



HONG KONG MONETARY AUTHORITY
香港金融管理局

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Dear

I have pleasure in enclosing an advance copy of the Hong Kong Monetary Authority's *Annual Report* for 2005, together with a booklet *An Introduction to the HKMA, 2006 Edition* for your information.

Hong Kong enjoyed robust economic growth in 2005, following a strong and broad-based recovery in 2004. The exchange and money markets were largely stable during the year despite massive fund flows, arising in the early part of the year, from speculation that the renminbi would appreciate and the Hong Kong dollar would follow suit, and from stock market activities. I am pleased to note that the three refinements to the Linked Exchange Rate system introduced in May 2005 have made the interest rate adjustment mechanism even more efficient in maintaining a stable exchange rate despite these fund flows. The banking sector continued to perform strongly, with retail banks' aggregate pre-tax operating profits in 2005 increasing by 8.2% from 2004.

2005 saw a significant rise in energy prices and the continued removal of the accommodative stance in the monetary policy of the US Federal Reserve. Global equity markets showed mixed results. Despite the difficult investment environment, the Exchange Fund earned an investment income of \$38.2 billion in 2005 while achieving its objectives of providing backing for the Monetary Base and safeguarding the exchange value of the Hong Kong dollar. The Fund's rate of return exceeded that of the investment benchmark by more than 0.2%.

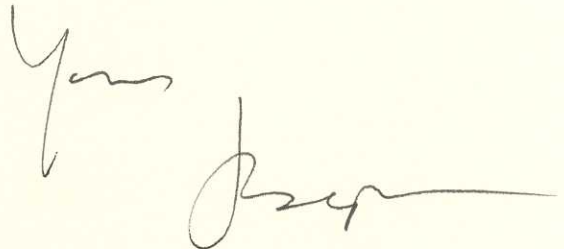
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The expanded system of the Exchange Fund Advisory Committee Sub-Committees functioned well in its first full year of operation in 2005. The governance structure of the HKMA enables us to operate independently and employ staff on terms different from those of the civil service. This independence allows the HKMA to do its job flexibly in an environment that is often changing rapidly and, when necessary, to take steps that might not be popular in the short term but which are necessary to achieve the policy objective of ensuring exchange rate stability. A system of accountability is in place to balance our operational autonomy. The HKMA is accountable to the Financial Secretary, and to the community, both directly and through its elected representatives on the Legislative Council.

I hope you will find the *Annual Report* informative. The *Report* will be released to the public today (21 April) and I will brief the Panel on Financial Affairs of the Legislative Council on 4 May.

With best regards,

A handwritten signature in black ink, appearing to read 'Yau Jee-yong', is written in a cursive style. The signature is positioned to the right of the closing text.