

The Evolution of the Hong Kong Currency Board During Global Exchange Rate Instability: Evidence from the Exchange Fund Advisory Committee 1967-1973

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Summary

Hong Kong is one of a few economies that operate a variation of a currency board as the basis of their monetary system. This system has persisted despite dramatic changes in the way that the international monetary system operates and despite changes in Hong Kong's political status. The currency board now faces new challenges with the greater flexibility in the RMB exchange rate and the recent depreciation of the USD that has been dramatically reversed as part of the global financial crisis of 2008. This paper examines how the operations of the Exchange Fund were adapted to react to an earlier period of international monetary disorder when the pegged exchange rate system of the 1950s and 1960s collapsed. Based on archival evidence from the HSBC Group Archive, the HSBC Asia Pacific Archive, the Bank of England, UK Treasury and UK Foreign Office, this paper examines how the core rule of issuing currency only against foreign exchange assets was abandoned in 1972. It presents new data on the accounts of the Exchange Fund for this period and describes minutes of the meetings of the Exchange Fund Advisory Committee. The evidence explores the 1972 decision in its longer term policy context and argues that it was the culmination of a series of alterations to the operation of the Exchange Fund during the collapse of the pegged exchange rate system from 1967 onward. The main argument is that the Hong Kong government's response to the crumbling of the international monetary system was to make the Exchange Fund operate as much more than a currency board well before 1972. In particular, it was used to provide forward cover for commercial banks but this proved especially costly in the volatile environment of the end of the global pegged exchange rate system, so that in 1974 the assets of the Exchange Fund fell to 77% of the note issue.