

Norman T L Chan: What does it take to develop a Global Offshore RMB Hub?

Speech by Mr Norman T L Chan, Chief Executive of the Hong Kong Monetary Authority, at the Treasury Markets Summit 2014, Hong Kong, 15 September 2014.

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1. A very warm welcome to all of you to this year's Treasury Markets Summit.
2. The theme of today's Summit is: "Development of Hong Kong as the Offshore Renminbi Hub". This is indeed a very timely topic as we have just marked the 5th anniversary of the launch of the pilot scheme for the use of renminbi (RMB) in cross-border trade transactions in the summer of 2009. We of course started the RMB banking business back in 2004, but until 2009 our business was restricted to the development of personal accounts for Hong Kong residents and use of credit cards. The major milestone was clearly the start of offshore RMB trade settlement and other businesses for corporates five years ago.
3. So what have we accomplished in the last five years? It is probably fair to say that very few of us could have envisaged the rapid progress that we have achieved in turning Hong Kong into the global offshore RMB business hub in such a short time. In terms of deposits, including Certificate of Deposit (CDs), we have grown from around RMB90 billion in end-June 2010 by nearly twelve times to RMB1.1 trillion now, which makes us the largest offshore RMB liquidity pool in the world. In trade settlement, Hong Kong banks handled a phenomenal amount of RMB2.9 trillion in the first half of 2014, as compared to the total amount of Mainland's external trade settled in RMB of RMB3.3 trillion in the same period. Hong Kong has also become the largest issuance hub of offshore RMB bonds or Dim Sum bonds, with a total of 93 issuances in the first six months of this year, amounting to RMB130 billion in value. The total amount of outstanding RMB bonds issued in Hong Kong amounted to RMB380 billion at end-June this year. In addition, the forex and financial derivative markets for RMB have grown steadily over these few years, which, according to SWIFT, have raised RMB from the 20th position of the most used payment currency to the 7th position lately. Most strikingly, the value of payments that go through our RMB Real Time Gross Settlement system has registered a phenomenal growth, reaching an average of around RMB700 billion each working day.
4. I won't bore you further with the numbers as I am sure you are very familiar with them. Surely it is useful for us to pause, look back, take stock and try to think of ways in which we can continue to excel as we go forward from where we are. So without further ado, let me quickly turn to the main theme of my remarks this morning: "What does it take to build a successful global hub for offshore RMB businesses?" The key to success, if I may summarise it, lies in the acronym: "PIPs".
5. "PIPs" stands for "Policy Headroom, Infrastructure and People/Products". Let me cover these three elements in the reverse order. For People and Products, I have said many times that for any financial centre to thrive and out-compete other centres, the crucial building block would be its people and products. It goes without saying that a world class financial centre must have the right people designing and distributing the right products that serve the needs of the financial consumers. This is an important and core component of the soft power that I have been talking about in the last few years. It is a key attribute that differentiates a global hub from the other financial centres. People and Products fall into the area in which the financial industry, including the individual firms, practitioners and industry bodies like the TMA, can and should play a dominant role. I am sure that you will agree with me

that policy makers and regulators, while having the responsibility to safeguard financial stability and to accord appropriate protection to financial consumers, are not really well suited to get too involved in gauging market demand and designing financial products that would best meet the requirements of the consumers.

6. Having said that, policy makers and regulators do have a crucial role to play in respect of Policy Headroom and Infrastructure, which are the first two elements of “PIPs”. Let me elaborate further.
7. Clearly there could not be any offshore RMB markets if the Mainland did not make a move in 2009 to change its policy of not allowing the use of RMB in cross-border trade and other transactions. But of course, the Mainland authorities were and still are understandably wanting to open up the capital account on an incremental basis, taking one step at a time. When one looks back at the last five years, the scope and breadth of the cross-border flow of RMB have been progressively and steadily expanded. While we have come a long way from 2009 and there have been many policy changes in this period that help the offshore market to move forward, I would like to highlight four major milestones of policy headroom expansion that made it possible for the incremental development of RMB markets offshore. The first one is the RMB trade settlement pilot scheme I mentioned at the beginning. Then comes the relaxation in the use of RMB for foreign direct investments into the Mainland and outward direct investments by Mainland corporates starting in 2011. Then channels for RMB portfolio investment flows have also been created, such as the RMB Qualified Foreign Institutional Investors (RQFII) scheme, so that offshore investors can invest in the onshore bond and equity markets. The fourth and most recent milestone is the Shanghai-Hong Kong Stock Connect Programme, which will enable Hong Kong and overseas investors to invest in A-shares listed in Shanghai through Hong Kong, and Mainland investors to invest in Hong Kong shares through Shanghai. This marks a significant step in the liberalisation of the Mainland’s capital account, and will increase the flows of RMB between the onshore and offshore markets and propel the development of offshore RMB business in Hong Kong to new highs. As far as the HKMA is concerned, we have used our best endeavours to work with the People’s Bank of China (PBoC) and other relevant Mainland authorities to continually expand the policy headroom that would enable Hong Kong to continue to thrive as the global hub for offshore RMB businesses.
8. Lastly, let me turn to the second element of the key to success in developing into a global offshore RMB hub, i.e. market infrastructure. I can think of four key components: (i) efficient clearing and settlement systems, (ii) robust and yet market friendly regulatory regime, (iii) financial benchmarks (such as CNH fixings) and (iv) liquidity. In the interest of time, I would skip the first three components and just focus on the fourth. As we all appreciate, in terms of financial market development, liquidity is essential. We also know that liquidity breeds further liquidity. Without ample market liquidity, it is hard for any financial centre to flourish or maintain a competitive edge. We of course are acutely aware of the importance of promoting market liquidity, especially in the early stages of our development of the CNH market. It was against this background that the HKMA has all along taken a proactive approach in seeking to strengthen the liquidity of the CNH market in Hong Kong. In June 2012, the HKMA launched a Repo facility to provide one-week funds for banks in Hong Kong as a backstop to facilitate banks’ liquidity management. However, the facility was for T+2 settlement and did not fully address the needs of the banks. In order to assist bank treasurers to better manage their liquidity, the HKMA shortened the settlement of the repo to T+1 in January 2013 and again to T+0 in July 2013.
9. Today, I am pleased to announce that, in preparation for the imminent launch of the Shanghai-Hong Kong Stock Connect, the HKMA will implement two additional

measures as backstop facility to assist banks in Hong Kong in managing their RMB liquidity:

- (a) In addition to what the BoC HK, as the RMB Clearing Bank, is providing to the Participating Banks through intraday overdraft, the HKMA will provide an intraday Repo facility of up to RMB10 bn to banks in Hong Kong. The HKMA will charge a fee, based on the actual time used during the day, for the use of the facility. The purpose of the HKMA intraday liquidity facility is to promote more efficient RMB payment flows between banks; and
- (b) The HKMA will also designate a number of banks active in the CNH market as Primary Liquidity Providers (PLPs). Banks that are designated as PLPs are committed to using and developing Hong Kong as the global platform for supporting their offshore RMB businesses. They are also committed to expanding their market-making activities in CNH market. In return, the HKMA will offer a repo line to each of the PLPs so as to facilitate more efficient liquidity management when they carry out market-making and other business activities in the CNH market. This bilateral repo line can be used by the PLPs as intraday or overnight liquidity management purposes. The HKMA is now finalising the list of PLPs and the necessary documentation. We hope to be able to announce the list of PLPs very shortly.

10. Ladies and gentlemen, let me conclude by saying that the competitive edge of a successful financial centre depends crucially on its soft powers, not just on hard infrastructure. Hong Kong is uniquely well positioned to take advantage and play a pivotal role in the new era of China's growth story and in the internationalisation of RMB. Hong Kong enjoys both first-mover advantages as well as many irreplaceable structural advantages, given Hong Kong's very close links with the Mainland in trade, investment and finance under the "One Country, Two Systems" principle. However, there is absolutely no room for complacency. As this new era of RMB internationalisation has just begun, we still have a long, long way to go as the offshore RMB markets continue to grow and mature, while the capital account controls in Mainland China are being gradually relaxed or lifted. In the early stages of this new era, the primary task of Hong Kong is to develop the CNH market and at the same time work with other financial centres such as Sydney, London or Paris to grow the pie, leading to win-win outcomes. As we move into the more mature stages of the internationalisation of RMB, the available policy headroom should be quite ample for the markets to flourish. At that time, the ^{2nd} and ^{3rd} elements of PIPs, i.e. Infrastructure and People/Products, would matter a great deal more if Hong Kong wishes to retain its competitive edge over the others. It will be up to our industry, financial firms and market practitioners to out compete the other centres in terms of product innovation and distribution of various financial products and services that best serve the needs of their clients. I am sure that the TMA, with the support of its members and the financial industry, will continue to play a leading role in developing the professionalism of the practitioners and in facilitating product innovation. Thank you.



What has changed in 5 years?

HK as offshore RMB Hub

	RMB (bn)		
	1H 2010	1H 2014	
Deposits (incl. Certificate of Deposit) as at end of half year	90	1,125	12 times
Trade Settlement Handled by Hong Kong Banks Total amount during half year	27	2,926	107 times
Bonds Issuance (Outstanding) as at end of half year	30	384	12 times
RTGS Average daily turnover	0.7	692	988 times



What does it take to develop a Global Offshore RMB Hub?

PIPS

Policy Headroom

Infrastructure

People & Products



Offshore RMB Markets

Major Milestones



2011

- Permission to use RMB for FDI and ODI

2011

- Launch of RMB Qualified Foreign Institutional Investors (RQFII) Scheme

2014

- Approval of Shanghai-Hong Kong Stock Connect Programme



Essential Financial Market Infrastructure

Clearing and Settlement Systems

- RTGS
- PVP
- CMU

Regulatory Environment

- Robust yet market friendly

Financial Benchmark

- CNH FX / Interest Rate Fixing

Liquidity



HKMA's Measure to Support Liquidity in CNH Market

Intraday Liquidity

**Repo Facility
Up to RMB10 bn**

Repo Facility

T+2 *Jun 2012*

T+1 *Jan 2013*

T+0 *Jul 2013*

**Primary Liquidity
Providers (PLPs)**

- To help make market and provide liquidity in CNH markets
- HKMA provides a bilateral Repo facility to each PLP