

A brief history of Hong Kong dollar exchange rate arrangements

Hong Kong has had a linked exchange rate regime of one kind or another for most of its history as a trading and financial centre.

In 1863 the Hong Kong Government declared the silver dollar – then a kind of international currency – to be the legal tender for Hong Kong, and in 1866 began issuing a Hong Kong version of the silver dollar. The silver standard became the basis of Hong Kong's monetary system until 1935, when, during a world silver crisis, the Government announced that the Hong Kong dollar would be taken off the silver standard and linked to the pound sterling at the rate of HK\$16 to the pound.²

Under the Currency Ordinance of 1935, banks were required to surrender to the Exchange Fund (which was invested in sterling assets) all silver bullion held by them against their banknote issues in exchange for Certificates of Indebtedness. These Certificates were the legal backing for the notes issued by the note-issuing banks under what became, in effect, a Currency Board system. The note-issuing banks were obliged to purchase the Certificates to back subsequent increases in their note issue with sterling.

In June 1972 the British Government decided to float the pound sterling. The Hong Kong dollar was then linked briefly to the US dollar, first at the rate of HK\$5.65 to the US dollar, and then, from February 1973, at HK\$5.085. But, from June 1972, the note-issuing banks were allowed to purchase Certificates of Indebtedness with Hong Kong dollars.

In November 1974, against a weakening US dollar, the Hong Kong dollar was allowed to float freely.

² For more details about the early monetary history of Hong Kong, see the HKMA publication *Money in Hong Kong: A Brief Introduction*, November 2000. A soft copy of the publication is available on the HKMA website (www.hkma.gov.hk).

| EXCHANGE RATE REGIMES FOR THE HONG KONG DOLLAR | | |
|--|---|---|
| <i>Date</i> | <i>Exchange rate regime</i> | <i>Reference rate</i> |
| 1863 – 4 November 1935 | Silver Standard | Silver dollars as legal tender |
| December 1935 | Link to Sterling | £1 = HK\$16 (December 1935 – November 1967) |
| | Link to Sterling | £1 = HK\$14.55 (November 1967 – June 1972) |
| 6 July 1972 | Link to the US dollar with ± 2.25% intervention bands around a central rate | US\$1 = HK\$5.65 (July 1972 – February 1973) |
| | Link to the US dollar | US\$1 = HK\$5.085 (14 February 1973 – November 1974) |
| 25 November 1974 | Free float | Exchange rates on selected dates US\$1 = HK\$4.965 (25 November 1974) US\$1 = HK\$9.600 (24 September 1983) |
| 17 October 1983 | Link to the US dollar | US\$1 = HK\$7.80 |

Although the first two years went fairly well, the experience of a floating rate regime was not a comfortable one. The then prevailing monetary policy framework was too rudimentary to replace the external monetary anchor. There was no clear monetary policy objective, let alone the tools to pursue such objectives. As a result, this was a period of high volatility on almost all fronts. Real GDP growth dropped to 0.3% in 1975 and climbed to 16.2% in 1976. Inflation swung sharply from 2.7% in 1975 to 15.5% in 1980. The value of the Hong Kong dollar moved from HK\$5.13 in 1981 to HK\$9.60 to

A brief history of Hong Kong dollar exchange rate arrangements

the US dollar in 1983. The depreciation of the Hong Kong dollar was made worse by speculative attacks and by the escalating crisis of confidence over the future of Hong Kong, which came to a head in 1983. The record low point of HK\$9.60 in September 1983 was reached after a drop of 13% in just two days.

Facing both a currency panic and nervousness about the soundness of a number of banks, the Government announced on 15 October 1983 a new policy to stabilise the currency, which is now the basis of Hong Kong's monetary system: the Link between the Hong Kong dollar and the US dollar at the fixed rate of HK\$7.80 to one US dollar.

