

# ECONOMIC FOCUS

Treasury Division



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## Hong Kong's Development as an Offshore Renminbi Centre

**Hong Kong will be the first place in the world outside mainland China to have an interbank market for Chinese renminbi (RMB) foreign exchange, and lending and borrowing business after the latest relaxation of RMB business in Hong Kong.**

**Interbank transfer of RMB deposits in Hong Kong is now permitted and there will no longer be any limit on RMB exchanges by companies in Hong Kong as long as the funds remain in the territory. However, restrictions on individuals will still apply.**

**Such a development will accelerate the development of Hong Kong as an offshore RMB centre.**

**Mainland China will also benefit as the increasing use of RMB outside the country will speed up the internationalisation of the RMB.**

### Major Milestones

The People's Bank of China and the Hong Kong Monetary Authority signed a significant agreement on July 19 on the conduct of RMB business in Hong Kong, which will help accelerate the development of Hong Kong as an offshore RMB centre, as well as speed up the internationalisation of the RMB.

Under the new rules, interbank transfer of RMB deposits in Hong Kong is permitted and there will no longer be any limit on RMB exchanges by companies in Hong Kong as long as the funds remain in the territory. However, restrictions on individuals still apply (Appendix).

The latest relaxation of RMB business in Hong Kong marked yet another milestone in the development of RMB business in Hong Kong. Since 2004 when RMB business was first launched in Hong Kong under the authorisation of the People's Bank of China (PBOC), expansion of the business has been fast in both scope and volume (Exhibit 1).



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## Exhibit 1: Chronological order of the relaxation of RMB business in HK

2004	RMB business including deposit, remittance, exchange and credit service for personal customers opened on a pilot basis
2005	Allowed seven designated business industries including retail sales, beverage and transports to open RMB deposit accounts
2006	Hong Kong residents allowed to open RMB cheque accounts
2007	Mainland financial institutions allowed to issue RMB bonds in Hong Kong
2009	Cross border trade between Shanghai, four cities in Guangdong province and Hong Kong allowed to be settled in RMB
2010	Cross border trade settlement expanded to 20 provinces and municipalities in Mainland China and to all countries and regions overseas
February:	<ul style="list-style-type: none"><li>– Banks in Hong Kong can determine the use of their renminbi funds as long as it does not involve the flow of renminbi back to the Mainland.</li><li>– Allow Mainland's non-financial corporate to issue RMB bonds in Hong Kong</li></ul>
June:	<ul style="list-style-type: none"><li>– Cross border trade settlement expanded to 20 provinces and municipalities in Mainland China and to all countries and regions overseas</li></ul>
July:	<ul style="list-style-type: none"><li>– Restrictions on interbank transfers of renminbi funds would be lifted and companies can buy renminbi in Hong Kong without cap.</li></ul>

Initially, banks in Hong Kong were only permitted to provide RMB deposit, exchange, remittance and credit card services to personal customers. This was later relaxed in 2005 to provide similar services to seven business groups including retail sales, beverage and transports. Both the scope of business and the maximum amount of transactions allowed have been raised accordingly. Further relaxation occurred in 2007 when the authorities allowed Mainland financial institutions to issue RMB bonds in the territory. Today, there are 64 banks in Hong Kong participating in RMB business, with RMB deposits amounting to about RMB85 billion (Exhibit 2). RMB bonds issued also reach RMB38 billion.

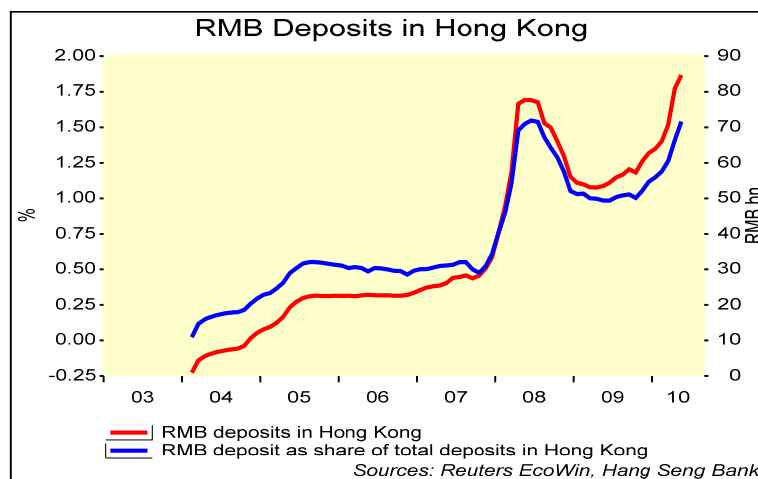


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Exhibit 2



The real breakthrough, however, was in July 2009 when the Mainland authorities allowed cross-border trade between Hong Kong/Macao and Shanghai/four Guangdong cities, and between ASEAN and Yunnan/Guangxi, to be settled in RMB. In June 2010, cross border trade settlement in RMB was expanded to 20 provinces/ municipalities on the Mainland and to all countries/ regions overseas.

According to the People's Bank of China, cross-border trade settlement in RMB amounted to RMB70.6 billion in the first half of 2010. Although the amount is small relative to mainland China's overall trade flows, the trend has been increasing in recent months. Of the overall total, Hong Kong's share was RMB53 billion. Judging by recent trends, Hong Kong's cumulative number could surpass RMB100 billion by the end of this year (Exhibit 3).

Exhibit 3: Cross-border Trade Settlement in RMB

	RMB bn
<b>2010H1</b>	<b>70.6</b>
<i>Involving trade between the Mainland and Other Countries</i>	<i>17.6</i>
<i>Involving trade between the Mainland and Hong Kong</i>	<i>53.0</i>
Jul-Dec (assuming RMB10 bn each month)	60
<b>end 2010 total (Hang Seng's forecast)</b>	<b>113</b>

Source: PBOC, Hang Seng Bank and newspaper reports





## Accelerate the Role of Hong Kong as an Offshore Renminbi Financial Centre

The changes announced on 19 July, with respect to the lifting of restrictions on interbank transfers of RMB funds and the purchase of RMB by companies without a cap, is likely to accelerate the development of Hong Kong as an offshore RMB centre and have important implications for Hong Kong's financial industry.

First of all, a variety of RMB-based financial products is likely to emerge in Hong Kong, including deposits and loans, insurance, stocks, mutual funds as well as derivatives products. However, we reckon that the real breakthrough lies in the creation of an offshore RMB interbank market in Hong Kong (Exhibit 4).

When the RMB interbank market starts to operate in Hong Kong, a two-tier market would likely emerge. The RMB spot foreign exchange and interest rates could deviate from those of the onshore market, reflecting the demand and supply conditions of RMB funds in Hong Kong, as well as the market's expectations about the future directions of change of the currency, providing important benchmarks for Mainland policymakers about the strength of RMB in the international market.

### Exhibit 4: Interbank RMB Market in Hong Kong

#### Spot RMB FX Market

- Banks in Hong Kong will start trading Spot RMB
- A two-tier market will emerge
  - The spot RMB exchange rate in Hong Kong would probably differ from that in the Mainland, reflecting supply and demand of RMB in the territory

#### An interbank money market for RMB funds

- Banks in Hong Kong will start lending and borrowing in RMB
- A two-tier market will emerge
  - The RMB HIBOR will probably differ from CHIBOR or SHIBOR in the Mainland

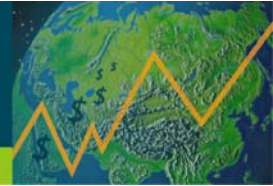
#### An interbank RMB Deliverable Forwards will gradually emerge

#### Capital market for RMB will grow over time

Renminbi trading in Hong Kong is also likely to be more volatile, allowing policymakers on the Mainland to gain experience before full-scale convertibility of the RMB is achieved, and before financial markets on the Mainland are fully open to the rest of the world.

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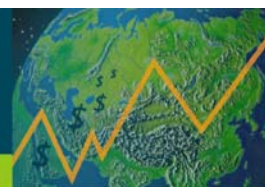


The move of the RMB towards an international currency brings enormous opportunities for the local financial industry, similar to those seen during the development of the Eurodollar market in London in the 1950s. Hong Kong will become the most liquid offshore financial centre for RMB business, offering the widest range of RMB financial products. Increasing use of the RMB outside mainland China, in the pricing and settlement of trade and financial transactions, as an investment vehicle, and eventually, as an international reserve currency, will help the RMB on its journey to becoming an international currency. This will, in turn, enhance Hong Kong's long-term competitiveness as an international financial centre.



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## Appendix: RMB Banking Business in Hong Kong

Existing	New
<p><b>Personal RMB business</b></p> <ul style="list-style-type: none"> <li>Accept RMB deposits from personal customers and designated business customers</li> <li>RMB exchange, remittance, credit card</li> <li>RMB bond issuance and trading</li> <li>RMB cheques (Hong Kong account for consumption spending in Guangdong province)</li> <li>RMB insurance</li> </ul> <p><i>Notes:</i></p> <ul style="list-style-type: none"> <li>Maximum RMB exchange: RMB20,000 per person per day</li> <li>Maximum RMB remittance: RMB80,000 per person per day</li> <li>Maximum cheque payment for consumption spending in Guangdong province: RMB80,000 per person per day</li> </ul>	<ul style="list-style-type: none"> <li>Interbank transfer of RMB deposits in Hong Kong permitted</li> <li>Other restrictions remain</li> </ul>
<p><b>Corporate RMB business:</b></p> <p>For Designated business customers (restricted to retail, beverage, hotels, transport, telecommunications, medical and education service)</p> <ul style="list-style-type: none"> <li>Accept deposits from designated business customers (<i>can only exchange RMB into HKD, not vice versa</i>)</li> </ul> <p>For trade settlement enterprises (TSE)</p> <ul style="list-style-type: none"> <li>Accept deposits from trade settlement enterprises (TSE)</li> <li>Conduct RMB exchange with TSE for the purpose of or arising from cross-border trades</li> <li>Conduct RMB remittance for TSE to settle cross-border trades,</li> <li>Provide trade finance facilities in RMB to TSE for the purpose of cross-border trades</li> <li>Participating banks can invest in RMB bonds issued in Hong Kong using own RMB funds</li> <li>Cheque and credit card</li> <li>RMB bonds issuance and trading</li> </ul>	<ul style="list-style-type: none"> <li>Interbank transfer of RMB deposits in Hong Kong permitted</li> <li>No limit on the amount that companies can exchange HKD for RMB, but the exchanged RMB have to be remained in Hong Kong</li> </ul>



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