

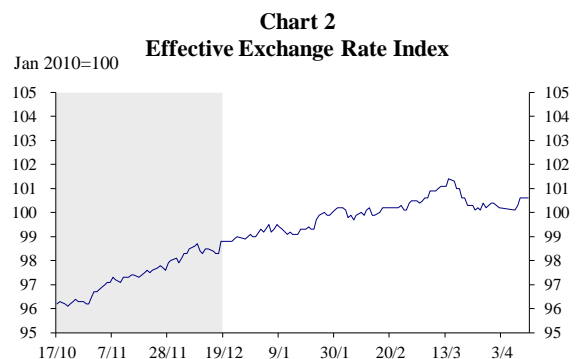
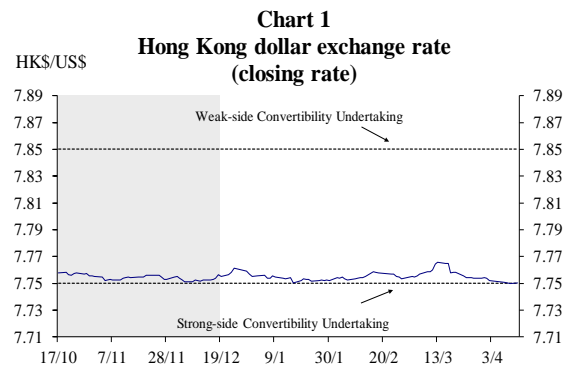
EXCHANGE FUND ADVISORY COMMITTEE
Currency Board Sub-Committee

Report on Currency Board Operations
(19 December 2014 – 13 April 2015)

During the review period, the Hong Kong dollar moved within a narrow range of 7.7500 – 7.7657 against the US dollar, and the Hong Kong dollar exchange market continued to operate smoothly despite increased volatilities in the international currency markets in January 2015. Towards the end of the review period, the Hong Kong dollar exchange rate strengthened amid surge in equity-related demand, with the strong-side Convertibility Undertaking (CU) being triggered a few times. For the whole review period, the Hong Kong dollar interbank interest rates remained steadily low. The Aggregate Balance expanded as a result of the triggering of the strong-side CU, and the Monetary Base increased to HK\$1,357.60 billion. All changes in the Monetary Base were fully matched by changes in foreign reserves in accordance with the Currency Board principles.

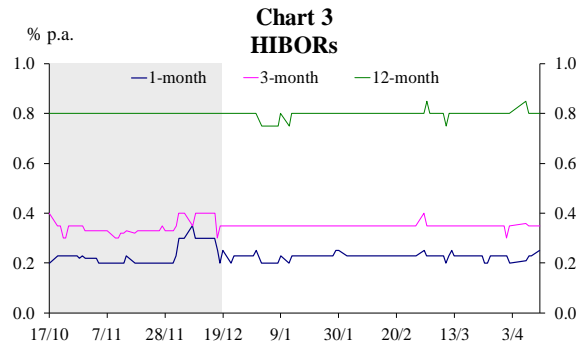
Hong Kong dollar exchange rate

1. During the review period, the Hong Kong dollar moved within a narrow range between 7.7500 and 7.7657 against the US dollar (Chart 1). Stepping into early 2015, the Hong Kong dollar exchange market continued to operate smoothly without disorderly adjustments, despite increased volatilities in the international currency markets amid selling pressures on emerging market currencies and the unexpected removal of the ceiling of the Swiss francs against the euro. Towards the end of the review period, the Hong Kong dollar exchange rate strengthened close to 7.75, mainly driven by equity-related demand. **The strong-side CU was triggered between 9 and 13 April 2015**, prompting the HKMA to passively purchase a total of US\$4.36 billion from banks in exchange for HK\$33.79 billion. **The nominal effective exchange rate index of the Hong Kong dollar picked up** during the review period along with the broad strength of the US dollar (Chart 2).

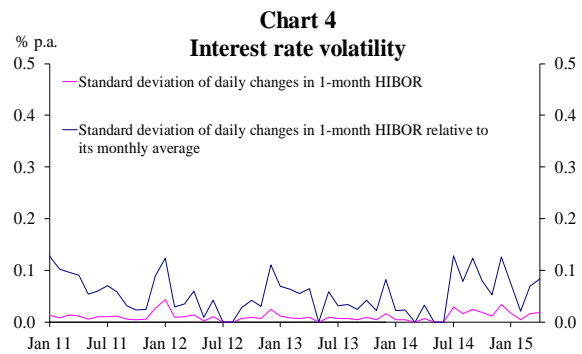


Interest rates

2. The Hong Kong dollar interbank interest rates remained steadily low during the review period (Chart 3). For the whole period, the one-month, three-month and 12-month HIBORs averaged 0.23%, 0.35% and 0.80% respectively.

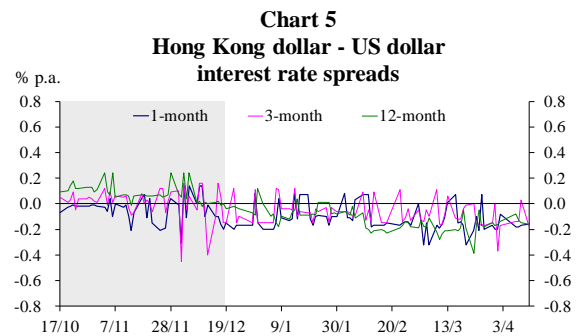


3. As a measure of interest rate volatility, the standard deviation of daily changes in the one-month HIBOR was slightly lower at 1.6 basis points in March and early April 2015, compared with 3.3 basis points in December 2014 (Chart 4). The standard deviation as a ratio of the average one-month HIBOR also followed similar movement.¹

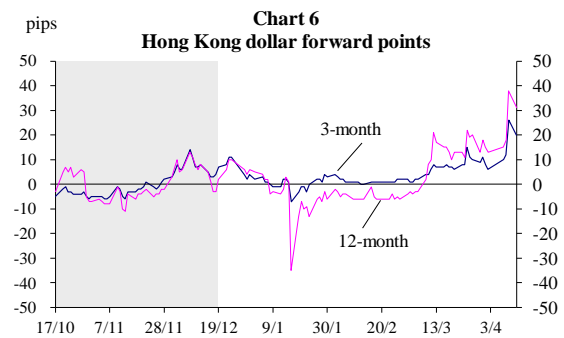


¹ The ratio of the standard deviation of daily changes in the one-month HIBOR to its monthly average measures the extent of interest rate fluctuations relative to the average level of interest rates.

4. The spreads between the Hong Kong dollar interest rates and their US dollar counterparts were roughly stable during the review period (Chart 5). Overall, the one-month, three-month and 12-month spreads averaged -12, -8 and -12 basis points respectively.



5. The Hong Kong dollar forward points declined and momentarily turned to a discount in the first two months of 2015, and then reverted back to a premium since mid-March, largely underpinned by funding demand for initial public offerings and increased equity trading activities, as well as quarter-end liquidity needs (Chart 6). At the end of the review period, the three-month and the 12-month forward points closed at +20 pips and +31 pips respectively.



6. Broadly tracking the movement of the US dollar yield curve, the **Hong Kong dollar yield curve flattened** during the review period (Chart 7). The yield of the 10-year tenor declined by 44 basis points to 1.57%, while that of the 3-year tenor decreased by 30 basis points to 0.71%. The yield spreads of the Hong Kong dollar Exchange Fund Paper and Government Bonds over the US treasuries were generally little changed (Table 1).

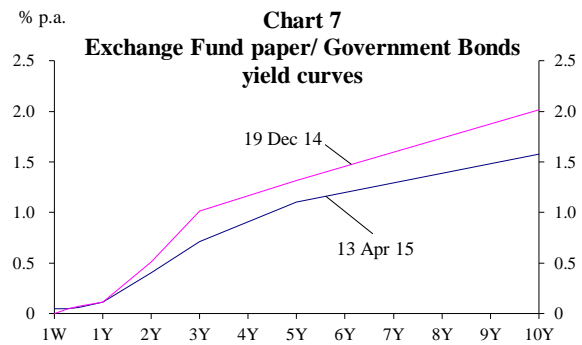
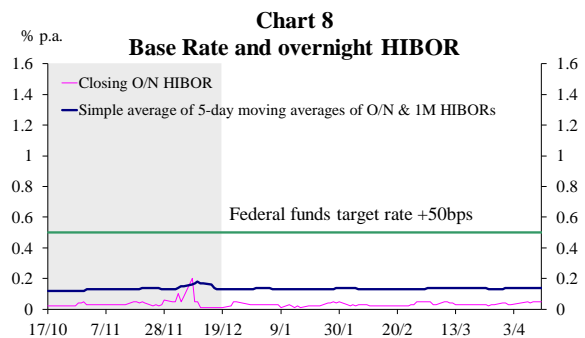
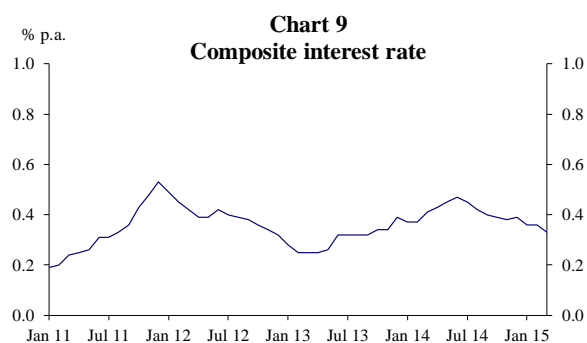


Table 1 Yield spreads of Exchange Fund paper and Hong Kong Government Bonds over US Treasuries (basis points)		
	19 Dec 14	13 Apr 15
3-month EFB	2	4
12-month EFB	-12	-11
3-year HKGB	-8	-21
5-year HKGB	-36	-30
10-year HKGB	-21	-39

7. At the January and March meetings, the US Federal Open Market Committee (FOMC) decided to keep the current range of the Federal Funds Target Rate (FFTR) unchanged at 0 – 0.25%. **The HKMA Base Rate remained unchanged at 0.5%** (Chart 8). It continued to be set at 50 basis points above the lower boundary of the FFTR target range in accordance with the revised Base Rate formula announced on 26 March 2009.



8. Consistent with the stable US FFTR, banks kept their Best Lending Rates unchanged. There continued to be two Best Lending Rates of 5.00% and 5.25% at the end of the review period. The average one-month Hong Kong dollar time deposit rate offered by retail banks remained stable at 0.01%.² **The composite interest rate³**, which indicates the average cost of funds for retail banks, **decreased to 0.33% in March 2015** from 0.39% in December 2014 (Chart 9). On the lending side, the average mortgage interest rates for newly approved mortgage loans remained low.



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

³ 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.

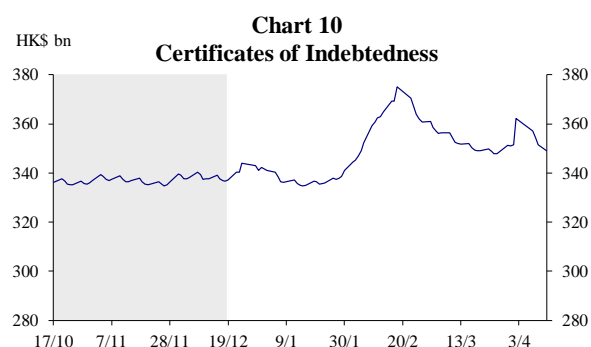
Monetary Base

9. **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, **increased to HK\$1,357.60 billion on 13 April 2015 from HK\$1,341.23 billion on 19 December 2014** (Table 2). Movements in the individual components are discussed below.

Table 2 Monetary Base		
(HK\$bn)	19 Dec 14	13 Apr 15
CIs	337.28	349.12
Government-issued Currency Notes and Coins in Circulation	11.33	11.73
Aggregate Balance	239.21	242.29
Outstanding EFBNs	753.41	754.47
Monetary Base	1341.23	1357.60

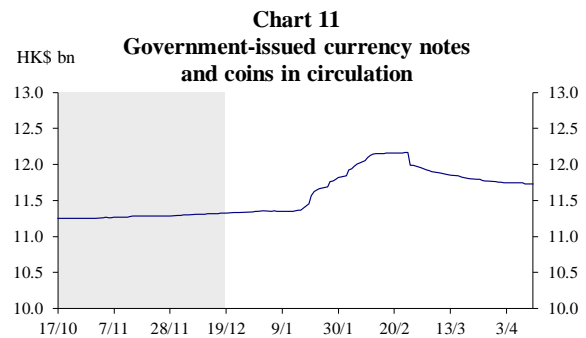
Certificates of Indebtedness

10. During the review period, the three note-issuing banks submitted US\$1.5 billion to the HKMA in exchange for HK\$11.84 billion worth of CIs. As a result, **the outstanding CIs increased** to HK\$349.12 billion on 13 April 2015 from HK\$337.28 billion on 19 December 2014 (Chart 10). The outstanding CIs rose momentarily ahead of the Chinese New Year holidays and the Easter holidays along with increased demand for banknotes.



Government-issued currency notes and coins in circulation

11. During the review period, the amount of **government-issued currency notes and coins in circulation** edged up to HK\$11.73 billion on 13 April 2015 from HK\$11.33 billion on 19 December 2014 (Chart 11).



Aggregate Balance

12. **The Aggregate Balance increased** to HK\$242.29 billion on 13 April 2015 from HK\$239.21 billion on 19 December 2014 (Chart 12), **due to triggering of the strong-side CU** on 9 April 2015 (Table 3).

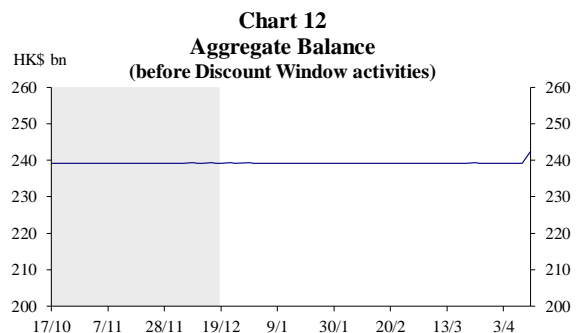
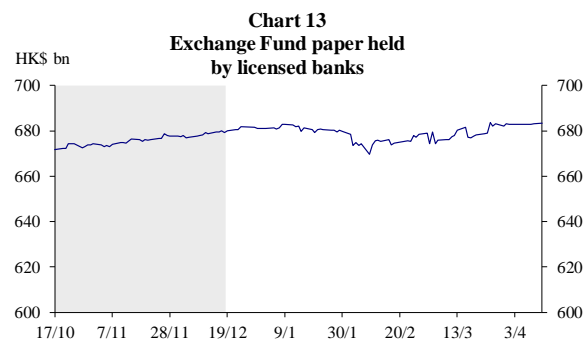


Table 3 HKMA HK\$/US\$ FX Transactions (19 Dec 14 - 13 Apr 15)	
Trade Date	Net sale of HK\$ (HK\$mn)
09-Apr-15	3,100.00
10-Apr-15	24,490.00*
13-Apr-15	6,200.00*
Total	33,790.00

* The figures were shown in the Aggregate Balance on 15 April, which rose to HK\$273.0billion.

Outstanding Exchange Fund Bills and Notes

13. The market value of outstanding Exchange Fund Bills and Notes edged up to HK\$754.47 billion from HK\$753.41 billion during the review period. Holdings of Exchange Fund paper by the banking sector (before Discount Window activities) increased to HK\$683.34 billion (90.6% of total) from HK\$679.89 billion (90.2% of total) (Chart 13).

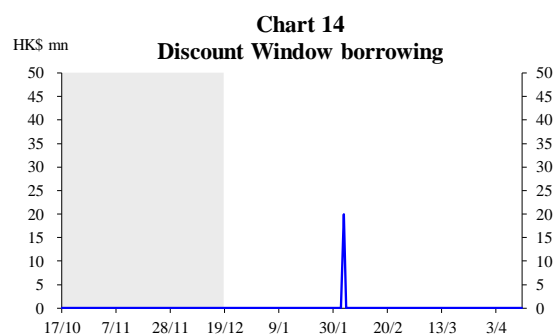


14. During the review period, **HK\$462.90 million of interest payments on Exchange Fund paper were made. An additional HK\$347.96 million (in market value) of Exchange Fund paper was issued to absorb these interest payments.** The remaining amount was carried forward in the Aggregate Balance. The Exchange Fund paper issued during the review period was well received by the market (Table 4).

Table 4 Issuance of Exchange Fund Bills and Notes (19 Dec 14 – 13 Apr 15)		
	No. of issues launched	Over-subscription ratio
1-month EFB	1	4.19
3-month EFB	16	2.33 – 5.51
6-month EFB	15	1.92 – 5.43
12-month EFB	4	5.54 – 13.94
2-year EFN	1	2.83
3-year EFN	1	2.14
5-year EFN	1	1.02

Discount Window activities

15. During the review period, **a bank borrowed HK\$20 million from the Discount Window**, while no banks borrowed from the Discount Window in the preceding review period (Chart 14 and Table 5).



Backing Portfolio

16. The Backing Assets increased during the review period, to HK\$1,455.89 billion on 13 April 2015 mainly reflecting an increase in the CIs. As the Backing Assets increased proportionally more than Monetary Base, **the Backing Ratio edged up to 107.35% from 107.30% during the review period** (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.

Table 5 Frequency of individual bank's access to the Discount Window (19 Dec 14 – 13 Apr 15)	
Frequency of using Discount Window	No. of banks
1	1

