBOR was lower than 1 basis point between June and September (Chart 4). The standard deviation as a ratio of the average one-month HIBOR also followed similar pattern<sup>1</sup>.

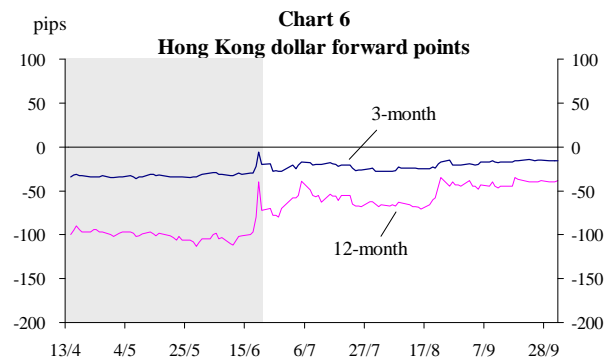


<sup>1</sup> The ratio of the standard deviation of daily changes in the one-month HIBOR to its monthly average measures the extent of interest rate fluctuations relative to the average level of interest rates.

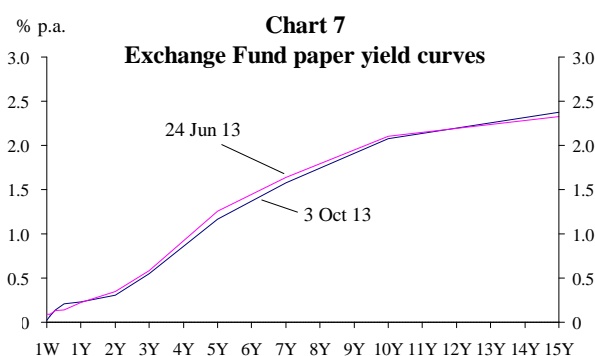
4. The spreads of Hong Kong dollar interest rates against their US dollar counterparts turned slightly positive during the review period, largely reflecting declines in the US dollar interbank rates (Chart 5). The three-month spread closed at +4 basis points on 3 October, compared with -6 basis points on 24 June. The positive 12-month spread widened further to +19 basis points from +3 basis points at the beginning of the review period.



5. Broadly tracking the movements in the interest rate spreads, the Hong Kong dollar forward discount narrowed slightly during the review period (Chart 6). The three-month and 12-month forward discounts closed at -16 and -38 pips respectively on 3 October.

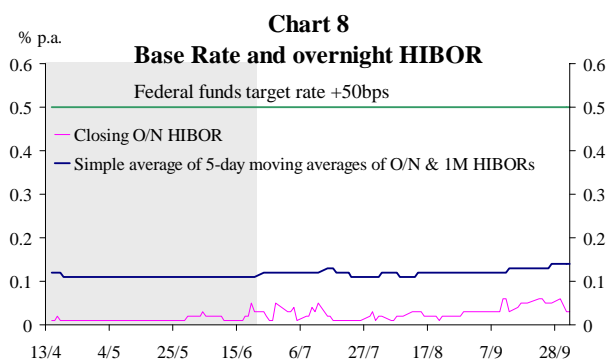


6. **The yield curve of Exchange Fund paper was little changed** during the review period (Chart 7). Reflecting the rises in the long-dated US dollar treasury yields, the negative yield spreads of Exchange Fund paper over US Treasuries widened slightly for tenors of five years and beyond (Table 1).



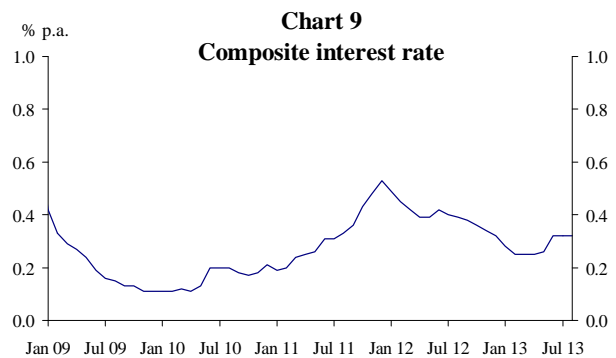
	24 Jun 13	03 Oct 13
3-month	8	13
1-year	9	12
3-year	-12	-5
5-year	-18	-21
10-year	-45	-56
15-year	-65	-80

7. At the July and September meetings, the US Federal Open Market Committee (FOMC) decided to keep the Federal Funds Target Rate (FFTR) at 0 – 0.25%<sup>2</sup>. As such, **the HKMA Base Rate stayed unchanged at 0.5%** (Chart 8). The Base Rate continued to be set at 50 basis points above the lower boundary of the FFTR target range in accordance with the revised Base Rate formula announced on 26 March 2009.



<sup>2</sup> At the September meeting, the FOMC decided to continue purchasing additional agency mortgage-backed securities at a pace of US\$40 billion per month and longer-term Treasury securities at a pace of US\$45 billion per month. The FOMC also anticipated that the exceptionally low range for the Federal Funds Target Rate will be appropriate at least as long as the unemployment rate remains above 6.5%, inflation between one and two years ahead is projected to be no more than a half percentage point above the FOMC’s 2% longer-run goal, and longer-term inflation expectations continue to be well anchored. In determining how long to maintain a highly accommodative stance of monetary policy, the Committee said it would also consider other information, including additional measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial developments.

8. In line with the stable US FFTR, banks in Hong Kong kept their Best Lending Rates unchanged. There continued to be two Best Lending Rates of 5.00% and 5.25% at the end of the review period. The average one-month Hong Kong dollar time deposit rate offered by retail banks continued to stay flat at 0.01%<sup>3</sup>. The weighted deposit rates remained broadly stable after slight pick-ups in May and June. As a result, **the composite interest rate**<sup>4</sup>, which indicates the average cost of funds for retail banks, **stayed at 0.32% between June and August** (Chart 9). On the other hand, the average mortgage interest rates for newly-approved loans decreased slightly during the review period.



<sup>3</sup> The figure refers to the average of interest rates offered by major authorized institutions for one-month time deposits of less than HK\$100,000.

<sup>4</sup> This is a weighted average interest rate of all Hong Kong dollar interest bearing liabilities, which include deposits from customers, amounts due to banks, negotiable certificates of deposit and other debt instruments, and Hong Kong dollar non-interest bearing demand deposits on the books of banks. Data from retail banks, which account for about 90% of the total customers' deposits in the banking sector, are used in the calculation.

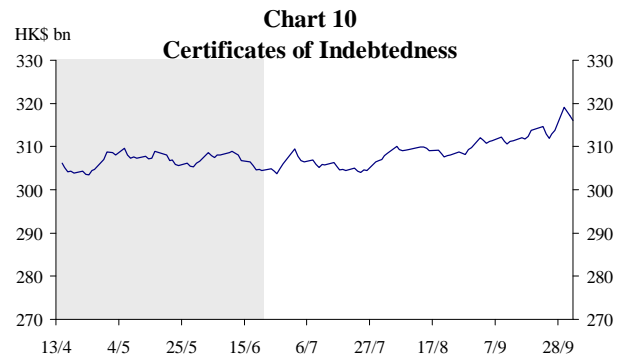
## Monetary Base

9. **The Monetary Base**, which consists of Certificates of Indebtedness (CIs), government-issued currency notes and coins in circulation, the Aggregate Balance and Exchange Fund Bills and Notes, **increased to HK\$1,242.35 billion on 3 October from HK\$1,230.50 billion on 24 June** (Table 2). Movements in the individual components are discussed below.

(HK\$bn)	24 Jun 13	03 Oct 13
CIs	304.88	316.02
Government-issued Currency Notes and Coins in Circulation	10.65	10.73
Aggregate Balance	163.94	163.88
Outstanding EFBNs	751.03	751.72
<b>Monetary Base</b>	<b>1230.50</b>	<b>1242.35</b>

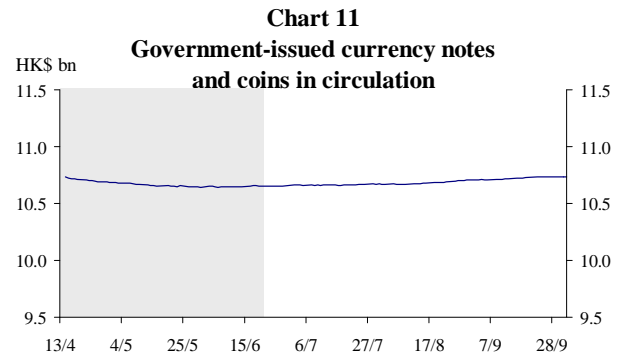
### *Certificates of Indebtedness*

10. During the review period, the three note-issuing banks submitted US\$1.43 billion in exchange for HK\$11.14 billion worth of CIs. As a result, **the outstanding CIs increased to HK\$316.02 billion on 3 October from HK\$304.88 billion on 24 June** (Chart 10).



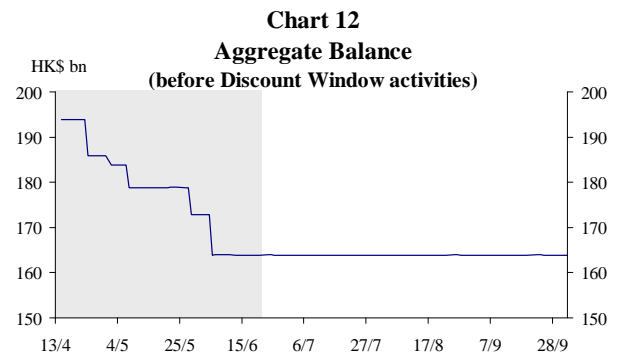
*Government-issued currency notes and coins in circulation*

11. During the review period, the amount of **government-issued currency notes and coins in circulation edged up** to HK\$10.73 billion on 3 October from HK\$10.65 billion on 24 June (Chart 11).



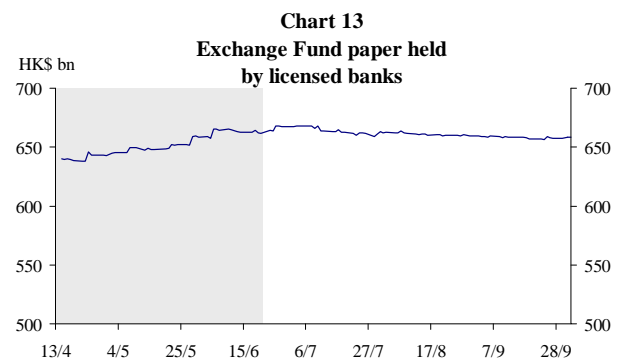
*Aggregate Balance*

12. **The Aggregate Balance was stable** at around HK\$163.9 billion during the review period, with small fluctuations due to interest payments on Exchange Fund paper (Chart 12).



*Outstanding Exchange Fund Bills and Notes*

13. **The market value of outstanding Exchange Fund Bills and Notes increased slightly** to HK\$751.72 billion from HK\$751.03 billion during the review period. Meanwhile, **holdings of Exchange Fund paper by the banking sector (before Discount Window activities) decreased** to HK\$658.66 billion (87.6% of total) from HK\$664.22 billion (88.4% of total) (Chart 13).



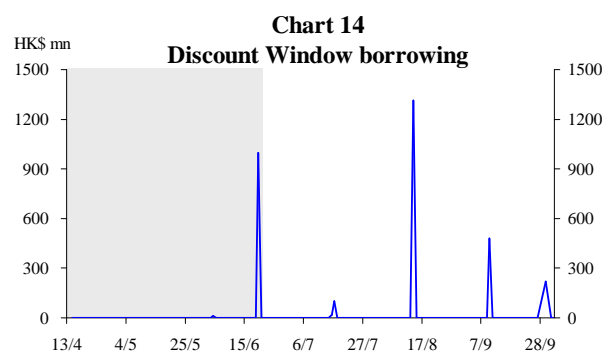


14. During the review period, **HK\$708.08 million of interest payments on Exchange Fund paper were made. An additional HK\$622.72 million (in market value) of Exchange Fund paper was issued to absorb these interest payments.** The remaining amount was carried forward in the Aggregate Balance. The Exchange Fund papers issued were well received by the market (Table 3).

	No. of issues launched	Over-subscription ratio
3-month EFB	15	0.81-3.32
6-month EFB	14	0.58-6.22
12-month EFB	3	1.81-2.15
2-year EFN	1	4.25
3-year EFN	1	2.01
5-year EFN	1	2.09
15-year EFN	1	5.98

**Discount Window activities**

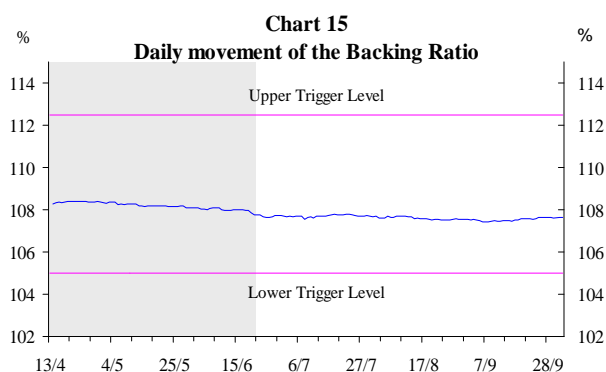
15. During the review period, **six banks borrowed a total of HK\$2.13 billion from the Discount Window**, compared with HK\$1.01 billion in the preceding period (Chart 14 and Table 4).



Frequency of using Discount Window	No. of banks
1	5
2	1

**Backing Portfolio**

16. The Backing Assets rose slightly to HK\$1,336.68 billion during the review period, mainly reflecting the increase in the CIs. As the Backing Assets increased proportionally less than the Monetary Base, **the Backing Ratio edged down to 107.63% from 107.75% during the review period** (Chart 15).



Under the Linked Exchange Rate system, while specific Exchange Fund assets have been designated for the Backing Portfolio, all Exchange Fund assets are available to support the Hong Kong dollar exchange rate.

**Hong Kong Monetary Authority**  
**3 December 2013**