

Hong Kong's Exchange Rate Regimes in the Twentieth Century: The Story of Three Regime Changes

Tony Latter

The University of Hong Kong

and

Hong Kong Institute for Monetary Research

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Summary

The three key changes to Hong Kong's monetary framework in the twentieth century are examined. In the first half of the 1930s, the rising price of silver caused mounting difficulties for China and Hong Kong, both then operating a silver standard. Consideration of a possible regime change in Hong Kong spread over a number of years, but it was always decided not to move before China. Eventually, when China left silver in 1935, Hong Kong left too and adopted what was effectively a sterling-based currency board. This is judged to have been the correct decision, although a case may be argued that the change should have taken place a couple of years earlier. In 1972, prompted by disenchantment with the weakness of sterling and the UK government's decision to let it float, the Hong Kong government abandoned both the sterling link and, in apparent ignorance of its fundamental monetary importance, the currency board principle. This propelled Hong Kong, which had no central bank at the time, into an era of monetary indeterminacy, where stability was dependent essentially on consensus and mutuality of interests between government and the principal banks. The system was destined to crack if ever market pressures exerted too great a strain, which they finally did in 1983. The currency board was then re-instituted, on this occasion based on the US dollar, and has succeeded in maintaining a stable exchange rate ever since. Various refinements in the years since 1983, including the establishment of the Monetary Authority in the role of a central bank, have made the system more robust. With a central bank, Hong Kong now has the capacity to operate an alternative monetary policy framework, should it so wish. For each of the three regime changes, this paper explores the background, both political and economic, the options which were considered and the reasons for the eventual decisions.