

# Record of Discussion of the Exchange Fund Advisory Committee Sub-Committee on Currency Board Operations on 7 May 2004

(Approved for Issue by the Exchange Fund Advisory Committee on 27 May 2004)

## Report on Currency Board Operations (26 March - 23 April 2004)

The Sub-Committee noted that the Hong Kong dollar had gradually moved back to a level very close to the official rate of 7.8 during the course of the period under review. Outside of this period, the Convertibility Undertaking had been activated once, on 30 April. The Aggregate Balance continued to be very high, at around HK\$54 billion. Short-term interest rates remained very low, but long-term rates had increased on expectations of monetary tightening in the US. Members observed that Hong Kong dollar forward points continued to be at a discount, which suggested that sentiment towards the Hong Kong dollar was still strong.

The Sub-Committee noted that, in accordance with Currency Board principles, changes in the Monetary Base during the reporting period had been fully matched by changes in the foreign reserves.

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

## Monitoring of risks and vulnerabilities

The Sub-Committee noted that global recovery continued to gather momentum. On the Mainland measures had been taken to address rapid growth in fixed asset investment and bank credit. The risks to monetary and financial stability in Hong Kong had continued to recede, and the near-term growth outlook was positive. The Sub-Committee noted the widespread expectations of a rise in US interest rates. While such a rise might have possible negative effects on consumption and investment in Hong Kong, the Hong Kong economy, which had strengthened over the past year, was now in a better position to absorb these effects.

## Key price indicators and inflation in Hong Kong

The Sub-Committee noted an information paper that sought to explain why the GDP deflator for Hong Kong had fallen at a greater rate than had the Composite Consumer Price Index (CCPI) in recent years. Members noted the importance of understanding the sources and significance of the difference in order to properly assess inflationary and deflationary pressures in the economy. Two factors appeared to be

involved. First, the GDP deflator had a wider coverage of goods and services. Secondly, the CCPI was a Laspeyres index, which had an upward bias, while the GDP deflator was a Paasche index with a downward bias. The bias rose as the weighting structure became increasingly outdated over time. Members observed that the discrepancy arose mainly from differences in coverage, rather than the choice of index, and that therefore the distortions arising from measurement issues should be limited.

## Alternative measures of core inflation on the Mainland

The Sub-Committee noted an information paper addressing the question of alternative measures of core inflation on the Mainland, given the importance of developments on the Mainland for Hong Kong. The paper examined the question of whether headline inflation was a good indicator of underlying pressure, taking into account the fact that the recent increase had come mainly from food prices. The paper considered several measures of core inflation. The analysis indicated that inflationary pressures had probably been more subdued than suggested by the headline inflation rate.

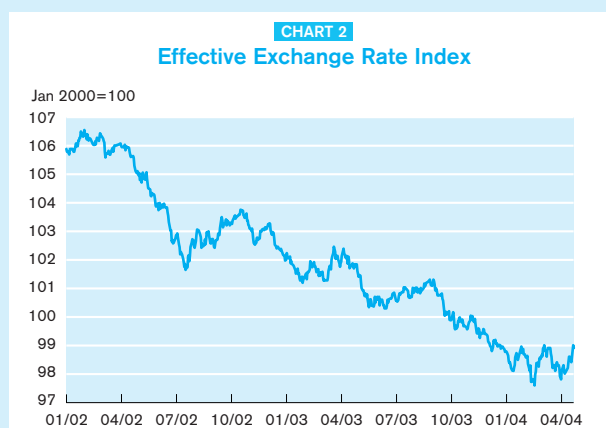
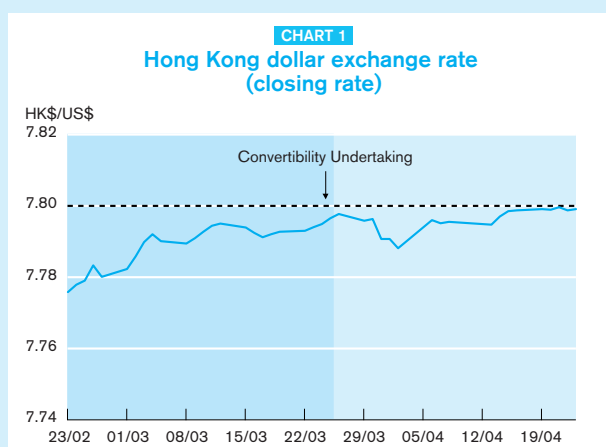
## Annex

# Report on Currency Board Operations (26 March – 23 April 2004)

The Hong Kong dollar exchange rate stayed close to the linked rate at the end of the reporting period. Short-term interbank interest rates remained close to zero, while longer-term rates increased on expectations of monetary tightening in the US. The Monetary Base rose modestly from HK\$321.58 billion to HK\$321.98 billion during the period: this was attributable to an increase 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.

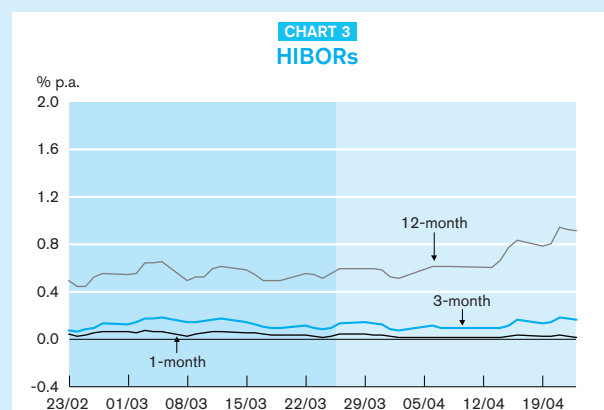
### Hong Kong dollar exchange rate

The Hong Kong dollar exchange rate firmed temporarily in the early part of the reporting period, prompted by a volatile Japanese yen and a rebound in the local stock market (Chart 1). The market exchange rate subsequently **eased to 7.7990 at the end of the reporting period**, close to the linked rate of 7.8. Meanwhile, the effective exchange rate of the Hong Kong dollar rose slightly (Chart 2).

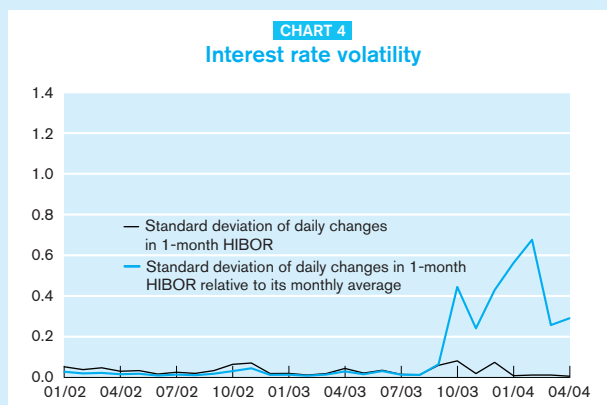


### Interest rates

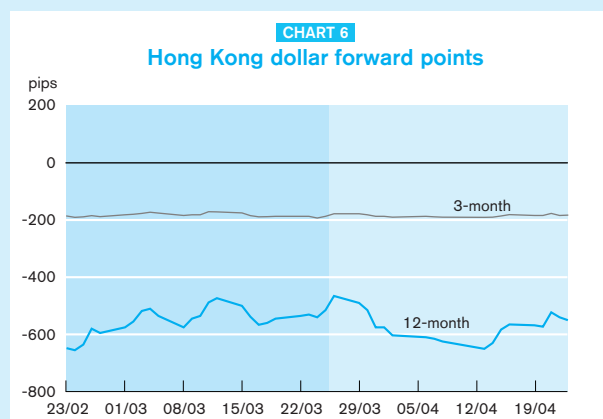
**Short-term Hong Kong dollar interest rates remained low.** For the period as a whole, one-month HIBOR fell by 3 bp to close at 0.02%, while three-month HIBOR edged up by 3 bp to 0.17%. 12-month HIBOR rose notably by 32 bp to 0.92%, reflecting market expectations of monetary tightening in the US (Chart 3).



**Interest rate volatility**, as measured by the standard deviation of daily changes in one-month HIBOR, **remained low**. As a ratio to the average level of one-month HIBOR, it increased in April, due to a decrease in the latter (Chart 4).<sup>1</sup>

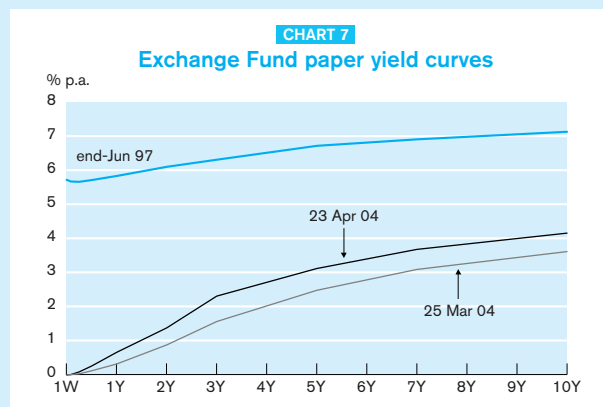
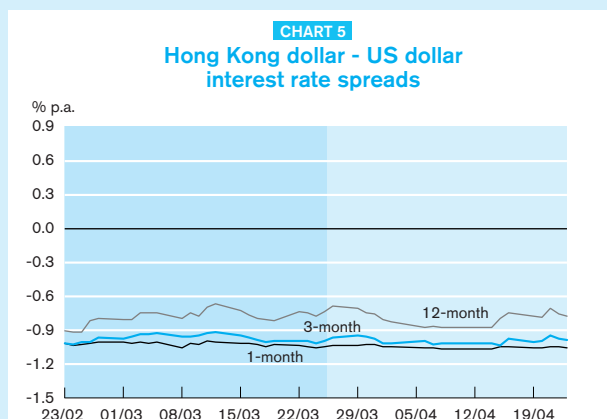


In line with the movements in interest rate spreads, **Hong Kong dollar 12-month forward discount widened to 550 pips** at the end of the reporting period. Meanwhile, three-month forward points continued to be stable and closed at -183 pips (Chart 6).



**Hong Kong dollar interbank interest rates stayed below the US dollar counterparts**. The one-month and three-month spreads against US dollar rates closed at -106 bp and -99 bp respectively, close to the levels at the beginning of the period. Meanwhile the 12-month spreads decreased by 9 bp to close at -78 bp (Chart 5).

Largely reflecting the movements of US counterparts, **yields of Exchange Fund paper rose during the period** (Chart 7). The negative yield spread for five-year and 10-year paper widened to -36 bp and -26 bp at end of the period (Table 1).

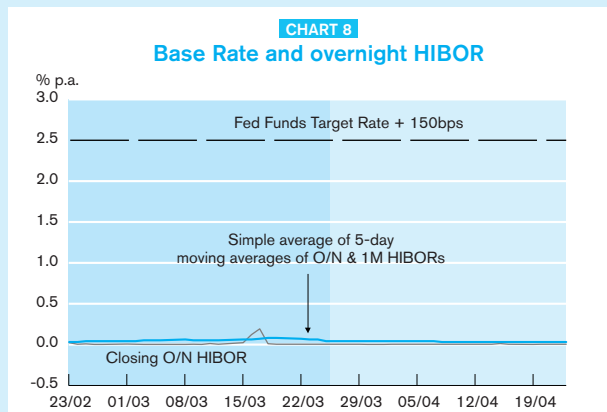


**TABLE 1**  
Yield spreads of Exchange Fund paper over US Treasuries (basis points)

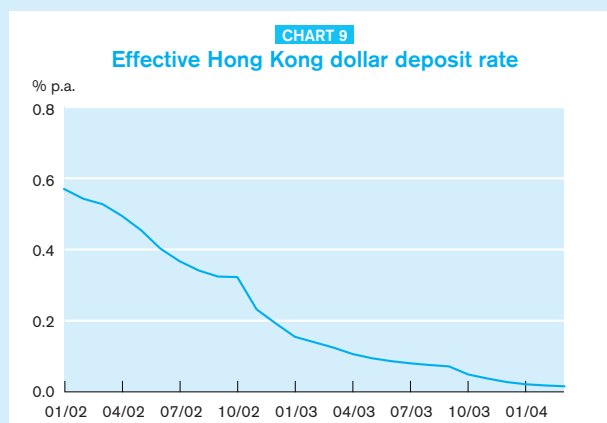
|         | 27 Jun 97 | 25 Mar 04 | 23 Apr 04 |
|---------|-----------|-----------|-----------|
| 3-month | 56        | -88       | -85       |
| 1-year  | 21        | -71       | -77       |
| 3-year  | 3         | -29       | -28       |
| 5-year  | 27        | -20       | -36       |
| 10-year | 54        | -13       | -26       |

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

The HKMA Base Rate remained at 2.50% (Chart 8). The banks also kept their Best Lending Rate unchanged at 5%.



The average rate offered by major authorized institutions for one-month time deposits was little changed at 0.004% during the period.<sup>2</sup> Meanwhile, the effective deposit rate was unchanged in March (Chart 9).<sup>3</sup>



<sup>2</sup> The figures refer to the average of interest rates offered by the major authorized institutions for one-month time deposits of less than HK\$100,000.

<sup>3</sup> This is the average of the interest rates on demand, 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.

## Monetary Base

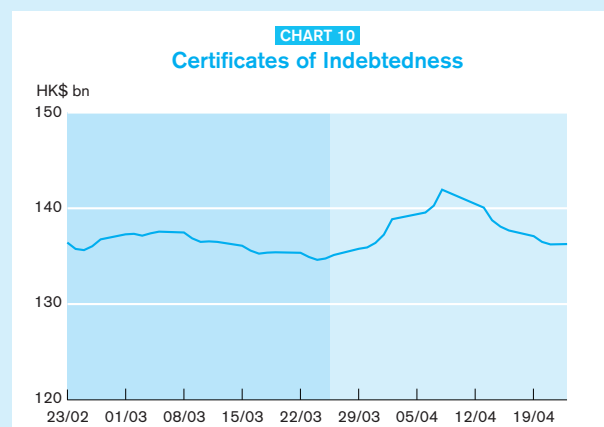
The **Monetary Base**, which comprises Certificates of Indebtedness (CIs), Government-issued currency notes and coins in circulation, the Aggregate Balance, and Exchange Fund Bills and Notes, **increased slightly from HK\$321.58 billion to HK\$321.98 billion** during the reporting period (Table 2). Movements in individual components are discussed below.

**TABLE 2**  
Monetary Base

| (HK\$ bn)   | 26 Mar 04     | 23 Apr 04     |
|---|---------------|---------------|
| CIs   | 135.19        | 136.33        |
| Government-issued Currency Notes and Coins in Circulation | 6.84          | 6.74          |
| Aggregate Balance   | 54.69         | 54.63         |
| Outstanding EFBNs   | 124.86        | 124.29        |
| <b>Monetary Base</b>                                      | <b>321.58</b> | <b>321.98</b> |

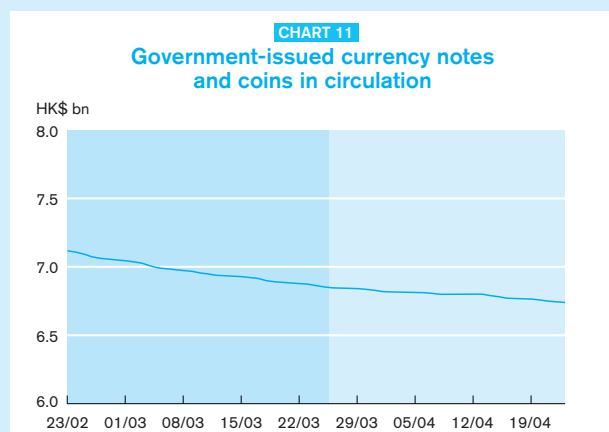
## Certificates of Indebtedness

In response to increased public demand for banknotes before the Easter holidays, the three note-issuing banks (NIBs) submitted to the HKMA a total of US\$0.88 billion in exchange for HK\$6.85 billion worth of CIs between 26 March and 8 April. As public demand for cash gradually declined after the holidays, the NIBs redeemed a total of HK\$5.71 bn of CIs in exchange for US\$0.73bn for the rest of the reporting period. As a result, **the outstanding amount of CIs increased from HK\$135.19 billion to HK\$136.33 billion** (Chart 10).



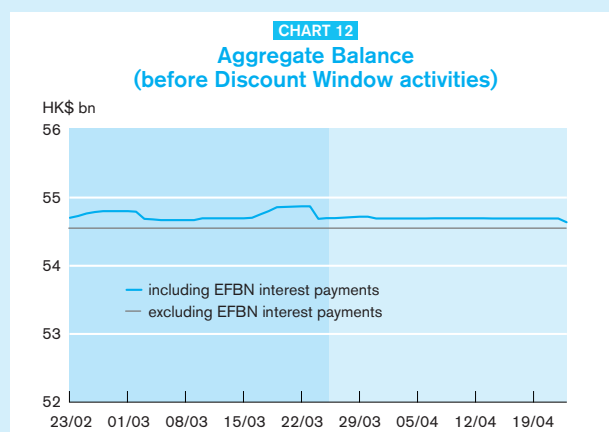
### Government-issued currency notes and coins in circulation

The total amount of **Government-issued currency notes and coins in circulation decreased from HK\$6.84 billion to HK\$6.74 billion** during the reporting period (Chart 11).



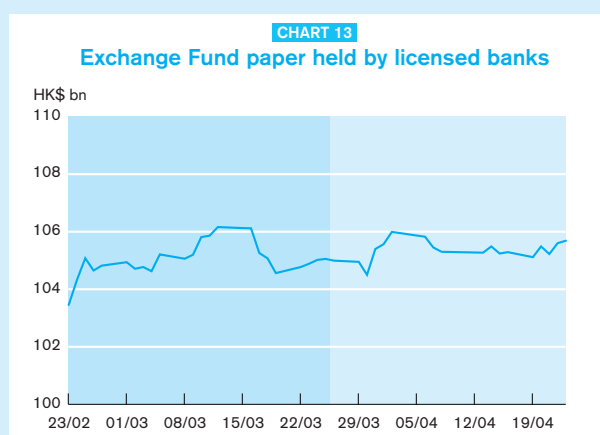
### Aggregate Balance

The **Aggregate Balance remained stable at HK\$54.63 billion** at the end of the period, with small fluctuations due to interest payments and new issues of Exchange Fund paper during the period (Chart 12).



### Outstanding Exchange Fund Bills and Notes

The market value of outstanding **Exchange Fund Bills and Notes decreased from HK\$124.86 billion to HK\$124.29 billion**. Meanwhile, **holdings of Exchange Fund paper by the banking sector (before Discount Window activity) increased from HK\$105.02 billion (84.11% of total) to HK\$105.71 billion (85.05% of total)** (Chart 13).



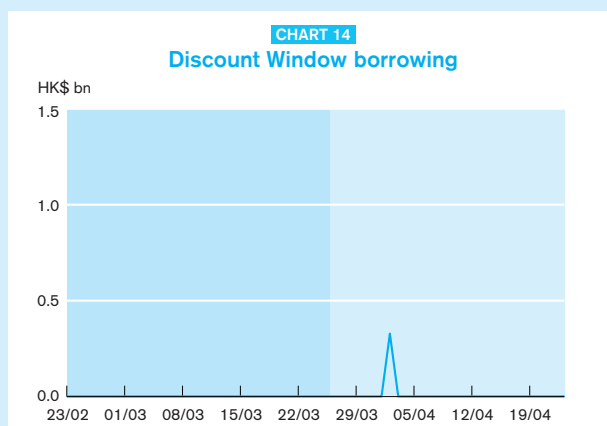
An additional **HK\$0.04 billion (in market value) of Exchange Fund paper was issued during the reporting period to absorb interest payments** for the current period as well as payments carried forward from the last one. All issues of Exchange Fund paper were well received by the market (Table 3). Nevertheless, because some Exchange Fund Notes were issued at premium, **the net payment on Exchange Fund paper (i.e. coupon payments less (plus) any premium (discount) on new paper issued) was HK\$ -0.02 billion**. This effect will be neutralised in the next period.

**TABLE 3**  
Issuance of Exchange Fund Bills and Notes (26 March – 23 April 04)

|             | No. of issues launched | Over-subscription ratio |
|-------------|------------------------|-------------------------|
| 3-month EFB | 4                      | 7.78-9.93               |
| 6-month EFB | 2                      | 6.52-6.88               |
| 1-year EFB  | 1                      | 5.04                    |
| 3-year EFN  | 1                      | 2.90                    |

## Discount Window activity

For the period as a whole, **two banks borrowed a total of HK\$0.33 billion from the Discount Window**, compared with zero in the preceding period (Chart 14). All borrowings used Exchange Fund paper as collateral (Table 4).

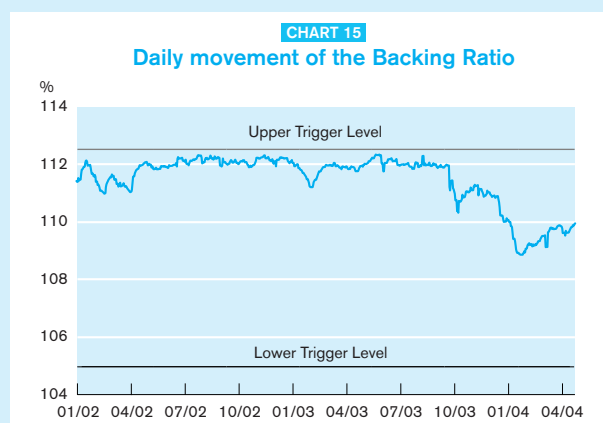


**TABLE 4**  
Frequency of individual bank access to the Discount Window (26 March – 23 April 04)

| Frequency of using Discount Window | No. of banks |
|------------------------------------|--------------|
| 1                                  | 2            |
| Total                              | 2            |

## Backing Portfolio

The Backing Assets increased during the period, mainly attributable to a rise in the outstanding amount of CIs, interest income and valuation gains. As a result, **the Backing Ratio increased from 109.87% on 26 March to 109.94% on 23 April** (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.

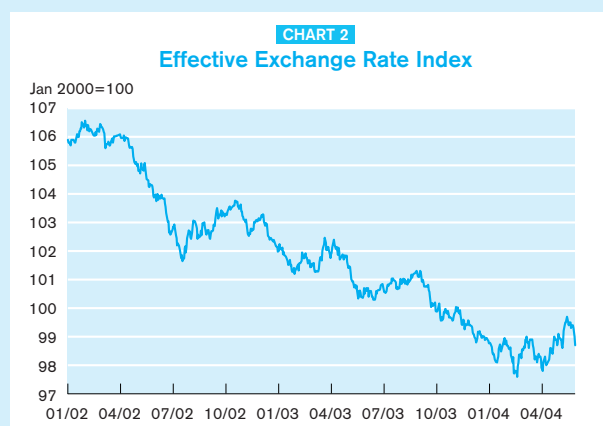
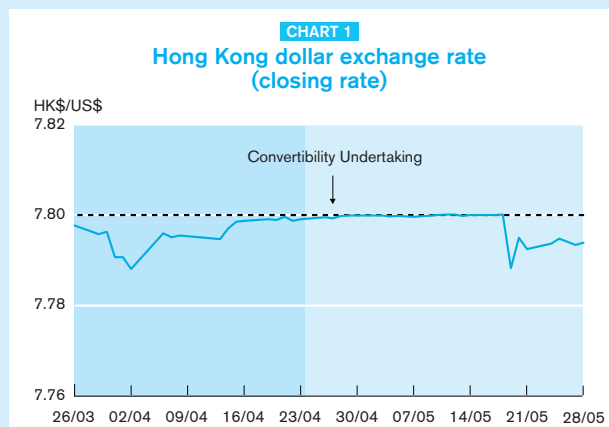


## Report on Currency Board Operations (25 April – 28 May 2004)

The Hong Kong dollar exchange rate was close to the linked rate of 7.8 until 19 May, when it strengthened abruptly alongside a rebound in the local stock market. The Convertibility Undertaking was triggered 29 times during the earlier part of the reporting period, shrinking the Aggregate Balance to HK\$35.63 billion. Interbank interest rates firmed in response to the reduction in liquidity. The Monetary Base declined from HK\$321.82 billion to HK\$303.48 billion during the period. In accordance with Currency Board principles, changes in the Monetary Base were fully matched by corresponding changes in foreign reserves.

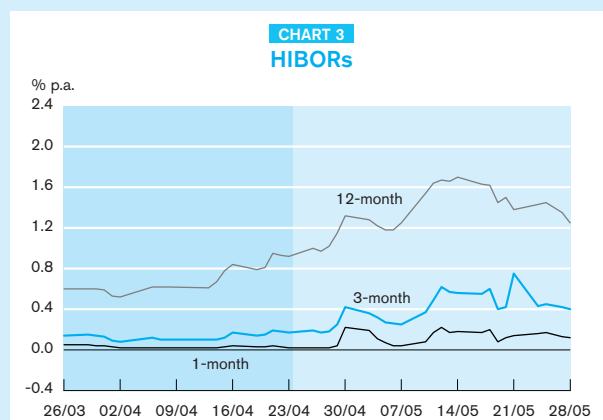
### Hong Kong dollar exchange rate

Reflecting corrections in the local stock market, **the Hong Kong dollar (HKD) exchange rate** stayed weak and the Convertibility Undertaking was triggered 29 times before 19 May. The Hong Kong dollar exchange rate then strengthened markedly on 19 May, along with a rebound in the local stock market. The reversal was reportedly exacerbated by the activation of stop-loss orders in the foreign exchange market. The exchange rate eased afterwards and **closed at 7.7938 at the end of the reporting period.** (Chart 1). Meanwhile, the effective exchange rate of the Hong Kong dollar was little changed (Chart 2).

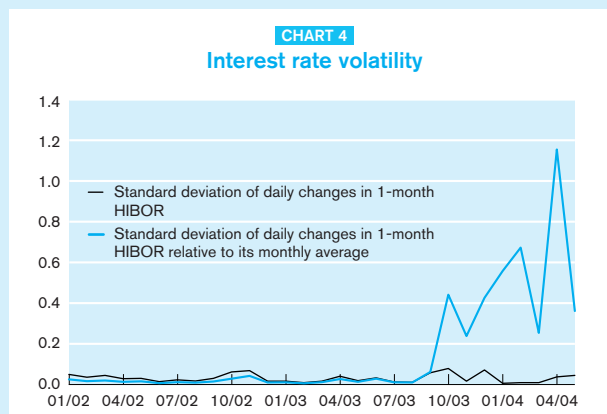


### Interest rates

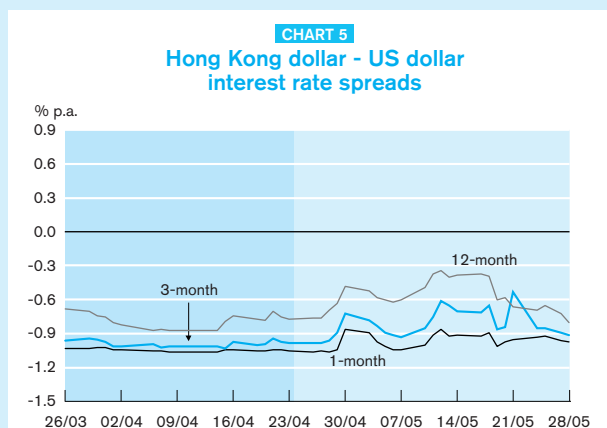
**Short-term Hong Kong dollar interest rates firmed during the period.** For the period as a whole, one-month HIBOR rose by 10 bp to close at 0.12%, while three-month HIBOR increased by 21 bp to 0.40%. 12-month HIBOR rose notably by 25 bp to 1.25%, reflecting higher US interest rates on expectations of monetary tightening in the US (Chart 3).



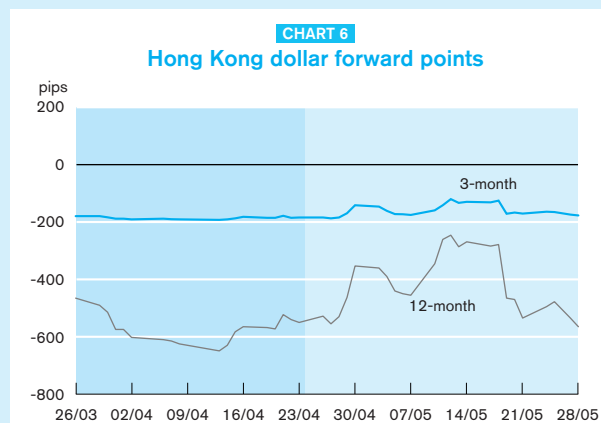
**Interest rate volatility**, as measured by the standard deviation of daily changes in one-month HIBOR, **remained low**. As a ratio to the average level of one-month HIBOR, it decreased in April, due to an increase in the latter (Chart 4).<sup>1</sup>



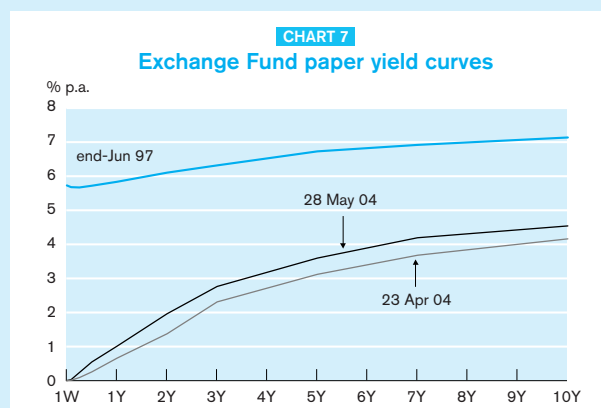
**Hong Kong dollar interbank interest rates stayed below US dollar rates**. The negative interest rate spreads narrowed in the earlier part of the period, but closed at levels broadly unchanged from those at the beginning of the period. The one-month, three-month and 12-month spreads against US dollar rates closed at -98 bp, -92 bp and -81 bp respectively (Chart 5).



Reflecting the movements in interest rate spreads, **Hong Kong dollar 12-month forward discount fluctuated and closed at 565 pips**, a level only slightly above that at the beginning of the period. Meanwhile, three-month forward points continued to be stable and closed at -176 pips (Chart 6).



In part reflecting the movements of US counterparts, **yields of Exchange Fund paper rose during the period**. (Chart 7). The negative yield spread for five-year and 10-year paper narrowed to -17 bp and -11 bp at the end of the period (Table 1).



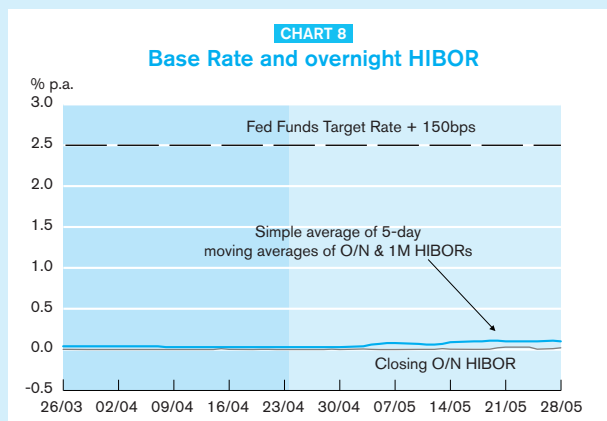
**TABLE 1**  
Yield spreads of Exchange Fund paper over US Treasuries (basis points)

|         | 27 Jun 97 | 23 Apr 04 | 28 May 04 |
|---------|-----------|-----------|-----------|
| 3-month | 56        | -85       | -80       |
| 1-year  | 21        | -77       | -73       |
| 3-year  | 3         | -28       | -26       |
| 5-year  | 27        | -36       | -17       |
| 10-year | 54        | -26       | -11       |

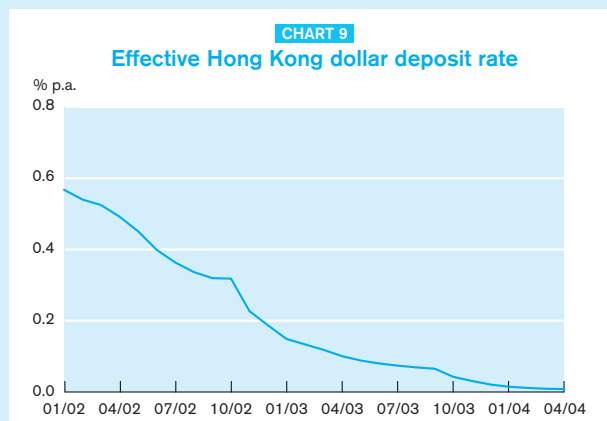
<sup>1</sup> The ratio of the standard deviation of daily changes in the 1-month HIBOR to its monthly average measures the extent of interest rate fluctuations relative to the average level of interest rates, which may vary over time.



The HKMA Base Rate remained at 2.50% (Chart 8). The banks also kept their Best Lending Rate unchanged at 5%.



The average rate offered by major authorized institutions for one-month time deposits increased slightly to 0.005% during the period.<sup>2</sup> Meanwhile, the effective deposit rate was unchanged in April (Chart 9).<sup>3</sup>



<sup>2</sup> The figures refer to the average of interest rates offered by the major authorized institutions for one-month time deposits of less than HK\$100,000.

<sup>3</sup> This is the average of the interest rates on demand, 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.

## Monetary Base

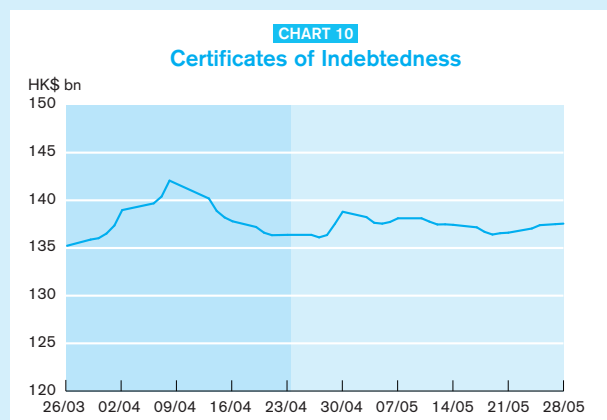
The Monetary Base, which comprises Certificates of Indebtedness (CIs), Government-issued currency notes and coins in circulation, the Aggregate Balance, and Exchange Fund Bills and Notes, decreased from HK\$321.82 billion to HK\$303.48 billion during the reporting period (Table 2). Movements in individual components are discussed below.

**TABLE 2**  
Monetary Base

| (HK\$ bn)   | 26 Apr 04     | 28 May 04     |
|---|---------------|---------------|
| CIs   | 136.34        | 137.52        |
| Government-issued Currency Notes and Coins in Circulation | 6.74          | 6.63          |
| Aggregate Balance   | 54.65         | 35.63         |
| Outstanding EFBNs   | 124.10        | 123.70        |
| <b>Monetary Base</b>                                      | <b>321.82</b> | <b>303.48</b> |

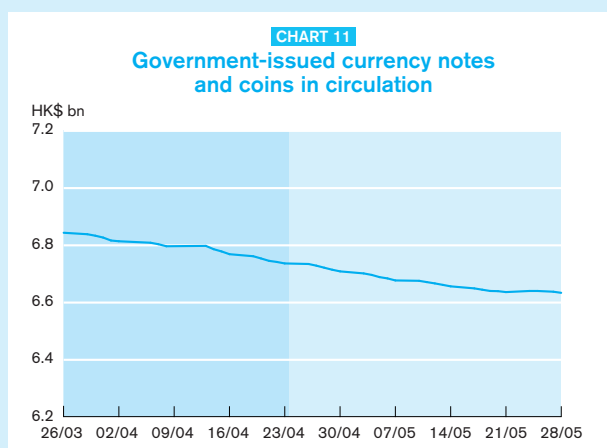
## Certificates of Indebtedness

During the period, the three note-issuing banks submitted to the HKMA a total of US\$0.15 billion in exchange for HK\$1.18 billion worth of Certificate of Indebtedness. As a result, the outstanding amount of CIs increased from HK\$136.34 billion to HK\$137.52 billion (Chart 10).



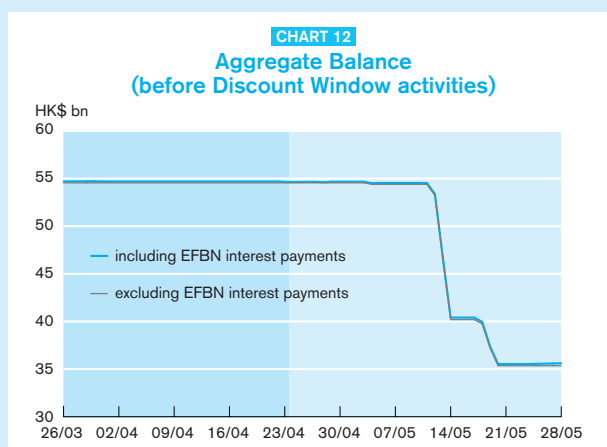
### Government-issued currency notes and coins in circulation

The total amount of **Government-issued currency notes and coins in circulation decreased from HK\$6.74 billion to HK\$6.63 billion** during the reporting period (Chart 11).



### Aggregate Balance

The HKMA bought a total of 19.16 billion of Hong Kong dollar under the Convertibility Undertaking between 30 April and 18 May, shrinking the Aggregate Balance to **HK\$35.63 billion at the end of the period**. (Chart 12 and Table 3).

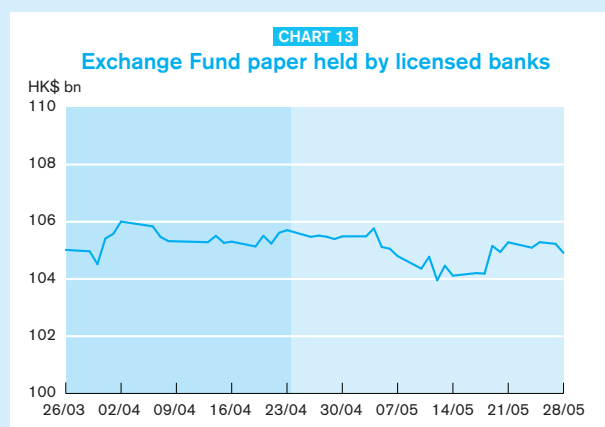


**TABLE 3**  
HKMA HK\$/US\$ FX transaction  
(25 April – 28 May 04)

| Trade Date | Net HK\$ purchase (+)<br>(HK\$ mn) |
|------------|------------------------------------|
| 30-Apr     | +156                               |
| 10-May     | +1,170                             |
| 11-May     | +6,622                             |
| 12-May     | +6,380                             |
| 14-May     | +468                               |
| 17-May     | +2,496                             |
| 18-May     | +1,864                             |

### Outstanding Exchange Fund Bills and Notes

The market value of outstanding Exchange Fund Bills and Notes decreased from **HK\$124.10 billion to HK\$123.70 billion**. Meanwhile, **holdings of Exchange Fund paper by the banking sector (before Discount Window activity) decreased** from HK\$105.48 billion (84.99% of total) to HK\$104.92 billion (84.82% of total) (Chart 13).



During the period, a total of HK\$0.31 billion of interest payments on Exchange Fund paper were made. **An additional HK\$0.15 billion (in market value) of Exchange Fund paper was issued to absorb these interest payments.** All issues of Exchange Fund paper were well received by the market (Table 4). The remaining amount was carried forward in the Aggregate Balance.

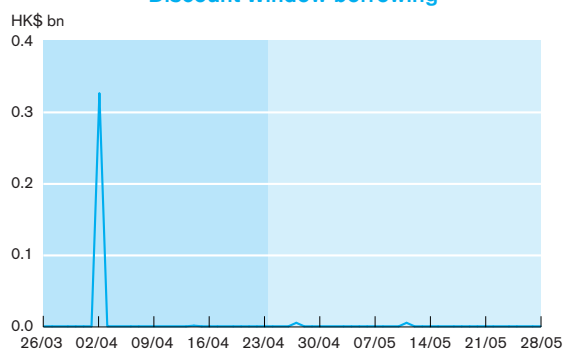
**TABLE 4**  
**Issuance of Exchange Fund Bills and Notes**  
 (25 April – 28 May 04)

|             | No. of issues launched | Over-subscription ratio |
|-------------|------------------------|-------------------------|
| 1-month EFB | 2                      | 11.42-26.00             |
| 3-month EFB | 5                      | 3.73-6.38               |
| 6-month EFB | 3                      | 3.91-5.59               |
| 1-year EFB  | 1                      | 5.15                    |
| 2-year EFN  | 1                      | 2.57                    |
| 7-year EFN  | 1                      | 2.28                    |

## Discount Window activity

For the period as a whole, **two banks borrowed a total of HK\$0.01 billion from the Discount Window**, compared with HK\$0.33 billion in the preceding period (Chart 14). All borrowings used Exchange Fund paper as collateral (Table 5).

**CHART 14**  
**Discount Window borrowing**



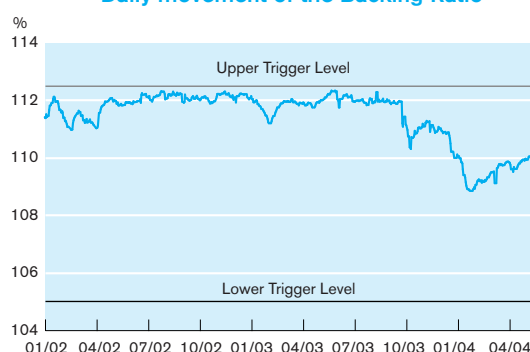
**TABLE 5**  
**Frequency of individual bank access to the Discount Window**  
 (25 April – 28 May 04)

| Frequency of using Discount Window | No. of banks |
|------------------------------------|--------------|
| 1                                  | 2            |
| Total                              | 2            |

## Backing Portfolio

Backing Assets decreased during the period, mainly attributable to a decline in the Aggregate Balance. Nevertheless, as the Monetary Base decreased proportionately more than the Backing Assets, **the Backing Ratio increased from 109.94% on 25 April to 110.65% on 28 May** (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.

**CHART 15**  
**Daily movement of the Backing Ratio**



# Record of Discussion of the Exchange Fund Advisory Committee Sub-Committee on Currency Board Operations on 9 July 2004

(Approved for Issue by the Exchange Fund Advisory Committee on 29 July 2004)

## Report on Currency Board Operations (29 May - 23 June 2004)

The Sub-Committee noted that the Hong Kong dollar exchange rate had eased during the reporting period, reflecting in part the strengthening of the US dollar. Hong Kong dollar interbank interest rates had firmed, reflecting expectations of higher US rates, but they had remained below their US dollar counterparts.

Members observed that, subsequent to the period under review, the Fed funds target rate of the US had increased by 0.25 percentage point. Although, in accordance with the Currency Board arrangements, the Base Rate had been increased by the same magnitude, banks in Hong Kong had generally not so far seen a need to increase Hong Kong dollar interest rates because of the large amount of liquidity remaining in the interbank market.

The Sub-Committee noted that, in accordance with Currency Board principles, changes in the Monetary Base during the reporting period had been fully matched by changes in the foreign reserves.

The report on Currency Board operations for the period under review is at **Annex**.

## Monitoring of risks and vulnerabilities

The Sub-Committee noted that there had in recent months been robust growth in the US, Japan and Asian economies. In Mainland China, however, there appeared to be early signs of a policy-induced slowdown. Economic developments in Hong Kong continued to be encouraging, with a generally positive near-term outlook. This was attributable both to the strong global recovery and to a marked revival in the local property market and in domestic consumption. Three main concerns presented possible risks to this outlook: these were the possibility of larger and faster-than-expected US interest rate increases; the possibility of a sharp slowdown in the Mainland economy; and possible higher oil prices.

## Macroeconomic conditions in Mainland China

The Sub-Committee noted a paper summarising current macroeconomic conditions in Mainland China and examining some issues of concern and the measures taken to address them. Among the concerns were the recent rapid expansion in fixed asset investment and bank credit; and rising inflation. Members noted signs that the tightening measures taken so far by the Mainland authorities had helped bring down growth in fixed asset investment and bank credit considerably, although headline inflation had continued to rise.

## Using the Federal Funds Futures Rate to extract information on market expectations of US monetary policy

Noting the importance of monetary policy actions for Hong Kong under the Linked Exchange Rate system, the Sub-Committee considered an information paper on issues arising from the common practice of extracting information on market expectation from US Federal Funds Futures Rates. Straightforward readings of the pricing of Fed Funds Futures could be misleading because of the presence of risk premia and persistent errors in market expectation: these difficulties were particularly pronounced during turns of the interest rate and business cycles. The paper examined how more meaningful market expectation of future US policy actions could be extracted from Fed Funds Futures by using business cycle indicators.

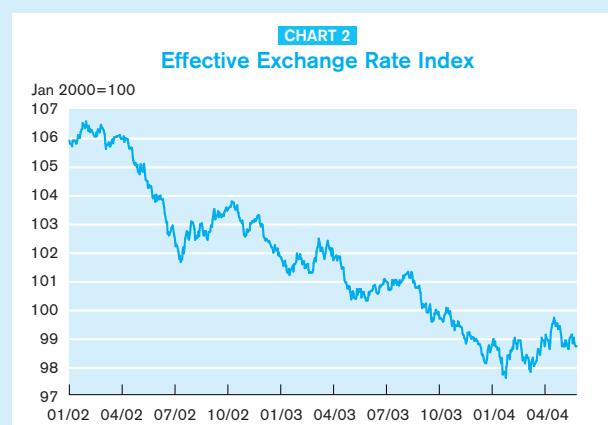
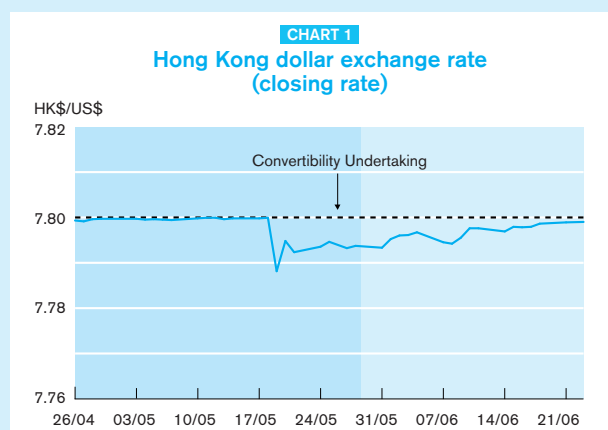
## Annex

### Report on Currency Board Operations (29 May — 23 June 2004)

The Hong Kong dollar exchange rate eased during the reporting period to close at 7.7991. Partly reflecting tightened liquidity due to IPO activities, interbank interest rates firmed but remained below US dollar rates. The Monetary Base declined slightly, from HK\$303.94 billion to HK\$303.71 billion. In accordance with Currency Board principles, changes in the Monetary Base were fully matched by corresponding changes in foreign reserves.

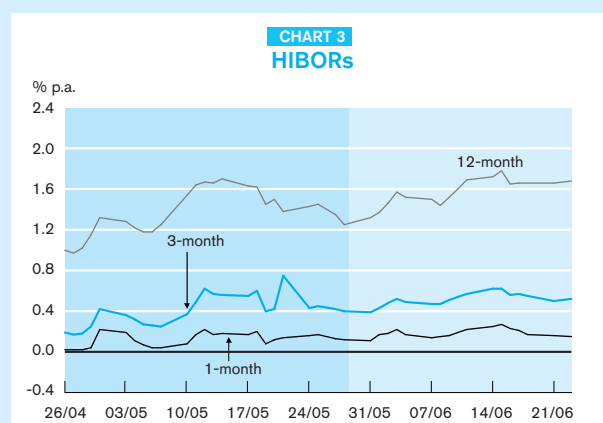
#### Hong Kong dollar exchange rate

Partly reflecting the strengthening of the US dollar, **the Hong Kong dollar exchange rate eased from 7.7934 to 7.7991** during the reporting period, close to the link rate of 7.8 (Chart 1). The effective exchange rate of the Hong Kong dollar was little changed (Chart 2).

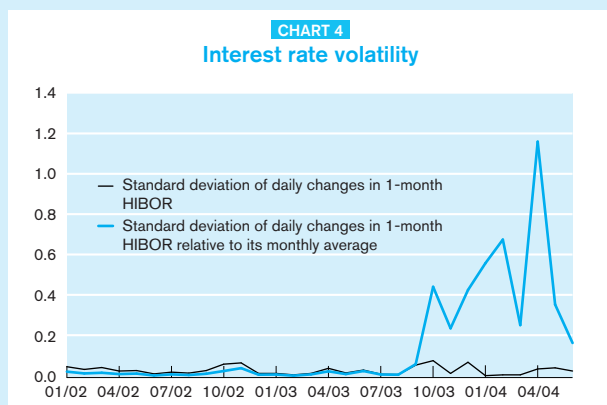


#### Interest rates

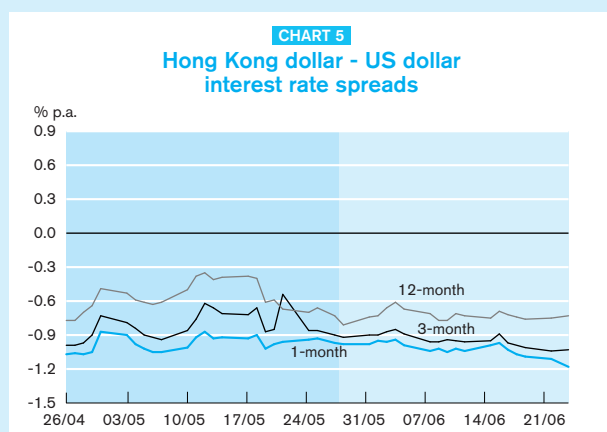
**Hong Kong dollar interbank interest rates firmed** during the period, reflecting tightened interbank liquidity due to IPO activities, as well as higher US dollar interest rates on expectations of Fed tightening. One-month and three-month HIBORs edged up by 4 bp and 13 bp to close at 0.15% and 0.52% respectively. Meanwhile, 12-month HIBOR rose by 36 bp to close at 1.68% (Chart 3).



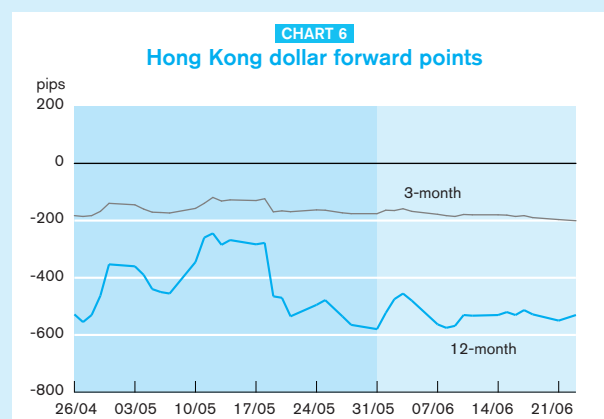
**Interest rate volatility**, as measured by the standard deviation of daily changes in one-month HIBOR, **remained low**. As a ratio to the average level of one-month HIBOR, it declined in June, due to the increase in the latter (Chart 4).<sup>1</sup>



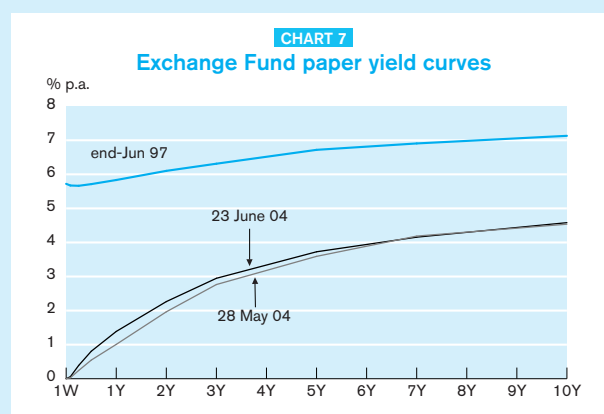
**Hong Kong dollar interbank interest rates stayed below US dollar rates**. For shorter-term rates, the negative spreads widened slightly towards the end of the period, with the one-month and three-month differentials closing at -118 bp and -103 bp respectively. On the other hand, the 12-month spread narrowed marginally to close at -73 bp (Chart 5).



Mirroring the movements in interest rate spreads, the **Hong Kong dollar 12-month forward discount narrowed by 50 pips to close at 530 pips**. Meanwhile, three-month forward discount widened by 25 pips to close at 201 pips (Chart 6).



**Yields of Exchange Fund paper rose during the period**, owing to larger increases in US Treasury yields (Chart 7). Negative yield differentials generally widened. In particular, the negative yield spreads for five-year and 10-year paper widened to 24 bp and 19 bp respectively at the end of the period (Table 1).

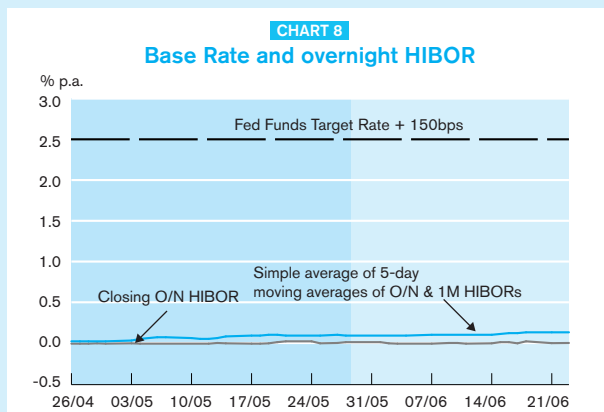


**TABLE 1**  
Yield spreads of Exchange Fund paper over US Treasuries (basis points)

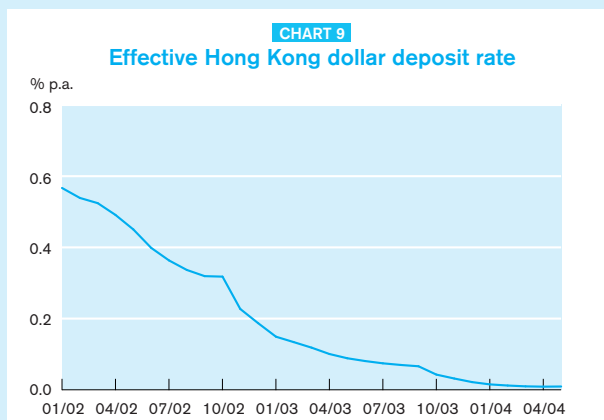
|         | 27 Jun 97 | 28 May 04 | 23 Jun 04 |
|---------|-----------|-----------|-----------|
| 3-month | 56        | -80       | -93       |
| 1-year  | 21        | -73       | -64       |
| 3-year  | 3         | -26       | -31       |
| 5-year  | 27        | -17       | -24       |
| 10-year | 54        | -11       | -19       |

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

The HKMA Base Rate remained at 2.50% (Chart 8). The banks also kept their Best Lending Rate unchanged at 5%.



The average rate offered by major authorized institutions for one-month time deposits edged up to 0.01% during the period.<sup>2</sup> Meanwhile, the effective deposit rate was unchanged in May (Chart 9).<sup>3</sup>



<sup>2</sup> The figures refer to the average of interest rates offered by the major authorized institutions for one-month time deposits of less than HK\$100,000.

<sup>3</sup> This is the average of the interest rates on demand, 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.

## Monetary Base

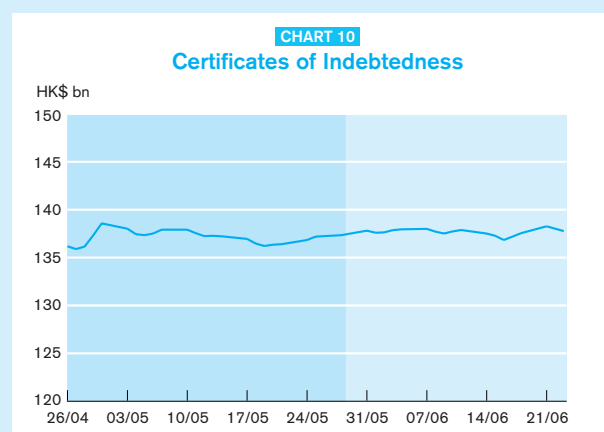
The Monetary Base, which comprises Certificates of Indebtedness (CIs), Government-issued currency notes and coins in circulation, the Aggregate Balance, and Exchange Fund Bills and Notes, **decreased slightly from HK\$303.94 billion to HK\$303.71 billion** during the reporting period (Table 2). Movements in individual components are discussed below.

**TABLE 2**  
Monetary Base

| (HK\$ bn)   | 31 May 04     | 23 Jun 04     |
|---|---------------|---------------|
| CIs   | 137.99        | 137.94        |
| Government-issued Currency Notes and Coins in Circulation | 6.63          | 6.61          |
| Aggregate Balance   | 35.63         | 35.53         |
| Outstanding EFBNs   | 123.69        | 123.63        |
| <b>Monetary Base</b>                                      | <b>303.94</b> | <b>303.71</b> |

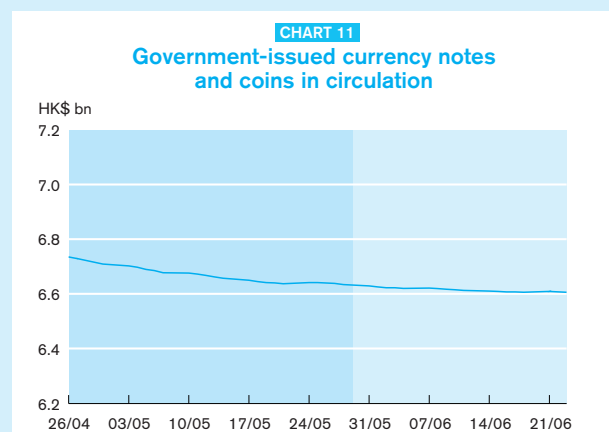
## Certificates of Indebtedness

During the period, the three note-issuing banks redeemed a total of HK\$50 million of CIs in exchange for US\$6.41 million. As a result, **the outstanding amount of CIs declined from HK\$137.99 billion to HK\$137.94 billion** (Chart 10).



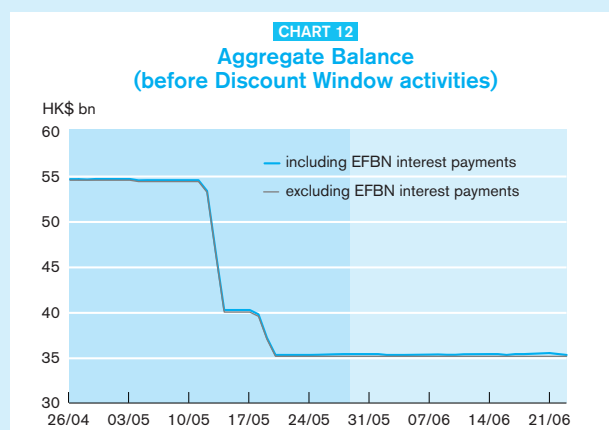
### Government-issued currency notes and coins in circulation

The total amount of **Government-issued currency notes and coins in circulation declined modestly from HK\$6.63 billion to HK\$6.61 billion** during the reporting period (Chart 11).



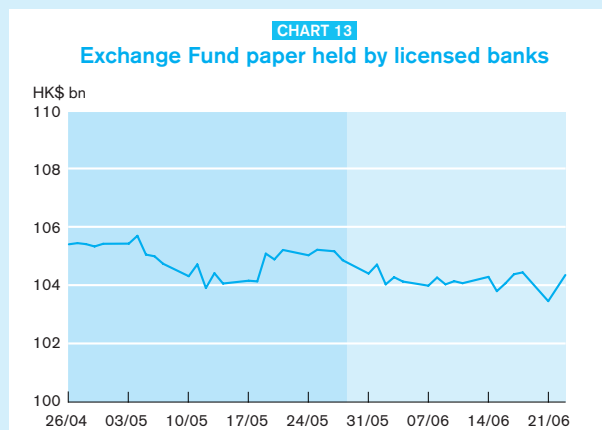
### Aggregate Balance

The **Aggregate Balance remained stable at around HK\$35.60 billion throughout the reporting period**, with small fluctuations due to interest payments on Exchange Fund paper (Chart 12).



### Outstanding Exchange Fund Bills and Notes

The market value of outstanding **Exchange Fund Bills and Notes declined slightly from HK\$123.69 billion to HK\$123.63 billion**. Meanwhile, **holdings of Exchange Fund paper by the banking sector (before Discount Window activity) declined** from HK\$104.46 billion (84.45% of total) to HK\$104.41 billion (84.45% of total) (Chart 13).



During the period, **a total of HK\$0.43 billion of interest payments on Exchange Fund paper were made**. Taking into account interest payments carried forward from the last reporting period, **an additional HK\$0.49 billion (in market value) of Exchange Fund paper was issued to absorb these interest payments**. All issues of Exchange Fund paper were well received by the market (Table 3).

**TABLE 3**  
Issuance of Exchange Fund Bills and Notes (29 May – 23 June 04)

|             | No. of issues launched | Over-subscription ratio |
|-------------|------------------------|-------------------------|
| 3-month EFB | 4                      | 3.51-4.86               |
| 6-month EFB | 2                      | 3.31-5.91               |
| 1-year EFB  | 1                      | 4.38                    |
| 5-year EFN  | 1                      | 1.58                    |
| 10-year EFN | 1                      | 2.29                    |



## Discount Window activity

There was no Discount Window borrowing during the period, compared with borrowing of HK\$0.01 billion in the preceding period (Chart 14). This reflected mainly the abundant liquidity in the interbank market.



## Backing Portfolio

Despite the decline in the Monetary Base, the Backing Assets increased during the period, mainly attributable to revaluation gains and higher interest income. As a result, **the Backing Ratio increased from 110.66% on 30 May to 110.74% on 23 June** (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.

