Press release

LCQ3: Development of Hong Kong as an offshore Renminbi business centre

Wednesday, January 12, 2011

Following is a question by the Hon Jeffrey Lam and a reply by the Secretary for Financial Services and the Treasury, Professor K C Chan, in the Legislative Council today (January 12):

Question:

In late October 2010, the Hong Kong Monetary Authority suddenly announced that the annual quota of eight billion Renminbi (RMB) yuan for conversion of RMB of the Bank of China (Hong Kong) Limited, which is the sole Clearing Bank for RMB Business in Hong Kong, has been fully depleted, and individual banks need to make use of their own positions to settle trade transactions for customers. In this connection, will the Government inform this Council:

(a) whether the authorities will discuss with the People's Bank of China the review of and increase in the annual quota for RMB conversion, and propose to include other financial institutions in the list of Clearing Banks for RMB Business, so as to further strengthen Hong Kong's role as an offshore RMB centre;

(b) given that it has been reported that with the continuous growth in RMB trade settlement, coupled with the anticipated appreciation of RMB, the volume of RMB funds have been accumulating in overseas markets, whether the authorities will expedite the issue of RMB stocks in Hong Kong and urge the central authorities to expedite the launch of the small-scale Qualified Foreign Institutional Investors Scheme to make Hong Kong a platform to pool overseas RMB funds; and

(c) given that the United States (US) has continued to adopt monetary easing policies and the RMB exchange rate has been hitting new highs, resulting in continuous inflow of hot money into Hong Kong and further aggravation of inflation, whether the Government will review its existing monetary relations with the State and US?

Reply:

President,

My reply to the three parts of the question is as follows:

(a) Following the substantial expansion of the geographical coverage of the cross-border RMB trade settlement scheme in June last 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 2010 to about RMB 30 billion each month in August and September, and then to RMB 68 billion in October. Under such circumstances, the amount of RMB purchased for trade settlement purpose by participating banks through the Clearing Bank in the China Foreign Exchange Trading System in Shanghai increased notably in October, resulting in the suspension of the conversion arrangement concerned in late October. In response, the Hong Kong Monetary Authority (HKMA) promptly introduced a number of measures, and the RMB market in Hong Kong has been operating orderly and smoothly.

As cross-border trade settlement in RMB expands and deepens, RMB payments from the Mainland to Hong Kong will continue to increase and funds so accumulated will become the major source of supply in the local RMB market. For the first 11 months in 2010, cross-border trade payment from the Mainland to Hong Kong amounted to RMB 180 billion while payments from Hong Kong to the Mainland amounted to RMB 50 billion. In other words, the net inflow into Hong Kong was about RMB 130 billion, which was much larger than the amount of RMB 10 billion funds purchased in Shanghai through the Clearing Bank by participating banks during the same period. Under such circumstances, RMB deposits in Hong Kong increased steadily to about RMB 280 billion at end November last year. Hence, the pool of offshore RMB funds in Hong Kong has reached a level that is adequate to meet the demand from local firms. In other words, the conversion window in Shanghai is a supplementary rather than the main source of conversion for RMB trade settlement.

Taking into account developments in the Hong Kong RMB market since last October, the HKMA discussed with the People's Bank of China (PBoC) and considered refinements to the arrangements for the conversion of RMB in relation to cross-border trade settlement, and a circular was issued on December 23, 2010 to participating banks in this regard. To maintain a steady supply of RMB, the HKMA clarified the arrangement for the conversion of RMB conducted by participating banks through the Clearing Bank in Shanghai, and at the same time, RMB 20 billion will be provided by the HKMA as a standing arrangement for cross-border trade settlements through its currency swap arrangement with the PBoC. The HKMA and the PBoC estimated that, after implementation of the refinements, the demand for RMB conversion in Shanghai by participating banks would be within RMB 4 billion in the first quarter of 2011. The volume of conversion will be assessed after the first quarter.

As the current arrangement of Clearing Bank has been operating smoothly, we do not consider that there is a need for making significant changes. The arrangement of having one RMB Clearing Bank is the same as the arrangements for the US dollar and Euro Real Time Gross Settlement (RTGS) systems in Hong Kong, each of which has only one settlement institution. As regards the issue of credit limits raised by the banking industry earlier (which arose from the increasing amount of RMB deposits being placed by participating banks with the Clearing Bank as RMB business in Hong Kong continued to expand and deepen), the HKMA and PBoC have discussed and considered that the issue can in principle be resolved by participating banks establishing custodian accounts with the Clearing Bank. The HKMA is in discussions with the PBoC, the Clearing Bank and participating banks on the details of such an arrangement including the related legal documents and operational procedures. It is hoped that the arrangement can be implemented as soon as early this year.

(b) With the support from the Central Government and the relevant Mainland authorities, there was good development of offshore RMB business in Hong Kong in 2010. RMB financing activities became more active, especially after the expansion of the RMB trade settlement scheme in June and the amendment to the RMB Clearing Agreement in July 2010. The amount of RMB bonds issued in 2010 exceeded RMB 30 billion, with issuers including local and multinational firms as well as international financial institutions such as the Asian Development Bank. Meanwhile, banks and financial institutions in Hong Kong also launched a wide range of RMB denominated financial products. In terms of clearing infrastructure, the RMB RTGS system in Hong Kong is ready to handle the clearing and settlement for such transactions. Whether to raise funds in RMB through initial public offerings will be a commercial decision for individual firms, taking into consideration of their own circumstances and market conditions.

The market infrastructure (including the trading and clearing platforms operated by the Hong Kong Exchanges and Clearing Limited (HKEx), and the interbank clearing platform operated by Hong Kong Interbank Clearing Limited) are ready to support the listing, trading and clearing of RMB stocks. The existing rules and regulations have already provided for the listing of RMB stocks. In fact, there are RMB products listed on HKEx. Fully capitalising opportunities arising from the development of RMB business has already been incorporated into HKEx Strategic Plan 2010-12.

There is no concrete timetable as regards the launching of the measure of using RMB funds in Hong Kong to invest in Mainland securities market (also known as "Mini-QFII"). We will maintain close communication with the Mainland regulatory authorities on the early implementation of the measure.

(c) The Linked Exchange Rate System (LERS) has served Hong Kong well since its establishment in 1983. It is the pillar of Hong Kong's monetary and financial stability. The Hong Kong Special Administrative Region Government has no intention to change it.

Given the small and externally-oriented nature of the Hong Kong economy and its role as an international trade and financial centre, maintaining exchange rate stability against the US dollar, which is still the most commonly used currency for conducting international trade and financial transactions, remains the most appropriate monetary policy for Hong Kong.

There is no evidence that the LERS is driving up inflation in Hong Kong. In fact, in terms of inflation, Hong Kong compares well with other Asian economies that operate more flexible exchange rate and interest rate regimes.

In the meantime, we do not agree to the suggestion of linking Hong Kong dollar to RMB now. Hong Kong dollar can be linked to RMB only when certain important, fundamental conditions are met, including that RMB must be freely convertible, the capital account control must be removed by Mainland China, the financial and asset markets in Mainland China should be wide, deep and liquid enough, etc. These fundamental conditions have not yet been fulfilled at the moment.

Ends