

Eddie Yue: Renminbi – a new era and the role of Hong Kong

Keynote address by Mr Eddie Yue, Deputy Chief Executive of the Hong Kong Monetary Authority, at the Global Offshore RMB Funding Forum 2012, Hong Kong, 23 May 2012.

* * *

Tony (Shale), Mark (Johnson), Distinguished Guests, Ladies and Gentlemen,

Thank you for being here this morning, and thanks to Euromoney for inviting me to speak at this “Global Offshore RMB Funding Forum”. It’s indeed an honour to have this opportunity to discuss this important topic in such distinguished company.

I understand that we will have a very comprehensive programme today, with editors, economists, bankers and financiers talking about the exciting developments of dim-sum bonds and other innovative products in the offshore RMB markets. By way of opening the dialogue, I’d like to focus my remarks on the bigger picture, and on three things in particular:

- First, the scale of change in the global economy, which is the backdrop for our discussion;
- Second, the expanding role of the RMB, past and future; and
- Third, the impact this all has on our role and opportunities here in Hong Kong.

China’s increasing integration with and contribution to the world economy

So, first, the scale of change. The foundation for any discussion on the role of the RMB, of course, is China’s growing economy. Now, we’ve all become very familiar with breathless reports on China’s “economic miracle,” so I won’t go over this at length. Still, the startling pace of growth does warrant underlining. In a little over a decade since the year 2000, the Mainland’s nominal GDP increased sixfold from 1.2 to 7.2 trillion US dollars; and its external trade expanded more than sevenfold, from less than 500 billion to over 3.6 trillion US dollars. At the same time, its cross-border direct investments rose fourfold, from just over 40 billion to approaching 180 billion US dollars. These are all impressive indicators of the vast amount of business opportunities present. It is perhaps even more astonishing that, by 2016, the Mainland is expected to contribute over a third of total world economic growth, according to the projections of the International Monetary Fund.

Change in the international financial system

Such shifts in the global economy have inevitably foreshadowed a change in the international financial system. As the Mainland economy has grown, its currency and financial sector have moved increasingly centre-stage. Over the last decade or so, policymakers, investors and others have shown more interest in using a greater mix of currencies for international trade and financial transactions. This trend has been accelerated by the recent Global Financial Crisis, as the need to reduce reliance on just one or two global currencies has grown.

Taken together, these trends imply a greater role for the RMB in the Mainland’s trade and investment with the rest of the world. Likewise, they suggest a much wider use and circulation of RMB in the international financial system.

Renminbi internationalisation: From where to where?

So let us now turn to this issue, and my second point – the expanding role of the RMB. The big question I’m often asked is how the wider use and eventual internationalisation of the

RMB is to unfold. This question is, of course, easier to ask than to answer. But I believe we can gain useful insights by taking some perspective on where we are now and how we arrived here.

How it started?

Given the pace of change, it is sobering to recall that it wasn't until 2009 – not all that long ago – that the Mainland authorities started to allow Mainland corporations to use the RMB when trading with the rest of the world.

- The first step was the launch of a pilot scheme in July 2009 allowing corporations in five Mainland cities to settle their trade with Hong Kong, Macau and ASEAN economies, in RMB. This pilot was subsequently expanded progressively. Today, all trade transactions between Mainland China and the rest of the world have the option to be settled in RMB.
- Another major milestone was reached in 2011, when the Mainland authorities began to liberalise the use of RMB for inward and outward direct investments. In addition, pilot arrangements were introduced allowing offshore entities to use RMB to invest in the interbank bond market and the Mainland stock market.
- A longer-term factor is China's 12th Five-Year Plan, which was released in March last year. The Plan made clear that the wider use of RMB in cross-border transactions will be promoted as a matter of national policy.

Where we are now?

Taken together, those steps mean that the use of RMB for trade is today largely liberalised. Let me just illustrate that with a few figures:

- In 2011, some RMB 2 trillion yuan, or 8% of the Mainland's external trade and current account transactions, were settled in RMB.
- The use of RMB for direct investments has also seen an encouraging start, amounting to some RMB 90 billion yuan for inward direct investments and RMB 20 billion yuan for outward direct investments in 2011.
- As for portfolio investments, some 40 offshore institutions have been allowed to invest in the interbank bond market, within varying quotas. Meanwhile, some RMB 20 billion yuan have been invested in the stock market through the RMB Qualified Foreign Institutional Investor (QFII) scheme.

As of course you know, over this period of liberalisation, a rapidly growing offshore RMB market has also emerged, centred in Hong Kong. The rising level of RMB trade flows to and from the Mainland has produced an expanding pool of RMB liquidity. And the growing liquidity in the offshore RMB market has led to the development of RMB financing and forex markets, with an estimated daily turnover of around 2 to 4 billion US dollars for spot and forward transactions. I will come back to the development of Hong Kong as the offshore RMB business centre later.

So, we are seeing a trend that RMB is increasingly used in Mainland China's external trade, followed by direct investments and portfolio investments. The offshore RMB market is growing with increasing breath and depth, serving the useful function of the intermediation of RMB funds. And these developments are bringing tremendous business opportunities, which corporations and financial institutions cannot ignore.

What next?

Now, it's worth emphasising that this has all taken place only since 2009. So, they are very much just first steps and we should expect further developments in the future. If we look ahead a little, what might we see?

Well, given what we've seen in terms of economic growth and liberalisation of policy, it would not be at all surprising to see the proportion of trade being conducted in RMB continue to rise in years ahead.

Longer term, many ask about the possibility of the RMB playing a more equal role alongside the dollar and the euro. On this, I would point out that the more widespread use of RMB has been a progressive and market-driven process, and I expect this to continue. I believe that, whilst liberalisation is important, the RMB becoming an international currency to a large extent is not a matter of policy alone – it is also subject to market forces. In other words, it would come from non-resident corporations and financial institutions deciding that the RMB served them well as a unit of account, means of payment and store of value for their international transactions.

I'm not sure any of us are in a position to predict if and when this will happen. However, I feel that we can say with some confidence that the landscape of the offshore RMB market will change in two respects.

First, we are likely to see the increasing maturity of the offshore RMB market, both in terms of the depth and breadth of the market and the efficiency of price-setting and allocation of RMB funds. In more granular terms, this means we will see an expansion and greater diversity of RMB financial activities:

- Up till now, the intermediation of RMB funds has been primarily about placement of bank deposits by personal and corporate customers. In future, it will move more towards issuance and investment of bonds and a wider range of other financial instrument and products.
- At the same time, I would expect that in future there will be more active borrowing and lending of RMB funds among banks. If so, this would lead to the emergence of a RMB interbank funding market.
- In addition, I would expect to see increased RMB trading in the forex market, which in turn should lead to the development of more sophisticated instruments.

The second change to offshore RMB markets we can confidently expect is the further development and strengthening of links with the onshore RMB market. As a critical piece of infrastructure that supports the internationalisation of RMB, the offshore RMB market cannot operate in isolation. Given continued liberalisation of cross-border RMB transactions by the Mainland authorities, we will see more and wider channels for the flow of RMB between the onshore and offshore RMB markets. This will be critical for the sustainable development of the offshore RMB market and, thus, the future role of Hong Kong.

Role of Hong Kong

And this brings me now to my third point, the development of Hong Kong as the offshore RMB business centre.

Let me start by saying that Hong Kong's role is not an accident or a result of chance. It stems from our city's historical and indispensable role facilitating the opening up of the Mainland economy. Since China's liberalisation and reform began three decades ago, Hong Kong has served as the global gateway for trade and investment with the Mainland. Even to this day, Hong Kong still intermediates some 30% of the Mainland's external trade and accounts for some 60% of cross-border direct investments in both directions. Against this backdrop, Hong

Kong is well-placed to serve as a key commercial and financial gateway, continuing to facilitate trade as it expands and is increasingly conducted in RMB.

Through its long history as an international financial centre, Hong Kong has built up the necessary infrastructure to support a growing RMB market. Indeed, Hong Kong has been steadily gearing up its capability to handle RMB servicing since it started back in 2004. This is what has enabled Hong Kong to become a global hub for offshore RMB businesses. Hong Kong today provides the largest and most effective platform for the complete range of RMB transactions, from banking and financing to asset management, at both customer and wholesale levels.

Just to give an illustration of Hong Kong's status as a global RMB hub, consider its recent record:

- RMB deposits in Hong Kong, including Certificates of Deposits, grew by a factor of ten between end-2009 and March 2012, from around RMB 60 billion to over RMB 660 billion yuan.
- RMB trade settlement transactions handled by banks in Hong Kong has also increased phenomenally, from less than RMB 2 billion yuan in 2009 to nearly RMB 2 trillion yuan in 2011.
- Over the same two-year period, the Hong Kong RMB dim-sum bond market has seen issuances growing from RMB 16 billion to RMB 108 billion yuan. I know many of you have come here today to hear more about how to tap into this rapidly developing market to finance your business in the future.

Now of course, as a global hub, it does not mean that all offshore RMB businesses are to be conducted only in Hong Kong. Quite the contrary. As RMB becomes more widely used and accepted by trading companies and investors worldwide, it is natural to see financial institutions providing RMB services to meet the demand of their customers.

That said, even as its role evolves over time in line with market changes, we do see Hong Kong continuing to be an ideal place for companies to conduct their RMB banking and financing activities. In addition, Hong Kong will develop its ability as a RMB hub to serve a growing network of financial institutions around the world.

And in this last respect we are seeing real signs of development. More foreign banks are either choosing to have a base in Hong Kong or are using RMB correspondent banking services provided by banks in Hong Kong. As of the end of March 2012, there were close to 200 banks participating in Hong Kong's RMB clearing platform. Of these, 170 are foreign-owned or located overseas. At the same time, over 1,100 RMB correspondent accounts were maintained by overseas banks with banks in Hong Kong. The amount due to and due from such overseas banks amounted to RMB 128 billion yuan and RMB 146 billion yuan respectively, a clear indication that banks from around the world are using the robust platform and large liquidity pool to offer RMB services to their customers at home.

Looking ahead, we in Hong Kong will seek to broaden and deepen our offshore RMB market further, by enhancing our RMB infrastructure and encouraging participation. In doing so, we will continue to cooperate with other places along the way. From the end of next month, the operating hours of our RMB Real Time Gross Settlement system will be lengthened to 11:30 pm Hong Kong time, giving financial institutions in different parts of the world an extended window to settle offshore RMB payments through the Hong Kong infrastructure. Moreover, the Hong Kong – London Forum for promoting cooperation on the development of offshore RMB business just convened its first meeting yesterday. I am very pleased to note that the group had a very productive discussion, with concrete joint action plans set forth for enhancing offshore RMB market activities in both places. Meanwhile, we at the HKMA will also be continuing our efforts to raise awareness about the developments of offshore RMB businesses and the comprehensive services provided by Hong Kong in this regard.

Concluding remarks

So, as I prepare to hand back to Mark (Johnson) for the panel discussion, I would just like to underline my points by summing them up very succinctly:

- First, I would say that, given the scale and the pace of change I mentioned earlier, we are now at the start of a new era. An era in which we will see a much greater use of RMB, driven by both policy and market forces.
- Second, we are only in the early days. The RMB started circulating outside Mainland China only in recent years, but is already starting to play a significant role in global trade and finance. It has the potential to go much further.
- Third, as the RMB develops a more central role and acquires more features associated with an international currency, Hong Kong is very well equipped to service the RMB needs of businesses around the world.

Let me just finally say that today's forum is a most welcome opportunity to help prepare for the future. As at any time of historic transition, if none of us have all the answers, then at least each of us has a piece of the answers; and if we don't have that, then perhaps we can contribute a better question.

I look forward to hearing your ideas and to working closely with you in our common effort to develop the offshore RMB market in the future.