

# Operation of monetary policy

by the Monetary Management Department

The Hong Kong-dollar exchange rate eased slightly from the strong-side Convertibility Undertaking (CU) level of HK\$7.75 in the first quarter of 2010. In the absence of net inflows, the strong-side CU was not triggered. The Aggregate Balance fell to HK\$186.6 billion by the end of March upon the additional issuance of HK\$78 billion of Exchange Fund Bills during the quarter. With ample liquidity, short-term local interest rates remained close to zero throughout the quarter, while the long-term rates tracked their US counterparts to move slightly higher. The Base Rate remained unchanged at 0.5%.

## Convertibility Undertaking and Aggregate Balance

The Hong Kong-dollar exchange rate eased moderately away from the strong-side of the Convertibility Zone during the quarter (Chart 1). The Hong Kong-dollar exchange rate ended the quarter at HK\$7.7637, slightly above the strong-side Convertibility Undertaking level of HK\$7.75. The strong-side CU was not triggered and the Aggregate Balance fell from HK\$264.6 billion to HK\$186.6 billion upon the additional issuance of HK\$78 billion Exchange Fund Bills during the quarter.

## Short-term Hong Kong-dollar interest rates

With ample liquidity in the interbank market, the overnight Hong Kong-dollar interest rates stayed close to zero throughout the quarter, whereas their US-dollar counterparts experienced some mild fluctuations (Chart 2).

CHART 1

Aggregate Balance, Discount Window activity and Hong Kong-dollar exchange rate

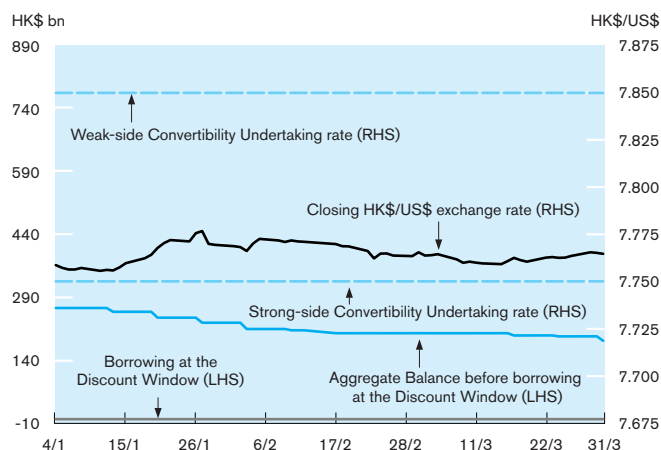
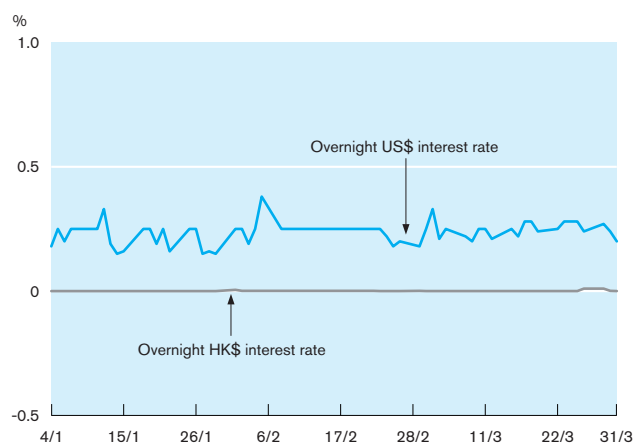


CHART 2

Overnight Hong Kong-dollar and US-dollar interest rates



The three-month interest rate spread between the US dollar and Hong Kong dollar narrowed slightly towards the end of the quarter as the three-month US-dollar interest rate eased and the corresponding Hong Kong-dollar interest rate hovering at around zero (Chart 3). On the other hand, six-month and 12-month Hong Kong-dollar forward discounts remained broadly stable (Chart 4).

## Long-term Hong Kong-dollar interest rates

Long-term yields of Exchange Fund Notes tracked those of US Treasuries during the quarter to move higher but by a bigger margin. As a result, the yield spread between 10-year US Treasuries and 10-year Exchange Fund Notes narrowed from -131 basis points at the beginning of the quarter to -113 basis points by the end of the quarter (Chart 5).

CHART 3

### Three-month Hong Kong-dollar and US-dollar interest rates

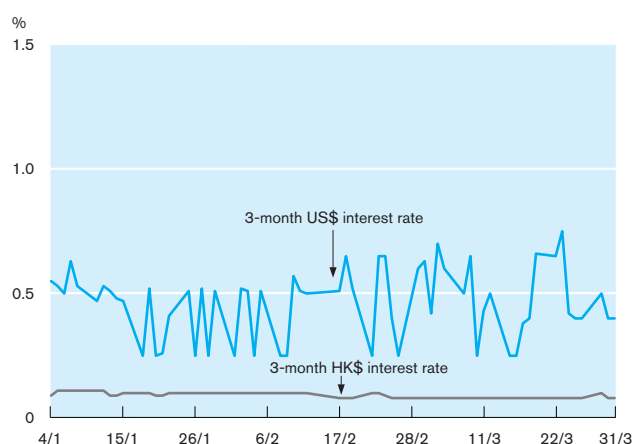


CHART 4

### Six-month and 12-month Hong Kong-dollar forward points

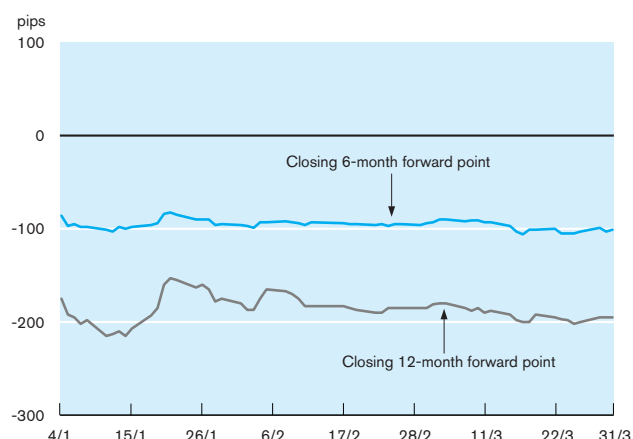
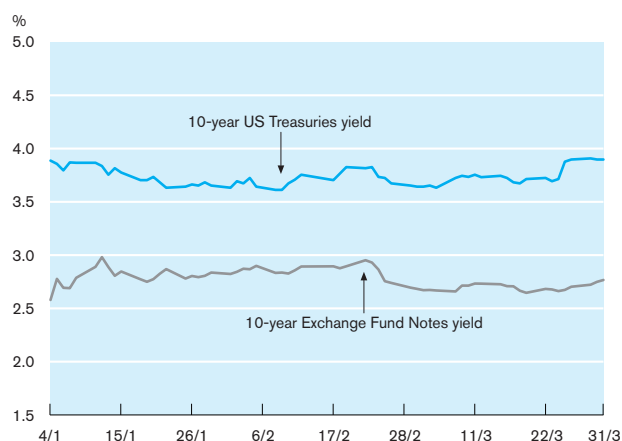


CHART 5

### Yields of 10-year Exchange Fund Notes and US Treasuries



## Hong Kong-dollar effective exchange rate

The Hong Kong-dollar trade-weighted nominal effective exchange rate index (NEERI), which measures the nominal exchange value of the Hong Kong dollar against the currencies of major trading partners, rose slightly to 87.2 on 31 March from 86.9 on 4 January (Chart 6). The higher NEERI reflects the strengthening of the US dollar, particularly against the euro and the Japanese yen.

CHART 6

Hong Kong-dollar/US-dollar exchange rate and Hong Kong-dollar nominal effective exchange rate index

