US hammer finds nail in HK banks

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The US House of Representatives on July 1 passed by unanimous consent a bipartisan bill that would penalize Chinese officials who implement Beijing's new national security legislation in Hong Kong, as well as banks that do business with them. The following day, the US Senate unanimously passed the bill, which was later sent to the White House, where it awaits US President Donald Trump's signature.

The bill does not spell out what the sanctions would look like and Trump has yet to sign it into law, but Reuters on Thursday last week reported that five major Chinese state lenders are considering contingency plans in anticipation of being cut off from US dollars or losing access to US-dollar settlements.

The article said the worst-case scenario that the Bank of China is considering is a run on its Hong Kong branches if clients realize it would run out of US dollars. Some Chinese banks are working to address clients that borrow US currency to purchase aircraft and machinery, and to meet other manufacturing needs.

Legal experts have warned of another potential scenario — possibly the most severe punishment — in which the bill gives the White House the power to prevent financial institutions in Hong Kong from clearing some US dollar transactions through the Society for Worldwide Interbank Financial Telecommunication (SWIFT) system, if the transactions involve Chinese officials or others blamed for destroying Hong Kong's autonomy.

Brussels-based SWIFT is a cooperative organization established in 1937. It provides safe and secure financial transactions and clearance services for member banks in 198 countries. The US has great influence over the nonprofit cooperative, to the point that it is able to monitor fund flows by individuals and between organizations, as well as restrict US dollar clearances by some countries.

If banks in Hong Kong are suspended from SWIFT's US dollar transaction processing, it would have larger consequences than imposing tariffs on Chinese goods, as the move would seriously disrupt banks' operations and affect local financial markets. Moreover, as the US dollar remains a dominant global currency, firms cut off from the SWIFT clearance system would be unable to engage in international trade activities using the greenback.

It remains unclear whether the US government would pursue the same sanctions on financial institutions in Hong Kong that it has imposed on their peers in Iran and Russia.

However, a Bloomberg report on Wednesday last week suggested that some Trump advisers had discussed a move to destabilize the local currency pegged to the greenback by limiting Hong Kong lenders' ability to buy US dollars. The article did not specify how the US president's advisers had proposed to proceed, but disconnecting Hong Kong from SWIFT would not only force many firms in the territory into operational crises, but also disrupt the exchange of Hong Kong and US dollars. Furthermore, any move to rattle the Hong Kong financial markets — the world's third-largest US-dollar trading center — would have an enormous effect on the territory as an international financial hub.

It is too early to nail down the scope of Washington's sanctions on financial institutions in Hong Kong, but the relationship between the US and China is growing increasingly tense, and the possibility of them decoupling is growing. Even though a complete decoupling between the world's two largest economies is not attainable in the short term, and such a delinking could go back and forth for a while, it is an inevitable trend. For those with assets in Hong Kong, it is time to prepare for the potential risks.

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