Box 4.1

Divergent movement between
the Hong Kong dollar narrow and broad money supply

HK$M1, as an indicator of narrow money supply, has increased much faster than HK$M3, as an indicator of broad money supply, by 48.5% as against 3.5% since mid-2001.

The following factors may have contributed to this divergent movement. First, interest rates have fallen continuously in recent years. Specifically, interest rates on savings deposits and three-month time deposits have both dropped from around 5% in late 2000 to near zero at present. This has reduced the cost of holding non-interest-bearing cash or demand deposits, as well as caused some portfolio shift away from broad money. Secondly, the increasing economic links between Hong Kong and the Mainland have raised the demand for Hong Kong dollar currency. This is particularly so upon implementation of the “individual visit” scheme for Mainland visitors to Hong Kong, and upon a relaxation of the limit to the amount of cash allowed to be carried by individuals when travelling abroad. Thirdly, the surge in local stock market activity since April has also led to an accelerated growth in Hong Kong dollar demand deposits.

A study by HKMA shows a stable relationship between GDP, broad money and the opportunity cost of holding money. Other things being equal, a 1% rise in real GDP would raise real money demand by 1.7% in the long run, whereas a 1 percentage point rise in the opportunity cost of holding money would reduce money balances by 4.2%.