

## REPORT ON CURRENCY BOARD OPERATIONS (21 DECEMBER 2000 - 31 JANUARY 2001)

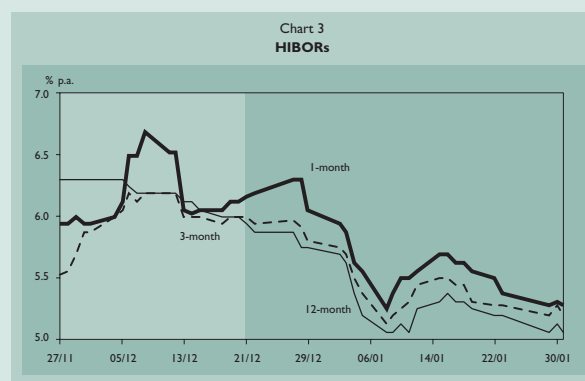
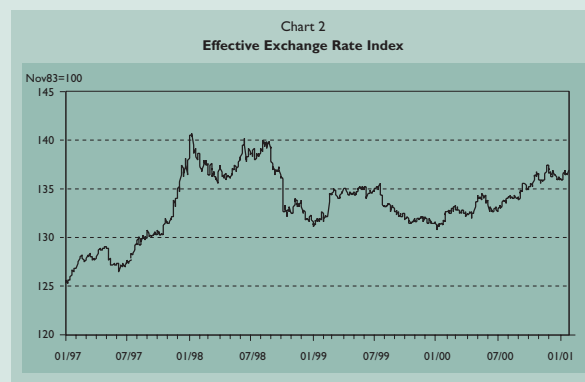
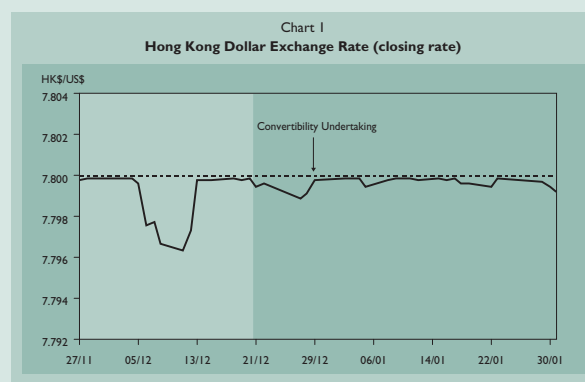
The Hong Kong dollar exchange rate stayed close to the linked rate, especially ahead of the Chinese New Year, as a result of increased US dollar purchases by the note-issuing banks for additional banknote issuance. Reflecting partly the 50 bp cut in the US Fed Funds Target Rate on 3 January, as well as expectations of further monetary easing in the US, interbank interest rates eased across the board. The monetary base increased from HK\$212.29 bn to HK\$228.10 bn during the period, largely because of an increase in the outstanding amount of Certificates of Indebtedness as a result of seasonal demand around Christmas and Chinese New Year. In accordance with currency board principles, changes in the monetary base were fully matched by corresponding changes in foreign reserves.

### Hong Kong Dollar Exchange Rate

Probably reflecting increased liquidity demand towards the year end, the Hong Kong dollar exchange rate briefly strengthened to around 7.7989 in the last week of 2000. Thereafter, partly due to increased purchases of US dollar by the note-issuing banks to provide backing for additional banknote issuance ahead of the Chinese New Year, the exchange rate eased and stayed close to 7.8000 towards the end of the period. Notwithstanding renewed pressures on some regional financial markets, the Hong Kong dollar exchange rate remained stable throughout the reporting period (Charts 1 and 2).

### Interest Rates

**Interbank interest rates eased across the board.** 1-month HIBOR remained firm at around 6.31% towards the end of 2000 on the back of increased demand for Hong Kong dollar funding straddling the year-end period. It then eased as the seasonal demand subsided. Reflecting the 50 bp rate-cut by the US Fed in early January as well as expectations for further rate cuts, 1-month HIBOR eased further to reach a low of 5.25% on 8 January. It then edged up again ahead of the Chinese New Year holidays before closing at 5.28% at the end of January. Both the **3-month and 12-month HIBOR followed the pattern of 1-month HIBOR, closing at 5.19% and 5.06% respectively** (Chart 3).



Measured in terms of the standard deviation of 1-month HIBOR, **interest rate volatility decreased** from 0.23 percentage points in December to 0.19 percentage points in January (Chart 4).

**The spreads between Hong Kong dollar interbank rates and their US counterparts remained in negative territory during the period.** Nevertheless, the negative spreads in terms of 1-month and 3-month rates generally narrowed, closing at 12 bp and 22 bp respectively. The negative spread for the 12-month rate was relatively stable, closing at 15 bp (Chart 5).

In line with the softening of interbank interest rates, **yields on Exchange Fund paper declined during the period** (Chart 6). The yields on 5-year and 10-year Exchange Fund Notes decreased by 34 bp and 21 bp to 5.51% and 6.20% respectively. **The yield spreads between 5-year and 10-year Exchange Fund paper and US Treasuries also narrowed considerably** (Table I).

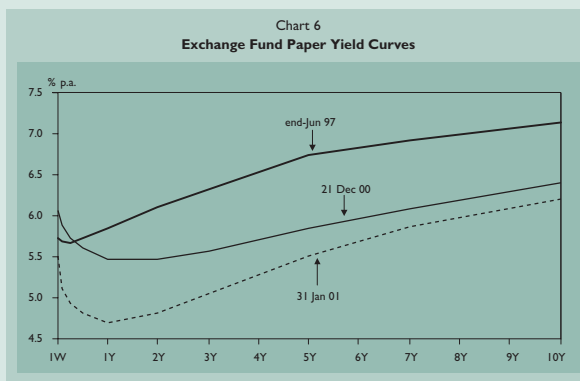
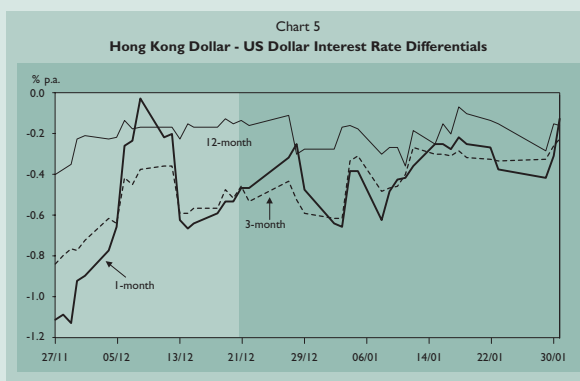
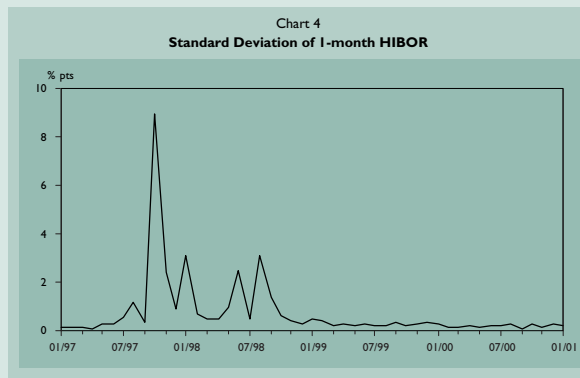
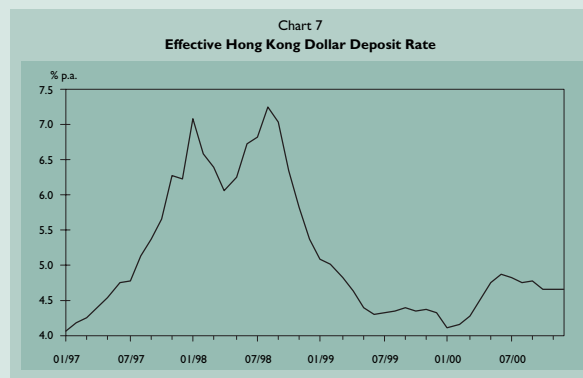


Table I  
Yield Spreads between Exchange Fund Paper  
and US Treasuries (basis points)

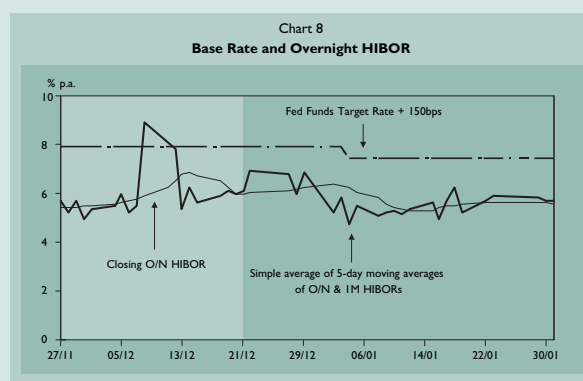
|         | 27-Jun-97 | 21-Dec-00 | 31-Jan-01 |
|---------|-----------|-----------|-----------|
| 3-month | 56        | -10       | -2        |
| 1-year  | 21        | -10       | 16        |
| 3-year  | 3         | 36        | 30        |
| 5-year  | 27        | 81        | 53        |
| 10-year | 54        | 131       | 88        |

Following the 50 bp reduction in the US Fed Funds Target Rate on 3 January, the HKAB **reduced the Savings Rate by 50 bp to 4.25%**, effective on 8 January. Concurrently, the **Best Lending Rate offered by major banks was also reduced from 9.50% to 9.00%**. The weighted average deposit rate offered by 44 major authorised institutions for 1-month time deposits decreased from 6.00% on 15 December to 5.34% on 23 January. The effective deposit rate stood at 4.67% in December, similar to the level in November (Chart 7)<sup>1</sup>.



#### Base Rate

Following the 50 bp cut in the US Fed Funds Target Rate on 3 January, the **Base Rate was adjusted downwards on 4 January to 7.50%**, 150 basis points above the US Fed Funds Target Rate (Chart 8). (Following another 50 bp rate-cut by the Fed on 31 January, the Base Rate was adjusted further downwards by 50 bp on 1 February to 7.00%.)



#### Monetary Base

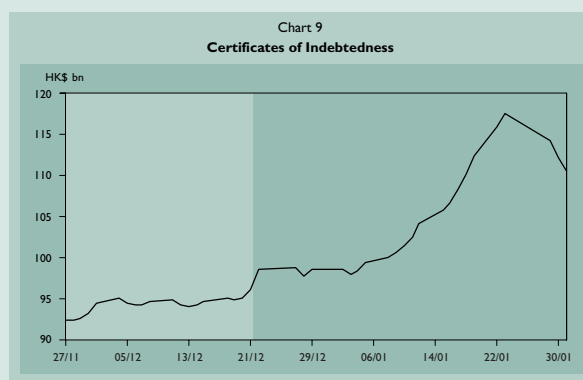
The **monetary base**, which comprises the outstanding amount of Certificates of Indebtedness, coins in circulation, the Aggregate Balance, and the outstanding amount of Exchange Fund Bills and Notes, **increased from HK\$212.29 bn to HK\$228.10 bn during the reporting period** (Table 2). Movements in individual components are discussed below.

Table 2  
Monetary Base

| (HK\$ bn)            | 21 Dec 00 | 31 Jan 01 |
|----------------------|-----------|-----------|
| CIs                  | 96.10     | 110.57    |
| Coins in Circulation | 6.15      | 6.29      |
| Aggregate Balance    | 0.41      | 0.28      |
| Outstanding EFBNs    | 109.63    | 110.96    |
| Monetary Base        | 212.29    | 228.10    |

#### Certificates of Indebtedness

In response to a significant rise in public demand for cash ahead of the Chinese New Year holidays, the three note-issuing banks submitted to the HKMA a total of US\$2.77 bn in exchange for HK\$21.57 bn worth of Certificates of Indebtedness (CIs) between 21 December 2000 and 23 January 2001. As the cash demand gradually reduced following the Chinese New Year, the banks then redeemed a total of HK\$7.1 bn in exchange for US\$0.91 bn for the rest of the period. As a result, the outstanding amount of CIs increased from HK\$96.10 bn to HK\$110.57 bn (Chart 9).



<sup>1</sup> This is the weighted average of the interest rates on demand deposits, savings and time deposits. As the banking statistics classify deposits by remaining maturities, we have used certain assumptions regarding the maturity distribution to compute the effective deposit rate.

## Coins

The total amount of **coins in circulation** increased from HK\$6.15 bn to HK\$6.29 bn during the period (Chart 10).

## Aggregate Balance

As the HKMA did not conduct any foreign exchange operations for the currency board account during the period, the Aggregate Balance remained stable at around HK\$0.3 bn to HK\$0.4 bn, with small changes due to interest payments and new issues of Exchange Fund paper (Chart 11).

During the period, a **total of HK\$0.63 bn in interest payments on Exchange Fund paper were made**. Taking into account the interest payments carried forward from the last reporting period, **an additional HK\$0.75 bn (market value) of Exchange Fund paper was issued to absorb these interest payments**.

## Outstanding Exchange Fund Bills and Notes

The market value of outstanding Exchange Fund paper increased from HK\$109.63 bn to HK\$110.96 bn. The increase was mainly a result of additional net issues (refer to the above paragraph). All issues of Exchange Fund Bills and Notes were well received by the market (Table 4). **Holdings of Exchange Fund paper by the banking sector (before Discount Window activities) increased** from HK\$97.39 bn (or 88.8% of total) on 21 December to HK\$100.82 bn (or 90.9% of total) on 31 January (Chart 12).

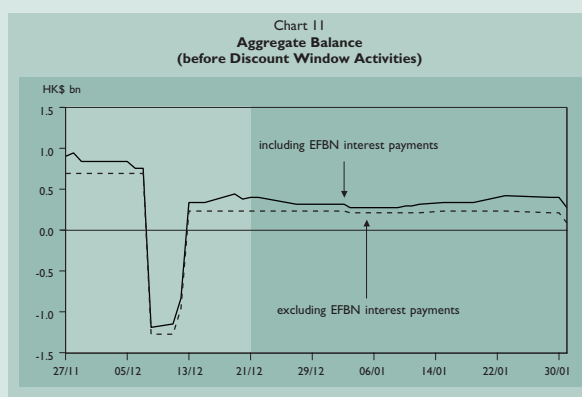
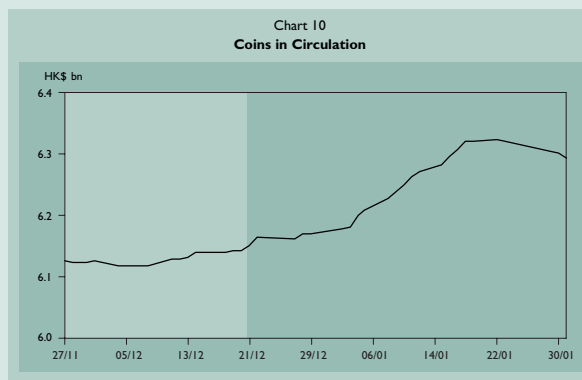
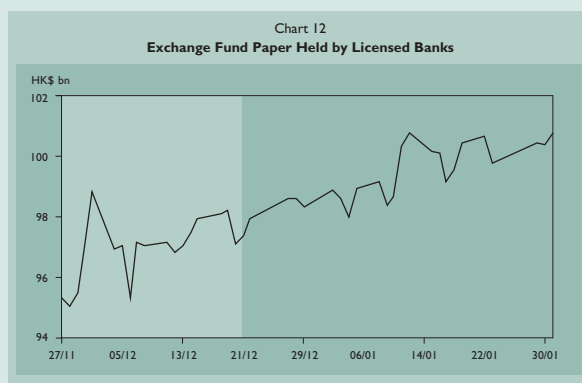


Table 4  
Issuance of Exchange Fund Paper  
(21 Dec 00 – 31 Jan 01)

|              | No. of Issues Launched | Over-subscription Ratio |
|--------------|------------------------|-------------------------|
| 1-month EFB  | 2                      | 2.29-5.07               |
| 3-month EFB  | 6                      | 1.78-3.93               |
| 6-month EFB  | 3                      | 2.18-4.55               |
| 12-month EFB | 1                      | 2.33                    |
| 3-year EFN   | 1                      | 4.81                    |




### Discount Window Activities

Reflecting stable liquidity conditions, Discount Window activities generally fell in the period. For the period as a whole, **banks in total borrowed HK\$5.71 bn** from the Discount Window, compared with HK\$8.19 bn in the preceding period. All except two of the borrowings used Exchange Fund paper as collateral (Chart 13).

**A total of 25 banks borrowed overnight funds through the Discount Window** (Table 5). Most banks used the Discount Window facility only infrequently.

### Backing Portfolio

Alongside the increase in outstanding CIs during the period, backing assets increased by the same amount. This nevertheless had the effect of pulling the backing ratio down **from 112.36% on 21 December to 111.70% on 31 January** (Chart 14). 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. 

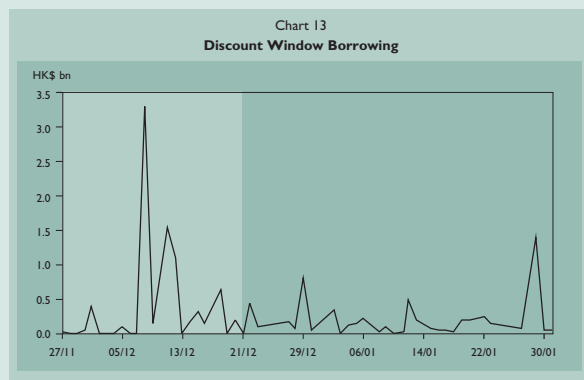
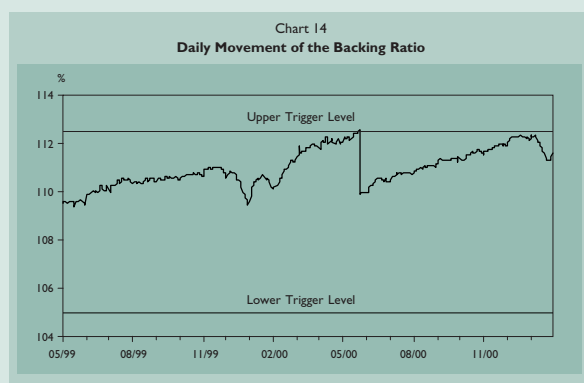


Table 5  
Frequency of Individual Bank's  
Access to the Discount Window  
(21 Dec 00 – 31 Jan 01)

| Frequency of Using Discount Window | No. of Banks |
|------------------------------------|--------------|
| 1                                  | 15           |
| 2                                  | 2            |
| 3                                  | 3            |
| 4                                  | 2            |
| >4                                 | 3            |
| <b>Total</b>                       | <b>25</b>    |



# RECORD OF DISCUSSION OF THE EXCHANGE FUND ADVISORY COMMITTEE SUB-COMMITTEE ON CURRENCY BOARD OPERATIONS ON 2 MARCH 2001

(Approved for Issue by the Exchange Fund Advisory Committee on 27 March 2001)

## Currency Board Operations for the Period 1 February - 21 February 2001

The Sub-Committee noted that this had been a stable period. The Base Rate had been adjusted downwards to 7.00% (150 basis points above the US Fed Funds Target Rate) following the 50 basis points cut in the US Fed Funds Target rate on 31 January. The Convertibility Undertaking had been triggered once, on 9 February, but the impact of this on the Aggregate Balance had been quickly offset by the sale of Hong Kong dollars in response to bank offers on the same day. The Sub-Committee also noted that, following the Chinese New Year holiday, there had been a reduction in the outstanding amount of Certificates of Indebtedness, and a consequent decrease in the monetary base from HK\$227.10 bn to HK\$216.36 bn. Having examined the trends in previous years, Members observed that the increase and decrease in Certificates of Indebtedness before and after the Chinese New Year holiday in 2001 followed very much the traditional pattern.

The Sub-Committee noted that on 20 February, towards the end of the reporting period, the backing ratio had reached 112.53%, passing the trigger of 112.5%. On the following day, in accordance with the policy approved in January 2000, assets had been transferred from the backing portfolio to the investment portfolio to reduce the backing ratio to around 110%.

Noting developments that had taken place after the reporting period, Members remarked that Hong Kong's markets had remained stable throughout the recent Turkish crisis.

The report on Currency Board operations for the period under review is at [Annex A](#).

## Monitoring of Risks and Vulnerabilities

The Sub-Committee noted the regular information paper on external and internal risks facing Hong Kong. Externally, the Sub-Committee noted that, barring a hard landing, the economic slowdown in the US was unlikely to arrest recovery in the Asian region as a whole, although the region would not escape some impact, and certain sectors (for example electronics) and economies might be affected more than others. Members also

noted that the Turkish crisis, while it might have had some mild contagion effect on certain emerging markets, had so far had no great effect on Asia and none at all on Hong Kong.


Domestically, the Sub-Committee noted the moderation in economic growth, and the complex relationships between property prices and economic activity.

## Corporate Restructuring in Hong Kong

The Sub-Committee noted an information paper on corporate restructuring in Hong Kong in the aftermath of the Asian Financial Crisis. The paper examined how economic adjustment had taken place under Hong Kong's linked exchange rate system (in contrast to the adjustment through currency depreciation in many of the other crisis-hit economies), taking into account the general principle that, under a fixed exchange rate system, competitiveness is restored through productivity increases or through internal price restructuring. Members noted a sharper slowdown in nominal wage increases in Hong Kong compared with other Asian economies, but greater resilience in wages in Hong Kong if measured in US dollar terms. Members observed that there had been reductions in rent of between 20% and 33%, although they noted that these reductions had been smaller than in other Asian economies when currency movements were taken into account. Members also noted significant and successful financial restructuring by companies in Hong Kong, and a gain of 6.5% in labour productivity during the post-crisis period, compared with a range of 2% to 6.9% for the region as a whole.

## Interest Rate Spreads

The Sub-Committee noted an information paper analysing the various risk components in the yield spreads of Exchange Fund paper over US Treasuries. The Sub-Committee remarked that the study, which covered the recent Asian Financial crisis and the recovery following it, dealt with an extremely volatile period, during part of which the currency had been the main focus of concern. Such spreads had widened to over 500 basis points during the Asian Financial crisis but had come down considerably over the past two years. They remarked that, while it was extremely difficult to

decompose the yield spread and attribute its components quantitatively to various risk factors, it appeared that long-term currency risk had been the main concern for investors over the crisis period, although, in retrospect, the risk seemed to have taken the form of confounded expectations. 

## REPORT ON CURRENCY BOARD OPERATIONS (1 - 21 FEBRUARY 2001)

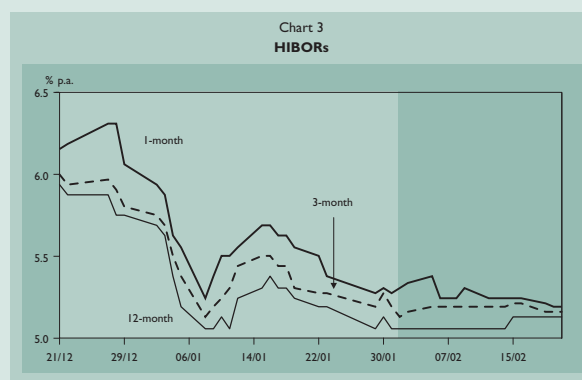
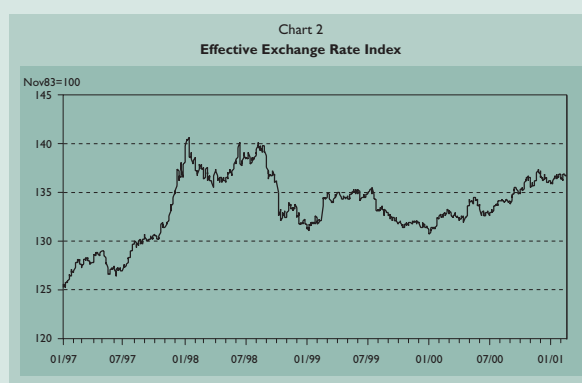
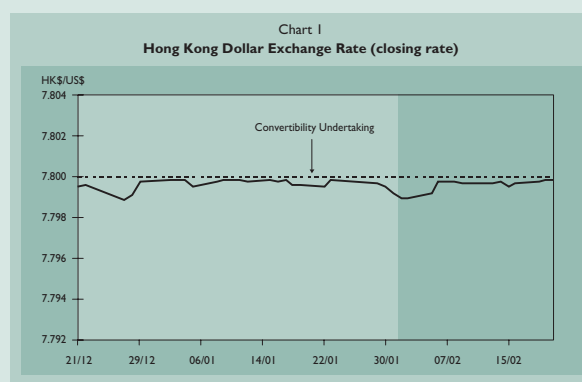
The Hong Kong dollar exchange rate stayed fairly close to 7.8000 during the reporting period. Reflecting partly the 50 bp cut in the US Fed Funds Target Rate on 31 January as well as expectations of further US monetary easing, interbank interest rates remained soft. The Aggregate Balance remained stable throughout the period. The Convertibility Undertaking was triggered once. But its impact on the Aggregate Balance was quickly offset by a sale of Hong Kong dollars by the HKMA in response to bank offers on the same day. The monetary base decreased from HK\$227.10 bn to HK\$216.36 bn, mainly due to a reduction in the outstanding amount of Certificates of Indebtedness after the Chinese New Year holidays. In accordance with currency board principles, changes in the monetary base were fully matched by corresponding changes in foreign reserves.

### Hong Kong Dollar Exchange Rate

The Hong Kong dollar exchange rate briefly strengthened to around 7.7990 after the Chinese New Year period, partly reflecting reduced demand for US dollars in the TT market on the part of note-issuing banks as Certificates of Indebtedness (CIs) were redeemed. On 9 February, the exchange rate briefly touched 7.8000, and the HKMA bought a total of HK\$1.17 bn under the Convertibility Undertaking, taking the forecast Aggregate Balance to negative territory. The projected shrinkage of liquidity strengthened the exchange rate. In response to bank offers, the HKMA sold a total of HK\$1.17 bn on the same day, restoring the forecast Aggregate Balance to the original level. The exchange rate eased, and stayed close to the linked rate throughout the rest of the reporting period (Charts 1 and 2).

### Interest Rates

Interbank interest rates were generally stable during the reporting period. 1-month HIBOR briefly firmed to 5.38% in the beginning of February. It then eased and moved within a range of 5.19% and 5.31% during the rest of the period. 3-month and 12-month HIBORs also remained stable, closing at 5.16% and 5.13% respectively (Chart 3).





Money market activity has been rather quiet. Measured in terms of the standard deviation of 1-month HIBOR, **interest rate volatility decreased** from 0.19 percentage points in January to 0.05 percentage points in February (up to 21 February) (Chart 4).

**The negative spreads between Hong Kong dollar interbank rates and their US counterparts persisted.** In terms of 1-month rate, the negative spread widened to close at 39 bp. The negative spreads in terms of 3-month and 12-month rates were relatively stable, closing at 20 bp and 13 bp respectively at the end of the reporting period (Chart 5).

**Yields on the Exchange Fund paper, particularly for those of 5-year term or below, increased slightly during the period** (Chart 6). In respect of 5-year and 10-year Exchange Fund Notes, yields increased by 17 bp and 5 bp to 5.50% and 6.10% respectively. **The yield spreads between 5-year and 10-year Exchange Fund paper and US Treasuries widened marginally** by 3 bp and 5 bp, to 54 bp and 94 bp respectively (Table I).

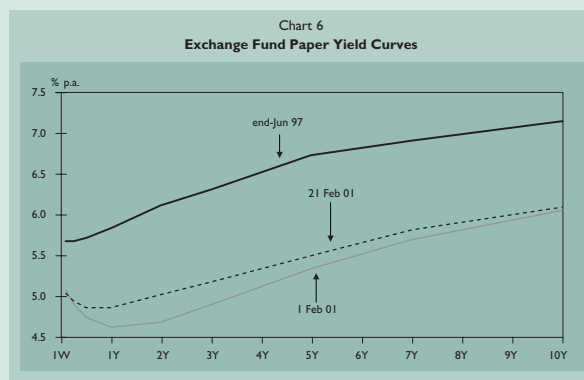
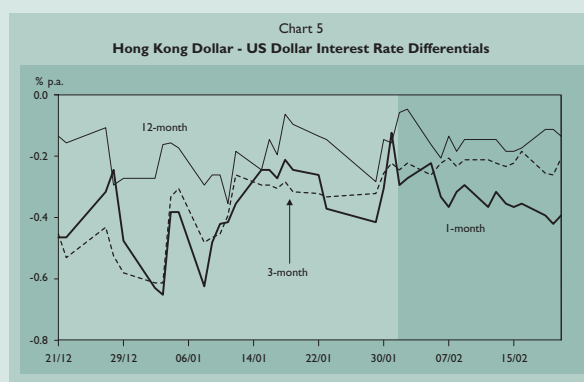
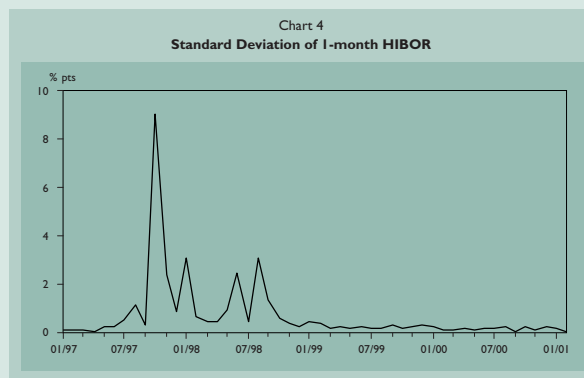


Table I  
Yield Spreads between Exchange Fund Paper  
and US Treasuries (basis points)

|         | 27 Jun 97 | 1 Feb 01 | 21 Feb 01 |
|---------|-----------|----------|-----------|
| 3-month | 56        | -19      | -18       |
| 1-year  | 21        | -5       | -2        |
| 3-year  | 3         | 17       | 27        |
| 5-year  | 27        | 51       | 54        |
| 10-year | 54        | 89       | 94        |

Following the 50 bp reduction in the US Fed Funds Target Rate on 31 January, the HKAB **reduced the Savings Rate by 50 bp to 3.75%**, effective on 5 February. Concurrently, the **Best Lending Rate offered by major banks was also lowered from 9.00% to 8.50%**. The weighted average deposit rate offered by 44 major authorised institutions for 1-month time deposits decreased from 5.34% on 23 January to 5.07% on 16 February. Meanwhile, the effective deposit rate decreased from 4.67% in December to 4.39% in January (Chart 7)<sup>1</sup>.

#### Base Rate

Following the 50 bp cut in the US Fed Funds Target Rate on 31 January, the **Base Rate was adjusted downwards on 1 February to 7.00%**, 150 basis points above the US Fed Funds Target Rate (Chart 8).

#### Monetary Base

The **monetary base**, which comprises the outstanding amount of Certificates of Indebtedness, coins in circulation, the Aggregate Balance, and the outstanding amount of Exchange Fund Bills and Notes, **decreased from HK\$227.10 bn to HK\$216.36 bn during the reporting period** (Table 2). Movements in individual components are discussed below.

#### Certificates of Indebtedness

As the seasonal demand for cash subsided after the Chinese New Year holidays, the outstanding amount of CIs started to decline in late January. The three note-issuing banks redeemed a total of HK\$10.79 bn of CIs in exchange for US\$1.38 bn during 1-21 February. As a result, the **outstanding amount of CIs decreased** from HK\$109.45 bn to HK\$98.66 bn (Chart 9).

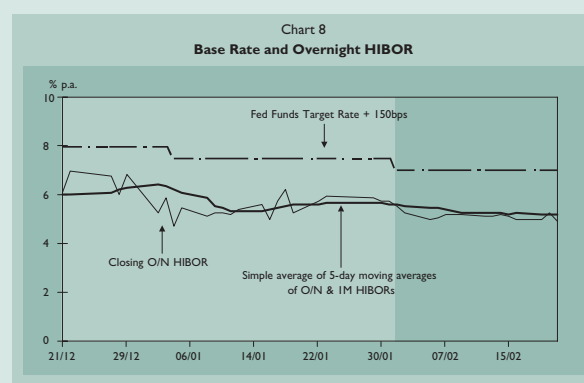
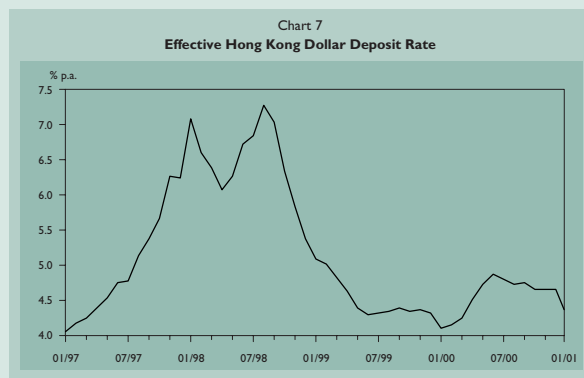
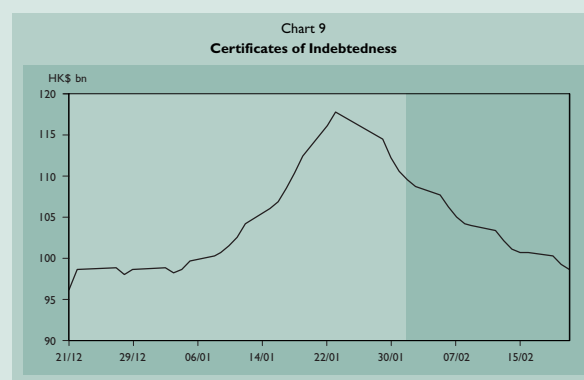


Table 2  
Monetary Base

| (HK\$ bn)            | 1 Feb 01 | 21 Feb 01 |
|----------------------|----------|-----------|
| CIs                  | 109.45   | 98.66     |
| Coins in Circulation | 6.29     | 6.23      |
| Aggregate Balance    | 0.28     | 0.33      |
| Outstanding EFBNs    | 111.08   | 111.14    |
| Monetary Base        | 227.10   | 216.36    |



<sup>1</sup> This is the weighted average of the interest rates on demand deposits, savings and time deposits. As the banking statistics classify deposits by remaining maturities, we have used certain assumptions regarding the maturity distribution to compute the effective deposit rate.

## Coins

The total amount of **coins in circulation** decreased from HK\$6.29 bn to HK\$6.23 bn during the period (Chart 10).

## Aggregate Balance

The Aggregate Balance remained stable at around HK\$0.30 bn during the period, with small changes due to interest payments and new issues of Exchange Fund paper (Table 3 and Chart 11). At one point, the Balance was forecasted to drop below zero as a result of the purchase of HK\$1.17 bn under the Convertibility Undertaking (9 February). But it quickly returned to the original level, following a sale of the same amount by the HKMA in response to bank offers.

During the period, a total of **HK\$0.31 bn of interest payments on Exchange Fund paper were made, while an additional HK\$0.27 bn (market value) of Exchange Fund paper was issued to absorb these interest payments.** The remaining amount was carried forward in the Aggregate Balance.

## Outstanding Exchange Fund Bills and Notes

The market value of outstanding Exchange Fund paper increased from **HK\$111.08 bn to HK\$111.14 bn.** The increase was mainly a result of additional net issues (refer to the above paragraph). All issues of Exchange Fund Bills and Notes were well received by the market (Table 4). **Holdings of Exchange Fund paper by the banking sector (before Discount Window activities) increased from HK\$100.29 bn (or 90.3% of total) on 1 February to HK\$100.84 bn (or 90.7% of total) on 21 February** (Chart 12).

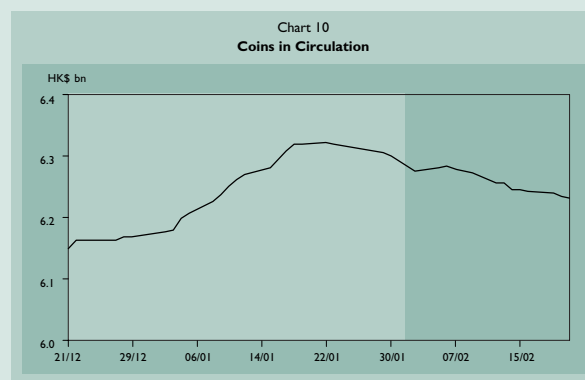
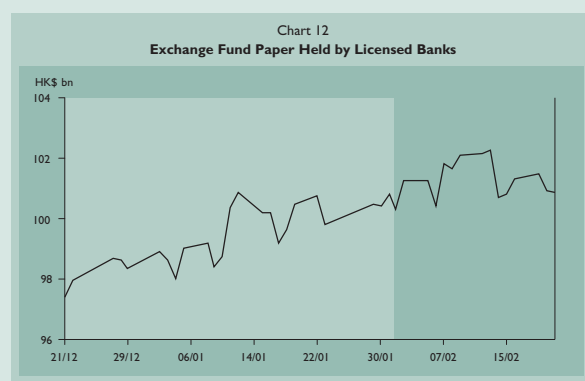
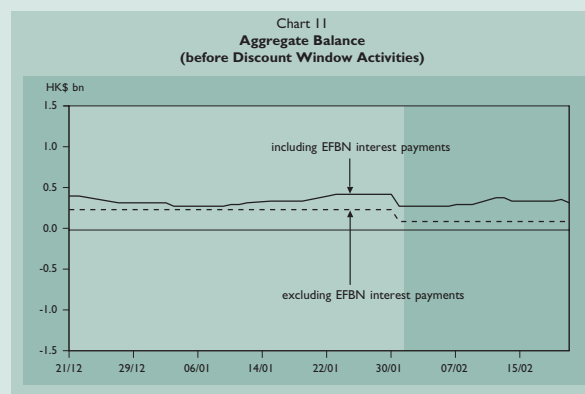


Table 3  
HKMA Hong Kong Dollar / US Dollar  
Foreign Exchange Transactions\*  
(1 – 21 February 01)

| Trade Date   | Net Hong Kong Dollar Purchase (+) / Sale (-) (HK\$ mn) |
|--------------|--|
| 9 Feb        | +1,170   |
| 9 Feb        | -1,170   |
| <b>Total</b> | <b>0</b>   |

\* Foreign exchange transactions may be due for settlement today, on the next business day, or the day after, at which point they would affect the Aggregate Balance.



## Discount Window Activities

Reflecting stable liquidity conditions, Discount Window activities fell in the period. **Banks in total borrowed HK\$1.52 bn** from the Discount Window, compared with HK\$5.71 bn in the preceding period. All of the borrowings used Exchange Fund paper as collateral (Chart 13).

**A total of 16 banks borrowed overnight funds through the Discount Window** (Table 5). Most banks used the Discount Window facility only infrequently.

## Backing Portfolio

Along with the decrease in CIs outstanding, backing assets fell accordingly. Nevertheless, the decline in backing assets was more moderate than that of the monetary base, partly due to positive net interest income. As a result, **the backing ratio increased from 111.87% on 1 February to 112.53% on 20 February, surpassing the upper-trigger level of 112.5%.** Pursuant to the arrangement approved by the Financial Secretary in January 2000, assets were transferred out of the backing portfolio to the investment portfolio to reduce the backing ratio to around 110% on 21 February (Chart 14). 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. 🌸

Table 4  
Issuance of Exchange Fund Paper  
(1 – 21 Feb 01)

|              | No. of Issues Launched | Over-subscription Ratio |
|--------------|------------------------|-------------------------|
| 1-month EFB  | 1                      | 10.45                   |
| 3-month EFB  | 3                      | 2.45-3.42               |
| 6-month EFB  | 2                      | 3.25-4.16               |
| 12-month EFB | 1                      | 2.26                    |
| 2-year EFN   | 1                      | 4.43                    |

Chart 13  
Discount Window Borrowing

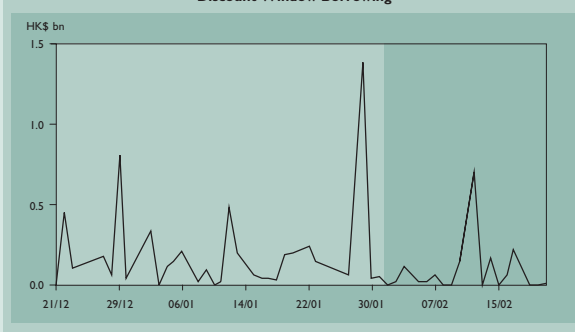
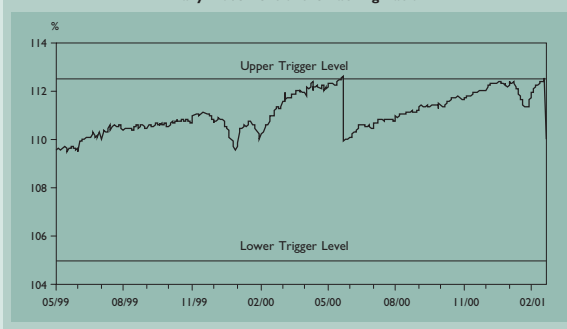


Table 5  
Frequency of Individual Bank's  
Access to the Discount Window  
(1 – 21 Feb 01)

| Frequency of Using Discount Window | No. of Banks |
|------------------------------------|--------------|
| 1                                  | 10           |
| 2                                  | 3            |
| 3                                  | 2            |
| 4                                  | 0            |
| >4                                 | 1            |
| <b>Total</b>                       | <b>16</b>    |

Chart 14  
Daily Movement of the Backing Ratio



## REPORT ON CURRENCY BOARD OPERATIONS (22 FEBRUARY - 31 MARCH 2001)

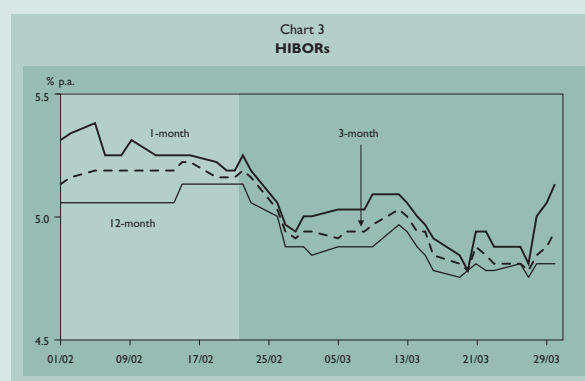
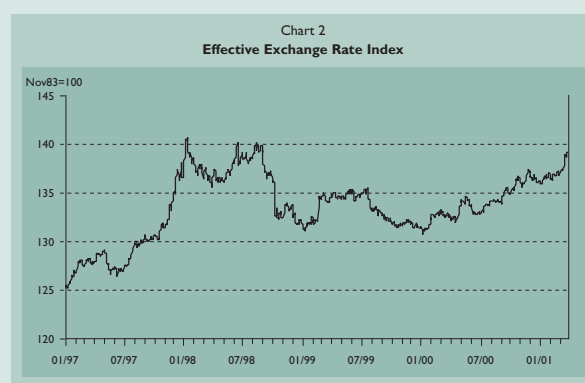
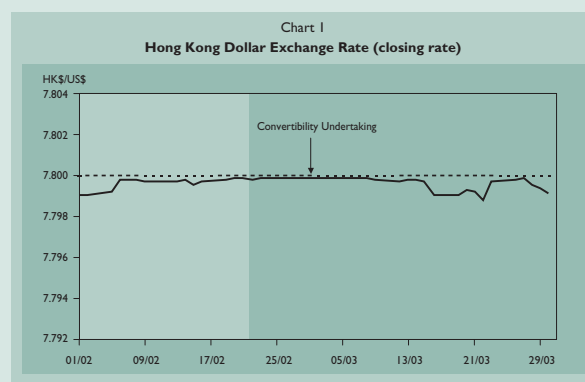
The Hong Kong dollar exchange rate remained stable despite corrections in world stock prices and volatility in some emerging markets. The Convertibility Undertaking was triggered in late March, bringing the forecast Aggregate Balance to a negative level. This was followed by a sale of Hong Kong dollars by the HKMA in response to bank offers on the following day, which restored the Aggregate Balance to the positive level. Reflecting the 50 bp cut in the US Fed Funds Target Rate on 20 March, as well as expectations of further US monetary easing, interbank interest rates remained soft, although the negative spreads with US interest rates largely disappeared. The monetary base decreased marginally from HK\$216.54 bn to HK\$216.34 bn, mainly due to a reduction in the outstanding amount of Certificates of Indebtedness. In accordance with Currency Board principles, changes in the monetary base were fully matched by corresponding changes in foreign reserves.

### Hong Kong Dollar Exchange Rate

Notwithstanding volatility in some emerging markets, including instability in the Argentinian financial markets, the Hong Kong dollar exchange rate remained stable. It stayed close to 7.8000 during most of the period. On 27 March, the Convertibility Undertaking was triggered, bringing the projected Aggregate Balance to a negative level. As a result, local interest rates firmed, and the exchange rate strengthened. In response to bank offers, the HKMA sold a total of HK\$1.17 bn on the following day, restoring the forecast Aggregate Balance to a positive level. Probably lured by higher local interest rates, there were increased demands for Hong Kong dollar assets towards the end of March. As the exchange rate slightly strengthened towards the end of the month, the HKMA sold another HK\$0.39 bn on 29 March in response to bank offers (Charts 1 and 2).

### Interest Rates

Tracking the movements of their US dollar counterparts, Hong Kong dollar interbank interest rates eased across the board during the period. 1-month HIBOR eased to a low of 4.78% on 20 March. It then firmed to 5.00% on 28 March, as the Aggregate Balance was forecast to fall to a negative level. Despite the sale of Hong Kong dollars by the HKMA in late March, 1-month HIBOR stayed firm towards the end of the period, partly due to strong month-end funding needs. 3-month and 12-month HIBORs followed a similar pattern, closing at 4.94% and 4.81% respectively reporting (Chart 3).



**Interest rate volatility**, measured in terms of the standard deviation of 1-month HIBOR, **decreased** from 0.11 percentage points in February to 0.09 percentage points in March (Chart 4).

During the period, Hong Kong dollar interest rates eased more moderately than the US dollar counterparts. As a result, **the negative spreads between Hong Kong dollar interbank rates and their US counterparts narrowed**. In terms of 1-month and 3-month rates, the negative spreads disappeared in late March. The 12-month HIBOR rose above its US dollar counterpart in mid-March, and the gap once widened to 20bp before narrowing to 11bp at the end of the reporting period (Chart 5).

In line with a softening of local interest rates, **yields on the Exchange Fund paper**, particularly those with short- to medium-term maturity, **decreased during the period**, (Chart 6). In respect of 5-year Exchange Fund Notes, the yield decreased by 10 bp to 5.39%. **The yield spreads between 5-year and 10-year Exchange Fund paper and US Treasuries widened** by 19 bp and 18 bp, to 71 bp and 110 bp respectively (Table 1).

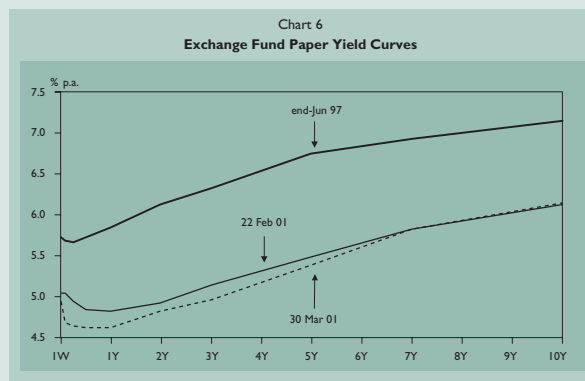
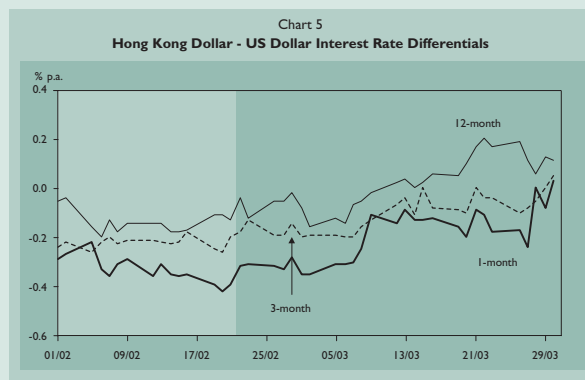
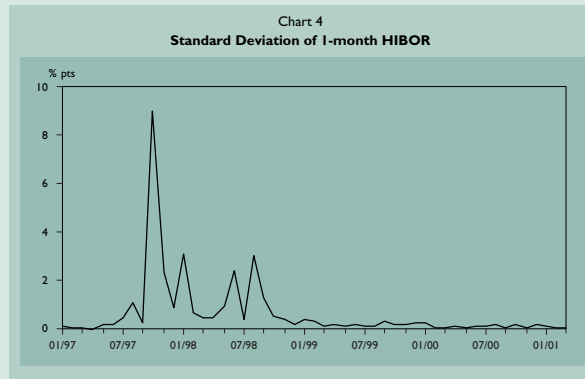
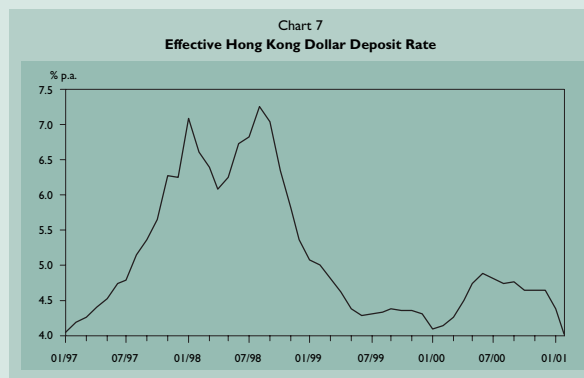


Table 1  
Yield Spreads between Exchange Fund Paper and US Treasuries (basis points)

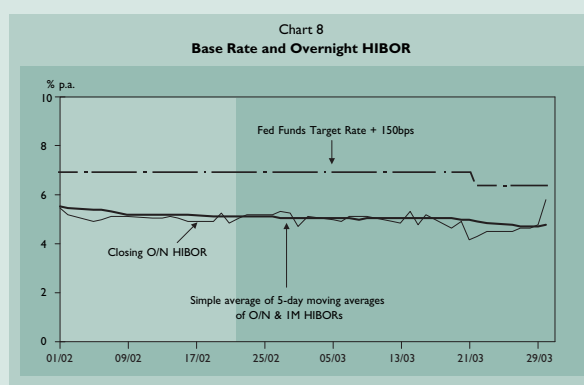
|         | 27 Jun 97 | 22 Feb 01 | 30 Mar 01 |
|---------|-----------|-----------|-----------|
| 3-month | 56        | -17       | 26        |
| 1-year  | 21        | -4        | 39        |
| 3-year  | 3         | 33        | 46        |
| 5-year  | 27        | 52        | 71        |
| 10-year | 54        | 92        | 110       |

Following the 50 bp reduction in the US Fed Funds Target Rate on 20 March, the HKAB **reduced the Savings Rate by 50 bp to 3.25%**, effective on 26 March. Concurrently, the **Best Lending Rate offered by major banks was also lowered from 8.50% to 8.00%**. The weighted average deposit rate offered by 44 major authorized institutions for 1-month time deposits decreased from 5.07% on 16 February to 4.69% on 30 March. Meanwhile, the effective deposit rate decreased from 4.39% in January to 4.03% in February (Chart 7)<sup>1</sup>.



#### Base Rate

Following the 50 bp cut in the US Fed Funds Target Rate on 20 March, the **Base Rate was adjusted downwards on 21 March to 6.50%**, 150 basis points above the US Fed Funds Target Rate (Chart 8).



#### Monetary Base

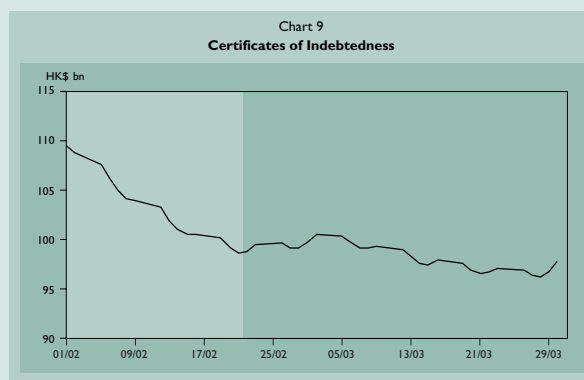
The **monetary base**, which comprises the outstanding amount of Certificates of Indebtedness (CIs), coins in circulation, the Aggregate Balance, and the outstanding amount of Exchange Fund Bills and Notes, **decreased slightly from HK\$216.54 bn to HK\$216.34 bn during the reporting period** (Table 2). Movements in individual components are discussed below.

Table 2  
Monetary Base

| (HK\$ bn)            | 22 Feb 01 | 30 Mar 01 |
|----------------------|-----------|-----------|
| CIs                  | 98.83     | 97.88     |
| Coins in Circulation | 6.23      | 6.12      |
| Aggregate Balance    | 0.33      | 0.49      |
| Outstanding EFBNs    | 111.15    | 111.85    |
| Monetary Base        | 216.54    | 216.34    |

#### Certificates of Indebtedness

The three note-issuing banks redeemed a total of HK\$0.95 bn of CIs in exchange for US\$0.12 bn during 22 February to 30 March. As a result, the **outstanding amount of CIs decreased from HK\$98.83 bn to HK\$97.88 bn** (Chart 9).



<sup>1</sup> This is the weighted average of the interest rates on demand deposits, savings and time deposits. As the banking statistics classify deposits by remaining maturities, we have used certain assumptions regarding the maturity distribution to compute the effective deposit rate.

## Coins

The total amount of **coins in circulation** decreased from HK\$6.23 bn to HK\$6.12 bn during the period (Chart 10).

## Aggregate Balance

The Aggregate Balance remained stable between HK\$0.30 bn and HK\$0.50 bn during the period (Table 3 and Chart 11). On 27 March, the forecast Aggregate Balance dropped below zero as a result of the purchase of HK\$1.37 bn by the HKMA under the Convertibility Undertaking. It then returned to a positive level following a sale of HK\$1.17 bn by the HKMA in response to bank offers on the following day. The Aggregate Balance increased further as the HKMA sold another HK\$0.39 bn on 29 March in response to bank offers.

During the period, a **total of HK\$0.60 bn of interest payments on Exchange Fund paper were made**. Taking into account the interest payments carried forward from the last reporting period, **an additional HK\$0.63 bn (market value) of Exchange Fund paper was issued to absorb these interest payments**.

## Outstanding Exchange Fund Bills and Notes

The market value of outstanding Exchange Fund paper increased from HK\$111.15 bn to HK\$111.85 bn. The increase was mainly a result of additional net issues (refer to the above paragraph). All issues of Exchange Fund Bills and Notes were well received by the market (Table 4). **Holdings of Exchange Fund paper by the banking sector (before Discount Window activities) increased from**

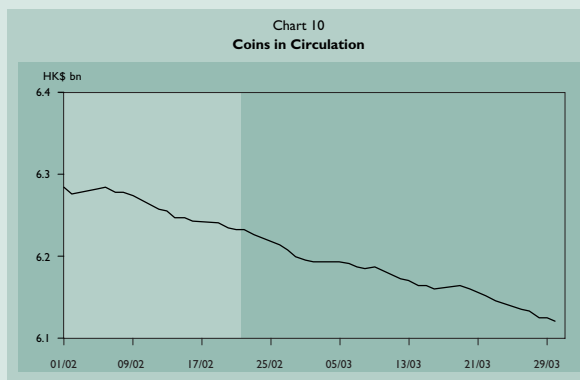


Table 3  
HKMA Hong Kong Dollar / US Dollar  
Foreign Exchange Transactions\*  
(22 Feb – 31 Mar 01)

| Trade Date   | Net Hong Kong Dollar Purchase (+) / Sale (-) (HK\$ mn) |
|--------------|--|
| 27 Mar       | +1,365   |
| 28 Mar       | -1,170   |
| 29 Mar       | -390   |
| <b>Total</b> | <b>-195</b>  |

\* Foreign exchange transactions may be due for settlement today, on the next business day, or the day after, at which point they would affect the Aggregate Balance.

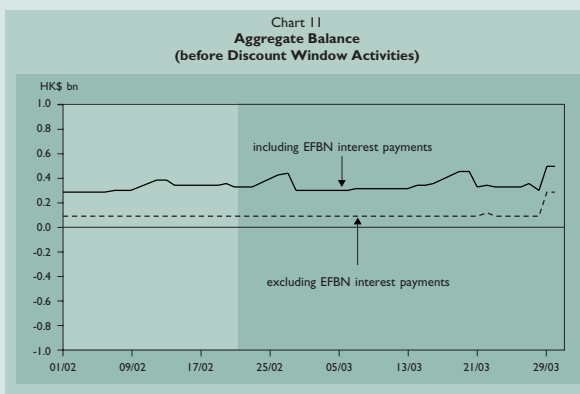


Table 4  
Issuance of Exchange Fund Paper  
(22 Feb – 31 Mar 01)

|              | No. of Issues Launched | Over-subscription Ratio |
|--------------|------------------------|-------------------------|
| 1-month EFB  | 1                      | 12.90                   |
| 3-month EFB  | 5                      | 2.64-3.41               |
| 6-month EFB  | 2                      | 3.96-4.28               |
| 12-month EFB | 1                      | 3.07                    |
| 5-year EFN   | 1                      | 5.77                    |




HK\$101.42 bn (or 91.2% of total) on 22 February to HK\$103.34 bn (or 92.4% of total) on 30 March (Chart 12).

### Discount Window Activities

Banks in total borrowed HK\$5.01 bn from the Discount Window, compared with HK\$1.52 bn in the preceding period. A large chunk of the borrowing was concentrated towards the month-end, reflecting an increase in liquidity demand. All of the borrowings used Exchange Fund paper as collateral (Chart 13).

A total of 26 banks borrowed overnight funds through the Discount Window (Table 5). Most banks used the Discount Window facility only infrequently.

### Backing Portfolio

Along with the decrease in CIs outstanding, backing assets fell accordingly. Nevertheless, the decline in backing assets was more moderate than that of the monetary base, partly due to positive net interest income. As a result, the backing ratio increased from 109.97% on 22 February to 110.36% on 30 March (Chart 14). 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. 

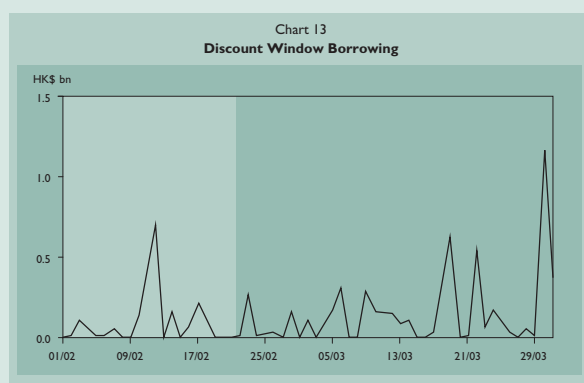
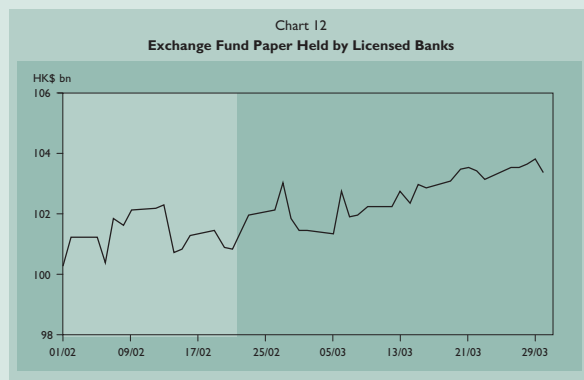


Table 5  
Frequency of Individual Bank's  
Access to the Discount Window  
(22 Feb – 31 Mar 01)

| Frequency of Using Discount Window | No. of Banks |
|------------------------------------|--------------|
| 1                                  | 15           |
| 2                                  | 4            |
| 3                                  | 3            |
| 4                                  | 2            |
| >4                                 | 2            |
| <b>Total</b>                       | <b>26</b>    |

