

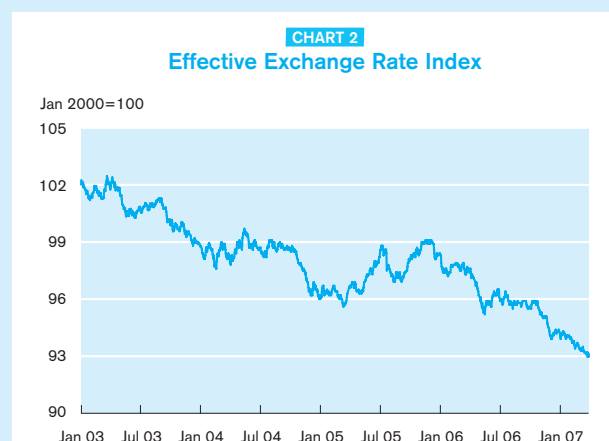
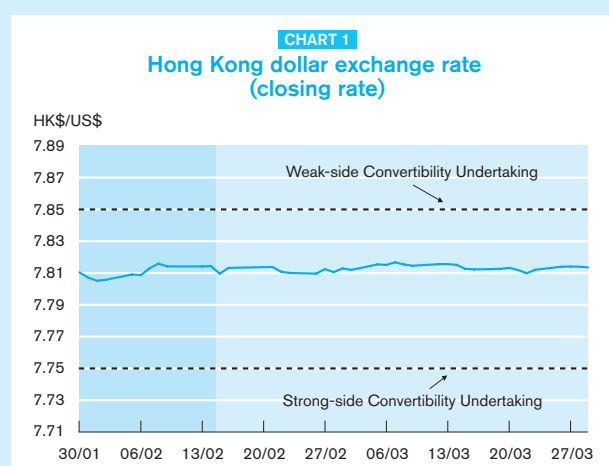
Report on Currency Board Operations (15 February – 29 March 2007)

The Hong Kong dollar exchange rate was stable during the reporting period. Movements in interbank interest rates and their negative spreads against US dollar interest rates showed mixed patterns. The Monetary Base declined from HK\$315.85 billion to HK\$297.84 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

The Hong Kong dollar exchange rate remained stable.

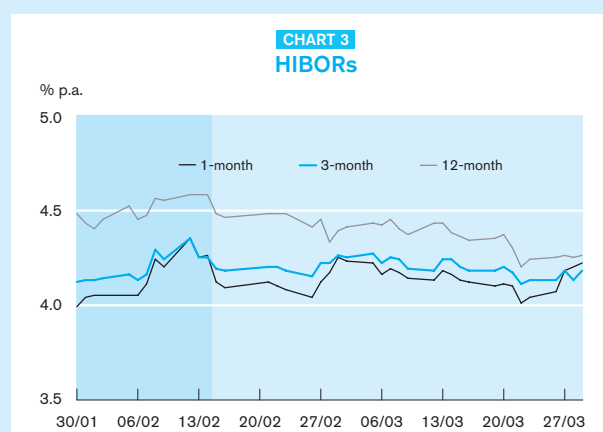
It stayed between 7.8092 and 7.8163 during the review period, and closed at 7.8132 (Chart 1). Meanwhile, the effective exchange rate index of the Hong Kong dollar declined, reflecting the strengthening of the renminbi, the Japanese yen and the euro against the US dollar (Chart 2).



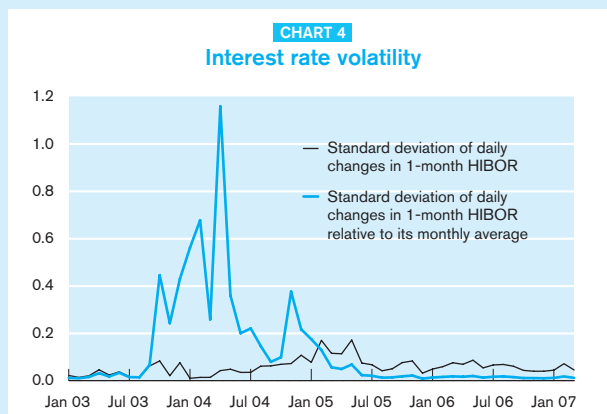
Interest rates

Hong Kong dollar interbank interest rates were mixed.

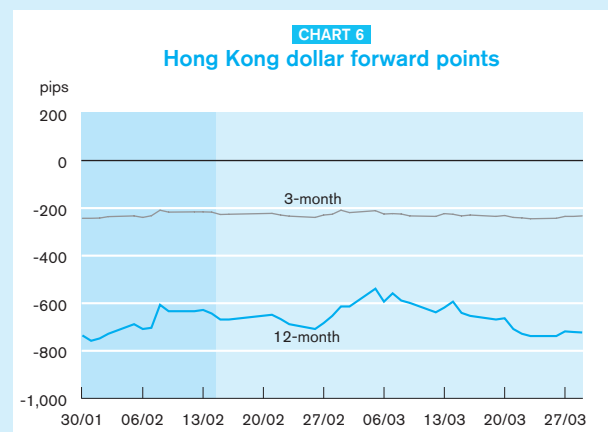
The one-month HIBOR fluctuated between 4.01% and 4.25%. It gradually increased towards the end of the review period to close at 4.22%, owing to heightened liquidity demand relating to stock market fund-raising activities. Meanwhile, the three-month HIBOR was roughly stable at 4.18%, but the 12-month HIBOR declined by 22 basis points to close at 4.26% (Chart 3).



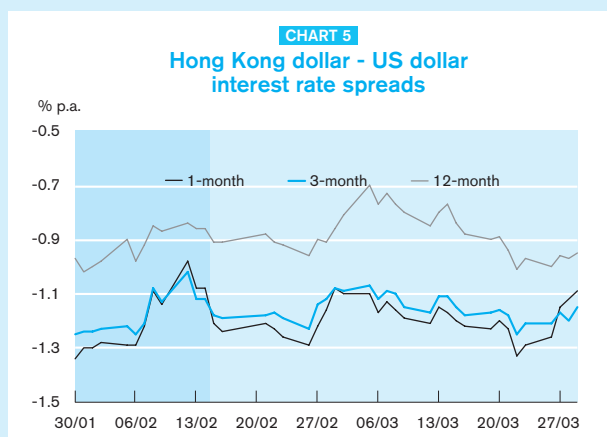
Interest rate volatility, measured by the standard deviation of daily changes in one-month HIBOR, **decreased** in March. The standard deviation as a ratio of the average level of one-month HIBOR also declined (Chart 4).¹



The Hong Kong dollar three-month and 12-month forward discounts increased by six and 55 pips to close at 229 and 720 pips respectively, in line with the movements in the interest rate spreads (Chart 6).



Negative spreads of Hong Kong dollar interest rates against their US dollar counterparts also showed a diverse pattern. The one-month and three-month negative interest rate spreads narrowed by 12 and three basis points to -109 and -115 basis points respectively, while the 12-month negative spread expanded modestly by four basis points to -95 basis points (Chart 5).



Yields of Exchange Fund paper decreased across the board during the period (Chart 7). The negative yield spreads against US Treasuries widened. In particular, the three-month negative spread widened by 16 basis points to -158 basis points, while the three-year and ten-year negative spreads increased by seven and six basis points to -69 and -55 basis points respectively at the end of the period (Table 1).

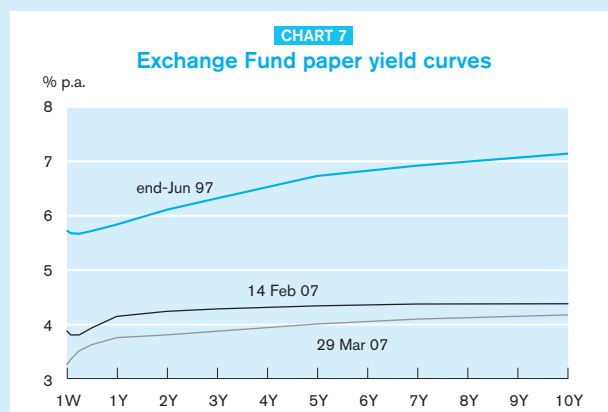
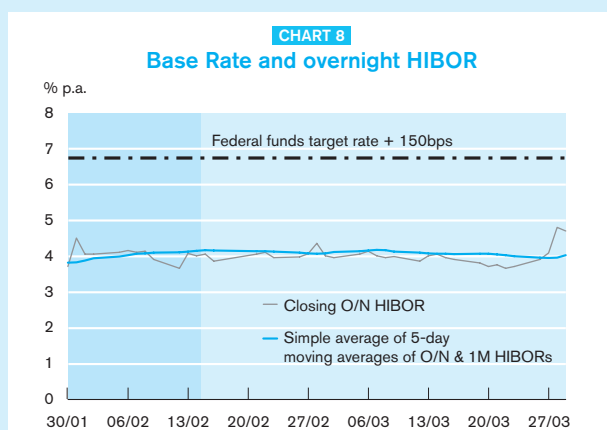


TABLE 1
Yield spreads of Exchange Fund paper over US Treasuries (basis points)

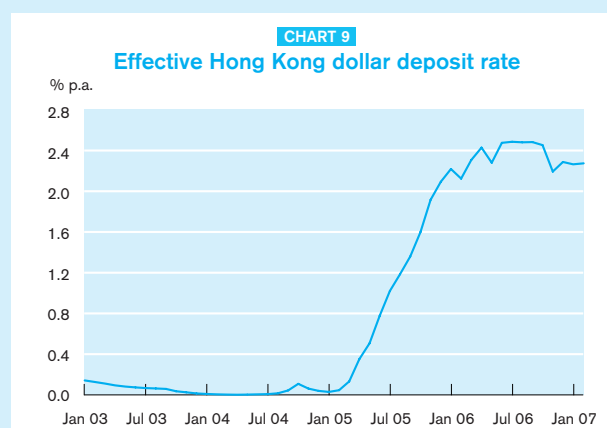
	27 Jun 97	14 Feb 07	29 Mar 07
3-month	56	-142	-158
1-year	21	-95	-114
3-year	3	-62	-69
5-year	27	-53	-54
10-year	54	-49	-55

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.

The HKMA Base Rate remained unchanged at 6.75% throughout the period (Chart 8). Banks kept their Best Lending Rates unchanged. There continued to be two Best Lending Rates of 7.75% and 8% at the end of the reporting period.



The average one-month time deposit rate offered by major authorized institutions was little changed and stood at 2.519% at the end of the review period.² The effective deposit rate increased slightly from 2.28% in January to 2.29% in February (Chart 9).³ The composite interest rate, which reflects the average cost of funds of banks, rose by seven basis points from 2.86% at the end of January to 2.93% at the end of February.⁴



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.

Monetary Base

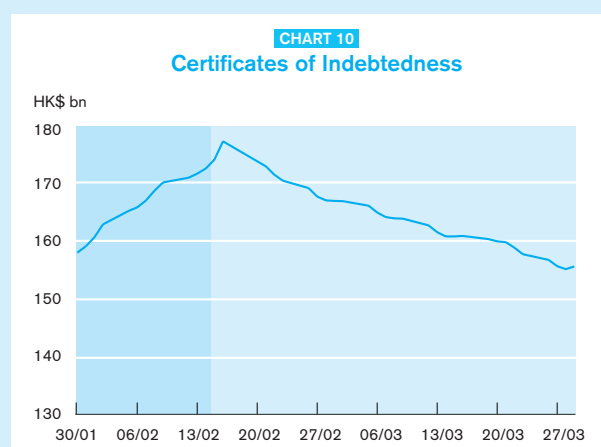
The Monetary Base, which consists of Certificates of Indebtedness (CIs), government-issued currency notes and coins in circulation, the Aggregate Balance and Exchange Fund Bills and Notes, decreased from HK\$315.85 billion to HK\$297.84 billion during the reporting period (Table 2). Movements in the individual components are discussed below.

TABLE 2
Monetary Base

(HK\$ bn)	15 Feb 07	29 Mar 07
CIs	174.45	155.81
Government-issued Currency Notes and Coins in Circulation	8.03	7.63
Aggregate Balance	1.35	1.31
Outstanding EFBNs	132.03	133.10
Monetary Base	315.85	297.84

Certificates of Indebtedness

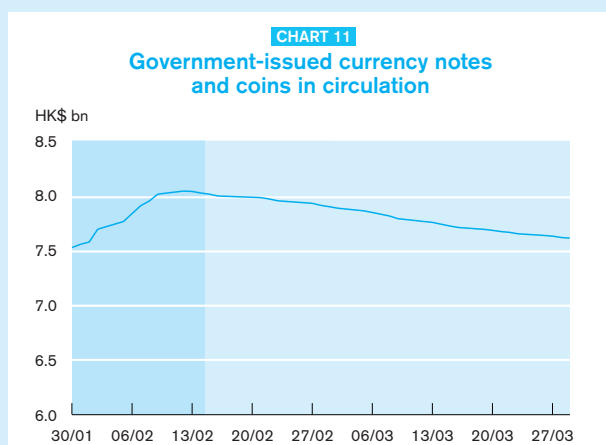
As public demand for banknotes subsided after the Chinese New Year holidays, the three note-issuing banks redeemed HK\$18.64 billion worth of CIs to the HKMA in exchange for US\$2.39 billion during the period. As a result, the outstanding CIs declined from HK\$174.45 billion to HK\$155.81 billion (Chart 10).



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.

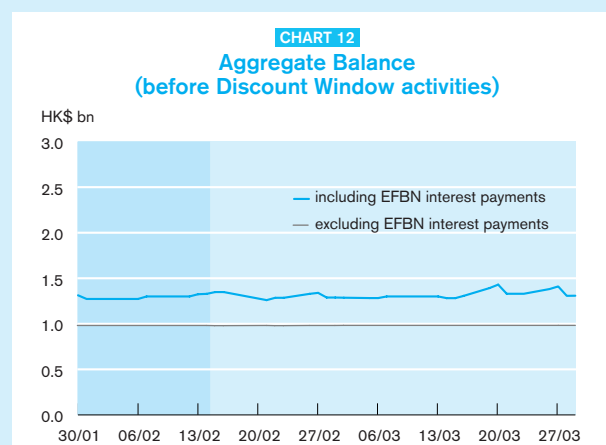
Government-issued currency notes and coins in circulation

In line with the contraction in CIs, **government-issued currency notes and coins in circulation decreased from HK\$8.03 billion to HK\$7.63 billion** during the reporting period (Chart 11).



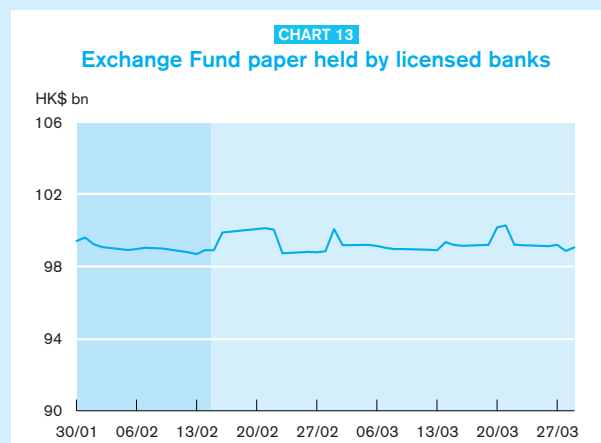
Aggregate Balance

In the review period, **the Aggregate Balance remained stable at around HK\$1.31 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 from **HK\$132.03 billion to HK\$133.10 billion** during the reporting period. **Holdings of Exchange Fund paper by the banking sector (before Discount Window activities) increased moderately** from HK\$98.95 billion (74.95% of total) to HK\$99.12 billion (74.47% of total) (Chart 13).



During the period, a **total of HK\$679.41 million of interest payments on Exchange Fund paper were made**. Taking into account interest payments carried forward from the last reporting period, an additional HK\$689.69 million (in market value) of Exchange Fund paper was issued to absorb these interest payments. The Exchange Fund papers issued were well received by the market (Table 3).

TABLE 3
Issuance of Exchange Fund Bills and Notes (15 Feb 07 – 29 Mar 07)

	No. of issues launched	Over-subscription ratio
1-month EFB	1	9.38
3-month EFB	6	0.99-3.53
6-month EFB	3	1.81-3.82
1-year EFB	1	3.52
3-year EFN	1	1.67
5-year EFN	1	1.50
7-year EFN	1	1.30

Discount Window activities

During the period, **seven banks borrowed a total of HK\$1.72 billion from the Discount Window**, compared with HK\$ 800 million in the preceding period (Chart 14 and Table 4). All borrowings used Exchange Fund paper as collateral.

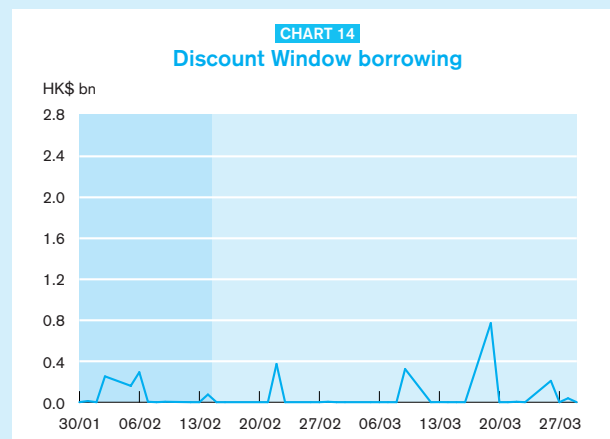


TABLE 4
Frequency of individual bank's access to the Discount Window (15 Feb 07 – 29 Mar 07)

Frequency of using Discount Window	No. of banks
1	6
3	1
Total	7

Backing Portfolio

The Monetary Base decreased during the period, mainly attributable to a decline in CIs. As a result, **the Backing Ratio rose from 109.86% on 15 February 2007 to 111.05% on 29 March 2007** (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.

