

Linking the Hong Kong Dollar to the SDR: An Increasingly Attractive Option

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Abstract

Since 1983, the Hong Kong dollar has been linked under a modified currency board mechanism to the US dollar. This arrangement has maintained confidence in the Hong Kong dollar's value, and is generally regarded as a success. Yet this confidence has been bought at the cost of volatility vis-à-vis other currencies and volatility in the economy as a whole. Geopolitically, as a Special Administrative Region of China, Hong Kong may find a link to the US dollar unsustainable, particularly if US-China tensions worsen. However, linking to China's RMB will not be a sensible option as long as convertibility of the RMB remains restricted. Linking the Hong Kong dollar to the IMF's SDR, which includes the RMB, would be a possibility in the future—the more attractive if by then there is wider use of the SDR.

Since October 1983, the Hong Kong dollar has been linked to the US dollar under a modified currency board mechanism. This arrangement is widely felt to have served Hong Kong well, putting an end to the lack of confidence that had previously plagued the currency.

The downside of the linked rate mechanism is that Hong Kong cannot operate an independent monetary policy, having in effect to

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