



HONG KONG MONETARY AUTHORITY
香港金融管理局

Press Releases

08 Jan 2009

Record of Discussion of the Meeting of the Exchange Fund Advisory Committee Currency Board Sub-Committee held on 5 December 2008

Approved for Issue by the Exchange Fund Advisory Committee by circulation on 7 January 2009)

Report on Currency Board Operations (20 September - 20 November 2008)

The Sub-Committee noted that the Hong Kong dollar exchange rate against the US dollar had strengthened towards the strong-side Convertibility Undertaking of 7.75 during the review period due to the unwinding of carry trades and possible repatriation of funds by domestic corporations. The Convertibility Undertaking had been triggered 26 times between 31 October and 20 November. Local interbank rates had risen markedly after the global financial crisis worsened in mid-September. To ease money-market stress, the HKMA had injected liquidity into the banking system; announced five temporary measures to provide liquidity assistance to banks; amended the formula for calculating the Base rate, effectively lowering borrowing costs at the Discount Window; and increased the supply of Exchange Fund Paper. The Financial Secretary had announced two pre-emptive measures on 14 October to bolster confidence in the banking system: a temporary 100% guarantee of bank deposits and a contingent bank capital facility. As a result of these measures, local interbank rates had eased.

2. The Sub-Committee noted that the Monetary Base had expanded during the period from HK\$328.79 billion to HK\$385.44 billion, mainly reflecting an increase in the Aggregate Balance due to the HKMA's operations within the Convertibility Zone and the repeated triggering of the strong-side Convertibility Undertaking.

3. The Sub-Committee noted that, in accordance with Currency Board Principles, changes in the Monetary Base had been fully matched by corresponding changes in foreign reserves.

4. The report on Currency Board operations for the period under review is at [Annex A](#).

Monitoring of Risks and Vulnerabilities

5. The Sub-Committee noted that the volatility in international financial markets had risen again in November. US stock market indices had retreated to their lowest levels since the financial crisis began as investors grew nervous about the depth of recessions in major economies. Oil and other commodity prices had continued to decline.
6. The euro area and Japan had entered recessions in the third quarter and recession in the US was likely to have begun in the fourth quarter. Leading indicators in these economies suggested further contraction in the near term. Unemployment was rising and consumer-price inflation in the US had declined by 1% month on month in October, signalling an increased deflation risk.
7. Major central banks had cut interest rates further. Interbank rates had declined from elevated levels but the banking sectors remained reluctant to lend to firms and households since the negative economic outlook implied higher default risk.
8. In Mainland China economic growth had slowed to 9% in the third quarter. The authorities had moved aggressively on monetary and fiscal policies, reducing deposit and lending rates by 108 basis points and announcing a four-trillion renminbi stimulus package. Market expectations about the renminbi exchange rate with the US dollar had shifted with investors anticipating a moderate depreciation.
9. The Hong Kong economy had contracted in the third quarter, the second consecutive quarter of negative growth. Unemployment had increased while inflation had declined to 3.7% in October and was expected to decline further. The Hong Kong dollar-US dollar exchange rate had remained at the strong side of the Convertibility Zone.
10. The Sub-Committee also noted an analysis suggesting that the current economic downturn in Hong Kong was likely to be more severe than that following the bursting of the IT bubble in 2001 and the SARS period in 2003, but less severe than that following the Asian financial crisis in 1997 to 1998. The main reasons for this are that there is little economic excess compared with 1997; economic fundamentals in Asia, particularly Mainland China, are much stronger than in 1997; easier US monetary policy cushions Hong Kong through the Linked Exchange Rate system; and policy measures in the 2008/09 Budget and supplementary relief measures announced in July 2008 provide a timely stimulus to the real economy.

Can Demand from China Shield East Asian Economies from Global Slowdown

11. The Sub-Committee noted a paper quantifying the proportion of exports from eight East Asian economies that was consumed by consumers in China, the US, Japan, other developed economies, and the rest of the world. The main findings were that roughly half of exports from East Asian Economies to China were used as intermediate inputs and exported from China; the role of demand from developed economies declined only slightly from 2000

to 2006, with US consumers still accounting for more exports from East Asian economies than Chinese consumers; demand from China is less important than commonly thought; and the share of exports from East Asia consumed by the US, Japan, other OECD countries and China did not change significantly between 2000 and 2006.

Measuring Financial Market Interdependence and assessing Possible Contagion Risk in the EMEAP Region

12. The Sub-Committee noted a study of the interdependence between the equity markets of the EMEAP economies and that of the US. The study concluded that the linkages between these markets were close and long term, implying that any large shock to the US will be transmitted to the EMEAP economies.

Review of the Report on Currency Board Operations

13. The Sub-Committee considered a review of the Report on Currency Board Operations and agreed that, since the statistical data contained in it are all published elsewhere, including on the HKMA website, on a monthly and sometimes daily basis; market practitioners were now much more familiar with the operation of the Currency Board than when the current Report was conceived; and given the desirability of providing more analysis and comment in the Report, it should be published quarterly from the beginning of 2009. Members noted that, since all data in the current Report was published elsewhere at least as frequently, this would not lead to any reduction in the transparency of the operations of the Currency Board.

Annex A

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