

Norman T L Chan: Latest developments of renminbi business in Hong Kong

Briefing by Mr Norman T L Chan, Chief Executive of the Hong Kong Monetary Authority, on the latest developments of renminbi (RMB) business in Hong Kong, Hong Kong SAR, 23 December 2010.

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Good afternoon. Today I would like to provide an update on the latest developments of renminbi (RMB) business in Hong Kong.

With the strong support from the Central Government and the relevant Mainland authorities, the development of RMB business in Hong Kong has been encouraging this year. Significant growth and progress have been seen in various areas, including cross-border trade settlement, deposits, bond issuance and the introduction of financial products in the second half of this year.

The total amount of RMB deposits increased markedly from RMB 60 billion at the end of last year to RMB 220 billion in October and RMB 280 billion in November this year. Of these deposits, those from personal customers amounted to RMB 120 billion, with a total of 2.2 million accounts and an average deposit size of RMB 54,000. Deposits from corporate clients amounted to RMB 160 billion at the end of November, with 117,000 accounts and an average deposit size of RMB 1.3 million.

Conversion arrangement for trade settlement in 2011

Following the substantial expansion of the geographical coverage of the cross-border RMB trade settlement scheme in June this year, the amount of cross-border RMB trade settlement has grown rapidly, from a monthly average of about RMB 4 billion in the first half of the year to about RMB 30 billion each month in August and September, and close to RMB 68 billion in October. Under such circumstances, the amount of RMB purchased by the Participating Authorized Institutions (Participating AIs) through the Clearing Bank in the China Foreign Exchange Trading System in Shanghai increased notably in October, and the conversion arrangement concerned was suspended in late October. In response, the HKMA promptly introduced a number of measures, and the RMB market in Hong Kong has been operating orderly and smoothly to date.

As regards the conversion arrangement for 2011, after discussions with the People's Bank of China (PBoC), the HKMA consider appropriate to introduce certain refinements to the arrangement for the conversion of RMB conducted by Participating AIs for their customers in relation to cross-border trade settlement. Before going into the specific refinements, I would like to elaborate the background of the arrangement for the conversion of RMB conducted by Participating AIs through the Clearing Bank in Shanghai:

- (1) First, RMB funds flowed into Hong Kong through trade payments or other channels will become RMB deposits in Hong Kong, and these RMB funds can be used, deployed or exchanged freely into other currencies in the market in accordance with the applicable laws and regulations in Hong Kong. This is the main premise of developing an RMB offshore market in Hong Kong. In other words, the exchange rate and interest rate of RMB are to be determined by the supply and demand of RMB funds in the Hong Kong market. As the offshore and onshore markets are segregated, it is not unusual that the pricing may be different between the two markets.

- (2) Secondly, we should look at the actual supply and demand of RMB funds in the Hong Kong market this year. At the end of November, the total amount of RMB deposits in Hong Kong reached RMB 280 billion. This means that Hong Kong has accumulated a substantial pool of RMB funds which can meet the market's daily demand. Regarding cross-border trade settlement, in the first 11 months this year, payments from the Mainland to Hong Kong amounted to RMB 180 billion while payments from Hong Kong to the Mainland amounted to RMB 50 billion, resulting in a net inflow of RMB 130 billion to Hong Kong. These RMB funds remain in Hong Kong and constitute a main source of supply in the local RMB market. Of the RMB 50 billion paid from Hong Kong to Mainland enterprises, only about RMB 10 billion was obtained by conversion in Shanghai through the Clearing Bank. In November alone, the payment from Hong Kong to the Mainland under the trade settlement scheme reached RMB 22 billion. However, as the arrangement for conducting RMB conversions in Shanghai was suspended, enterprises in Hong Kong could only purchase RMB funds from the Hong Kong market. Given the abundant supply of RMB funds in the local market, the pricing of RMB funds in the Hong Kong offshore market and that in Shanghai were quite close to each other, with the differential between the two staying within 300 pips for most of the time in recent weeks. This shows that the offshore pool of RMB funds in Hong Kong is serving the function of supplying RMB funds to meet the demand from local enterprises, such that there is no need to rely heavily on the onshore conversion window in Shanghai for trade settlement. In other words, the conversion window in Shanghai serves a supplementary rather than the main source of RMB funds for trade settlement purpose.

In order to further promote the steady development of the RMB market in Hong Kong, the following refinement measures will take effect from January next year:

- (1) Participating AIs can square their positions with the Clearing Bank when there is a shortfall of RMB arising from conversions with customers for cross-border trade settlement transactions. In other words, Participating AIs should first utilise the RMB trade proceeds purchased from their customers to satisfy requests for RMB conversions for trade settlement transactions before purchasing RMB through the Clearing Bank in Shanghai.
- (2) Participating AIs can only purchase RMB through the Clearing Bank in Shanghai for their customers in relation to trade transactions due for payments to the Mainland within three months. The HKMA and the PBoC estimate that the demand for RMB conversion in Shanghai would be within RMB 4 billion in the first quarter of 2011. The volume of conversion will be assessed and appropriately adjusted after the first quarter taking into consideration the actual circumstances.
- (3) In order to maintain a steady supply of RMB, the HKMA will, as a standing arrangement, provide RMB funds of RMB 20 billion through its currency swap arrangement with the PBoC, for cross-border RMB trade settlements.
- (4) Given the restrictions in the convertibility of RMB, Participating AIs are required to limit their RMB net open positions (whether net long or net short) to 10% of their RMB assets or liabilities.

Participating AIs' credit risk exposure to the Clearing Bank

In their letter to the HKMA in November, the Hong Kong Association of Banks raised the issue of credit limit against the background of an increasing amount of RMB deposits being placed by Participating AIs with the Clearing Bank as the RMB business in Hong Kong continued to expand and deepen. The HKMA and the PBoC have held discussions about this issue, and it is considered that the issue could in principle be resolved by the Participating

Als establishing custodian accounts with the Clearing Bank. This means that the RMB funds will be placed with the PBoC Shenzhen Branch through the Clearing Bank as a custodian to overcome the issue of credit limit. We will further discuss with the PBoC, the Clearing Bank and Participating Als on the details of such an arrangement including the related legal documents and operational procedures. It is hoped that the arrangement can be implemented soon early next year.

Conclusion

I believe that next year will be a crucial year for the development of offshore RMB business in Hong Kong. We have made very good progress this year. Along this positive trend, and with the number of Mainland enterprises eligible for the cross-border RMB trade settlement scheme increased substantially to 67,000 recently and with the refinements that we are going to introduce, I am confident that the offshore RMB market in Hong Kong will continue to develop progressively in the coming year, both in terms of the depth and breadth of the market and product development. Four Hong Kong banks have been approved to participate in the Mainland's interbank bond market, and the applications by a number of banks are being processed by the Mainland authorities. This will provide a channel for the circulation and capital preservation for the RMB funds in Hong Kong. Meanwhile, we have just been informed that HKMA's eligibility for investing in the Mainland's interbank bond market has been approved by the PBoC. We are working closely with the PBoC on the implementation arrangements.

Finally, to further promote the development of the RMB offshore business in Hong Kong, the HKMA is making preparations for overseas roadshows with the financial industry, focusing on locations which have growing trade and investment flows with the Mainland. We believe that with our joint efforts, Hong Kong will be able to play its role as an RMB offshore market to the fullest, thereby promoting and supporting the nation's increasing cross-border trade and investment activities while enhancing and consolidating the status of Hong Kong as an international financial centre.