

Provision of Liquidity Assistance To Licensed Banks in Hong Kong

Five Temporary Measures

Background

1. Currently there are two avenues for the Hong Kong Monetary Authority (HKMA) to provide **liquidity to individual licensed banks** in Hong Kong – the Discount Window and the Lender of Last Resort arrangements. Both are well established and clearly articulated in the relevant documents issued by the HKMA to licensed banks.
2. In addition, the HKMA has the discretion to provide **liquidity to the banking system as a whole** through money and foreign exchange market operations that vary the size of the Aggregate Balance, or the liquidity of the inter-bank market, when circumstances justify doing so, in accordance with the Currency Board rule of 100% US dollar backing for the Monetary Base and without affecting stability of the exchange rate.
3. Ongoing financial stress in the financial systems of developed markets has caused some concern among licensed banks in Hong Kong over the credit worthiness of each other. This concern, together with a wish to preserve liquidity to meet their own contingent needs, has led to a general shortage of interbank liquidity and difficulties on the part of individual licensed banks in obtaining funding in the interbank market.

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4. The HKMA has already injected considerable liquidity into the banking system. These liquidity injections, which took the form of purchases of US dollars and the corresponding increases in the Aggregate Balance, have had the effect of relieving considerably the tightness in the inter-bank market. To further mobilise liquidity in a targeted manner to banks that may find themselves in need, the HKMA will, starting from Thursday 2 October and for a six-month period until the end of March 2009, operate the following **five temporary measures**, the first three to be invoked by individual licensed banks, and the last two to be exercised at the discretion of the HKMA in response to requests from individual licensed banks.
5. **First**, the eligible securities, for access by individual licensed banks to liquidity assistance through the Discount Window, will be expanded to include US dollar assets of credit quality acceptable to the HKMA.

6. **Second**, the duration of liquidity assistance provided to individual licensed banks through the Discount Window will be extended, at the request of individual licensed banks on a case-by-case basis, from overnight money only to maturities of up to three months.

7. **Third**, the 50% threshold for the use of Exchange Fund paper as collateral for borrowing through the Discount Window at the HKMA Base Rate will be raised to 100%. In other words, the 5% premium (or penalty) over the Base Rate for the use of Exchange Fund paper beyond the 50% threshold, as collateral for borrowing through the Discount Window, will be waived.

8. **Fourth**, the HKMA will, in response to requests from individual licensed banks and when it considers necessary, conduct foreign exchange swaps (between the US dollar and the Hong Kong dollar) of various durations with licensed banks.

9. **Fifth**, the HKMA will, in response to requests from individual licensed banks and when it considers necessary, lend term money of up to one month to individual licensed banks against collateral of credit quality acceptable to the HKMA.

10. Further details for the operation of these measures, including the eligibility criteria of US dollar assets for Discount Window borrowing, collateral for term money, the pricing arrangements, and the settlement arrangements will be separately conveyed to licensed banks in a technical note to be issued by the HKMA.

11. When providing liquidity assistance through these five temporary measures, the HKMA will, as has been the case with the existing measures, ensure that the Currency Board Rule of 100% backing for the Monetary Base by US dollars – the important characteristic of the Linked Exchange Rate system – is strictly observed. However, operations making use of these measures may cause transient changes to the Aggregate Balance. Where these changes affect monetary conditions to the extent of causing instability in the exchange rate, the HKMA may at its discretion conduct compensating money or foreign exchange market operations within the Convertibility Zone to ensure exchange rate stability. Timely forecasts of changes in the Aggregate Balance as a result of any such operations will be published as usual.

12. The HKMA will, before the end of March 2009, review whether or not these five temporary measures for the provision of liquidity assistance to licensed banks in Hong Kong continue to be necessary, in the light of domestic and international financial market conditions.