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Hon Bernard Chan, JP  
Chairman of LegCo Panel on Financial Affairs  
Legislative Council  
Legislative Council Building  
8 Jackson Road  
Central  
Hong Kong

**Refinements to the Operation of the Linked Exchange Rate System**

I am writing to inform you that, with the agreement of the Financial Secretary following consultation with the Exchange Fund Advisory Committee, the HKMA is introducing, with immediate effect, three refinements to the operation of the Linked Exchange Rate System. Details of the three refinements are set out in the attached press release.

The refinements are aimed at removing uncertainty about the extent to which the exchange rate may strengthen under the Linked Exchange Rate System and promoting the smooth functioning of the money and foreign exchange markets in accordance with Currency Board arrangements.

We believe that these refinements will further strengthen the Linked Exchange Rate System and its ability to deliver monetary stability in Hong Kong. They should also reduce the usage of the Hong Kong dollar as a vehicle for speculation on a revaluation of the renminbi.

Should you have any questions regarding these refinements, please contact Mr Eddie Yue, Executive Director (Monetary Management and Infrastructure) at tel 2878 8806.

Yours sincerely,

cc Clerk to Panel on Financial Affairs (Attn: Ms Salumi Chan)

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## Press Release

### Refinements to the Operation of the Linked Exchange Rate System

The Hong Kong Monetary Authority (HKMA) announced today (18 May 2005) the introduction, with the agreement of the Financial Secretary following consultation with the Exchange Fund Advisory Committee, of three refinements to the operation of the Linked Exchange Rate System. The refinements are aimed at removing uncertainty about the extent to which the exchange rate may strengthen under the Linked Exchange Rate System and promoting the smooth functioning of the money and foreign exchange markets in accordance with Currency Board arrangements.

The three refinements are: -

- (a) the introduction with immediate effect of a strong-side Convertibility Undertaking by the HKMA to buy US dollars from licensed banks at 7.75;
- (b) the shifting of the existing weak-side Convertibility Undertaking by the HKMA to sell US dollars to licensed banks from 7.80 to 7.85, so as to achieve symmetry around the Linked Rate of 7.80. This shift will be achieved in a gradual manner over five weeks by moving the exchange rate of the weak-side Convertibility Undertaking by 100 pips on every Monday starting with 7.81 on 23 May 2005 until it reaches 7.85 on 20 June 2005;
- (c) within the zone defined by the levels of the Convertibility Undertakings (the "Convertibility Zone"), the HKMA may choose to conduct market operations consistent with Currency Board principles. These market operations shall be aimed at promoting the smooth functioning of the Linked Exchange Rate System, for example, by removing any market anomalies that may arise from time to time.

The HKMA will continue to maintain a high degree of transparency in the operation of the Linked Exchange Rate system. The impact on the Aggregate Balance arising from deals initiated by licensed banks at the levels of the Convertibility Undertakings and market operations initiated by the HKMA, if any, within the Convertibility Zone will, as is the current practice, be announced immediately. The relevant information will also be included in the monthly Reports on Currency Board Operations to the Currency Board Sub-Committee of the Exchange Fund Advisory Committee, which are published on the HKMA website and in the HKMA's *Quarterly Bulletin*.

"The refinements to the operation of the Linked Exchange Rate System introduced today by the HKMA will contribute to enhancing monetary

and financial stability which is clearly in the public interest,” Mr Henry Tang, the Financial Secretary, said. “The Government has no plan or intention to change Hong Kong’s Linked Exchange Rate System,” Mr Tang added.

The Chief Executive of the HKMA, Mr Joseph Yam, said the refinements took into account changing market conditions and the recent experience in the operation of the Linked Exchange Rate System. “The introduction of the Convertibility Undertaking on the strong-side should remove uncertainty about the extent to which the exchange rate may strengthen. It should also reduce the usage of the Hong Kong dollar as a vehicle for speculation on a revaluation of the renminbi,” he said.

18 May 2005

Hong Kong Monetary Authority