

# Maintaining Monetary Stability

## THE LINKED EXCHANGE RATE SYSTEM

The monetary policy objective of Hong Kong is currency stability. This is defined as a stable external exchange value of the Hong Kong dollar in terms of its exchange rate against the US dollar at around HK\$7.80 to one US dollar. The monetary policy objective is achieved through the Linked Exchange Rate system, which has been implemented since 17 October 1983. The Linked Exchange Rate system plays an important part in supporting Hong Kong's role as a trading, service and financial centre.

## THE CURRENCY BOARD SYSTEM

Exchange rate stability in Hong Kong is achieved through a Currency Board system. The Monetary Base is fully backed by foreign currency reserves at the fixed exchange rate of HK\$7.80 to US\$1. Any change in the Monetary Base must be fully matched by corresponding changes in foreign currency reserves.

Hong Kong's Monetary Base consists of four components:

- Certificates of Indebtedness, which back the banknotes issued by the three note-issuing banks

- government-issued currency notes and coins in circulation
- the sum of the balances of the clearing accounts maintained by banks with the HKMA (known as the Aggregate Balance)
- Exchange Fund Bills and Notes, which are issued by the HKMA on behalf of the Government.

Under the Currency Board system, the stability of the Hong Kong dollar exchange rate is maintained through an interest rate adjustment mechanism.

In recent years the Currency Board system has been strengthened to make it more transparent and resilient to external shocks. In particular, the HKMA has provided a clear undertaking to all banks to convert their Hong Kong dollar clearing balances into US dollars at the Convertibility Rate of HK\$7.85 to US\$1, and in the other direction to convert their US dollars into Hong Kong dollars at the Convertibility Rate of HK\$7.75 to US\$1.

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## The Currency Board mechanism

