Market Watch

The US responds to Hong Kong

Summary

- The US responded to China's plans for a new Hong Kong security law by announcing it would start to end preferential treatment for Hong Kong in trade and travel, as well as sanctions against certain officials, albeit without specific details.
- Risk assets responded positively as President Trump indicated there would be "exceptions" and investors were worried there could have been a stronger response from the US.
- In our view, the USD-HKD peg is unlikely to be disrupted.

China's new security laws for Hong Kong and the US response

- On 21 May, China's National People's Congress announced plans for a national security law in Hong Kong.
- In response, last Friday, US President Donald Trump announced it would start to end preferential treatment for Hong Kong in trade and travel codified under the United States-Hong Kong Policy Act of 1992, albeit without a specific timeline or finer details. Trump also announced unspecified sanctions on Chinese and Hong Kong officials.

How might market participants react in the near term?

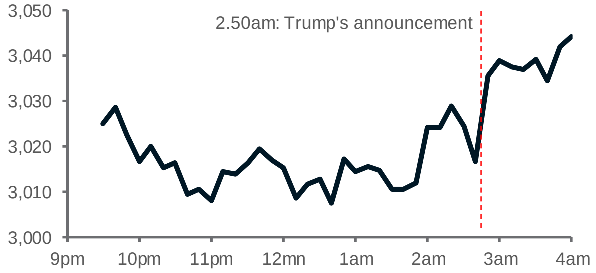
- After being on edge for most of last Friday, US equities rallied in the wake of Trump's announcement, signalling that the measures were not as severe as anticipated.
- The measures do not involve Hong Kong's financial markets, thus limiting the feedback loop into global risk assets. Leaving Hong Kong's markets out of the picture may hint at the US' intention to deliver a symbolic protest rather than a damaging blow. As Hong Kong is the most likely relisting venue for Chinese ADRs and USD/HKD free convertibility is a key part of the 1992 Act, these areas are likely to have been targeted should the US have been intended to materially impact China.
- As long as these areas remain off the table, market participants are likely to be sanguine over the situation.

Should we be concerned about the USD-HKD peg?

- Nevertheless, there is a risk of the US taking further action down the road against China via Hong Kong, be it in relation to the national security law or in response to other bilateral issues.
- Market participants would be concerned about the USD-HKD peg as a target, since a sudden disruption is likely to adversely affect global markets, as Hong Kong is a global financial centre.
- In our view, a disruption of the peg is unlikely. This is underpinned by strong foreign reserves of over USD 440Bn, which is more than twice of the Hong Kong monetary base. The banking system has 1) strong capital adequacy ratio, currently at 20%, 2) abundant liquidity ratio at 160%, and 3) good asset quality, with classified loan ratio at 0.6%.

S&P 500 rallies after Trump announces measures

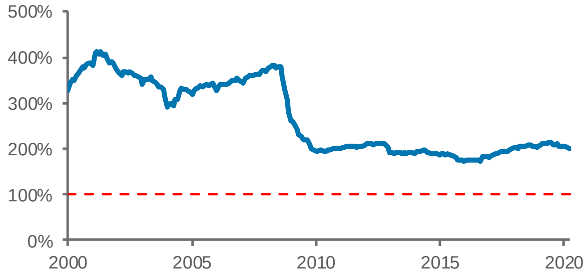
S&P 500 intraday price for 29-30 May (HKST)



Source: Bloomberg, Standard Chartered

HKD monetary base is over 100% backed by FX reserves

Ratio of Hong Kong FX reserves to monetary base



Source: Bloomberg, Standard Chartered

FX market steady over the USD-HKD peg

USDHKD spot and 12-month forward price

Source: Bloomberg, Standard Chartered

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