

The Hong Kong Dollar is a Side Show

The world is my oyster

Ha ha ha ha ha!

In Xanadu did Kublai Khan

A pleasure dome erect

Using my power, I sell it by the hour

I have it so I market it, you really can't afford it-yeah

Really can't afford it

Shooting stars never stop, even when they reach the top

Shooting stars never stop, even when they reach the top

There goes a supernova, what a pushover-yeah

There goes a supernova, what a pushover

We're a long way from home

Welcome to the Pleasure dome

Frankie Goes to Hollywood

The **DSGAsia** inbox has been inundated with Hong Kong-related questions in recent weeks, broadly falling into three buckets. First, is the Hong Kong dollar peg to the Greenback at imminent risk of breaking as per the claims of one particularly vocal and high-profile money manager? (Short answer no.) Second, what are my thoughts on the proposed amendments to the SAR's extradition treaties? (Not good, not good at all.) And third, how does the revised extradition law, in the context of the ongoing and escalating US-China, trade, investment and technology war, specifically put at risk partial- or full-revocation of the 1992 USA-Hong Kong Policy Act,¹ and more generally, erode the SAR's semi-distinct status in the eyes of foreign governments and companies? (The trend is not your friend.)

**Hong Kong is caught
firmly in the cross-
currents**

¹ The Policy Act is the basis for the US government approach to treat Hong Kong as a non-sovereign entity distinct from China for the purposes of US domestic law. The approach is based on the principles of the 1984 Sino-British Joint Declaration. In this case, Hong Kong is considered an independent economic entity. Section 202 of the Policy Act states that the US President can, by executive order, suspend the application of any part of the Hong Kong Policy Act by “[determining] that Hong Kong is not sufficiently autonomous to justify treatment. <https://harbourtimes.com/2019/05/24/extradition-law-move-to-bypass-legco-usa-hk-policy-act-under-increasing-threat/>



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I am publishing this article² the day after perhaps a million Hong Kong citizens took to the streets in a public protest that seems to have exceeded even 2003's extraordinary turnout.³ Sixteen years ago, the proximate catalyst was the SAR government's proposal to enact its Article 23 national security legislation, but the backdrop was the general frustration with the authorities' perceived serial mendacity and incompetence.⁴ Plus ça change....

Yesterday perhaps a million Hong Kong citizens took to the streets in a public protest that seems to have exceeded even 2003's extraordinary turnout

I will return to legal and societal matters in due course but let me first try to swiftly dispatch the HKD question. Due to a combination of my business model, my paranoia and my desire to preserve my sanity, I endeavour to steer as far clear from social media as is feasibly possible, and certainly never seek to involve myself in public slanging matches. My good friend Louis Gave of www.gavekal.com penned an excellent line-by-line rebuttal⁵ to the deeply flawed and, in many places, factually-incorrect article that kicked off the storm in the *gong fu cha* teapot.

2019 is not 2003

Myriad versions of Louis' counter can be found on-line. I would heartily endorse almost everything he argued and will merely reproduce some updated charts and comments from my piece of a year ago, "Hong Kong and Singapore – An Absence of Arbitrage".⁶ It was my thesis back then that the

There are bigger things to worry about than a HKD which is not under any real pressure

² I have endeavoured to keep this analysis as factual and dispassionate as possible, but when one's home of three decades is facing seemingly existential risks, this does not make the task particularly easy. There is also much I prefer not to put into print. Please give me a ring (preferably on a secure line) if you would like additional colour.

³ Such an assessment depends on whose estimates one employs: more than a tenth of the population, according to the organisers; in fact, only twelve showed up, including a couple of lost tourists and a stray dog called Barney, based on the independent police count.

⁴ The mendacity-incompetence combo would be poisonous in any society, but throw into the mix major curtailments of civil freedoms and political rights, in the context of an increasingly authoritarian sovereign with scant respect for human rights and its own constitutional niceties, and one can understand why a desire to resist is tinged with trepidation and fear. Thankfully, yesterday's protests were overwhelmingly peaceful albeit a small group of more radical protestors fought running battles with the police after midnight. Meanwhile, as yet, supersized "vocational education and employment training centres" have not been introduced to the SAR.

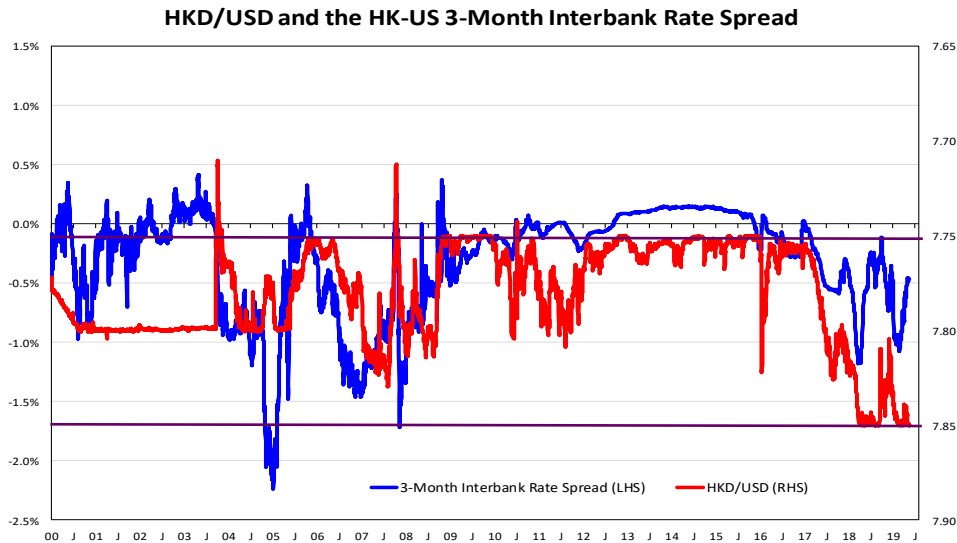
⁵ "Q&A on the Hong Kong Dollar Peg", May 3rd, 2019.

⁶ May 21st, 2018. I am happy to resend a copy of the article on request.



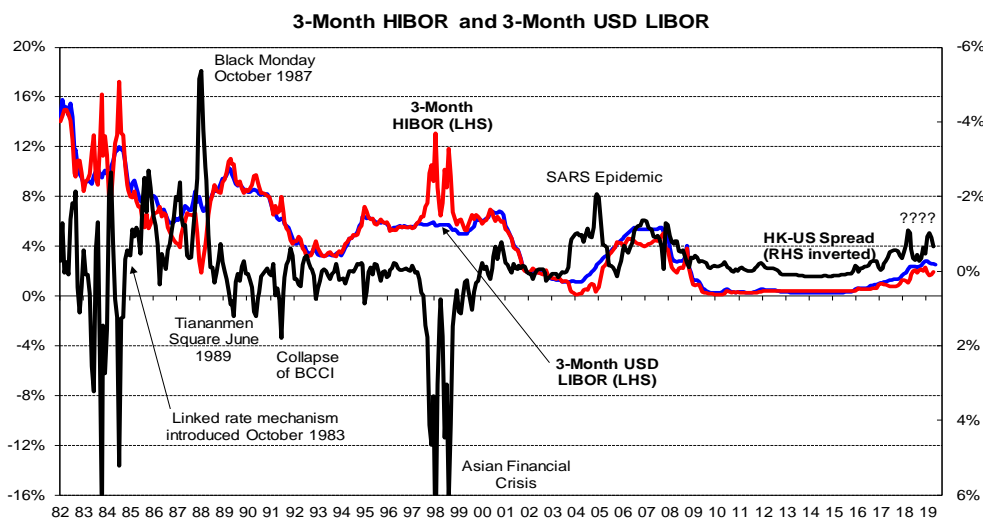
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discount of Hong Kong money market rates to their US equivalents was unsustainable and that as the Fed continued to shrink its balance sheet, the HKMA would need to follow suit as per the stipulations of its modified currency board. As the charts below illustrate, HIBOR has indeed edged up but following the Fed's change of policy course earlier in the year, some of the immediate pressures have already dissipated (for now).



Indeed, HIBOR has not traded sustainably and meaningfully above LIBOR since the Asian Crisis, and before then the time of the Joint Declaration and the establishment of the linked exchange rate mechanism. June 4th 1989 and the collapse of BCCI in 1991 proved to be only temporary dislocations.

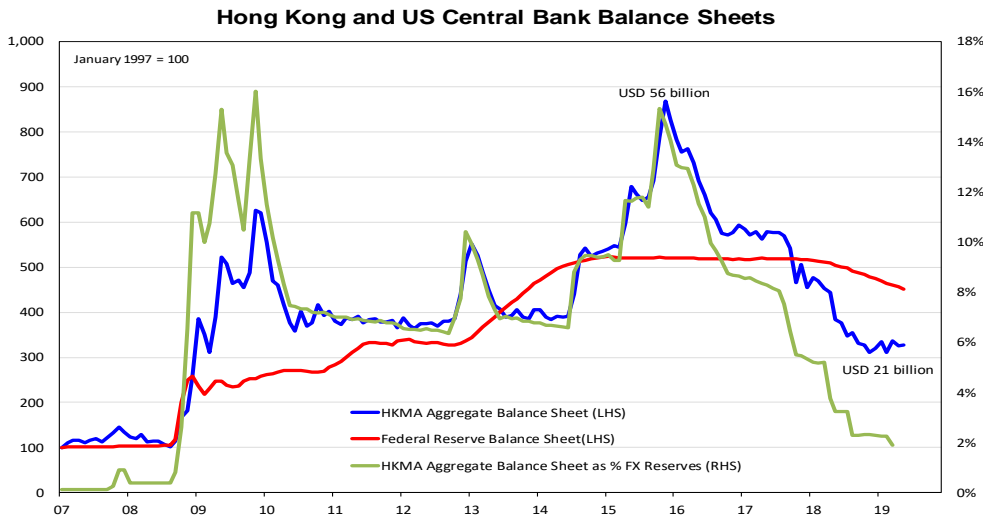
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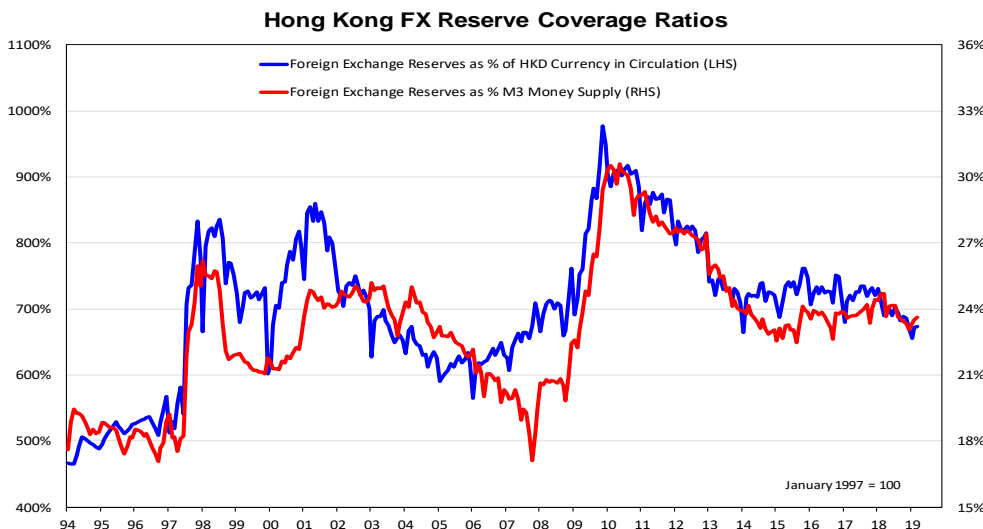
My regular refrain has been that Hong Kong has inherited a highly inappropriate cost of capital from the US and a highly incontinent supply of capital from the Mainland. The result is an HKMA balance sheet that has mirrored moves in its Federal Reserve equivalent but in a magnified manner.

Hong Kong has inherited a highly inappropriate cost of capital from the US and a highly incontinent supply of capital from the Mainland



A focus on the narrow Aggregate Balance is misguided however. While this can be thought of as a rough proxy for the excess liquidity in the local financial system, it is actually only a minor component of the HKMA's total FX reserves of circa USD440 billion. Add to this, fiscal reserves of USD150 billion, around USD20,000 per capita, and it is difficult to argue that the SAR authorities are about to run out of firepower any time soon. Especially if one considers the potential further backstop provided by Beijing.

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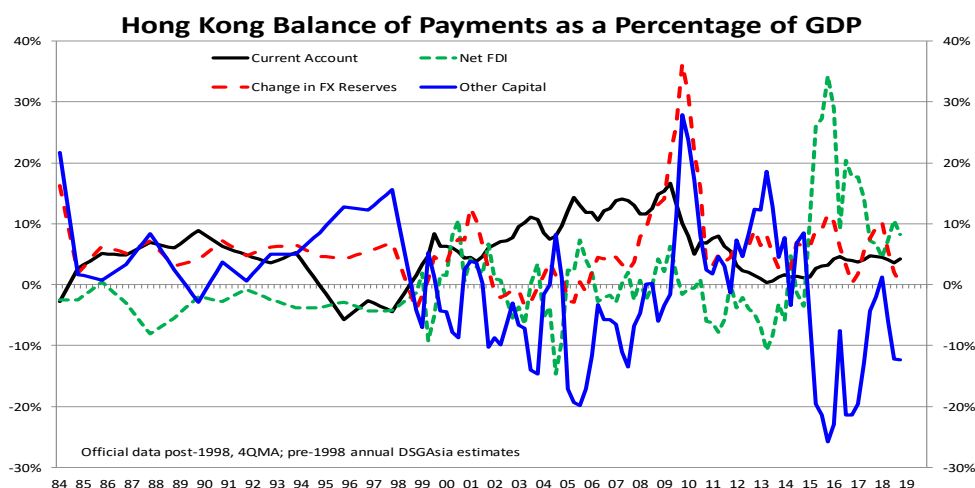


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Nevertheless, it has remained a bit of a puzzle why Hong Kong interest rates have not moved higher still given the HKD trading persistently at the weak end of its band. I will merely repeat some comments from the aforementioned “Hong Kong and Singapore – An Absence of Arbitrage” article.

Having conducted a series of interviews with various market participants including the Monetary Authority and “The World’s Local Bank” three logical and complementary explanations – two that would be officially acknowledged; one that cannot – emerged. First, as discussed above, the excess balances in the HKMA’s Aggregate Balance Sheet have yet to be fully chewed through, though at the current run rate, this would seem to be a sooner rather than later eventuality. Second, “well-intentioned” (discuss) regulators have succeeded in gumming up the plumbing across many areas of the financial system. Higher capital requirements for banks and their markedly reduced ability to make markets in securities and OTC instruments, combined with reduced leverage limits for both banks and investment funds, have, arguably, made the financial system safer (we shall see). They have also contributed to persistent divergences in the pricing of offshore and onshore US dollars, and in the specific case of Hong Kong, have undermined the system’s arbitrage potential.

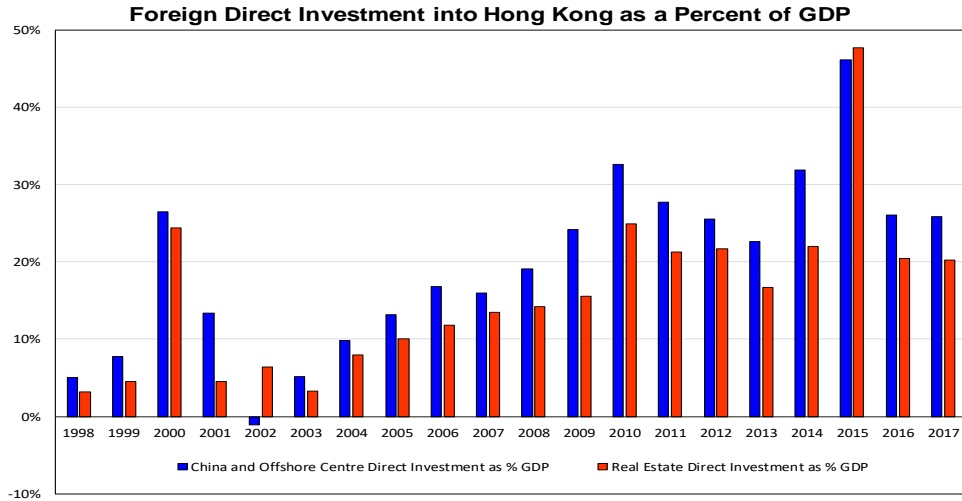
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The Giant Panda in the room is, of course, Chinese capital flows which, safe to say, are not primarily concerned with HKD-USD interest rate differentials. As the chart above illustrates, capital flow swings in and out of Hong Kong have become increasingly wilder and proportionally larger relative to the size of the local economy since the 1997 handover. The chart overleaf shows the specific real estate and (implied) China constituents.

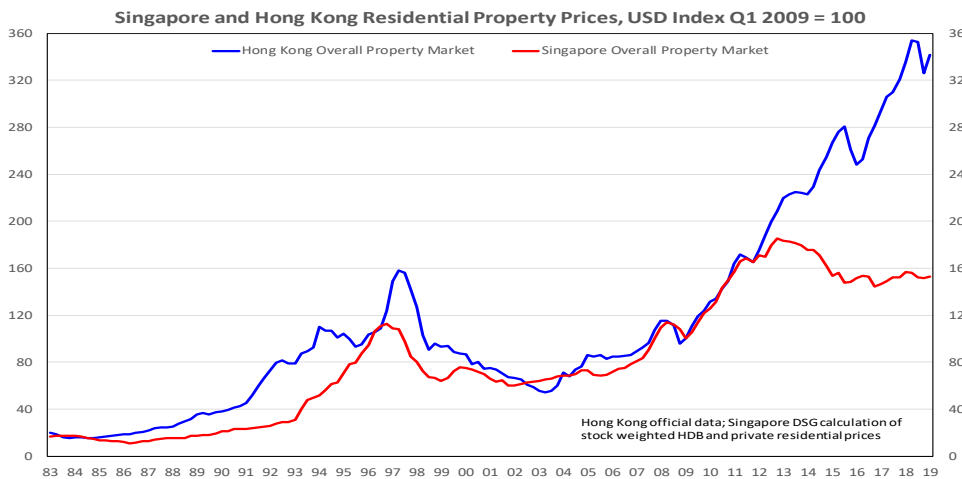


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With such sums persistently looking to find a home in the SAR's real estate market, and a government unwilling and/or unable to enforce its own anti-money laundering regulations when it comes to property, it is of little surprise that the HKMA's employment of stamp duties and LVR caps has done little to arrest the market's seemingly inexorable rise. The SAR authorities' disingenuous arguments about a lack of land that its own mendacious policies artificially help to sustain, further exacerbate the imbalances.⁷

The government is unwilling and/or unable to enforce its own anti-money laundering regulations when it comes to property



⁷ It is beyond the scope of today's article to delve into the pervasive distortions of the SAR's land and property policies. Suffice it to say, Hong Kong has problems that are relatively easy to fix given a modicum of political will that has been serially absent while its massively strong fiscal position means the resources are there to deploy. Manifesto to be published...

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While regulatory and prudential restrictions might crimp local demand and push local purchasers into higher-risk non-bank financing channels, if your aim is to legitimise “spontaneously privatised” funds, then higher transaction costs and potential downside risks are less of a consideration. Singapore has employed a similar suite of policies to far greater effect and it remains my structural call that this gap will close again in Singapore’s favour over the medium-term.

The valuation gap should close again in Singapore’s favour over the medium-term

Returning to the subject of AML forbearance, coincidentally, as I was supping my Sunday morning coffee before writing up this analysis, I came across a rather damning exposé in my South China Morning Post. The salient paragraphs to highlight read as follows:

All the dirt dished here....

[Although a] company’s auditor is required by law to report suspicions of money laundering, in 2018, of nearly 74,000 suspicious transaction reports made to authorities in Hong Kong, just 0.03 per cent were filed by accountants. Trade-based money laundering is effective too for layering, further obfuscating money from its original source, and for the integration of illicit money, for example, by using the company to buy big-ticket items, such as property.

Hong Kong requires real estate agents to verify the identity of the ultimate owner of a property but, as with accountants, suspicious transaction reports are not prevalent. Of all such reports last year, just 0.06 per cent were from real estate agents. And a sophisticated money launderer would be unlikely to pay for a property with a suitcase full of cash: by this stage their dirty money will have been washed several times and appear legitimate.^{8 9}

⁸ <https://www.scmp.com/magazines/post-magazine/long-reads/article/3013411/hong-kong-trying-shake-its-reputation-haven> The now Jack Ma/Alibaba-owned SCMP has morphed into an interesting hybrid beast. While interminable Belt & Road and Greater Bay Area puff-pieces are *de rigueur* and the some of the editorial writers seem to be moonlighting from Global Times, the paper still manages to run a regular stream of interesting and occasionally rather alarming articles. It is by no means a PRC mouthpiece and still has the latitude to provide a platform for dissenting economic and political views that would not see the light of day north of the border (where it is largely inaccessible).

⁹ In a triumph of form over substance, the local banks seem to be doing their best to close down accounts for SMEs on the flimsiest of excuses. Sour grapes here since my own experience has been corporate account closures with zero advance notice and interminable demands for duplicate and often irrelevant paperwork in order to keep others open. As for opening new company accounts, camels pass more easily through the eyes of needles....



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By contrast, the UK has belatedly been trying to plug similar loopholes¹⁰ though whether the attack dogs will be called off post-Brexit (if this indeed happens), when attracting foreign capital may be even more at a premium, is an open question. Particularly relevant in the Hong Kong context – albeit there is all but a zero chance of such measures being adopted in the SAR – is the UK’s “People with Significant Control Register,” introduced in April 2016. This *requires all companies to keep a register of the people who can influence or control a company, that is, the PSC of the company. PSC are popularly referred to in the press as the “beneficial owners” of a company. As companies are already required to keep certain information in their company registers; the new PSC register includes details such as the names, dates of birth and nationalities of the PSC. The company must confirm with the PSC that the information is correct.*^{11 12}

The UK seems to be taking property-related money laundering rather more seriously

A second prong of attack introduced by the UK authorities is the introduction of Unexplained Wealth Orders or UWOs. The first test case has been one involving a *Mrs [Zamira] Hajiyeva, 55, [who] is the wife of Jahangir Hajiyev, a former chairman of the International Bank of Azerbaijan who was jailed for 15 years in 2016 by a court in Baku for embezzlement and other charges. Last year the National Crime Agency applied for two unexplained wealth orders (UWOs) against her relating to £22m of properties, including an £11.5m house in Knightsbridge that was bought by an offshore company. UWOs were introduced in early 2018 to help stem the huge sums of “dirty” money washing through London. They allow investigators to ask anyone with*

Needless to say, such administrative diligence does not appear to have been extended to accounts controlled by the ultra-wealthy and the well-connected.

¹⁰ <https://www.bloomberg.com/news/articles/2018-09-13/u-k-targeting-lawyers-accountants-in-illicit-funds-crackdown>

¹¹ <https://companieshouse.blog.gov.uk/2016/04/13/the-new-people-with-significant-control-register/>

¹² Global Witness has trawled through the data and compiled this rather interesting summary: https://www.globalwitness.org/en-gb/blog/what-does-uk-beneficial-ownership-data-show-us/?gclid=EAIAIQobChMI9ufxsTb4gIVWqWWCh3BXg3qEAAAYASAAEgKrWfD_BwE As per their website: “Global Witness campaigns to end environmental and human rights abuses driven by the exploitation of natural resources and corruption in the global political and economic system.”

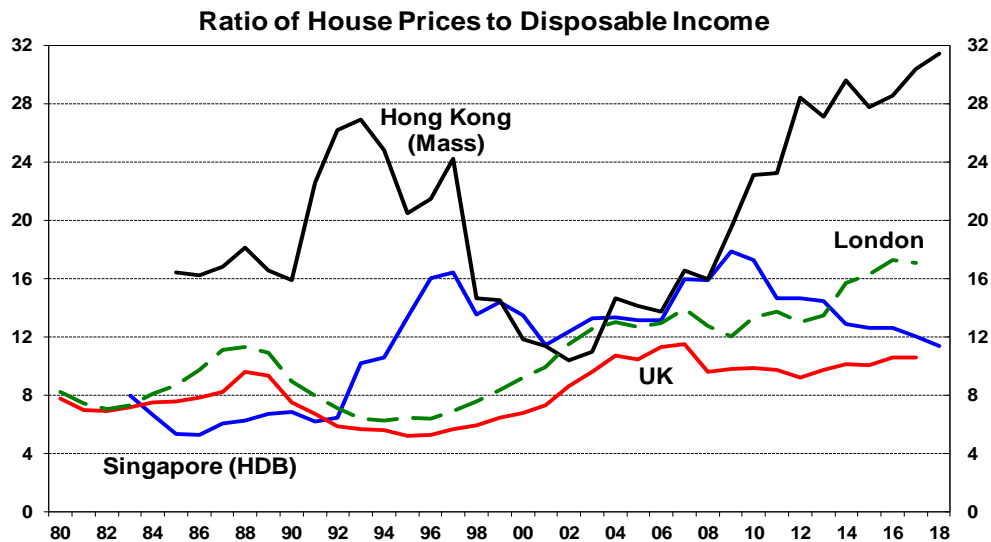


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assets of more than £50,000 to explain how they can afford them if it appears their income is insufficient.¹³

The official amount Chinese citizens can remit overseas each year is capped at USD50,000,¹⁴ in the context of only a USD30,000 household wealth per capita average¹⁵ and average government salaries of USD13,000 per annum (themselves at an 80% premium to the private sector). It is, therefore, somewhat hard to explain how such numbers are commensurate with the ability to purchase Hong Kong apartments which start at a cool USD1 million for even the smallest of flats. Yet such purchases – licit or otherwise – have been made in spades and have helped push the SAR’s property prices to an eye-watering 32 times average disposable income.

SAR property prices are now an eye-watering 32 times average disposable income



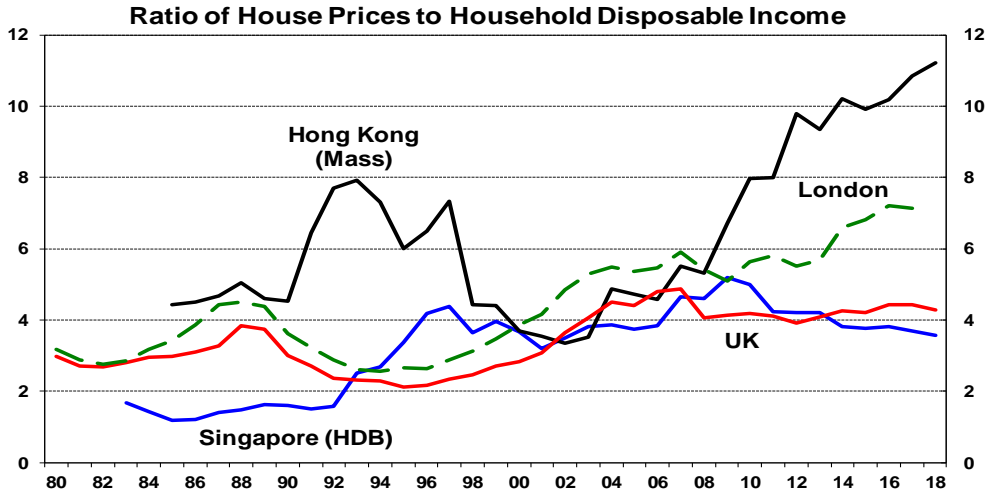
¹³ <https://www.ft.com/content/e660594e-8140-11e9-b592-5fe435b57a3b>

¹⁴ <https://www.scmp.com/news/china/economy/article/2126252/china-puts-us1500-daily-personal-cap-overseas-bank-card> and for an inventive counter <https://www.scmp.com/business/china-business/article/2183152/chinese-police-break-criminal-syndicate-illicit-transfers>

¹⁵ China is still a poor country in aggregate albeit one with a humungous debt burden. See “China – Japan 1970 Development, Japan 1989 Debts”, March 12th 2018.

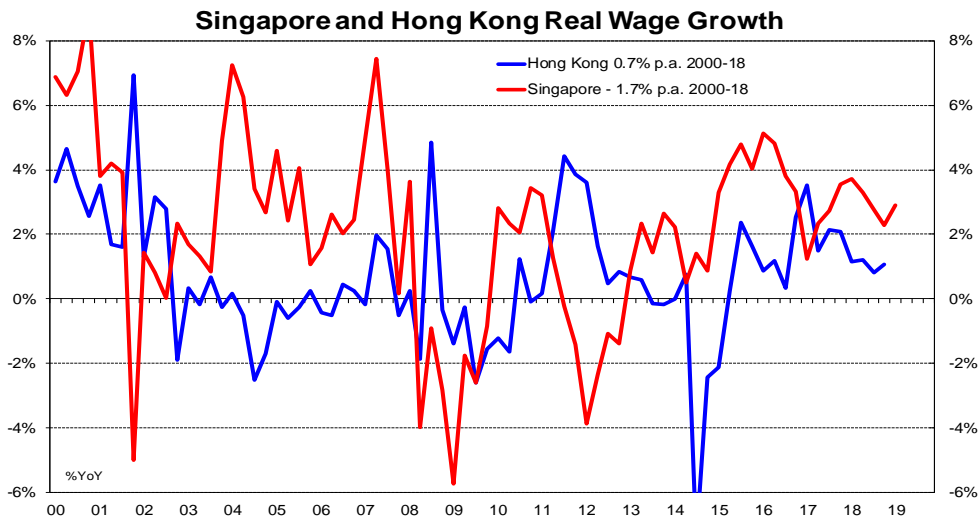


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It would be remiss to blame this all on Chinese money looking for a hedge against the knock on the door from Xi Jinping’s investigators. The abomination otherwise known as QE or “monetary policy for the rich” has surely helped too as it has in other similar jurisdictions. But Hong Kong provides a case study on steroids. And it is the resultant inequality and lack of hope of ever getting on the property ladder that is one of the root causes of so much popular discontent, both in the SAR and further afield.

The abomination otherwise known as QE or “monetary policy for the rich” has surely helped too



Surging property prices would be arguably less of a problem were real wages growing strongly. They have not been. Since 1982, real wages have risen on average just 1% per annum while nominal and real property prices have increased at 8% and 4% average annualised clips respectively.

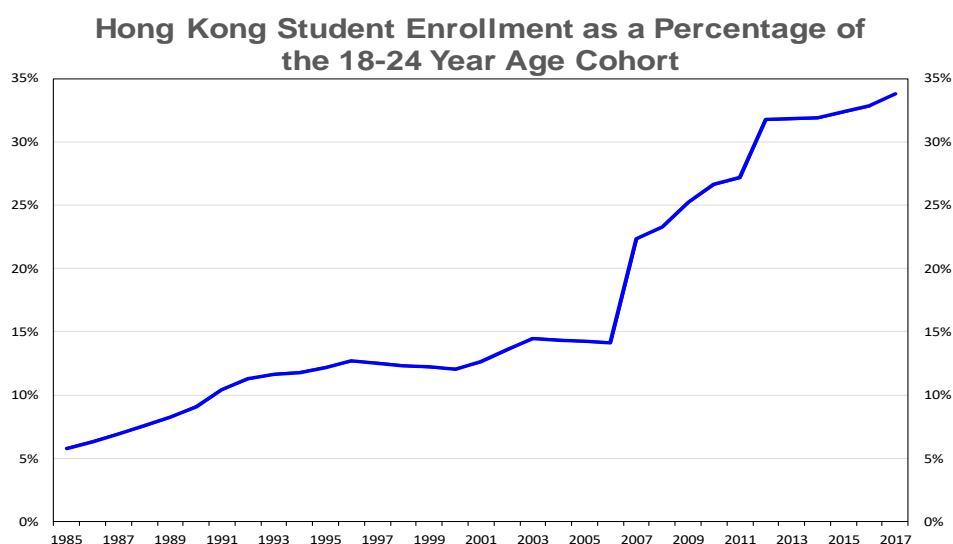
Surging property prices might be less of a problem were real wages growing strongly



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This period has coincided with a massive increase in tertiary education enrolment – as in many places serving as an unemployment deferral scheme – which in turn has helped to (unfairly?) boost expectations. Leaving aside questions of the quality of the courses being offered to the marginal graduate, whether he/she should be at university in the first place or studying something more practical, and whether he/she is actually more employable as a result, if outcomes are being measured in terms of returns on investment, then the results are damning. A government survey from 2014 reports that the starting monthly earnings of new Hong Kong graduates was just HKD1,800 (USD230) more than their predecessors two decades earlier.¹⁶ In real terms, this represents a 24% fall.

More graduates; more disappointments



Further down the education food chain, the public-school system is sputtering. Whatever the merits of mother tongue teaching, the decision in 1997 to emphasise Cantonese pedagogy has delivered a generation of students who are functionally illiterate in both English and Mandarin.¹⁷

¹⁶ <https://www.scmp.com/news/hong-kong/economy/article/1856256/incomes-hong-kong-university-graduates-lag-way-behind>

¹⁷ Needless to say, the language-medium switch also led to a mass exodus of students from better-off and civil servant families to the private sector which, in turn, bid up the salaries for more talented teachers further eroding the quality of the state schools. By contrast in Singapore, local citizens are compelled to send their children to state schools. Illiberal this policy might be but it ensures that the administrative class has skin in the game and thus a motivation to deliver better outcomes for everyone.

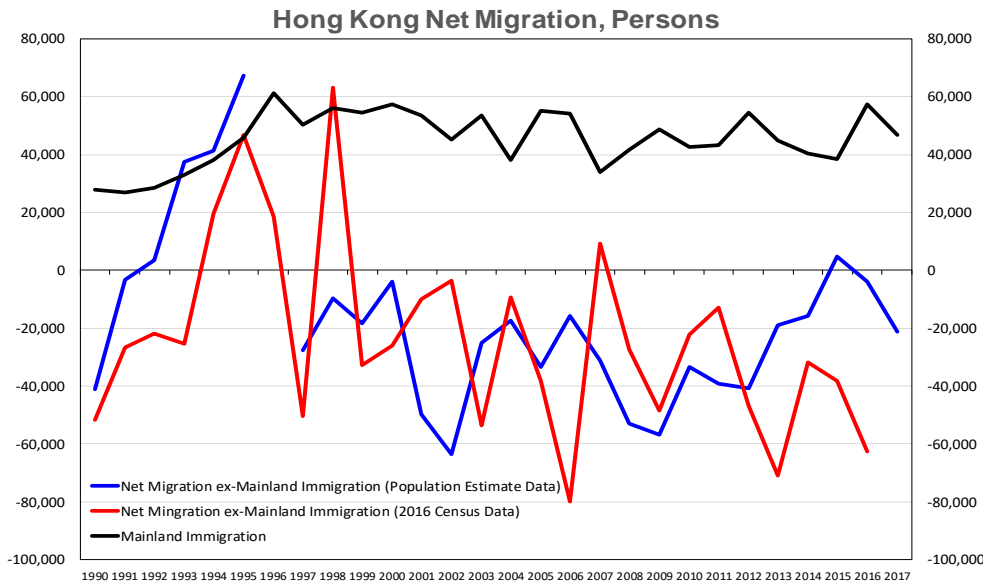


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Furthermore, even if their Putonghua skills are well-developed, local pupils often lack the mindset or the *guanxi* (connections) to carve out good careers with the increasingly dominant PRC employers.

Beyond economics, there is also, rightly or wrongly, a pervasive sense of cultural invasion and a not unjustified fear that Beijing's medium-term aim is to employ demographic warfare, as it has elsewhere, that will condemn Hong Kongers to becoming second-class citizens in their own homes. The chart below tells its own story in the context of a local fertility rate of just 1.13 – one of the world's lowest (the replacement rate is 2.1).

Beijing's medium-term aim is arguably to employ demographic warfare



The counter is that the vast majority of Hong Kong people are Han Chinese as well, hence comparisons with Beijing's policies in its more recently acquired western provinces are spurious. Furthermore, since most SAR citizens originally came as immigrants from the Mainland in the first place, what on earth could they have to fear? They just have to up their game to compete with the influx of hungrier and more motivated newcomers.¹⁸

¹⁸ I come across a variety attitudes amongst the locals I deal with in the work, social and family milieus ranging from resignation to cynicism to abandonment. As the chart above suggests, many of those who can, are already (re)emigrating. Others, almost always in the wealthier echelons, cannot seem to understand (or do not want to understand) what the kids are so unhappy about. As per an exasperated and emotional outburst at a dinner I was attending: "not everyone has a foreign passport and not everyone has rich parents."

The Hong Kong Dollar is a Side Show

The realist/cynical view is that it was always inevitable that Hong Kong would become ever more absorbed into China over time. While such an absorption would produce some collateral damage, as long as money making opportunities abounded, and as long as matters of social conscience could be ignored, business could continue as normal. The analogy often employed was Singapore where civic society remained legally constrained yet the commercial code always followed international best practice.

The realist/cynical view is that it was always inevitable that Hong Kong would become ever more absorbed into China over time

I have always viewed this analogy to be false since I could not see how the Communist Party could help itself over time. Back in 1997 I penned what seems now a pretty prescient article entitled “Asia’s World City” or a “Big City in China”? (please request a copy of you are interested) in which I argued that the sanctity of the border would be paramount since for *‘one country two systems’ to have any real meaning, the continued separation of the physical, and the economic, social and judicial barriers between the territory and China is imperative.*

The analogy often employed was Singapore where civic society remained legally constrained yet the commercial code always followed international best practice

Lee Kuan Yew was in many ways the archetypal Confucian patriarch but when it came to matters of the law, he had little time for traditional forms of Chinese legality remaining deeply attached to UK legal traditions and mores he studied and (brilliantly) practiced.¹⁹ Although Singapore’s government-linked companies play a significant role in the local economy they are expected to respect the general commercial code and to litigate on an equal footing with all other commercial parties. Hong Kong similarly, has a greater preponderance of GLCs and government-protected cartels than its free market groupies might admit, but hitherto they have been again subject to the same legal standards as truly-local private and international businesses. And hitherto, Mainland entities operating in the SAR have largely been held to the same constraints.

Lee Kuan Yew was in many ways the archetypal Confucian patriarch but when it came to matters of the law, he had little time for traditional forms of Chinese legality

It is somewhat difficult to argue that China today practices Marxist economics (though Xi Jinping seems minded to revisit this notion) but its

¹⁹ The primacy of societal and familial relationships is enshrined and legitimised in the Confucian Analects. Hence, relational and local loyalties are generally held to be more important than due legal process as the following passage illustrates: *The duke of Sheh informed Confucius, saying, ‘Among us here there are those who may be styled upright in their conduct. If their father have stolen sheep, they will bear witness to the fact’. Confucius said, “Among us, in our part of the country, those who are upright are different from this. The father conceals the misconduct of the son, and the son conceals the misconduct of the father. Uprightness is to be found in this.*



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political and legal system is still steeped in Leninist mores with more than a dash of Confucian feudalism. Marxist legal philosophy would argue that as the State is the embodiment of the will of the people, and as the people collectively own the means of production, so the judiciary should always rule in favour of the State. This is why the Party's 2017 *force majeure* insertion of its explicitly dominant role into the articles of association of PRC listed companies in Hong Kong²⁰ was a game-changer for those who were paying attention²¹ (On the Mainland this stipulation was extended to private and foreign companies.)

It is well-understood (or perhaps not) that the CPC has been trying to insert its own people into Hong Kong's institutions of governance over the decades. Hitherto, few of these inserts have managed to rise to the top echelons of the administration or the judiciary since a legacy of meritocracy and institutional knowledge and precedence has remained robust. Nevertheless, as senior functionaries retire, and promotion from lower levels becomes more about pandering to the desires of Grandfather up North, so the risks of judicial impartiality being undermined – not only in the social but also the commercial sphere – will become more elevated.

I should stress that for now, when it comes to matters of company litigation, the Hong Kong courts continue to function overwhelmingly as designed. Notwithstanding, as the upper chart overleaf suggests, some international plaintiffs are already reconsidering their options,²² while the lower chart implies that foreign professionals are also gradually exiting as companies localise their operations.

Over time, the risks of judicial impartiality being undermined – not only in the social but also the commercial sphere – will become more elevated

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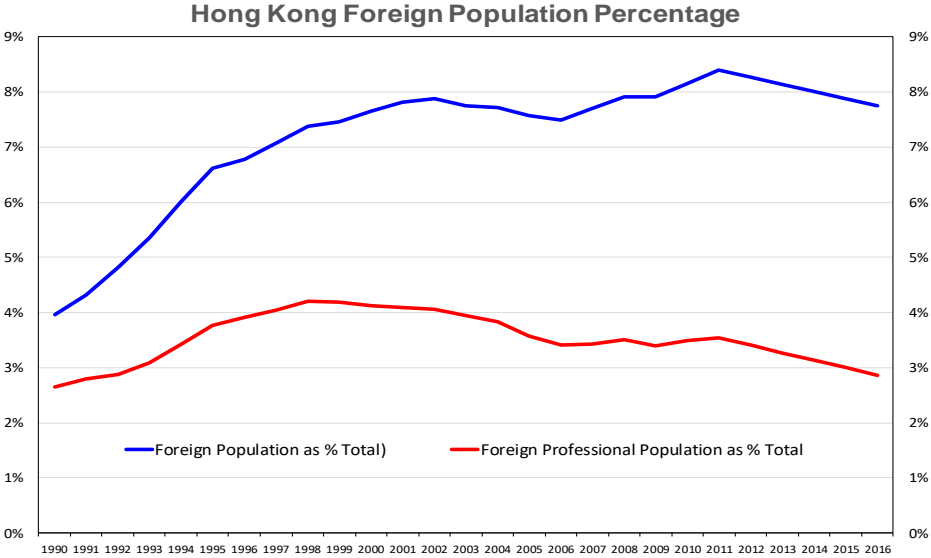
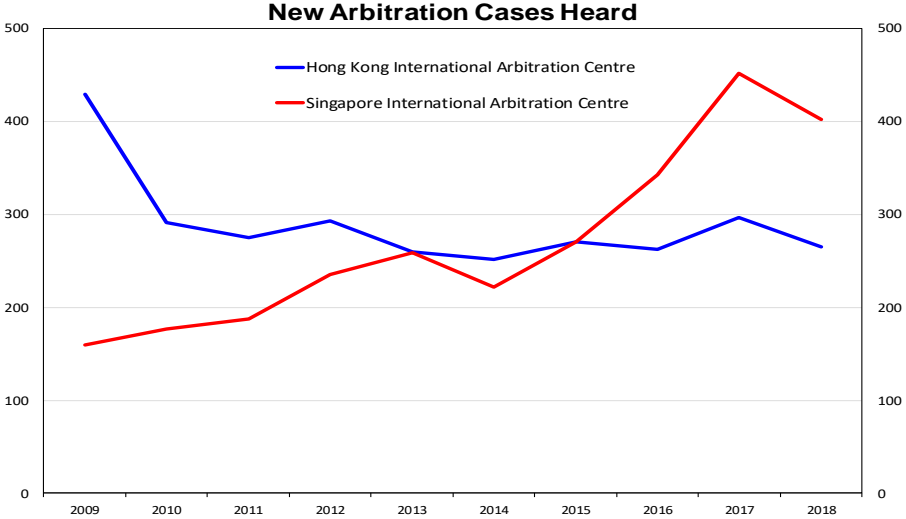
²⁰ The changes describe the Party as playing a core role in *an organised, institutionalised and concrete way*” and *“providing direction [and] managing the overall situation.* <https://www.ft.com/content/a4b28218-80db-11e7-94e2-c5b903247afd>

²¹ Clearly Hong Kong's regulators were not for as Upton Sinclair wrote in “The Jungle”: *It is difficult to get a man to understand something, when his salary depends on his not understanding it.*

²² The HKIAC statistics are pretty comprehensive and illuminating but breakdowns of the cases heard by the domicile/nationality of the participants do not appear to be available going back a decade. In recent years though, the cases heard have overwhelmingly involved protagonists from the PRC, Hong Kong and places such as Cayman and the BVI. *Prima facie* it would seem that Singapore increasingly offers perceptions a more impartial platform than the SAR.

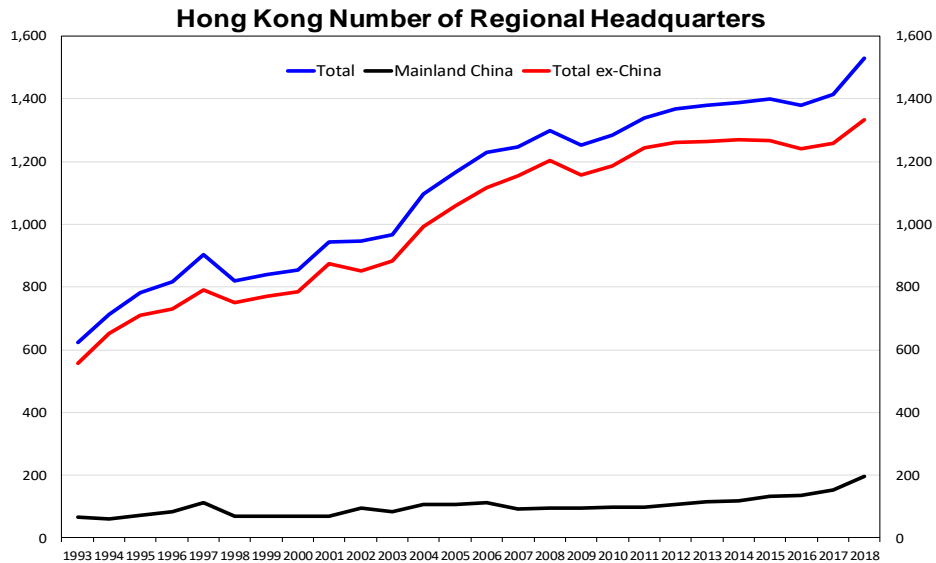


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Although the number of regional headquarters domiciled in the SAR has continued to steadily grow, Singapore now boasts 4,200 equivalents. Unfortunately, I could not source data for earlier years but anecdotal evidence that this number has been strongly on the rise.



Source: Cushman & Wakefield, APAC Regional Headquarters, 2016



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I should also stress that as a place to run a business, the SAR retains many world-beating advantages such as low and transparent taxation, and an efficient and generally light-touch bureaucracy. Moreover, the sphere in which I operate is very unlikely to bring me directly into conflict with a Mainland commercial litigant. Hence businesses like mine can afford to be sanguine, no?

I should also stress that as a place to run a business, the SAR retains many world-beating advantages

The revised extradition law is a game-changer for everyone. The 2003 Article 23 national security legislation promulgated was concerning enough, and brought half a million people onto the streets, but under that bill, Hong Kong courts would at least have been in charge of the whole process. The extradition law leaves anyone who is shipped across the border at the mercy of their Mainland equivalents which are not exactly known for their respect for human rights and due process.²³

The revised extradition law is a game-changer for everyone

Since 2003, the SAR has seen confidence in judicial independence undermined by events such as the disbarment of sitting and aspirant legislators, the jailing of protestors and those who have called for protests, the deportation of foreign journalists, and the like. Moreover, the man in charge of China today is a far tougher nut than his immediate predecessors and has championed increased repression and an all-encompassing surveillance state.

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²³ Exhibit A, witness the divergent treatment of Huawei's Meng Wanzhou who irrespective of the case against her, was brought before a judge in short order and is now under what seems to be pretty comfortable house-arrest, and that of the hapless Canadians seized in retaliation. One barely credible argument offered up is that the new law just formalises Beijing's kidnapping policies which makes one feel much better. It also continues to be argued by our shameless officials that the law needs to be rushed through to allow the extradition of a Hong Kong citizen to Taiwan even though Taipei has repeatedly said that it would not accept him back under the proposed mechanism. In many ways, Taiwan is to blame for everything since One Country-Two Systems was explicitly designed to entice the renegade province back to the motherland, and in this core aim, it has failed abjectly. I would date Tsai Ing-wen's 2016 victory as the time when Beijing, under an increasingly assertive Xi Jinping, decided it no longer needed to pretend when it came to Hong Kong.



The Hong Kong Dollar is a Side Show

No wonder that Chief Executive Carrie Lam's assurances that she will have the final say over any extradition decisions have done little to assuage very real and justifiable fears. I suspect she must be channelling Brecht today.

Carrie Lam must be channelling Brecht today

*[T]he people
Had forfeited the confidence of the government
And could win it back only
By redoubled efforts. Would it not be easier
In that case for the government
To dissolve the people
And elect another?*

Bertolt Brecht, The Solution

Furthermore, the extradition law's promulgation has managed to unite three very disparate strands of society – opposition legislators and concerned local citizens, and both the local and international business communities. In some ways it is amusing to watch the local business worthies squirm since they have been both complicit in Hong Kong's serial bad governance and maintenance of restrictive practices, and in many cases have dirt from previous dealings on the Mainland that they know can be dug up or fabricated if necessary. Irrespective, it is hard to see how the government can back down this time as happened in 2003. As already noted, China under Xi does not wontedly do capitulation whilst unlike the Article 23 episode when Beijing maintained a degree of plausible deniability, this time the extradition law changes have been endorsed at the highest Politburo level.²⁴ I hope I am wrong but suspect I will not be.

The extradition law's promulgation has managed to unite three very disparate strands of society. They will all likely be disappointed

Returning to more mundane financial and business matters, while the government can count on the levers of state coercion (with help from across the border in reserve) and a supine and neutered legislature to pursue its agenda, the risks in terms of Hong Kong being treated as a separate economic and legal entity to China are clearly on the rise. It does little good for officials to merely mouth that nothing has changed and that foreign observers just do not understand the true situation. When a country like Germany, which has generally been happy to cosy up to China, decides to grant asylum to two Hong Kong activists (whatever the merits of their cases), this sends a rather stark message. International capital is mobile and international attitudes

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²⁴ http://www.chinadaily.com.cn/hkedition/2019-05/24/content_37473240.htm



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towards Hong Kong are hardening. Especially in the context of the ongoing and escalating US-China, trade, investment and technology war.

Since 2017, my base case has called for an intensification of trade and technology wars which would lead to a recalibration of supply chains and a potential Balkanisation of technology standards and spheres of investment. I have also been flagging changes to America's CFIUS/FIRMMA regime²⁵ which will subject cross-border investment flows to a far greater degree of scrutiny than hitherto. Without getting into the rights and wrongs of the debate, aside from noting that both the US and China are highly culpable in their own ways, Hong Kong has to date been treated as a separate and largely trusted entity to the Mainland.

Since 2017, my base case has called for an intensification of trade and technology wars

Nevertheless, there are parties in Congress who would seek to revisit some of the provisions of the 1992 US-Hong Kong Policy Act which treats Hong Kong as a non-sovereign entity distinct from China for the purposes of US domestic law. The approach is based on the principles of the 1984 Sino-British Joint Declaration with the SAR being considered an independent economic entity. In a similar vein, there are rumblings also that a bill is being proposed to prevent US public pension funds from investing directly or via other intermediaries in certain Chinese stocks and bonds.²⁶ This is one of the proximate causes of Alibaba seeking a secondary listing back in Hong Kong and Semiconductor Manufacturing International Corp (SMIC) delisting altogether from the US markets. Details remain sketchy and there is by no means a plurality to pull either lever near-term, but the risk of the SAR being

When elephants mate....

²⁵ *The Foreign Investment Risk Review Modernization Act of 2018 ("FIRMMA") was signed into law by President Trump on August 13, 2018. FIRMMA represents the first reform in over a decade of the process by which foreign investments in American businesses are reviewed by the Committee on Foreign Investment in the United States ("CFIUS"). The new law leaves in place much of the existing process by which investors may submit voluntary notice filings to CFIUS for review. However, FIRMMA expands the scope of investments which are subject to CFIUS review and establishes the review process as mandatory for investments in certain businesses which own critical technology or critical infrastructure.* <https://www.lexology.com/library/detail.aspx?g=fc8ef0dd-d6a2-4a5f-af3e-0bc56e861820>

²⁶ <https://www.nytimes.com/2019/05/28/business/alibaba-trade-war-wall-street.html> The mechanism would likely be via the Treasury's Office of Foreign Assets Control (OFAC) whose powers have been used in the past to force disinvestment from certain Russian counters.



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exposed to significant collateral damage in either eventuality should not be underestimated.

Taken altogether, the impact this might have on local asset prices is ambiguous. Foreign capital and individuals may choose, or be forced to exit as might wealthy and mobile indigenous capital and personnel. However, for every exit, there is still likely to be a matching influx of money and people from the Mainland who still view Hong Kong offering protections and services superior to those available back home.

I personally have a great deal of sympathy for those who feel that their home is being transformed in ways that are highly discombobulating, especially those who do not have the financial resources and human capital skills to exit should they wish not to stick around. Nevertheless, the harsh reality is that there is little if anything foreign interests can do to influence things otherwise and those that do not like it, will either need to hold their peace or exit. Meanwhile, the deployment of measures such as repealing some or all of the US-Hong Kong Policy Act or OFAC financial sanctions will do little near-term to help the cause of the ordinary man. Indeed, they may provide the cover for stepped up repression and further erosion of civil liberties.

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*Beware the ghost that floats two steps behind you
It breathes the dust you shake off of your shoes
While tracing ancient scars just to remind you
Of every battle past that left a bruise
Your angels and your saviours
Have long since disappeared
And judgement day is here*

*Get out while you can
Get out while you can*

*Tangled in a web of words unspoken
While fending off the Huns inside your head
The burden of a static soul unspoken
Is breeding monsters underneath your bed
You're wrenched out of indifference
You sense that something's wrong
The Sirens start their song*



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*Get out while you can
Get out while you can
When you are gone
Life goes on*

Spock's Beard – The Oblivion Particle

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