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Future of Hong Kong's Currency Regime in an Era of Declining U.S. Dollar Hegemony

Zhiheng Li

Columbia University, New York, USA
lizziheng@gmail.com

Abstract. Hong Kong's Linked Exchange Rate System (LERS) has provided decades of stability by pegging the Hong Kong dollar to the U.S. dollar. However, global shifts are raising questions about the longevity of this arrangement. U.S. dollar hegemony—long taken for granted as the cornerstone of international finance—is facing gradual erosion as countries diversify reserves and seek alternatives amid geopolitical tensions. The Trump administration's aggressive use of tariffs and other unilateral trade measures in the late 2010s and early 2020s is widely viewed as having undermined confidence in U.S. economic leadership, thereby accelerating moves toward "de-dollarization." This paper examines how these trends might impact Hong Kong's currency regime. The paper reviews the status of USD hegemony and recent global trends (including the impact of Trump-era tariffs), analyzes the HKD peg's performance and trade-offs, and evaluates possible policy paths ranging from maintaining the USD peg to basket peg or other options. The analysis finds that while the USD's dominant role is moderating, it remains unparalleled in global finance, and Hong Kong's existing USD peg continues to serve the territory well under present conditions. Abrupt changes appear unwarranted given financial and economic constraints. Instead, policymakers should plan for a long-term transition only if global and domestic conditions align to make an alternative regime more viable.

Keywords: Hong Kong Dollar Peg, U.S. Dollar Hegemony, De-dollarization, Reciprocal Tariff, Re-pegging

1. Introduction

Under the LERS established in 1983, the HKD is pegged to the USD at a tight band of HK$7.75–7.85 per USD through a currency board arrangement. This system has ensured a stable exchange rate, which in turn underpins Hong Kong's status as a global financial center and an entrepôt for capital flows between China and the West. Hong Kong's experience is part of a broader pattern in which many economies tether their currencies to the dollar for stability. According to Ilzetzki, Reinhart, and Rogoff, as of the mid-2010s, roughly 50% of world GDP was produced in countries whose currencies were effectively anchored to the U.S. dollar, compared to only about 5% for the euro [1]. The dollar's role as a linchpin of the international monetary system reflects its post-WWII hegemony in trade and finance.

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In recent years, questions about the dollar's continued dominance have intensified amid clear signs of a gradual decline in U.S. dollar hegemony. The USD still accounts for the majority of official foreign exchange reserves, yet its share has been falling as central banks diversify their holdings. IMF data show that the dollar's share of global foreign exchange reserves has declined significantly since 2000 as many central banks reallocate reserves into other currencies [2]. This erosion of dollar dominance has occurred not because a single challenger has taken its place, but due to collective moves into multiple alternative currencies. Crucially, the steady drumbeat of "de-dollarization" has been amplified by geopolitical and policy shocks over the past decade. In particular, the Trump administration's imposition of reciprocal tariffs and trade wars strained the global trading system and rattled investors' faith in the reliability of U.S. economic stewardship. Trump's aggressive tariff campaigns—targeting not only strategic rivals but even traditional allies—fueled uncertainty about the USD's future and sparked an urgent discourse on reducing dependence on the dollar. By early 2025, in the wake of escalated U.S. tariffs, markets were openly questioning whether the dollar's "unassailable" safe-haven status might be fading. The convergence of these global trends raises an important issue: What do they mean for Hong Kong's long-standing USD peg?

2. U.S. dollar hegemony and global trends

The USD has long been the cornerstone of the international monetary system, serving as the world's primary reserve, invoicing, and vehicle currency. The United States enjoys well-documented benefits from this "exorbitant privilege," such as lower borrowing costs and greater geopolitical leverage [3]. For decades, much of the global economy was organized around the dollar as a stable unit of account and medium of exchange. In recent years, however, incremental shifts have been underway beneath this outward stability. Over the past two decades, many central banks have gradually diversified their reserve portfolios away from the dollar. IMF statistics indicate that the dollar's share of global foreign exchange reserves has fallen markedly since 2000, with central banks reallocating portions of their reserves into currencies like the Chinese RMB and the Australian and Canadian dollars [2]. This "stealth erosion" of dollar dominance has occurred without a sudden flight from dollar assets, but it reflects strategic hedging by reserve managers. The drivers of this trend include a desire for greater diversification and growing concern over the political risks associated with U.S. financial sanctions. After a series of global shocks—trade disputes, a global pandemic, and geopolitical conflicts—many countries are rethinking their heavy reliance on the USD in international transactions and reserves. For example, since the onset of U.S.–China trade tensions in 2018, China and its economic partners have increasingly conducted trade in RMB or local currencies. By 2023, in China's own cross-border transactions, use of the RMB had surged to around 50% (up from essentially 0% in the mid-2000s) [4]. Even so, the RMB remains a relatively minor player in international finance compared to the dollar's dominance [5]. At the same time, a number of countries—including some economies—have sharply increased their gold holdings as a politically neutral reserve asset to hedge against dollar-centric risks [6]. These developments illustrate a growing resolve internationally to reduce vulnerability to a single dominant currency.

3. HKD peg in a changing environment

Hong Kong's currency board system pegs the HKD to the USD within a narrow band (currently HK$7.75–7.85 per USD). The HKD monetary base is fully backed by USD reserves, and the Hong

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Kong Monetary Authority (HKMA) maintains the peg through automatic convertibility commitments—buying or selling USD for HKD whenever the exchange rate threatens to move outside the band. In effect, Hong Kong imports U.S. monetary policy: interest rates in Hong Kong track U.S. interest rates under the currency board. This design has yielded a remarkably stable HKD–USD exchange rate for decades, insulating Hong Kong from exchange rate volatility. The stability and credibility of the dollar peg have been major foundations of Hong Kong's economic success. It provides a transparent nominal anchor that keeps investor confidence high, and it enables seamless convertibility between HKD and USD—crucial for Hong Kong's role as a global financial hub and the gateway for Chinese firms to access international capital.

3.1. Resilience and benefits

The USD peg has weathered numerous shocks without breaking. For instance, during the 1997 Asian financial crisis, Hong Kong defended the peg by sharply raising interest rates and intervening in markets, maintaining its currency board even as other Asian pegs collapsed. This demonstrated the authorities' resolve and the system's robustness. Over the years, the HKMA has amassed one of the world's largest foreign exchange reserves (around US$413 billion as of March 2025) to reinforce the peg's credibility. These ample reserves, together with implicit backing from Beijing, render speculative attacks on the HKD largely futile. For example, when U.S. interest rates rose sharply in 2022–2023, the HKD faced mild weakening pressure at the edge of its band. The HKMA responded by buying HKD (and selling USD) while allowing local interest rates to rise in tandem with U.S. rates. As a result, the HKD remained firmly within its band. Hong Kong's banking system is highly liquid and well-regulated, and the government's fiscal reserves are strong factors that further bolster confidence in the LERS. The IMF's assessments of Hong Kong consistently conclude that the LERS is functioning smoothly and continues to serve as an effective nominal anchor for the economy. In its 2024 Article IV review, the IMF affirmed that Hong Kong's external position is in line with fundamentals and that the territory's robust buffers have preserved financial stability under the peg [7].

The USD peg also offers Hong Kong crucial advantages in its unique geopolitical and economic position. By anchoring to the USD, Hong Kong enjoys monetary stability without having to mirror Mainland China's exchange rate regime. The HKD remains fully convertible, unlike the Chinese RMB, which is subject to capital controls, allowing Hong Kong to act as a key financial intermediary between China and global markets. International investors can trade HKD-denominated assets with confidence in the currency's stability, while Chinese firms can raise USD or HKD capital in Hong Kong and convert it as needed. In short, the dollar peg has been integral to Hong Kong's identity as a stable, rule-of-law financial center bridging East and West. This status would be difficult to maintain under a less stable or less internationally accepted currency regime.

3.2. Costs and challenges

Notwithstanding its successes, the LERS entails trade-offs. Hong Kong relinquishes independent monetary policy under the currency board—its interest rates must shadow U.S. interest rates regardless of local economic conditions. This imported monetary stance can at times be misaligned with Hong Kong's domestic needs. For example, in 2022–2023 Hong Kong's economy was recovering only slowly, yet the U.S. Federal Reserve was aggressively hiking rates to combat inflation. Hong Kong had to tighten monetary conditions in step with the U.S., contributing to a sharp drop in property prices and stress on local borrowers. Such pro-cyclical effects are an inherent

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limitation of the peg: Hong Kong cannot lower interest rates to stimulate its economy if the U.S. is tightening. Another challenge is that the HKD can be buffeted by speculative capital flows whenever U.S.-China interest rate differentials shift or geopolitical tensions flare. The HKMA's interventions to defend the peg cause the local money supply to expand or contract, affecting domestic liquidity and asset prices. Thus far, Hong Kong has managed these side effects with macroprudential measures and by firmly reiterating its commitment to the peg, which helps deter speculators.

A more profound challenge is the geopolitical risk of being tied to the USD amid U.S.-China strategic rivalry. In 2020, there were discussions in Washington about restricting Hong Kong's access to the U.S. dollar system as a response to China's actions in Hong Kong. No such extreme measure was ultimately implemented—likely to avoid collateral damage to U.S. interests and global markets—but the fact it was considered highlighted Hong Kong's vulnerability to U.S. political decisions. If U.S.-China tensions were to escalate drastically, Hong Kong could find itself in an uncomfortable position: dependent on a U.S. currency anchor that might be politicized, or under pressure from Beijing to reduce that dependence. To date, the U.S. has refrained from directly targeting Hong Kong's financial system, and China has signaled it is content for Hong Kong to keep its USD link (which, as noted, offers Mainland China certain benefits as well). Nonetheless, this backdrop underscores the importance of Hong Kong's authorities maintaining robust contingency plans.

4. Policy options for Hong Kong's currency regime

4.1. Status Quo – retaining the USD peg

Continuing with the LERS unchanged remains the most straightforward and, for now, the most prudent path [8]. The USD peg has provided Hong Kong with stability and predictability. Given that the USD still dominates global trade and finance, maintaining the peg avoids unnecessary disruption and preserves investor confidence. Officials have repeatedly affirmed that there are no plans to change a regime that has served Hong Kong well. In late 2024, Hong Kong's Financial Secretary and the HKMA chief publicly dismissed speculation about dropping the dollar link as "misconceptions" [9]. Market analysts likewise see no immediate trigger for a change: despite cyclical economic challenges and U.S.–China tensions, Hong Kong continues to function effectively under the peg, which serves as a vital anchor of stability in uncertain times.

The status quo is not without risks. Hong Kong's authorities must remain alert to global monetary shifts. For example, if the U.S. were to enter a period of persistently high inflation or severe fiscal instability that undermined the dollar's value, Hong Kong could import undesirable inflation or volatility via the peg. Additionally, as discussed, geopolitical frictions could put Hong Kong in a difficult position regarding its dollar dependence. Therefore, even while retaining the USD peg, Hong Kong should strengthen its contingency planning. Gradually expanding the financial infrastructure for RMB-based transactions—something already underway as Hong Kong builds up its offshore RMB market—will help facilitate a smoother transition if a pivot becomes necessary in the future. For the time being, however, upholding the USD peg with ample reserves, clear communication, and close coordination with both U.S. and Chinese authorities appears to be the optimal policy. This approach provides monetary stability in a still dollar-centric world and gives Hong Kong the flexibility to observe how global currency trends evolve.

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4.2. Re-pegging to RMB

Re-pegging the Hong Kong dollar from its longstanding U.S. dollar peg to the Chinese renminbi (RMB) is another option that would have significant strategic, economic, and geopolitical ramifications. Strategically, such a move aligns with Beijing's drive to internationalize the RMB and reduce reliance on the U.S.-centric financial order: China's proprietary payment network already handles over 15% of international transactions and more than half of China's trade is settled in RMB, even though the RMB remains limited as a global investment currency under strict capital controls [9]. Proponents argue that re-pegging would instantly re-denominate Hong Kong's large capital market in RMB, creating a deep offshore pool of RMB assets and positioning Hong Kong as the centerpiece of a parallel renminbi-based financial system. Economically, however, an abrupt shift to an RMB peg could unsettle Hong Kong's financial stability, potentially triggering capital flight and undermining investor confidence. Geopolitically, it could strain relations with Western countries–inviting sanctions or other pushback, even as some of China's Belt and Road partners might welcome Hong Kong's closer alignment with the RMB, partly cushioning the transition. Beijing appears to be laying the groundwork for re-pegging, but faces significant political and economic headwinds in executing this policy. Overall, while tying the HKD to the RMB could advance China's strategic aim of RMB internationalization and financial security, these gains would have to be weighed against the substantial economic disruption and geopolitical friction such a change may entail.

4.3. Modified peg or basket peg

Another option would be to adjust the HKD's exchange-rate anchor. One idea is to peg the HKD to a basket of currencies (for example, including the USD and RMB) instead of solely to the USD. In theory, a basket peg could spread exchange-rate risk and better reflect the mix of Hong Kong's economic linkages. In practice, however, moving to a basket would introduce complexity and reduce the transparency that is a hallmark of the current system. The HKMA would need to manage the HKD against a weighted index of currencies, which would be far less straightforward for the public and markets to understand than the present one-to-one (within a narrow band) link to the USD. Moreover, a basket peg would effectively transform the rules-based currency board into a managed float, requiring active policy intervention like Singapore's regime. Such a drastic change would likely be considered only if the USD became highly unstable or if the RMB's global role grew so large that a dual-anchor system was justified—conditions that do not hold today. At present, there is little impetus to pursue this approach.

A more modest adjustment that has occasionally been suggested is to widen the HKD's trading band against the USD (for example, to 7.70–7.90). This would grant slightly more room for interest rate differentials to persist without immediate intervention. However, a wider band might simply invite speculative tests of the new limits and could dilute the psychological clarity of the peg. The current ±0.5% band is well understood and has proven effective; widening it would not address any fundamental issue and thus appears unnecessary.

4.4. Floating or currency union

The most radical option would be for Hong Kong to abandon the peg entirely—either allowing the HKD to float freely or replacing it with another currency (essentially a currency union with the USD or RMB). Under current conditions, neither option is viable. A free-floating HKD would likely

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be extremely volatile given Hong Kong's small, open economy and sensitivity to capital flows; this was evident in the early 1980s, before the peg was adopted. Establishing a credible independent monetary policy would be difficult. Meanwhile, adopting another currency outright would mean surrendering Hong Kong's monetary autonomy and symbolic currency identity without clear benefit. Any move to eliminate the HKD would be politically sensitive and would only be conceivable if the HKD became fundamentally unviable—which is not the case.

5. Conclusion

Hong Kong's currency regime stands at the crossroads of a changing international monetary landscape and the city's evolving relationship with Mainland China. This analysis finds that although U.S. dollar hegemony is gradually receding, it has not yet diminished to a degree that would compel Hong Kong to abandon its USD peg. The dollar remains dominant by most metrics, and the benefits Hong Kong gains from the dollar peg—exchange rate stability, investor confidence, and a unique intermediary role—continue to outweigh the drawbacks. Recent episodes such as tariff wars and the de-dollarization discourse have heightened Hong Kong's awareness of the risks of over-reliance on the dollar and underscored the need for long-term contingency planning. However, these factors alone do not warrant an abrupt change in Hong Kong's currency system. The prudent course is to retain the LERS if the USD-centric system prevails, while gradually preparing for a more multipolar monetary future.

If U.S. dollar dominance were to erode substantially in the coming decades—for example, if the RMB or even a new digital reserve currency was to rise to rival the dollar's global stature [10]—then Hong Kong would need to re-evaluate its currency strategy. In such a scenario, a shift to a basket peg or an RMB peg could become viable, especially if it aligns with China's strategic objectives to promote the RMB's international use [11]. Any transition to a new regime would have to be executed with great caution, drawing on Hong Kong's extensive experience and credibility to maintain confidence during the changeover. Until and unless those conditions materialize, stability remains paramount. Hong Kong's monetary authorities recognize this; their consistent "no change" message regarding the exchange rate regime has itself been a stabilizing factor. The HKD–USD peg has been a cornerstone of Hong Kong's economic success in the era of dollar hegemony, and it will likely remain appropriate so long as the dollar continues to play a leading role in global finance.

In summary, even as the era of unquestioned U.S. dollar hegemony fades and global currency diversification gathers pace, Hong Kong's optimal strategy is one of adaptive conservatism. By maintaining its trusted currency regime and robust defenses while staying alert to global shifts—and incrementally enhancing its capacity to operate in other currencies—Hong Kong can maximize monetary stability and policy flexibility. Such an approach will ensure that the HKD remains resilient amid external changes.

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