Research Brief
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Offshore Renminbi Centre

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Hong Kong is the first offshore market to launch renminbi business, and is now the largest offshore renminbi centre in the world. Yet other places such as London, Singapore and Taiwan are determined to grow their renminbi business in a move to catch up with Hong Kong. This Research Brief highlights the profiles of the above four offshore renminbi centres, as well as the development of Shanghai as a potential market for offshore renminbi business.

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1. Introduction

1.1 China is the world's second largest economy after the United States ("US"), as well as the world's largest exporter and second largest importer of goods. However, the international use of its currency, renminbi, is not commensurate with the importance of China's economic status. In September 2013, renminbi was the 12th most-used payment currency in the world with a mere 0.86% share of all global payments.

1.2 In recent years, Mainland authorities have promoted the internationalization of renminbi with a three-pronged approach to:

(a) facilitate international trade and investment denominated and settled in renminbi;

(b) develop offshore renminbi-denominated financial products and encourage investment in these products; and

(c) encourage central banks to hold renminbi as part of their foreign exchange reserves.

1.3 The major benefits of renminbi internationalization include reducing the exchange rate risks for importers/exporters and facilitating investment flows into and from China. An internationalized renminbi also enables China to slow down the build-up of foreign exchange reserves in US dollar, thereby reducing its exposure to the volatility of the US dollar.[1]

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[1] Years of trade surpluses and foreign capital inflows have rendered China as the largest holder of foreign exchange ("forex") reserves in the world. Most of China's forex reserves are held in assets denominated in US dollar, as an overwhelming share of its international trade and financial transactions have been settled in US dollar over the past years.

2. Development of offshore renminbi centre in Hong Kong

2.1 To promote the internationalization of renminbi, the Central Government supported Hong Kong as early as 2004 to develop its offshore renminbi business.[2] In January 2004, local banks were authorized to launch personal renminbi businesses for Hong Kong residents, including deposit taking, currency exchange, credit card and remittance services. Hong Kong's offshore renminbi business has since then undergone a number of breakthroughs and the key milestones during the period are listed in **Figure 1**.

Figure 1 — Key milestones in development of offshore renminbi business in Hong Kong

	2004	2007	2009	2010	2011	2012	2013
Personal/ Corporate Rmb Services	Personal Rmb services for Hong Kong residents			Corporate customers allowed to open Rmb deposit accounts		Personal Rmb services for non-Hong Kong residents	
Rmb Bond Market		1st Rmb bond by Mainland financial institution	1st Rmb sovereign bond	1st Rmb bond by overseas corporate	1st Rmb bond by Mainland non-financial institution		1st Rmb sovereign bond with a 30-year tenor
Rmb Trade Settlement			Pilot scheme launched in Hong Kong, Macao, ASEAN countries and five Mainland cities	Expanded to 20 provinces and cities in Mainland China	Further expanded to whole Mainland China	Pilot scheme formalized to cover all companies in Mainland China	
Rmb Investment					Rmb ODI (1) and Rmb FDI (2) RQFII scheme (3) with initial quota of Rmb20 billion	RQFII quota expanded by Rmb250 billion	

Notes: (1) Rmb ODI refers to the Renminbi Overseas Direct Investment programme, under which Mainland enterprises are allowed to conduct overseas direct investment in renminbi.

(2) Rmb FDI refers to the Renminbi Foreign Direct Investment programme, under which foreign enterprises are allowed to conduct foreign direct investment in the Mainland China in renminbi.

(3) RQFII scheme refers to the Renminbi Qualified Foreign Institutional Investor scheme. Under the scheme, retail investors are allowed to invest in Mainland China's bond and equity markets through qualified fund management and securities companies in Hong Kong.

Sources: HKEx (2012) and Hong Kong Monetary Authority (2013).

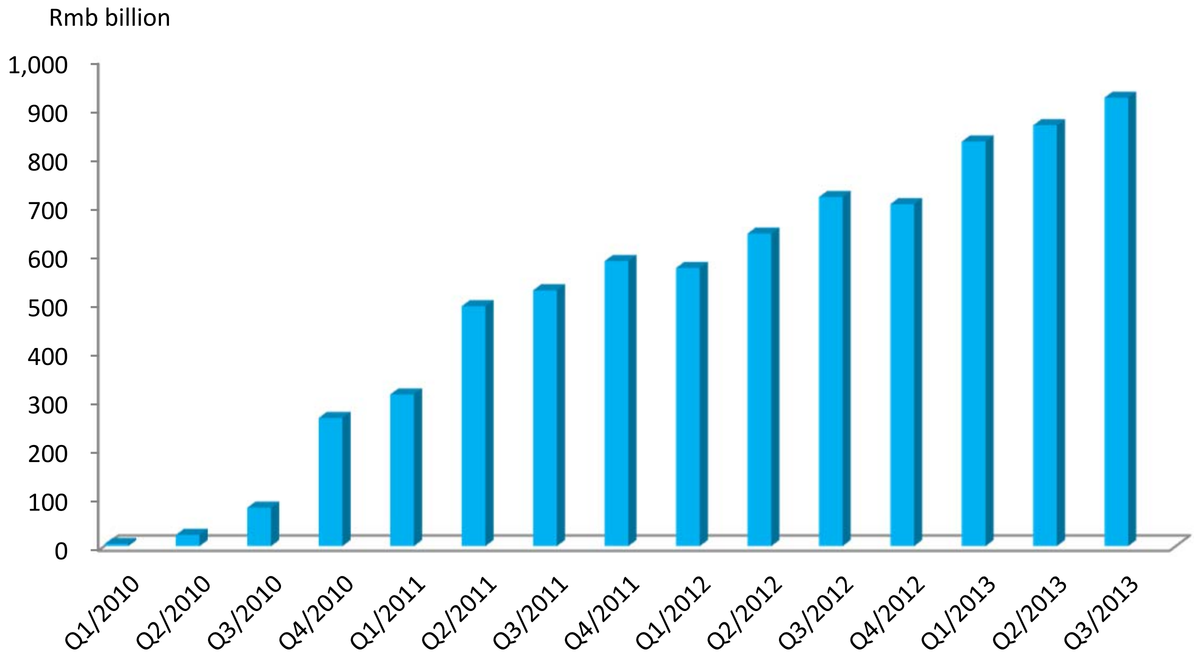
[2] The role of Hong Kong was underscored in the National 12th Five-Year Plan (2011-2015) promulgated in March 2011, in which the Central Government stated its support for Hong Kong's development as an offshore renminbi business centre.

2.2 After a decade of development, Hong Kong has established itself as the largest offshore renminbi centre in the world due to its efficient market infrastructure, first-mover status, close economic ties with the Mainland China and other advantages. In particular, it is the global hub for both renminbi trade settlement and offshore renminbi financing/wealth management.

Global hub for renminbi trade settlement

2.3 With the introduction and the subsequent expansion of the pilot scheme for renminbi trade settlement, cross-border trade transactions settled in renminbi through banks in Hong Kong have increased markedly since early 2010 (see **Figure 2**). In 2012, renminbi trade settlement handled by banks in Hong Kong amounted to Rmb 2,633 billion, as compared with the total amount of Mainland China's external trade settled in renminbi of Rmb 2,938 billion during the same period. This reflects Hong Kong's role as the global hub for renminbi trade settlement, serving both local and overseas banks and companies.

Figure 2 — Renminbi trade settlement in Hong Kong



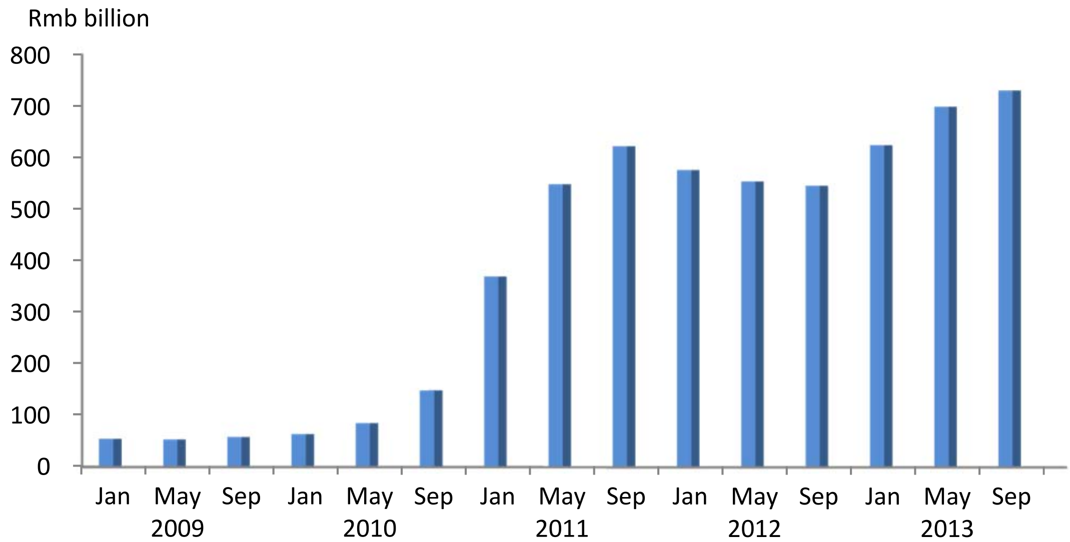
Source: Financial Secretary's Office (2013).

Global hub for offshore renminbi financing/wealth management

Renminbi deposits

2.4 Hong Kong has the world's largest offshore pool of renminbi liquidity. Renminbi customer deposits grew rapidly from Rmb 54.4 billion at end-January 2009 to Rmb 730 billion at end-September 2013 (see **Figure 3**). Growth was initially driven by retail deposits on the expectation of renminbi appreciation, and later fuelled by the increase in renminbi receipts by corporate customers through cross-border trade settlement transactions.

Figure 3 — Renminbi deposits in Hong Kong

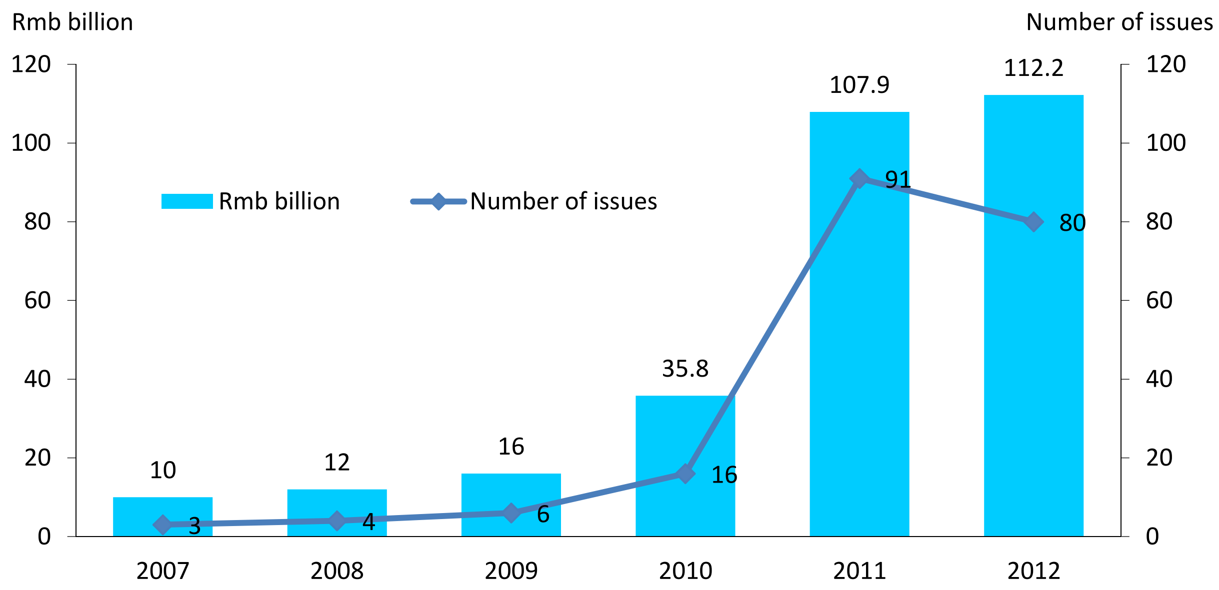


Source: Hong Kong Monetary Authority.

Renminbi bonds

2.5 Hong Kong's renminbi bond market (or the dim sum bond market) is the largest outside Mainland China. It has grown markedly since 2011 (see **Figure 4**) when foreign investors were allowed to engage in direct investment in Mainland China using offshore renminbi funds, including proceeds from dim sum bond issues. Prior to 2011, remittance of dim sum bond proceeds from Hong Kong to the Mainland required case-by-case approval by the Mainland regulators.

Figure 4 — Renminbi bond issuance in Hong Kong



Source: Hong Kong Monetary Authority.

Renminbi loans and shares

2.6 Besides the issuance of renminbi bonds, bank credit and other forms of renminbi financing are also available to companies. Renminbi loans outstanding in Hong Kong reached Rmb 107 billion at end-September 2013, higher than the amount of Rmb 30.8 billion in 2010 and Rmb 79 billion in 2011. The first offshore renminbi-traded share was listed in Hong Kong in October 2012 under the innovative "Dual Tranche, Dual Counter" model.

Wealth management

2.7 A wide range of renminbi financial products such as currency futures, investment funds and insurance policies are available in Hong Kong to meet the needs of investors. Investors can invest in products with access to Mainland China's bond and equity markets through various channels, such as the arrangement for offshore institutions to invest in the Mainland China's interbank bond market[3] and the Renminbi Qualified Foreign Institutional Investor ("RQFII") scheme.

3 Since August 2010, renminbi clearing banks and other eligible institutions outside Mainland China have been able to participate in the interbank bond market in Mainland China.

3. Development of offshore renminbi centres in London, Singapore and Taiwan

3.1 With the wider use of renminbi in international trade and investment activities, the demand for renminbi financial services from overseas individuals and corporates has increased gradually. This attracts overseas financial centres to promote their renminbi business. Indeed, there are now multiple offshore renminbi centres around the world, including Hong Kong, London, Singapore and Taiwan (see **Table** below for the profiles of these four offshore renminbi centres).

Table — Profiles of offshore renminbi centres in Hong Kong, London, Singapore and Taiwan

	Hong Kong	London	Singapore	Taiwan
Year of establishment	First-mover, established in 2004	Established in 2011	Latecomer, established in 2013	Latecomer, established in 2013
Market positioning	A global hub	A western hub	An offshore Rmb centre serving ASEAN countries	An offshore Rmb centre handling cross-strait trade and financial transactions
Clearing bank	Bank of China	Using Hong Kong's existing infrastructure for clearing	Industrial and Commercial Bank of China	Bank of China
Rmb bond market	A mature market for dim sum bonds	A developing market	A developing market for Rmb-denominated Lion City bonds	A developing market for Rmb-denominated Formosa bonds
Rmb customer deposits	Rmb 730 billion (September 2013)	Rmb 5 billion (December 2012)	Rmb 140 billion (July 2013)	Rmb 123 billion (October 2013)
Currency swap facility with China	Rmb 490 billion(1)	Rmb 200 billion(1)	Rmb 300 billion(1)	Nil
Quota for RQFII scheme	Rmb 270 billion	Rmb 80 billion	Rmb 50 billion	Rmb 100 billion

Note: (1) Currency swap facility allows central banks to exchange currencies from one another. Under such arrangement, the Hong Kong Monetary Authority, the Monetary Authority of Singapore and the Bank of England can obtain renminbi funding from the People's Bank of China and provide it to banks in their jurisdiction as an emergency source of liquidity.

Sources: Channel NewsAsia (2013), Bloomberg (2013), Bourse Consult (2012) and 中央銀行全球資訊網 (2013).

3.2 Hong Kong possesses first-mover advantages in offshore renminbi business. It is unlikely that London, Singapore and Taiwan will be able to challenge Hong Kong's position as the largest offshore renminbi centre in the short to medium term. Nevertheless, London, Singapore and Taiwan appear determined to grow their renminbi business, which should pose competition to Hong Kong in the years ahead.

4. Challenges from Shanghai Free Trade Zone

4.1 On 29 September 2013, the State Council announced the General Plan for the China (Shanghai) Pilot Free Trade Zone ("FTZ"). FTZ seeks to, among other things, push forward the opening up and innovation of the financial sector through measures such as greater cross-border use of renminbi, free convertibility of renminbi and interest rate liberalization as long as risks are under control. The proposed financial liberalization measures have aroused concerns over the challenges posed by FTZ to Hong Kong as an offshore renminbi centre.

4.2 Shanghai is now the largest financial centre of Mainland China. In 2012, China's National Development and Reform Commission announced a blueprint to develop Shanghai as a global centre for renminbi trading, clearing and pricing by 2015, as part of a broader plan to build up Shanghai as an international financial centre by 2020. From a regional perspective, Shanghai also benefits from being situated in the Yangtze River Delta Economic Delta, which is currently the largest regional economy in Mainland China that accounts for about 20% of the Gross Domestic Product. In this connection, one should not lose sight of the potential of Shanghai as an offshore renminbi market. However, it may be difficult to ascertain at this stage the impact of the establishment of FTZ on Hong Kong as it will depend on the extent of the liberalization measures of FTZ. As of to date, the State Council has not set out details and deadline for the implementation of the reform measures mapped out in the General Plan.

5. Strengthening of Hong Kong's status as the major offshore renminbi centre

5.1 The Financial Services Development Council ("FSDC")[4] issued a report entitled "Proposals to Advance the Development of Hong Kong as an Offshore Renminbi Centre" in November 2013. In the report, FSDC sets out 21 policy recommendations to accelerate Hong Kong's development as an offshore renminbi centre, which include proposing the Mainland authorities to launch the Qianhai qualified domestic institutional investors scheme[5] and easing the Rmb20,000 daily exchange limit applicable to Hong Kong residents. The 21 policy recommendations are categorized into three parts involving the Government (three recommendations), the Mainland authorities (13 recommendations) and the local financial industry (5 recommendations).

5.2 While giving credence to FSDC's proposals, the market is concerned over the feasibility of these proposals. In particular, many of the proposals are very dependent on the Mainland regulators who set their own pace in internationalizing the renminbi.[6] Some analysts therefore propose the Government to do more on promoting the local renminbi market such as the development of more renminbi products and an active renminbi repo market in Hong Kong.

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4 FSDC was established in January 2013 by the Government as a high-level, cross-sectoral advisory body to engage the industry in formulating proposals to promote the further development of Hong Kong's financial services industry and map out the strategic direction for development.

5 The scheme allows all financial institutions that have registered in Qianhai to obtain a certain quota for offshore investments.

6 See Asiamoney (2013).

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