

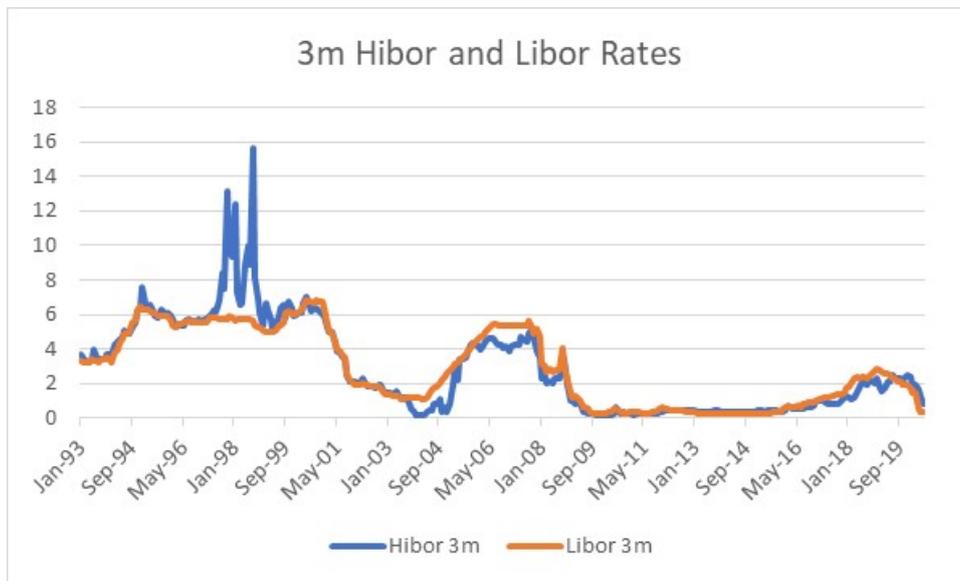
WHAT IF THE HONG KONG DOLLAR REPEGS TO THE RENMINBI?



Russell Clark's
Market Views

“If US sanctions deny Hong Kong access to the US dollar, it could repeg to the Chinese Yuan. How would this impact dual listed equities?”

The Trump Administration is considering sanctions against China and Hong Kong due to the imposition of their national security laws. The Hong Kong Autonomy act (HR7440) includes provisions to limit Hong Kong banks access to the US dollar. Hong Kong has a peg to the US dollar with local rates typically following US rates, apart from periods of Asian currency strength or weakness.

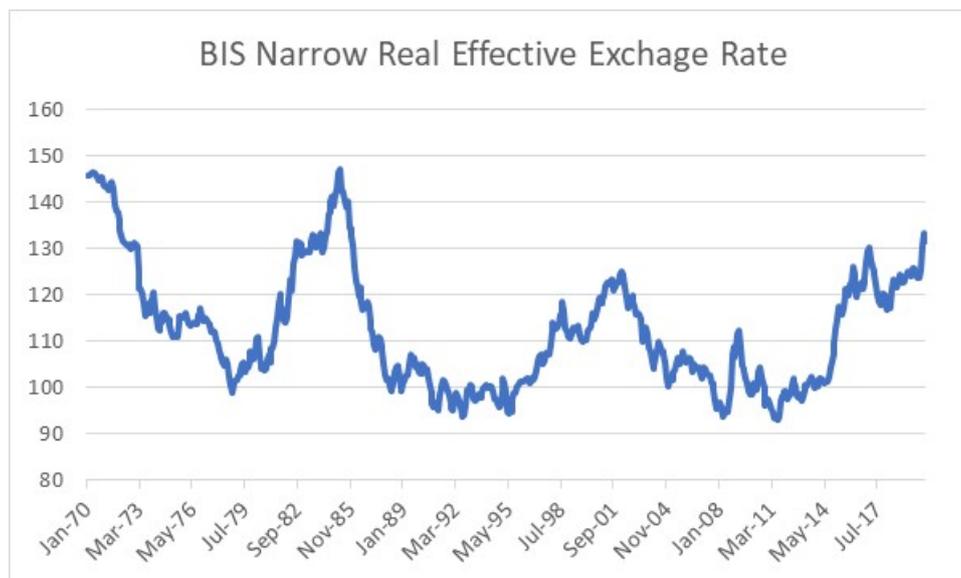


Hong Kong Interbank Offered Rate (Hibor), London Interbank Offered Rate (Libor)

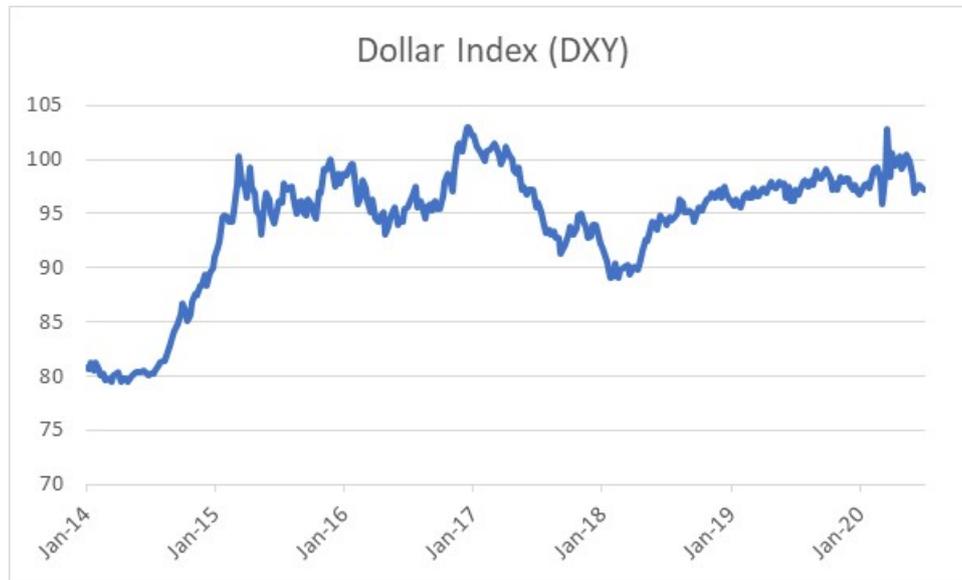
If Hong Kong was denied access to US dollar under US sanctions, it could repeg to the Chinese Yuan. If this were to happen, the first change would be that Hong Kong Interbank Offered Rate (Hibor) rates would need to move close to Chinese Shanghai Interbank Offered Rates (Shibor). At current rates, this would mean that Hong Kong interest rates would rise, potentially negatively for property in Hong Kong, but the higher interest rate would help stabilise the exchange rate.



There are currently restrictions on the Chinese capital account. Perhaps the bigger question would be whether China would impose capital flow restrictions on the Hong Kong dollar, or whether the repegging of the Hong Kong dollar to the Renminbi would coincide with a general loosening of capital account restriction in mainland China? If the US dollar weakened, China opening its capital account becomes more likely. On the BIS Real Effective Exchange Rate, the US dollar is very expensive.



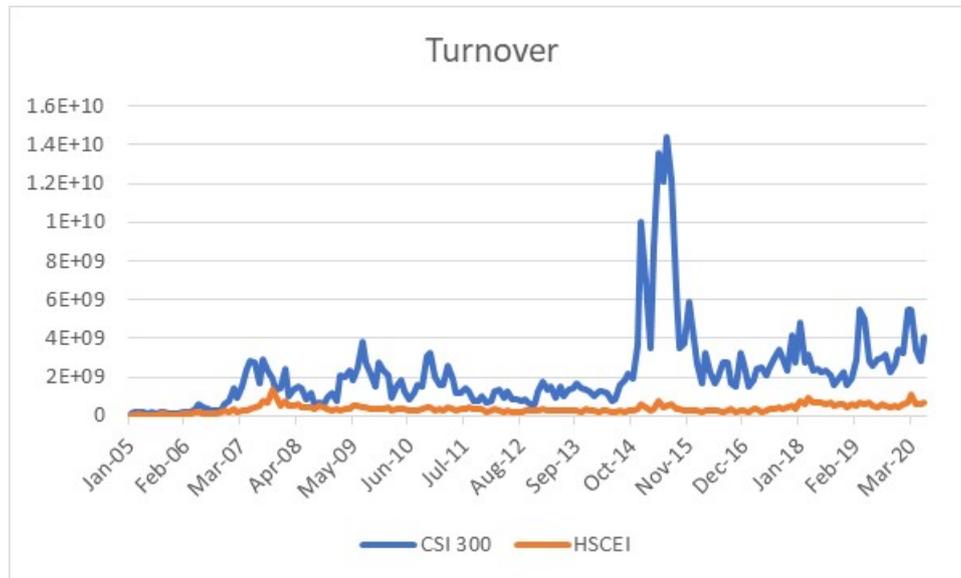
The BIS Index is updated quarterly. The timelier DXY index, which is updated continuously is beginning to show some weakness in the US dollar again.



With rising Chinese interest rates and the US dollar threatening to break down, there is a temptation for mainland China to kill two birds with one stone, by re-opening its capital account and repegging the Hong Kong Dollar to the Chinese Yuan. In that case, the most interesting question would be whether equities that are currently dual-listed in Hong Kong and mainland China become fungible. For the last five years, A-shares (Chinese listed shares) have traded at a premium to H-shares (Hong Kong listed shares).



Chinese mainland stock exchange volumes are now much larger than Hong Kong volumes – suggesting the pull of Hong Kong shares will be higher, rather than A shares moving lower.



If the Hong Kong dollar was repegged to the Chinese Yuan, it is unlikely the currency would move substantially, and local interest rates may rise. However, the biggest effect would be likely a substantial rally in Hong Kong listed shares, particularly if China chose to remove broader capital controls at the same time.

INFORMATION

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 Investor Relations: Samantha Dunn
 Email: info@russellclarkim.com
 Telephone: +44 (0)20 7838 7580
 Website: www.russellclarkim.com
 Business and registered address: Russell Clark Investment Management Limited, 9 Chester Close, London SW1X 7BE, United Kingdom. Registered in England and Wales - Company number: 04034280

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