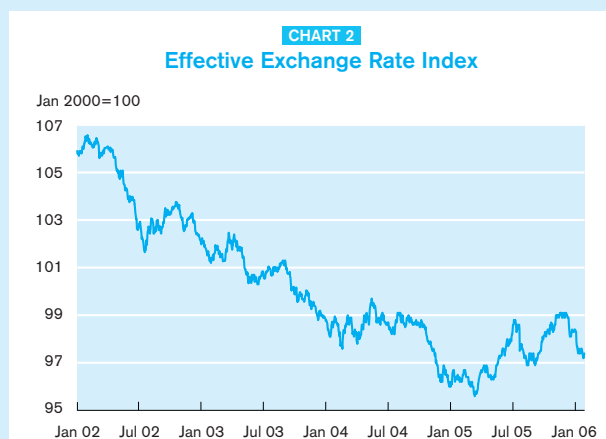
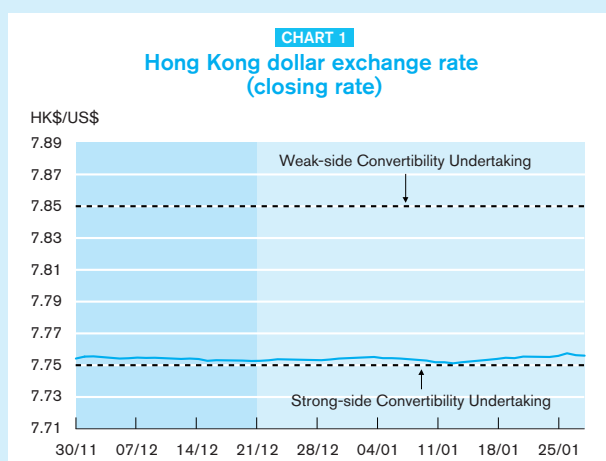


Report on Currency Board Operations (21 December 2005 – 27 January 2006)

The Hong Kong dollar exchange rate weakened slightly during the reporting period. Interbank interest rates eased. The Monetary Base rose from HK\$279.49 billion to HK\$303.98 billion, largely because of increases in 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

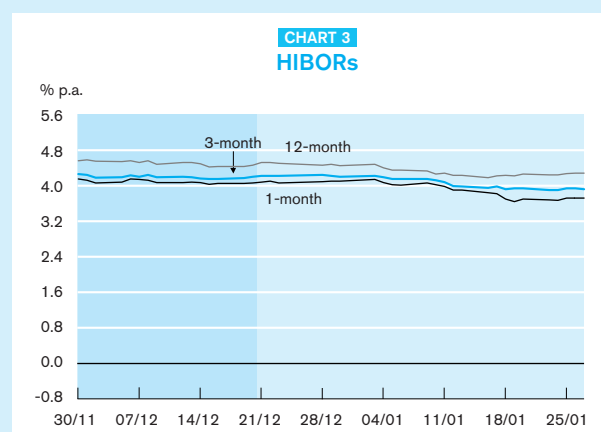
The Hong Kong dollar exchange rate weakened slightly to close at 7.7558 at the end of the reporting period, partly reflecting arbitrage buying of the US dollar (Chart 1). The effective exchange rate of the Hong Kong dollar eased moderately, owing to the weakening of US dollar against other major currencies (Chart 2).



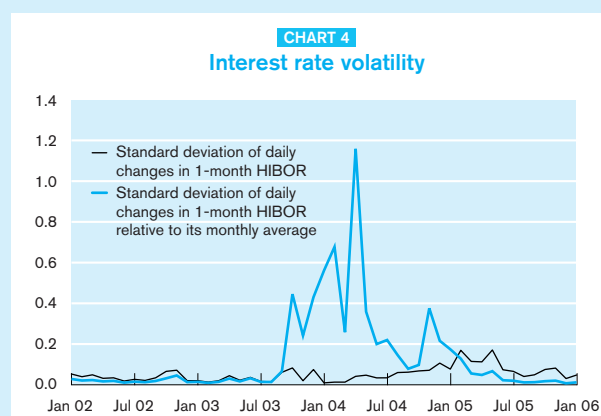
¹ The ratio of the standard deviation of daily changes in the one-month HIBOR to its monthly average measures the extent of interest rate fluctuations relative to the average level of interest rates.

Interest rates

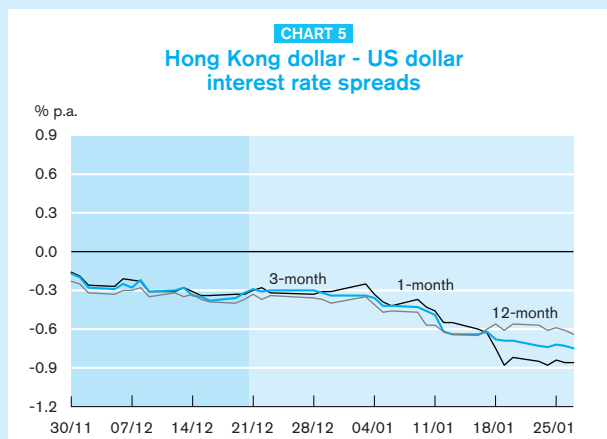
Hong Kong dollar interbank interest rates eased slightly during the reporting period. The one-month and three-month HIBORs dropped by 36 basis points and 30 basis points respectively to close at 3.72% and 3.92%. The 12-month HIBOR decreased by 24 basis points to close at 4.28% (Chart 3).



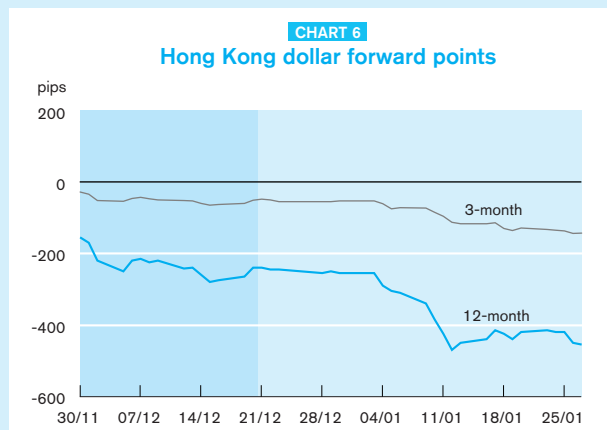
Interest rate volatility, measured by the standard deviation of daily changes in one-month HIBOR, **increased** in January. The standard deviation as a ratio of the average level of one-month HIBOR also increased (Chart 4).¹



Negative spreads of Hong Kong dollar interest rates over the US dollar counterparts widened during the reporting period. The one-month and three-month spreads increased by 56 basis points and 46 basis points respectively to -86 basis points and -75 basis points. Meanwhile the 12-month spread widened by 31 basis points to close at -64 basis points (Chart 5).



In line with the movements in interest rate spreads, the **Hong Kong dollar 12-month forward discount widened by 215 pips to close at 455 pips**, while the three-month forward discount increased by 95 pips to close at 143 pips (Chart 6).



Yields of Exchange Fund paper eased across the board, except for the short end, during the period (Chart 7). The negative yield spreads against US Treasuries widened. In particular, the five-year and 10-year spreads increased to -47 basis points and -41 basis points respectively at the end of the period (Table 1).

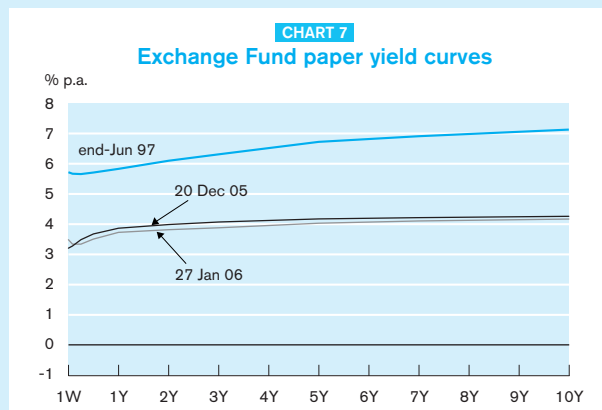
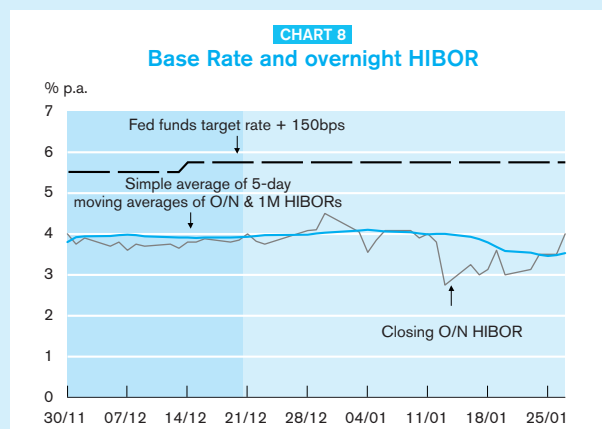


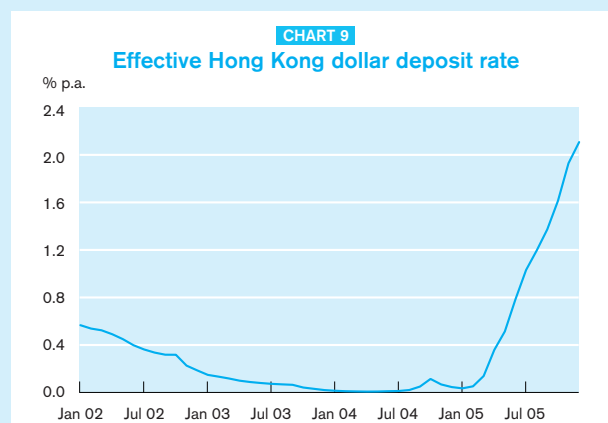
TABLE 1
Yield spreads of Exchange Fund paper over US Treasuries (basis points)

	27 Jun 97	20 Dec 05	27 Jan 06
3-month	56	-49	-112
1-year	21	-54	-86
3-year	3	-31	-60
5-year	27	-19	-47
10-year	54	-20	-41

In the absence of policy rate changes in the US during the reporting period, **the HKMA Base Rate remained unchanged at 5.75%** (Chart 8). **Banks also kept their Best Lending Rates unchanged.**



The average one-month time deposit rate offered by major authorized institutions dropped from 2.671% to 2.596% during the period.² Meanwhile, the effective deposit rate rose from 1.93% to 2.11% in December (Chart 9).³



Monetary Base

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, **expanded from HK\$279.49 billion to HK\$303.98 billion** during the reporting period (Table 2). Movements in the individual components are discussed below.

TABLE 2
Monetary Base

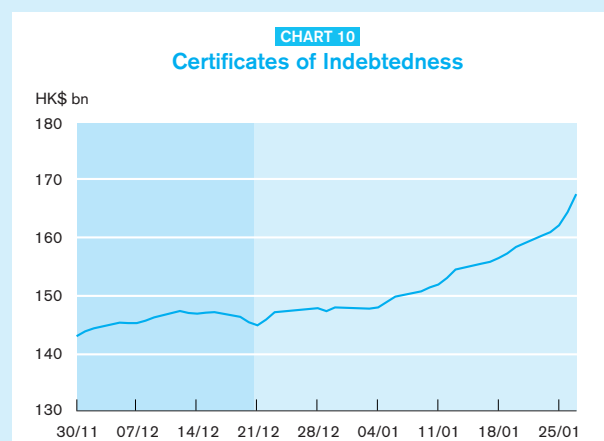
(HK\$ bn)	21 Dec 05	27 Jan 06
CIs	144.99	167.84
Government-issued Currency Notes and Coins in Circulation	6.81	7.68
Aggregate Balance	1.34	1.25
Outstanding EFBNs	126.36	127.22
Monetary Base	279.49	303.98

² 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.

³ 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 made certain assumptions regarding the maturity distribution in computing the effective deposit rate.

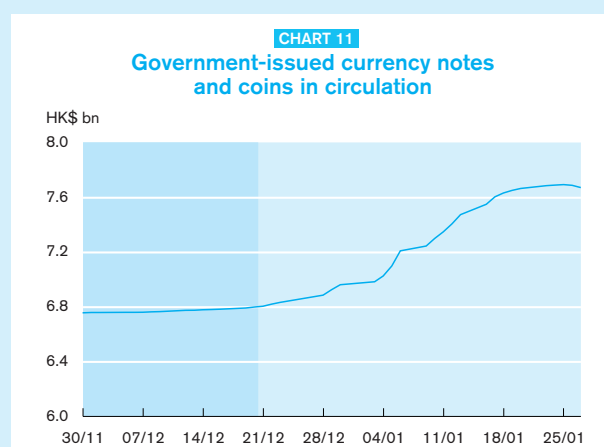
Certificates of Indebtedness

Reflecting increased public demand for banknotes before the Chinese New Year holidays, the three note-issuing banks submitted a total of US\$2.93 billion to the HKMA in exchange for HK\$22.85 billion worth of CIs during the period. As a result, **the outstanding amount of CIs increased from HK\$144.99 billion to HK\$167.84 billion** (Chart 10).



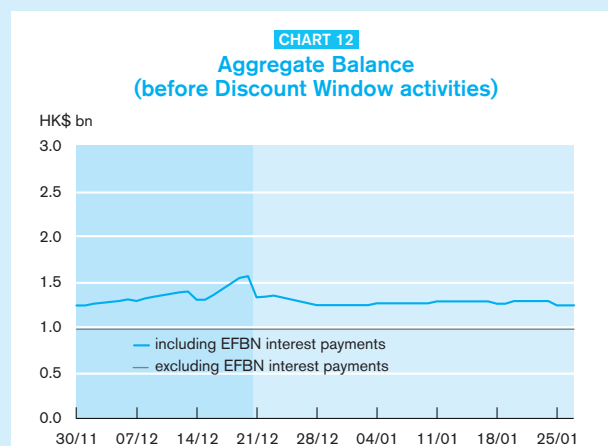
Government-issued currency notes and coins in circulation

Alongside the increase in CIs, the total amount of **government-issued currency notes and coins in circulation rose from HK\$6.81 billion to HK\$7.68 billion** during the reporting period (Chart 11).



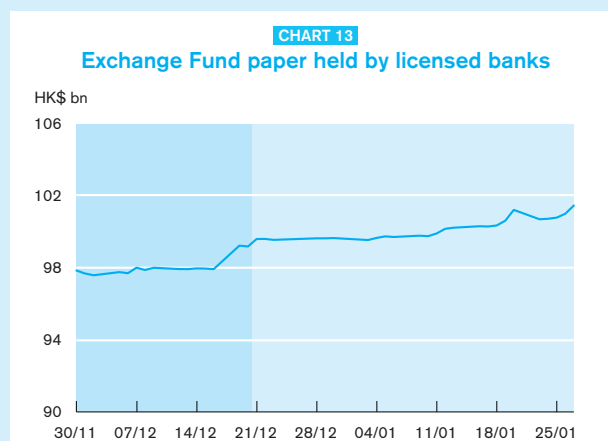
Aggregate Balance

The Aggregate Balance was little changed during the reporting period to close at around HK\$1.2 billion, 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 rose slightly from HK\$126.36 billion to HK\$127.22 billion. Holdings of Exchange Fund paper by the banking sector (before Discount Window activities) increased from HK\$99.64 billion (78.85% of total) to HK\$101.52 billion (79.80% of total) (Chart 13).



During the period, **HK\$321.07 million of interest payments on Exchange Fund paper were made.** Taking into account interest payments carried forward from the preceding reporting period, **an additional HK\$644.37 million (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
(21 Dec 05 – 27 Jan 06)

	No. of issues launched	Over-subscription ratio
1-month EFB	1	13.00
3-month EFB	6	1.00-4.64
6-month EFB	3	1.73-5.21
1-year EFB	1	2.91

Discount Window activities

During the period, **eleven banks borrowed a total of HK\$1.31 billion from the Discount Window**, compared with HK\$757 million in the preceding period (Chart 14). All borrowings used Exchange Fund paper as collateral (Table 4).

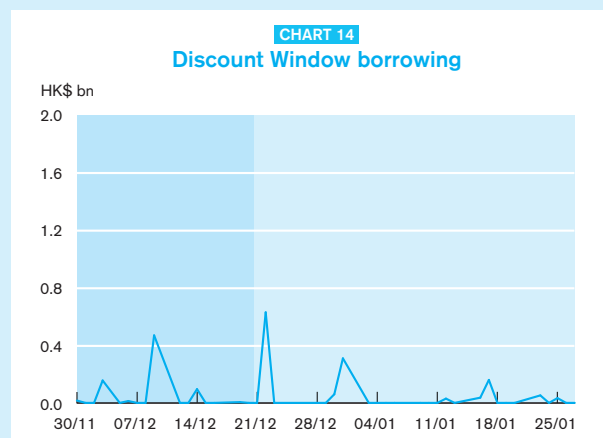
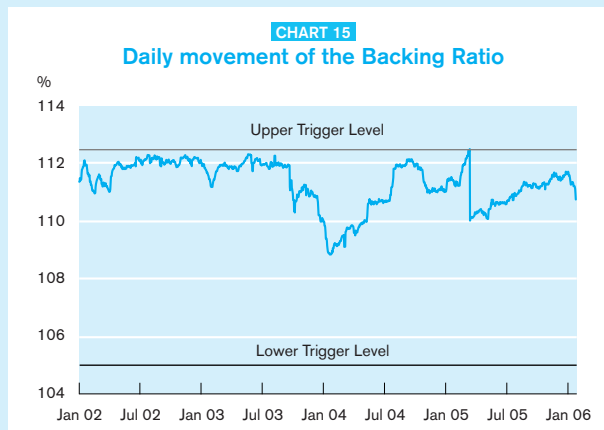


TABLE 4
Frequency of individual bank's access to the Discount Window
(21 Dec 05 – 27 Jan 06)

Frequency of using Discount Window	No. of banks
1	10
2	1
Total	11

Backing Portfolio

Backing Assets rose during the period, largely due to increases in Certificates of Indebtedness. As the Backing Assets increased proportionally less than the Monetary Base, **the Backing Ratio decreased from 111.60% on 21 December 2005 to 110.76% on 27 January 2006** (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.

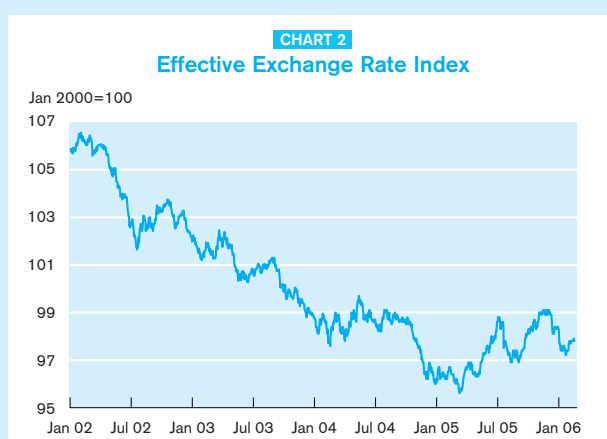
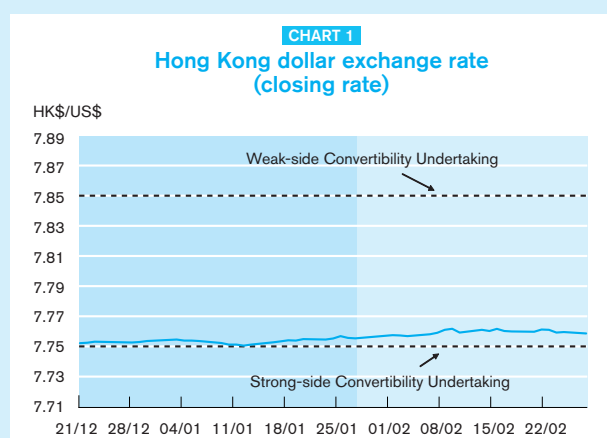


Report on Currency Board Operations (28 January – 27 February 2006)

The Hong Kong dollar exchange rate weakened modestly during the reporting period. Interbank interest rates edged up. The Monetary Base declined from HK\$301.25 billion to HK\$287.94 billion, largely due to decreases in 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

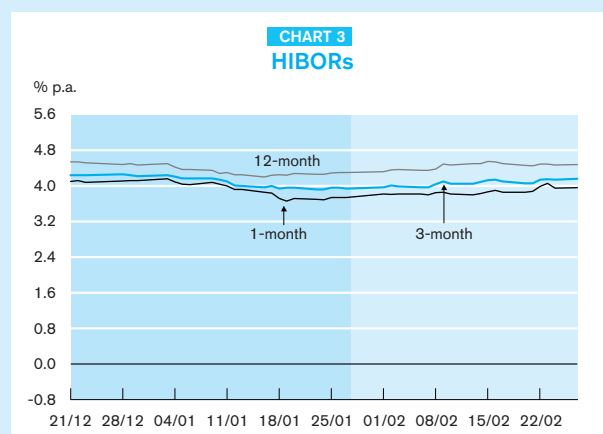
The Hong Kong dollar exchange rate softened moderately to close at 7.7591 at the end of the reporting period, driven in part by arbitrage buying of the US dollar (Chart 1). Separately, the effective exchange rate of the Hong Kong dollar rose slightly (Chart 2).



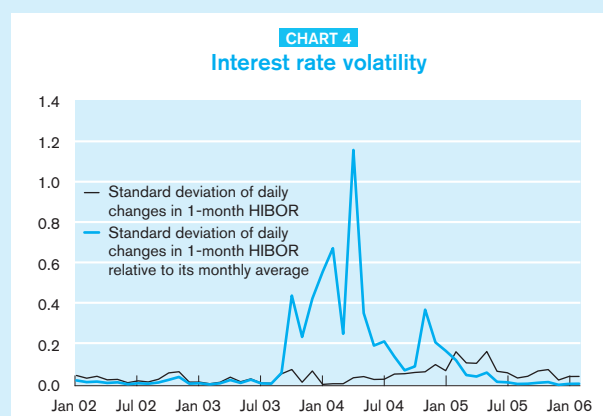
¹ The ratio of the standard deviation of daily changes in the 1-month HIBOR to its monthly average measures the extent of interest rate fluctuations relative to the average level of interest rates.

Interest rates

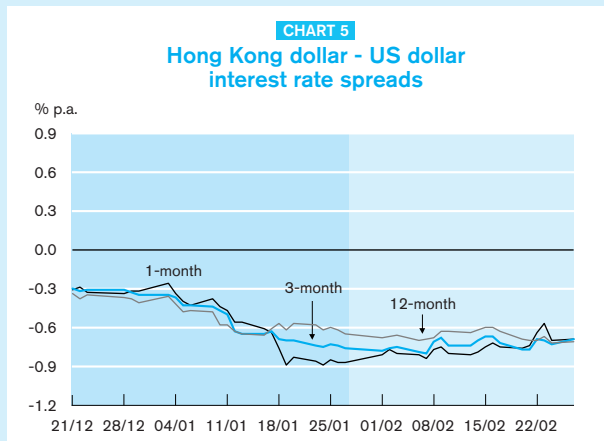
Hong Kong dollar interbank interest rates rose during the reporting period. The one-month and three-month HIBORs increased by 14 basis points and 19 basis points to close at 3.94% and 4.14% respectively. The 12-month HIBOR rose by 16 basis points to close at 4.46% (Chart 3).



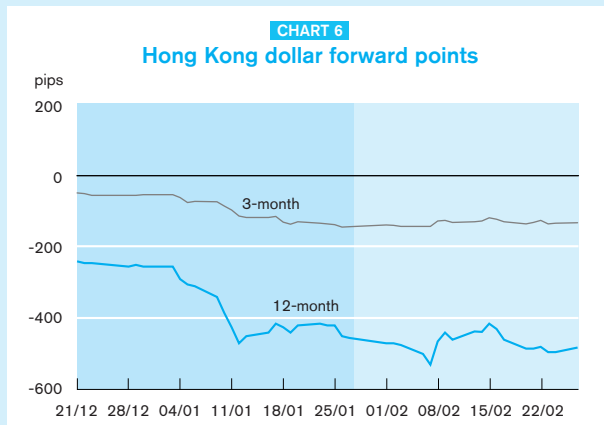
Interest rate volatility, as measured by the standard deviation of daily changes in one-month HIBOR, increased slightly in February. The standard deviation as a ratio of the average level of one-month HIBOR was little changed (Chart 4).¹



Short-term negative spreads of Hong Kong dollar interest rates over the US dollar counterparts narrowed slightly during the reporting period. The one-month and three-month spreads decreased by 12 basis points and 9 basis points respectively to -68 basis points. However, the 12-month spread widened by 3 basis points to close at -70 basis points (Chart 5).



Alongside the movements in interest rate spreads, the **Hong Kong dollar 12-month forward discount widened by 12 pips to close at 482 pips**, while the three-month forward discount decreased by 6 pips to close at 132 pips (Chart 6).



Yields of Exchange Fund paper rose across the board during the period (Chart 7). The negative yield spreads against US Treasuries narrowed at the short end, widened at the intermediate end and remained unchanged at the long end. In particular, the three-month spread narrowed to -97 basis points and the five-year spread widened to -53 basis points, while the 10-year spread remained unchanged at -41 basis points at the end of the period (Table 1).

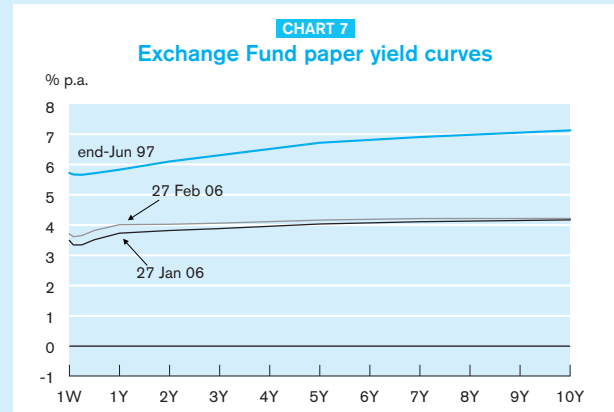
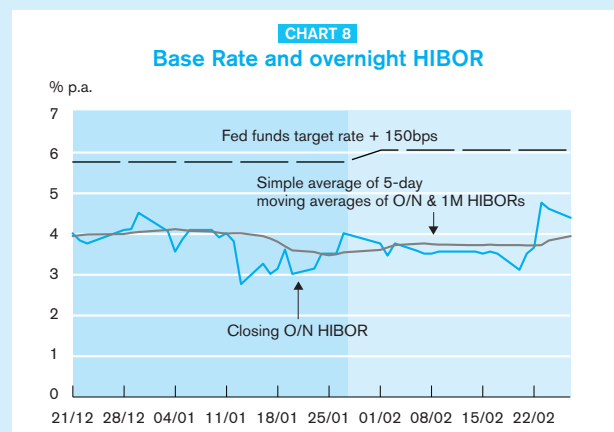


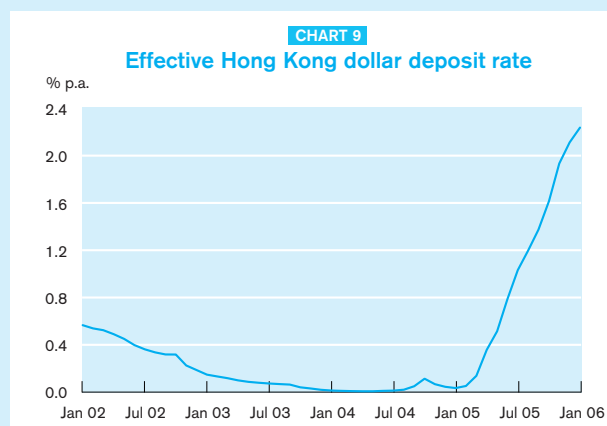
TABLE 1
Yield spreads of Exchange Fund paper over US Treasuries (basis points)

	27 Jun 97	27 Jan 06	27 Feb 06
3-month	56	-112	-97
1-year	21	-86	-78
3-year	3	-60	-69
5-year	27	-47	-53
10-year	54	-41	-41

Following a 25-basis-point hike in US federal funds target rate after the January FOMC meeting, **the HKMA Base Rate was adjusted upward by 25 basis points to 6% on 1 February** according to the established formula (Chart 8). However, **most banks kept their Best Lending Rates unchanged**.



The average one-month time deposit rate offered by major authorized institutions rose from 2.596% to 2.615% during the period.² Meanwhile, the effective deposit rate rose from 2.11% to 2.23% in January (Chart 9).³



Monetary Base

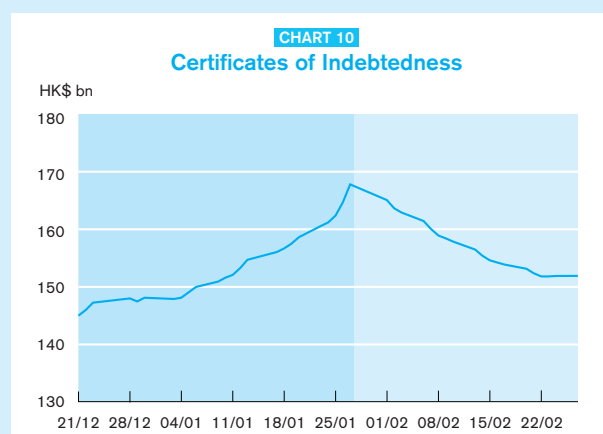
The **Monetary Base**, which consists of Certificates of Indebtedness (CIs), government-issued currency notes and coins in circulation, the Aggregate Balance and Exchange Fund Bills and Notes, **decreased from HK\$301.25 billion to HK\$287.94 billion** during the reporting period (Table 2). Movements in the individual components are discussed below.

TABLE 2
Monetary Base

(HK\$ bn)	01 Feb 06	27 Feb 06
CIs	165.10	151.92
Government-issued Currency Notes and Coins in Circulation	7.66	7.40
Aggregate Balance	1.34	1.30
Outstanding EFBNs	127.15	127.32
Monetary Base	301.25	287.94

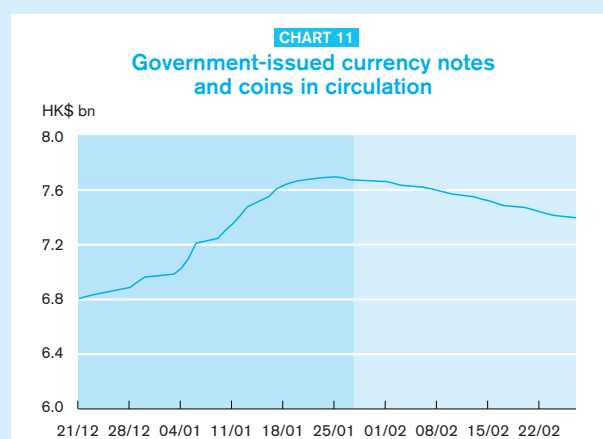
Certificates of Indebtedness

Reflecting decreased public demand for banknotes after the Chinese New Year holidays, the three note-issuing banks redeemed HK\$13.18 billion worth of CIs to the HKMA in exchange for US\$1.69 billion during the period. As a result, **the outstanding amount of CIs declined from HK\$165.10 billion to HK\$151.92 billion** (Chart 10).



Government-issued currency notes and coins in circulation

In line with the contraction in CIs, the total amount of **government-issued currency notes and coins in circulation declined from HK\$7.66 billion to HK\$7.40 billion** during the reporting period (Chart 11).

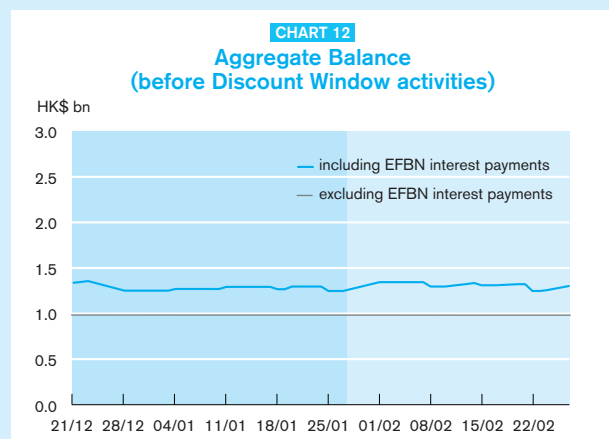


² The figures refer to the average of interest rates offered by the major authorized institutions for one-month time deposits of less than HK\$100,000.

³ 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 made certain assumptions regarding the maturity distribution in computing the effective deposit rate.

Aggregate Balance

The Aggregate Balance was little changed during the reporting period to close at around HK\$1.3 billion, with small fluctuations due to interest payments on Exchange Fund paper (Chart 12).



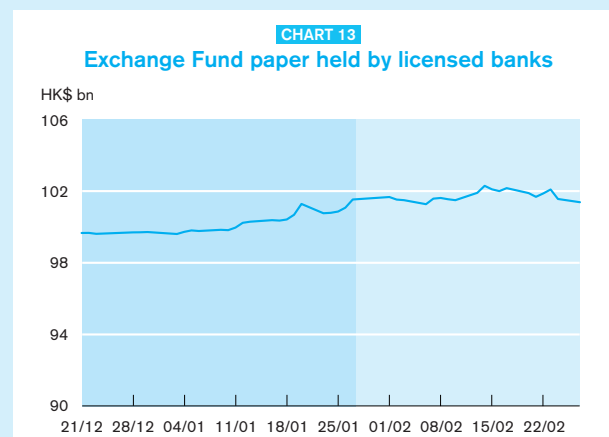
During the period, a total of HK\$384.32 million of interest payments on Exchange Fund paper were made. An additional HK\$330.08 million (in market value) of Exchange Fund paper was issued to absorb these interest payments. The remaining amount was carried forward in the Aggregate Balance. All issues of Exchange Fund paper were well received by the market (Table 3).

TABLE 3
Issuance of Exchange Fund Bills and Notes
(28 Jan 06 – 27 Feb 06)

	No. of issues launched	Over-subscription ratio
1-month EFB	1	12.68
3-month EFB	4	2.48-4.55
6-month EFB	2	4.81-7.61
1-year EFB	1	3.02
2-year EFN	1	2.21
7-year EFN	1	4.62

Outstanding Exchange Fund Bills and Notes

The market value of outstanding Exchange Fund Bills and Notes rose modestly from HK\$127.15 billion to HK\$127.32 billion. Holdings of Exchange Fund paper by the banking sector (before Discount Window activities) decreased from HK\$101.65 billion (79.95% of total) to HK\$101.36 billion (79.61% of total) (Chart 13).



Discount Window activities

During the period, nine banks borrowed a total of HK\$1.94 billion from the Discount Window, compared with HK\$1.31 billion in the preceding period (Chart 14). All borrowings used Exchange Fund paper as collateral (Table 4).

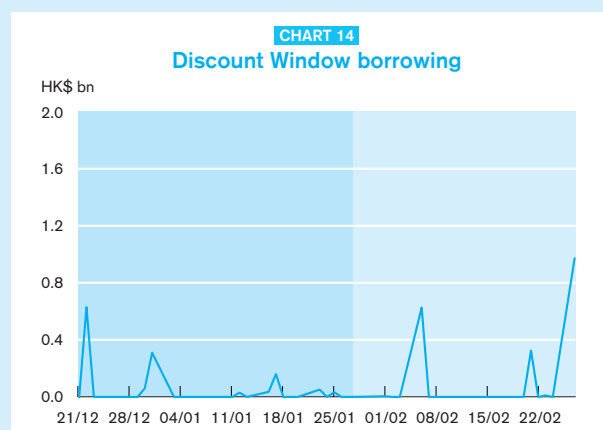
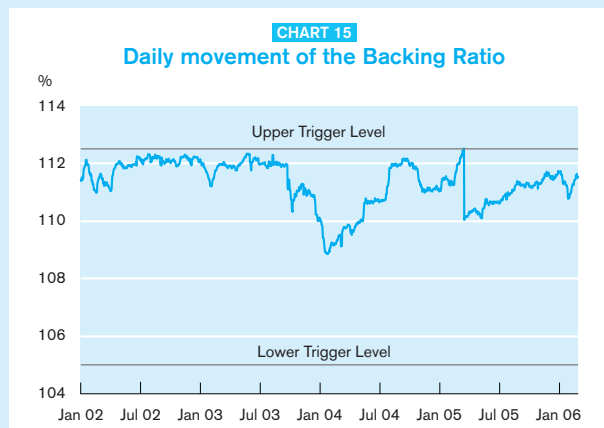


TABLE 4
Frequency of individual bank's access to the Discount Window
(28 Jan 06 – 27 Feb 06)

Frequency of using Discount Window	No. of banks
1	9
Total	9

Backing Portfolio

Backing Assets decreased during the period, mainly reflecting contraction in Certificates of Indebtedness. As the Backing Assets declined proportionally less than the Monetary Base, **the Backing Ratio increased from 110.79% on 31 January 2006 to 111.53% on 27 February 2006** (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.

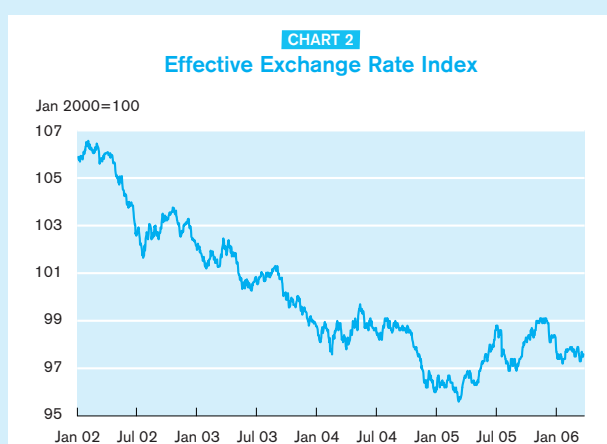
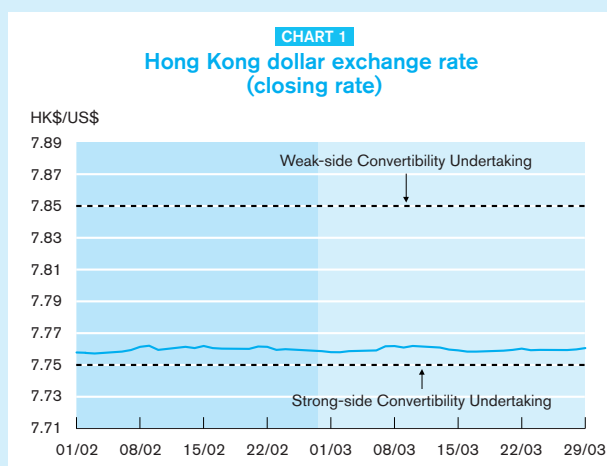


Report on Currency Board Operations (28 February – 29 March 2006)

The Hong Kong dollar exchange rate weakened modestly during the reporting period. Interbank interest rates increased. The Monetary Base declined from HK\$287.72 billion to HK\$285.33 billion, largely due to decreases in Certificates of Indebtedness. In accordance with Currency Board principles, changes in the Monetary Base were fully matched by corresponding changes in foreign reserves.

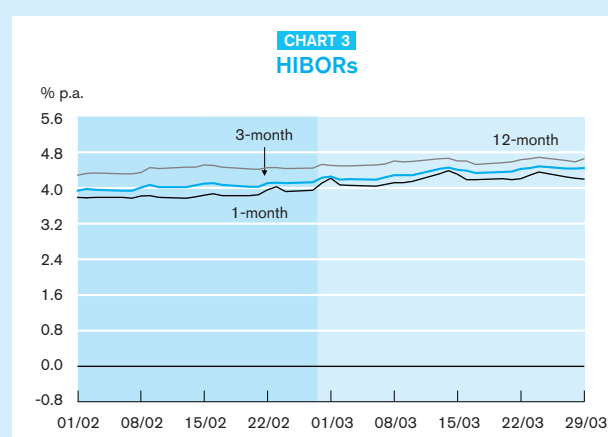
Hong Kong dollar exchange rate

The Hong Kong dollar exchange rate softened moderately to close at 7.7607 at the end of the reporting period (Chart 1). Meanwhile, the effective exchange rate of the Hong Kong dollar was little changed (Chart 2).

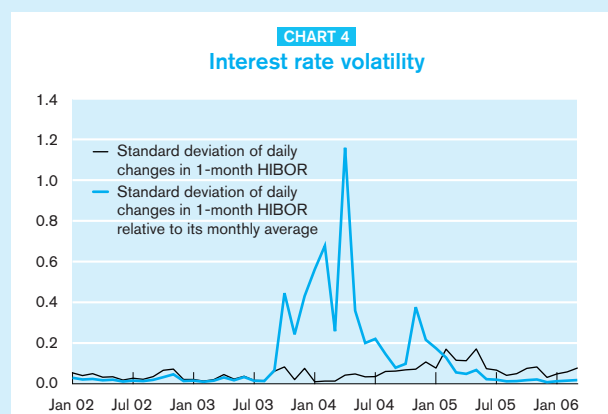


Interest rates

Hong Kong dollar interbank interest rates rose during the reporting period. The one-month and three-month HIBORs increased by 9 basis points and 22 basis points to close at 4.21% and 4.46% respectively. The 12-month HIBOR rose by 13 basis points to close at 4.67% (Chart 3).

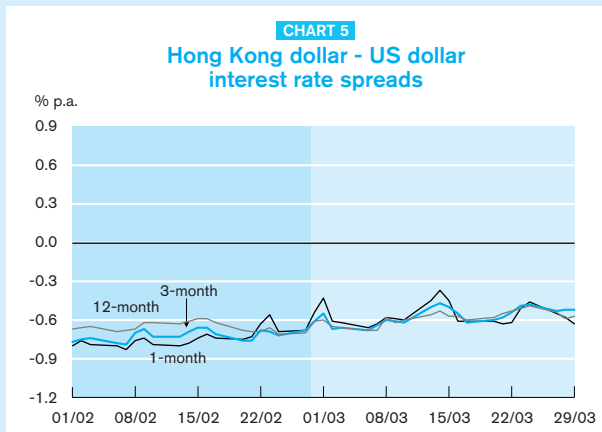


Interest rate volatility, measured by the standard deviation of daily changes in one-month HIBOR, increased in March. The standard deviation as a ratio of the average level of one-month HIBOR rose slightly (Chart 4).¹

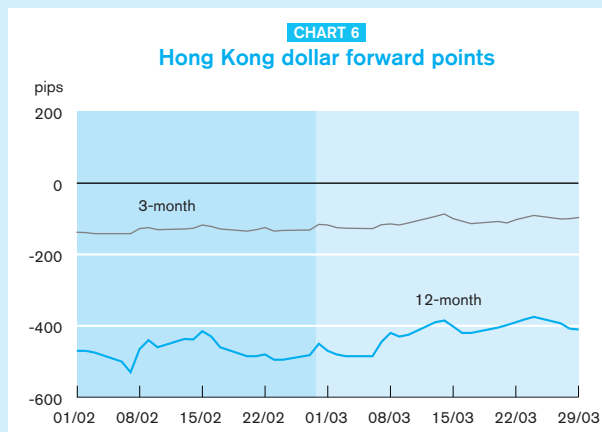


¹ The ratio of the standard deviation of daily changes in the 1-month HIBOR to its monthly average measures the extent of interest rate fluctuations relative to the average level of interest rates.

Hong Kong dollar interbank interest rates remained below US dollar rates. The short-term negative interest rate differentials widened during the period except for the three-month tenor. The one-month spread increased by 9 basis points to close at -63 basis points, but the three-month and 12-month spreads narrowed by 9 basis points and 4 basis points to -52 basis points and -57 basis points respectively (Chart 5).



Alongside the movements in interest rate spreads, the **Hong Kong dollar 12-month forward discount narrowed by 40 pips to close at 410 pips**, while the three-month forward discount decreased by 19 pips to close at 97 pips (Chart 6).



Yields of Exchange Fund paper rose across the board during the period (Chart 7). The negative yield spreads against US Treasuries narrowed. In particular, the three-month and the five-year spreads narrowed to -74 basis points and -42 basis points respectively, while the 10-year spread decreased to -34 basis points at the end of the period (Table 1).

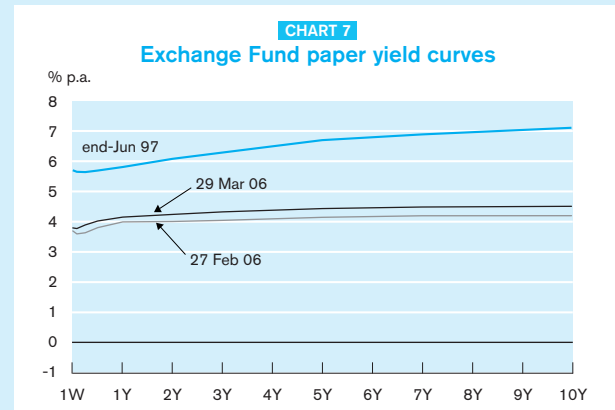
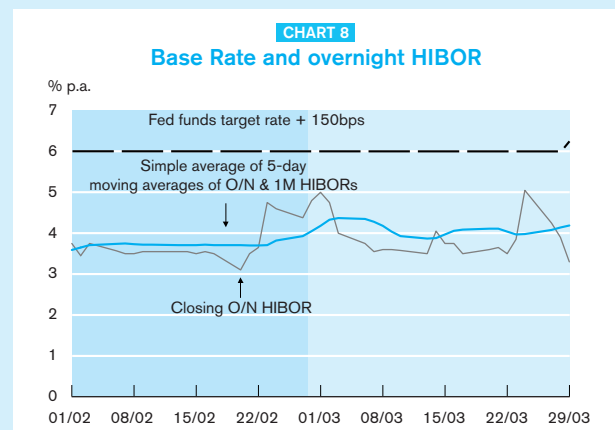


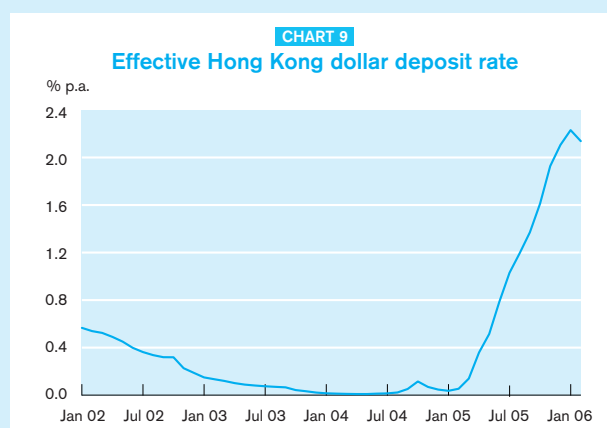
TABLE 1
Yield spreads of Exchange Fund paper over US Treasuries (basis points)

	27 Jun 97	27 Feb 06	29 Mar 06
3-month	56	-97	-74
1-year	21	-78	-75
3-year	3	-69	-55
5-year	27	-53	-42
10-year	54	-41	-34

Following a 25-basis-point hike in the US federal funds target rate after the March FOMC meeting, **the HKMA Base Rate was adjusted upward by 25 basis points to 6.25% on 29 March** according to the established formula (Chart 8). Meanwhile, **most banks raised their Best Lending Rates by 25 basis points.**

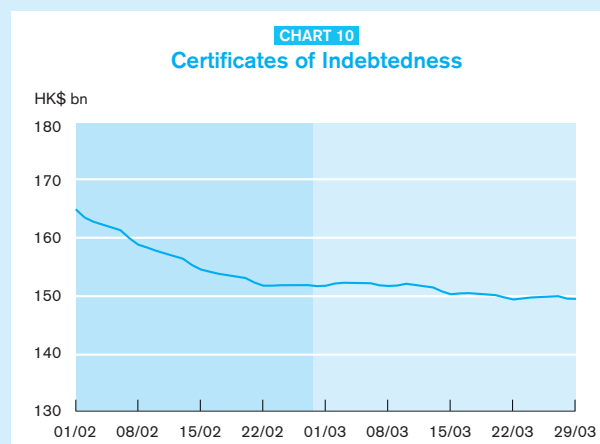


The average one-month time deposit rate offered by major authorized institutions rose from 2.615% to 2.658% during the period.² Meanwhile, the effective deposit rate fell from 2.23% to 2.14% in February (Chart 9).³ The composite interest rate, which reflects the average cost of funds of banks, increased from 2.84% at the end of January 2006 to 2.94% at the end of February 2006.⁴



Certificates of Indebtedness

The three note-issuing banks redeemed HK\$2.22 billion of CIs to the HKMA in exchange for US\$0.28 billion during the period. As a result, **the outstanding amount of CIs decreased from HK\$151.75 billion to HK\$149.53 billion** (Chart 10).



Monetary Base

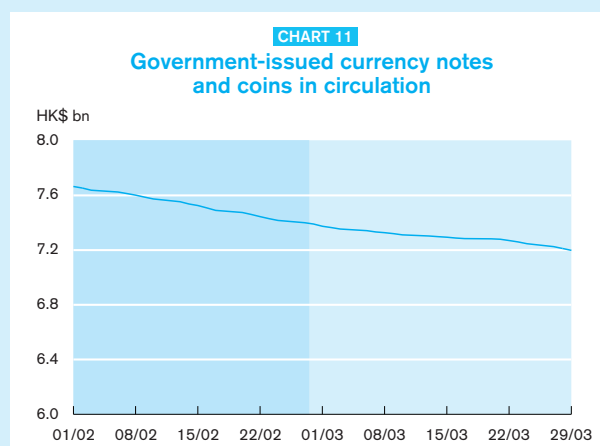
The **Monetary Base**, which consists of Certificates of Indebtedness (CIs), government-issued currency notes and coins in circulation, the Aggregate Balance and Exchange Fund Bills and Notes, **decreased from HK\$287.72 billion to HK\$285.33 billion** during the reporting period (Table 2). Movements in the individual components are discussed below.

TABLE 2
Monetary Base

(HK\$ bn)	28 Feb 06	29 Mar 06
CIs	151.75	149.53
Government-issued Currency Notes and Coins in Circulation	7.39	7.20
Aggregate Balance	1.30	1.29
Outstanding EFBNs	127.28	127.31
Monetary Base	287.72	285.33

Government-issued currency notes and coins in circulation

As the CIs contracted, the total amount of **government-issued currency notes and coins in circulation declined from HK\$7.39 billion to HK\$7.20 billion** during the reporting period (Chart 11).



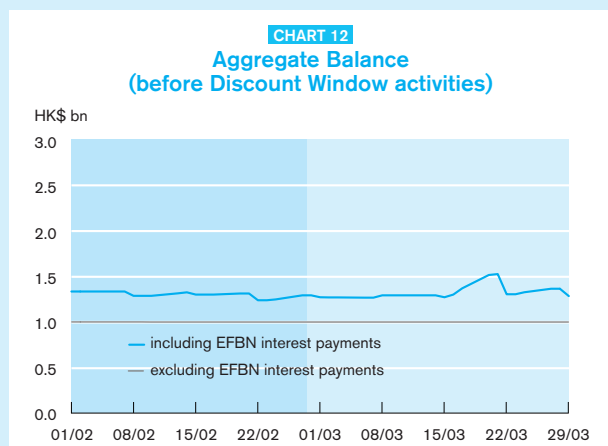
² The figures refer to the average of interest rates offered by the major authorized institutions for one-month time deposits of less than HK\$100,000.

³ 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 made certain assumptions regarding the maturity distribution in computing the effective deposit rate.

⁴ 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.

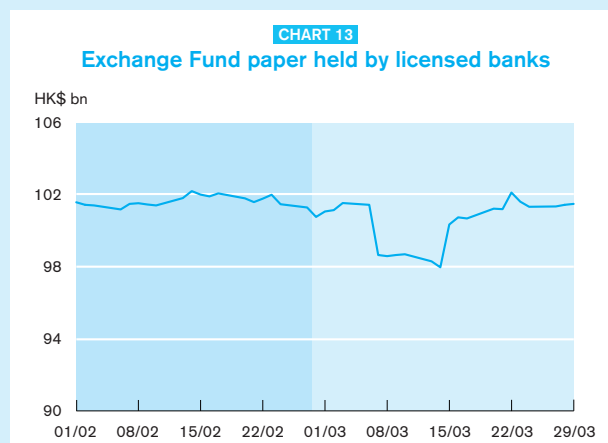
Aggregate Balance

The Aggregate Balance was little changed during the reporting period to close at around HK\$1.3 billion, 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 rose modestly from HK\$127.28 billion to HK\$127.31 billion. Holdings of Exchange Fund paper by the banking sector (before Discount Window activities) increased from HK\$100.84 billion (79.22% of total) to HK\$101.56 billion (79.77% of total) (Chart 13).



During the period, a total of HK\$594.65 million of interest payments on Exchange Fund paper were made. An additional HK\$594.23 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. Most issues of Exchange Fund paper were well received by the market (Table 3).

TABLE 3
Issuance of Exchange Fund Bills and Notes
(28 Feb 06 – 29 Mar 06)

	No. of issues launched	Over-subscription ratio
3-month EFB	5	1.35-4.28
6-month EFB	3	2.44-7.23
1-year EFB	1	2.48
3-year EFN	1	2.08
5-year EFN	1	0.82

Discount Window activities

During the period, five banks borrowed a total of HK\$1.88 billion from the Discount Window, compared with HK\$1.94 billion in the preceding period (Chart 14). All borrowings used Exchange Fund paper as collateral (Table 4).

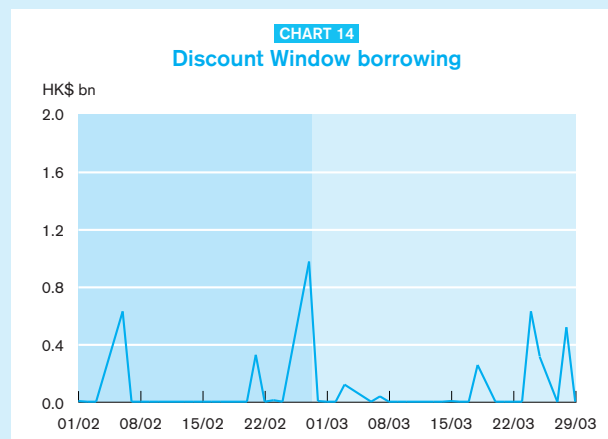


TABLE 4
Frequency of individual bank's access to the Discount Window
(28 Feb 06 – 29 Mar 06)

Frequency of using Discount Window	No. of banks
1	3
2	1
4	1
Total	5

Backing Portfolio

Backing Assets decreased during the period, mainly reflecting contraction in Certificates of Indebtedness. As the Backing Assets declined proportionally less than the Monetary Base, **the Backing Ratio increased from 111.50% on 28 February 2006 to 111.77% on 29 March 2006** (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.

