

Eddie Yue: The development and future of the offshore Renminbi market

Keynote address by Mr Eddie Yue, Deputy Chief Executive of the Hong Kong Monetary Authority, at the Euromoney Global Offshore RMB Funding Forum 2013, Hong Kong, 8 May 2013.

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Tony (Shale)¹ Richard (Morrow),² Distinguished Guests, Ladies and Gentlemen,

Good morning, and thank you all for coming. I'm honoured that Euromoney has invited me to speak at the Global Offshore RMB Funding Forum for the second year in a row. I recognise many familiar faces in the audience today, and I note the presence of a wide range of panellists who will no doubt examine the offshore RMB market from every possible angle and perspective.

Here in Hong Kong – the world's premier offshore RMB business centre – we have had a front row seat to watch the offshore RMB market take shape over the past few years. Since I last addressed this forum in May 2012, this market has continued to expand and evolve at a dizzying pace, which will provide for an interesting and timely dialogue today.

However, before we get into what will be a spirited discussion, I want to use my role as the opening keynote speaker to take a step back and gain a broader perspective of developments to date. I also want to look at the macro context, which is likely to play a major role in shaping future developments.

As we consider the possibilities for the offshore RMB market, it is instructive to review the development of the Eurodollar market. What are the key underlying elements that have driven the growth of the Eurodollar market and how do they feature in the current offshore RMB market environment?

The Eurodollar market as a comparison

A close examination of the differences and similarities between the two markets can help shed light on how offshore RMB market activities might evolve as well as how its further development can be fostered. Let's compare the two markets using four sets of characteristics.

Economic weight and trade centrality

The first set of characteristics involves economic weight and trade centrality.

The Eurodollar market is an offshore market for the currency of a country that has both.

Similarly, the offshore RMB market is supported by China's rapidly expanding economy and its substantial trade links with other parts of the world, given its status as the world's second largest economy and largest trading nation.

Indeed, these are two important macro trends that are driving offshore RMB market activities now and in the future. In roughly three years since the relevant policies were liberalised, currently some 10% of Mainland China's total trade, about 12% of foreign direct investment into China and about 4% of outward direct investment from China are settled in RMB.

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Compare this with the fact that about 30% of Japanese trade is settled in yen, 50–60% of euro area trade is settled in euros, and 80–90% of US trade is settled in US dollars. Clearly there is the potential for more RMB transactions – especially trade and direct investment transactions where regulations have been liberalised – to be carried out internationally. And we can trust that China’s economic development and its global links will continue to be at the forefront in the coming years to support a full spate of offshore market activities.

Currency convertibility and onshore financial market depth and liquidity

The second set of characteristics involves currency convertibility and onshore financial market depth and liquidity.

The Eurodollar market is an offshore market of a convertible currency and supported by extensive links with deep and liquid onshore financial markets.

On the other hand, the offshore RMB market is a market of a currency that is not yet fully convertible, and the links with the onshore financial markets are still subject to limitations. The RMB is convertible in respect of the current account and certain capital account items such as direct investments, while other flows like portfolio investments can only be conducted under specified quotas.

The opening up of even more channels for two-way flows between the onshore and offshore markets would be required to spur offshore RMB activities. A few years ago, these ideas would have sounded difficult, but today we are edging ever closer to realising many of them, which is indicative of the rapid pace of change in the offshore RMB market. But as we all recognise, this will be a paced process and not something that would or should happen overnight.

On this front, the HKMA has been engaging with Mainland Chinese authorities on further expanding fund flows between the onshore and offshore RMB markets. And I am pleased to say that significant progress has been made. Most recently, the quota for the RMB Qualified Foreign Institutional Investor (RQFII) scheme was expanded by RMB200 billion, bringing the total to RMB270 billion. The Qianhai cross-border lending pilot scheme was also launched, enabling companies incorporated in Qianhai to borrow RMB loans from banks in Hong Kong for uses relating to the development of Qianhai.

I look forward to the further streamlining of policy arrangements so that all cross-border transactions currently settled in US dollars can have the option to be settled in RMB also. This in turn could be followed by the continued relaxation of cross-border flows of RMB into and out of Mainland China along with the liberalisation of China’s capital account. The relaxation of capital account restrictions, the expansion of the offshore RMB market, and an increase in the financial depth of the onshore markets can be mutually reinforcing and beneficial to the growth of the offshore RMB market.

Intermediation among non-residents

The third set of characteristics involves the provision of intermediation among non-residents.

The Eurodollar market provides efficient intermediation among non-residents. For example, it allows for Eurodollar bonds to be issued by non-US entities and bought by non-US investors.

To an increasing extent, the offshore RMB market is functioning as a platform for RMB financial activities conducted by non-residents. The pool of RMB deposits in Hong Kong, being deposits of mainly non-Mainland individuals and corporates, is exceeding RMB 800 billion. Adding to that is the dim sum bond market, which has a size of RMB 260 billion at present. Offshore RMB bonds are being issued by Mainland Chinese entities as well as multinationals, and they are being bought by offshore investors. At the same time, banks in Hong Kong are extending RMB loans to customers, with the outstanding amount of such RMB loans currently stands at close to RMB90 billion.

As the market deepens and a greater variety of RMB products become available offshore, we will eventually see more RMB intermediation within the offshore markets, especially as non-Chinese residents become willing borrowers of RMB. However, for that to happen, work on different fronts needs to be pursued and market efficiency furthered through innovative solutions and active participation by different market players. I anticipate this could play out in three dimensions:

- First, there will be a need to facilitate the further development of the RMB banking market so that offshore RMB liquidity can be efficiently allocated, which would enable banks in need of RMB to easily obtain it from banks with surplus liquidity. We can already see the market moving in this direction as banks begin to diversify and expand their RMB assets progressively. Meanwhile, the introduction of a cross-border collateral management arrangement opens an efficient channel for financial institutions to widen their liquidity sources and obtain offshore RMB liquidity from Hong Kong, using even non-RMB papers for repos.
- Second, there will also be a need to facilitate the development of RMB capital markets. On this front, Hong Kong's dim sum bond market has shown encouraging development. Already, multilateral companies and international financial institutions such as the World Bank and the Asian Development Bank have tapped the dim sum bond market. For the market to develop further, there will be a need to continue to broaden the participation of both issuers and investors. Additionally, the tenor and variety of debt instruments will need to increase to meet the financing requirements of different issuers while satisfying the appetites of different investors. There has been repeated RMB sovereign bond issuance by the Ministry of Finance and more regular issuance in due course will help to gradually build a benchmark yield curve. In the meantime, I am pleased to note that the first RMB equity securities have been listed on the Hong Kong Stock Exchange.
- Third, there will also be a need to enhance the price discovery process and related market infrastructure for RMB transactions. This will mean introducing the necessary benchmarks for RMB transactions in the offshore market, including an exchange rate fixing, interest rate fixing and various kinds of benchmarks for RMB investments. The Treasury Markets Association introduced spot USD/CNH fixing in June 2011, and they recently announced the June 2013 launch of CNH HIBOR fixing. This welcome development will provide a reliable benchmark to price loan facilities and facilitate the development of the offshore RMB interest rate swap market.

Global hubs and linkages

The fourth and final characteristic – the presence of a network of global hubs and linkages – is especially apt for all of us in this room today as we consider Hong Kong's role in the nascent offshore RMB market.

The Eurodollar market, which originated in London, is made up of different hubs connected by extensive links. London remains a major centre, while other hubs serve other time zones and networks, and together they form an integrated whole through the free flow of funds.

In 2004, Hong Kong was the first offshore market to launch RMB business, and since then it has provided an efficient and reliable settlement platform from which trade settlement is conducted, RMB liquidity built up, financing activities arranged and a wide range of RMB products developed.

As the RMB becomes more widely used internationally, other markets that complement Hong Kong's central role are emerging around the world. Cooperation between these different markets is conducive to growing the whole market, and we are seeing increasing linkages being set up to facilitate the flow of funds between the markets.

These increasing linkages are the result of several encouraging trends, including the fact that financial institutions in different financial centres have strengthened their business networks in order to serve customers' RMB needs. For instance, the operating hours of Hong Kong's RMB Real Time Gross Settlement system have been lengthened, providing the capability to serve the settlement of offshore transactions in the European timezone and early business hours in North America. We at the HKMA are also conducting a range of outreach activities to strengthen Hong Kong's RMB business links with other parts of the world. These include conducting roadshows to showcase Hong Kong as the offshore RMB business centre, as well as facilitating private sector-led forums and dialogue meetings with authorities in Australia and London. These and other initiatives have encouraged actions to enhance various financial services, including RMB liquidity management and settlement arrangements, between markets in different parts of the world.

Concluding remarks

As I mentioned at the outset, I had the privilege of delivering the keynote address at last year's Global Offshore RMB Funding Forum as well. In my remarks of a year ago, I mentioned that we are at a period of historic transition with regard to the development of the offshore RMB market.

Looking at the development of the Eurodollar and offshore RMB markets side-by-side, as we just did, gives us a unique perspective on how things might play out in the long run. Indeed, as the offshore RMB market reaches maturity, there will no doubt be volumes of literature written by financial historians that compare the birth and development of these two markets.

While developments so far have been encouraging, we are still at the initial phase of RMB offshore market development. The policy headroom to develop RMB business is already present, and we at the HKMA will continue to provide a safe and efficient financial infrastructure for the conduct of RMB offshore activities. But the most important of all, I would encourage businesses and financial institutions to make full use of such opportunities already available and promote the development of a wide range of RMB services and financial products. Forums like this one help us prepare for the future by examining what has transpired, making comparisons and exploring business opportunities and collaborative initiatives.

I am eager to work together with all of you in shaping what is to come.

Thank you.