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Why the Victory of the Hong Kong Pro-democracy Camp is a Turning Point

Transformation of Xi Jinping's Hard Line is Now Inevitable

Democrats won an overwhelming majority in the Hong Kong District Council Elections. The outcome of this direct election, which reflects the authentic and sole will of the people of Hong Kong, completely shatters China's empty ambitions for its one country, two systems constitutional principle. In the United States, the Hong Kong Human Rights and Democracy Act of 2019 has been passed by overwhelming majorities in the Congress and Senate, and the pressure from the monitoring of the international community is being maintained at an extremely high level. Since taking action that directly contravenes human rights would definitively obliterate China's international reputation, clearly neither armed intervention nor forcible suppression in Hong Kong is an option. On the other hand, however, options such as prolonging Hong Kong's turmoil, causing the Hong Kong economy to deteriorate or weaken, or absorbing Hong Kong's financial and trade functions into the markets of Shenzhen and Shanghai are all equally out of the question. Hong Kong is a foreign trade and financial gateway for China, and the loss of its role in these areas would be fatal for China. Consequently, China has no choice but to try to calm the situation by making concessions to the democrats such as consulting with the United States and asking it what it wants. The enactment of the Hong Kong Human Rights and Democracy Act of 2019 in the US Congress and the victory of the Pro-democracy Camp in the Hong Kong District Council Elections will also incentivize the Chinese side to make concessions and seek an early settlement in the ongoing US-China trade talks.

Hong Kong and the World in One Country, Two Systems

The fraudulent and enigmatic system known as the "socialist market economy" in China worked because the world capitalist system continued to provide capital by falsely pretending that China, which is not a democratic country, was actually a democratic system. The system that served as the intermediary between China and the rest of the world is the one country, two systems in Hong Kong. The economic scale of Hong Kong (in terms of Hong Kong GDP vs. Mainland GDP) is now about 2.7%, a significant drop from 18.4% at the time of the handover in 1997, but Hong Kong's role as a gateway for funds has not changed in any way at all. This means that if China takes steps to repress Hong Kong, there will be significant financial costs.

Hong Kong's Position is Essential for China's Dollar Procurement, but this is Jeopardized by the Hong Kong Human Rights and Democracy Act

Hong Kong is a safe investment location for global players, thanks to the establishment of the rule of European-American law, guaranteed free movement of capital, low tax rates, and the use of English, etc. The huge capital pool provided Chinese companies with a great funding base. According to the Wall Street Journal (October 23rd), the cumulative amount of IPO funding by Chinese companies since 1997 has played a major role in Hong Kong with \$335 billion in the Hong Kong market and \$268 billion in the Shanghai market. Hong Kong is even more important for bank loan financing and corporate bond issuance. The majority of Chinese companies issuing US dollar-denominated bonds do so in Hong Kong and are listed on the Hong Kong stock market. Of the \$138 billion in China's inward direct investment in 2018, 65%, or \$90 billion, was channelled via Hong Kong, and 61% of the foreign direct investment, \$143 billion, and \$87 billion, also passed through Hong Kong.

It is anticipated, however, that the current account balance in China will deteriorate significantly in the future, and that dollar funding will also become increasingly difficult. In

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this context, Hong Kong will become even more important as a gateway for dollar funding. Clearly then, if the Hong Kong issue is not handled properly, this could create huge problems for the Xi Jinping regime.

The Xi Jinping Regime Being Forced to Shift to a Conciliatory Attitude

The Xi Jinping administration has been trying to create something that is nothing more than a convenient facade of the one country, two systems arrangement. In other words, it has taken away Hong Kong's autonomy and strengthened the control of the Chinese Communist Party. It is clear, however, that Xi Jinping's hard-line policy of snatching away freedom from Hong Kong while raising global money by making use of free Hong Kong has wandered into a cul-de-sac. If the Hong Kong Human Rights and Democracy Act enacted in the United States is implemented, the preferential financial and commercial status that the United States has given to Hong Kong could be lost, which, in turn, would mean that China loses its lifeline for dollar procurement. It is not clear whether, if the Xi Jinping regime were to choose to adopt a conciliatory attitude, this would also mean that it would be forced to transition to the true meaning of the one country, two systems idea, or not.

The New Normal of US-led Opposition

The US-China struggle for hegemony can be said to be a new normal that will last for 5 to 10 years. Both the United States and China are deeply and economically interdependent, and so cannot immediately break the relationship between them. It is a format in which the democratic/capitalist system and the Chinese political dictatorship structure are in a state of economic coexistence. Under this new normal, economic activities including trade and investments are carried out, economic fluctuations occur, as do economic recoveries. This new normal can be said to be one that consists of one country and two systems.

In the process, the global supply chain that is concentrated in China will be restructured. Companies that are currently producing in China and relying on China for supply will most likely accelerate the process of transferring their activities to other countries. In China, efforts to cover up the negatives occurring in trade activity by engaging in the promotion of domestic demand will continue. The US side is in control of the US-China negotiations. If sanctions tariffs are raised to 100% and 200% in response to China failing to make concessions, US-China trade will decline sharply, and the Chinese economy will surely collapse immediately. China's current account balance is about \$400 billion in surplus to the US, and at about \$350 billion in non-US deficit, totaling \$50 billion, and so it is obvious that it cannot continue to confront US. Eventually, therefore, China will be forced to declare a temporary ceasefire.

When the temporary cease-fire in US-China trade war comes to an end, a global economic recovery will come into view. It is conceivable then that, from the end of 2019 onwards, in the era of the new normal of US-China competition, an acceleration into a risk-taking environment of rising global stock prices and appreciation in the US dollar will become apparent.