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THE VIEW
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New rules of the game

The Chinese Dream means Hong Kong will have to get used to a more volatile dual currency regime

The slogan "the Chinese Dream" conjures up images of hope and strong nationalistic fervour.

It illustrates why President Xi Jinping's determined campaign against corruption has been successful, something that may well become his key legacy and just one sign of the administration's tough political stance. This toughness is seen in the intense monitoring of the internet that has slowed it down to a "world wide wait". It is seen in the most assertive Chinese foreign policy in many a year, reflected in the military strongpoints being built in the South China Sea, creating a Chinese Lake adding 37 per cent to China's air, land and sea space.

It is seen in the intense diplomatic offensive recently forged by both Xi and Premier Li Keqiang in extending the Chinese Dream through the concept of the new Silk Road – and promising tens of billions of dollars to countries like Brazil, Pakistan and India.

Against this backdrop, the recent rapid liberalisation of a tightly controlled, command economy seems surprising – all the more so as the economy itself is not in good shape. Yet this economic dawn sits happily alongside the conservative politics of the Chinese Dream. China knows that in opening up its economy, Chinese influence will spread still further.

The Chinese economy now needs no defensive protection against the rest of the world and must open if it is to take a full part in the supra-national institutions that provide good global order. So the hints from the People's Bank of China that the yuan might become convertible in just a couple of years are credible – for to be involved in the IMF (and its international store of value, the Special Drawing Rights) the yuan must be freely exchangeable.

> **These reform measures are irreversible – akin to a dam bursting**

This political commitment to the liberalising economy was illustrated not only by the opening of the Shanghai-Hong Kong Stock Connect but also by the authorities subsequently allowing a much broader range of investors to take part when at first it was not working.

On Monday, the mutual fund recognition programme came into effect to enable Hong Kong and mainland Chinese investors to buy each other's authorised funds. It has been much hoped-for but the speed with which hope moved to expectation, to actuality, has been breathtaking. Mutual Fund Connect will allow different types of capital to flow faster and more freely between China and the West.

Further opening up is inevitable – next is likely to be the Bond Connect to help develop a pool of long-term domestic capital, which is urgently needed to enhance financial stability.

These reform measures are irreversible – akin to a dam bursting; firstly a trickle erodes a channel, a stream slices through, and a flood sweeps away the impediment.

But what of Hong Kong?

No city has been given such generous advantages as Hong Kong. But this is less an expression of generosity as accepting reality. There are few truly global financial centres around the world and Hong Kong is one of them. No matter the resistance from Beijing and Shanghai, and the eagerness of Singapore, London and New York to take part, Hong Kong is the only Chinese city perfectly tuned to globalise the Chinese economy.

It is yet to be seen whether we can effectively monetise this windfall or whether we are merely a convenient location for global institutions to trade between themselves. And it will not be long before China, if only for diplomatic reasons, does allow similar connections with other money centres around the world.

One key impact is that the Hong Kong currency, albeit protected by the Basic Law, will become almost irrelevant. The peg makes our unit equivalent to the US dollar, so yuan convertibility will cause challenges when it begins to fluctuate more freely.

When the dollar is expensive, everybody and his friend from China will want investments here. Result: bubble. When the buck is weak against the yuan, investment will flow out of Hong Kong. Result: misery, deflation of assets and inflation of prices – though we will still get shoppers.

Nevertheless, there is no need to change the peg. The two currencies could easily coexist as they do in many jurisdictions.

The Chinese Dream means that we are going to have to get used to these fluctuations as the yuan will be as much our home currency as the US dollar – sorry, the Hong Kong dollar. We will buy with, sell with, live with, and invest with both currencies. Hong Kong investors have always been flexible so we will adapt to the new rules of the game.

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