



## An Analysis on the Latest Developments and Comparative Advantages of Offshore RMB Centers

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Recently, London and the Chinese government have signed a Memorandum of Understanding on RMB clearing and settlement, and offshore RMB businesses in Europe are growing steadily. According to the latest Global Financial Centers Index (GFCI) compiled by Z/Yen, a well-known London based Group, London, Hong Kong and Singapore were ranked as the second, third, and fourth global financial centers respectively. As top-tier international global financial centers, Hong Kong, London and Singapore have similar advantages in developing offshore RMB businesses, such as favorable time-zones, robust legal systems, free capital flow, relatively low tax rates and English language backgrounds etc. Meanwhile, these three financial centers also have their unique comparative advantages in developing offshore RMB businesses.

### I. Comparative advantages of Hong Kong

Hong Kong is the largest offshore RMB center. It provides wholesale business functions thanks to the following comparative advantages.

#### **1. Geographical location advantage with close proximity to onshore RMB market.**

Geographically, Hong Kong is near the mainland market and next to Guangdong province. As a result, Hong Kong has a first-mover advantage in business cooperation with the mainland. Firstly, there is close bilateral trade between Hong Kong and the mainland. According to statistics from the General Administration of Customs of the People's Republic of China, total bilateral trade amounted to USD 401 billion between Hong Kong and the mainland in 2013. Secondly, Hong Kong is the greatest source of the mainland's foreign direct investment and vice versa. According to the Ministry of Commerce, the accumulated investments from Hong Kong-based companies amounted to USD 673.16 billion as of January 2014, which accounted for 47.8% of the total accumulated foreign direct investment amount. Thirdly, due to the Individual Visit Scheme, mainland visitor arrivals reached 40.73 million in 2013, accounting for 75% of total visitors. Such considerable cross-border mobility of business, investment and people provides a strong foundation of developing RMB businesses in Hong Kong. A huge RMB capital pool was established through import settlements, currency exchange from Hong Kong residents and RMB outward direct investment etc. At the end of 2013, the RMB capital pool amounted to

RMB 1,053 billion (RMB deposit plus certificate of deposit), which accounted for about 70% of total offshore capital.

**2. First-mover advantage in developing offshore RMB businesses.** Hong Kong has 10-year experience and good foundation of developing offshore RMB businesses. It has developed advantages in market scale, depth and width. Firstly, the potential as a RMB financing center kept growing. Dim sum bonds issued amounted to RMB 112.2 billion in 2012 and RMB116 billion in 2013. Outstanding amount was RMB 309.2 billion at the end of 2013. Secondly, Hong Kong accounted for 70% of global offshore RMB settlement. Thirdly, the RQFII quota for Hong Kong amounted to RMB 270 billion. For the time being, the approvals of 57 institutions and the accumulated amount of RMB 167.8 billion were mostly from Hong Kong. Fourthly, RMB is widely recognized and well received in Hong Kong. As of November 2013, the number of personal RMB accounts for Hong Kong residents was 4.05 million, with personal deposit amounting to RMB 245.4 billion. Assuming 4 accounts per person, more than 1 million people have RMB accounts. The less developed RMB loan outstanding was growing rapidly and amounted to RMB 109.7 billion at the end of 2013. There is a greater variety of RMB investment products in Hong Kong compared with other offshore markets. If the RMB 20,000 daily currency exchange limit is relaxed within this year, demand for RMB products in Hong Kong will be further stimulated.

**3. Advantage of "One Country, Two Systems".** During Hong Kong's development of offshore RMB businesses in the past 10 years, Hong Kong often acted as the pilot zone of new policy launches. If successful, the policies were then further promoted to other offshore centers. This is manifested by Hong Kong's journey in becoming an offshore RMB clearing center. In November 2003, the State Council allowed Hong Kong to launch personal RMB businesses. Afterwards, the "Clearing Arrangement" appointed Bank of China (Hong Kong) as the clearing bank, and offshore RMB clearing function were then established. The People's Bank of China (PBOC) made several amendments on the "Clearing Arrangement" in July 2010. Moreover, the PBOC introduced custodian accounts in 2011 to solve counterparty risk problem. At the end of 2013, there were 210 participating banks in Hong Kong. Average daily and aggregate clearing volume for the year was RMB 440.8 billion and RMB 80 trillion respectively. In contrast, the clearing volume for Singapore and Taiwan only amounts to several trillion RMB. Therefore, Hong Kong has an absolute advantage in RMB clearing business. This is mainly due to "One Country, Two Systems", where Hong Kong serves as a testing zone for RMB internationalization reform. However, neither London nor Singapore has such advantage or relationship with the mainland market.

**4. Advantage of having plenty of China-based financial institutions.** Compared with London and Singapore, the asset scale and functions of China-based financial institutions are much stronger in Hong Kong, and they have been major contributors of developing offshore RMB businesses. Firstly, the banking system is the strongest part of Hong Kong's

financial system. At the end of 2013, there were 156 licensed banks in Hong Kong. 70 out of the largest 100 banks around the globe have operations in Hong Kong. China-based banks expanded their businesses actively in recent years. For the time being, 20 licensed banks are China-based banks with aggregate asset size accounting for 26.9% of the total. With existing advantage of onshore RMB market, they expanded their RMB businesses in Hong Kong actively. Secondly, Hong Kong's stock market has developed considerable width and depth. Hong Kong is one of the top 3 global markets in terms of IPO amount. In terms of proportion of listed companies, aggregate market value of H shares and red chip shares accounts for more than half of total market cap. This indicates Hong Kong is a major offshore financing channel for mainland corporations. Thirdly, the size of asset management in Hong Kong amounts to USD 1,624 billion, the seventh largest in the world. For the time being, deposits in the mainland is over RMB 100 trillion, and official foreign currency reserve reached USD 3.82 trillion. Therefore, there is huge demand for overseas investment. If mutual recognition of funds between Hong Kong and the mainland materializes shortly, there will be lots of potential for asset management business in Hong Kong and the mainland. Fourthly, Hong Kong has a pool of financial professionals who know the mainland and global markets well.

**5. Advantage of leading RMB business financial infrastructure.** Hong Kong has developed a comprehensive settlement and clearing systems, including four Real Time Gross Settlement (RTGS) for handling HKD, USD, EUR and RMB, Central Clearing and Settlement System (CCASS) and Central Moneymarkets Unit (CMU) for debenture custodian settlement institution, which enables payment and settlement to operate at the same time in different major global financial centers. In terms of offshore RMB exchange rate and interest rate fixing, the Treasury Markets Association provides USD-CNH spot rate and CNH HIBOR fixing, which are the benchmarks for investors. It is foreseeable that pricing power will become the next focus of competition among different offshore RMB centers. Hong Kong is ahead of others in establishing offshore RMB pricing mechanism, which would help reinforce Hong Kong's leading position.

## **II. Comparative advantages of London**

According to the latest GFCI report, compared with the end of 2012, the scale of RMB foreign exchange transactions and RMB deposits in London grew 32% and 23% respectively as of 1H 2013. Many people believe that London will be a major competitor of Hong Kong in developing offshore RMB businesses. In addition to various market factors, London also has the following comparative advantages.

**1. Different time zone advantage and a major global clearing center.** London is in GMT+0 zone, while Hong Kong and Beijing are in GMT+8 zone. The time zone of London follows Asia and is ahead of North America. As a result, by providing RMB services in the Western hemisphere and complementing with Hong Kong's business, London is a critical

part of a 24-hour RMB business chain. In addition, London is the world's clearing center. Most international trading settlements take place in London. The British and Chinese governments have signed a Memorandum of Understanding on RMB clearing and settlement, and a clearing bank will be appointed in the near future. Once a clearing bank is ready, together with its existing time zone advantage, experienced clearing function and a large pool of professionals, the development of offshore RMB business in London will accelerate.

**2. Advantage of being the largest foreign exchange center in the world.** According to the triennial BIS Survey on Foreign Exchange published in September 2013, London retained its position as the largest foreign exchange center in the world as of April 2013. Global average daily foreign exchange transaction reached USD 5.3 trillion of which London accounted for 41%. Meanwhile, derivative trading in London accounted for 49% of global volume. In addition, the Quarterly Report published by the Bank of England in December 2013 showed that 215 non-financial institutions traded in London. Supported by its strong foreign exchange transaction function, trading in RMB surged. Statistics from GFCI showed that average daily deliverable and non-deliverable foreign exchange in RMB reached USD 15.6 billion and USD 22.3 billion respectively in 1H 2013, significantly more than those in other major financial centers. To conclude, boosted by its advantage as a foreign exchange center, London is actively developing offshore RMB businesses, especially in foreign exchange and investments.

**3. Advantage of relatively loose regulations on offshore foreign currency business.** As with common practice of Eurodollar business in London, the regulations on offshore business are relatively loose and encourage market to practice self-discipline. Loose regulations help reduce financing and transaction costs. Self-disciplined markets would help enhance the efficiency of capital allocation and pricing in the market. London may follow the relative loose regulation approach in developing offshore RMB businesses. In October 2013, British Chancellor of the Exchequer has reached a series of financial cooperation agreements with the Chinese government during his visit to China. This included accepting the applications from China-based banks with only wholesale business to set up branches in the UK. For the time being, Bank of China is the only China-based bank that has been granted a branch license in the UK. Others operate through subsidiaries. If the abovementioned agreement is implemented as soon as possible, current operating limitations for many China-based banks will be relaxed substantially and more China-based banks will set up branches in London. Thanks to China-based financial institutions' deep understanding of RMB business, such move will further promote the development of offshore RMB business in London.

**4. Expanding channels of offshore RMB business.** Firstly, the Chinese and the UK government have signed a RMB 200 billion bilateral local currency swap agreement. This would be an important step for enhancing market confidence and provide liquidity when necessary. Secondly, RMB and GBP can trade directly with each other, which will

encourage corporations in the two nations to use the currencies for investment and trade settlement. Thirdly, an initial RQFII quota of RMB 80 billion to the UK would bring new investment opportunities to corporations and investors. Fourthly, London is actively seeking cooperation with other offshore RMB centers. London and Hong Kong have close ties because of historical reason. Many influential financial institutions in London already have played an active role in the Hong Kong market, with their businesses in London and Hong Kong complementing one another. London is also strengthening cooperation with Singapore, which will help promote further development of offshore RMB business centers in both markets.

**5. Fast development of cross-border payment in RMB.** According to SWIFT data, cross-border RMB payments in London, Singapore and Taiwan were in still early stage in early 2011. However, the latest data showed that RMB accounted for 1.42% of global payment currencies in February this year. Hong Kong accounts for about 70% of total offshore RMB payment. The remaining 30% is divided by London (27%), Singapore (17%) and Taiwan (9.7%). As such, compared with other offshore RMB business centers aside from Hong Kong, the development of cross-border payment in RMB is much faster in London.

### **III. Comparative advantages of Singapore**

According to the latest data from the Monetary Authority of Singapore, RMB deposits in Singapore reached RMB 200 billion at the end of 2013. Accumulated RMB loan (probably with a different definition from that of Hong Kong) was over RMB 300 billion. Six Lion City Bonds were successfully issued last year. The rapid development of offshore RMB business in Singapore was mainly due to the following comparative advantages.

**1. Geographical location advantage as the business center of Southeast Asia.** Singapore is at the eastern part of Strait of Malacca and is a key shipping channel and the center of ASEAN. Although Singapore is a small country, its economy is closely tied with 10 ASEAN member states with a 618-million population and aggregate GDP of USD 2.55 trillion in 2013. Following closer integration among ASEAN economies, nearly 99% of tariffs in the core nations have been removed, strengthening Singapore's leading position in ASEAN. At USD 75.9 billion in 2013, bilateral trade between Singapore and China is not particularly large, while Singapore has a trade deficit with China. However, bilateral trade between ASEAN and China was USD 443.6 billion in 2013. In addition, ASEAN has a trade surplus with China. As such, this situation would have increase RMB inflow to ASEAN and help build up a capital pool in Singapore. According to the Ministry of Commerce, outward investments from non-financial corporations to ASEAN grew 52% and 35.3% YoY in 2012 and 2013 respectively. In addition, most of the investment capital would be used in Singapore. For the time being, there are about 3,700 China-based entities in Singapore. Furthermore, Singapore has a cultural background advantage. In contrast to the US and Europe, Singapore is mostly an ethnic-Chinese society. Many Chinese also live in ASEAN countries. People have better understanding on China and RMB. Therefore they

have higher acceptance of RMB.

## **2. Advantage of being a major commodity and foreign exchange center worldwide.**

Singapore is a major commodity trading center. About 230 commodity dealers have operations in Singapore. Trading in Singapore accounts for 8% of global volume. There are great varieties of commodity trading products, including natural rubber, palm oil, soya bean, cotton, copper and crude oil. Commodity trading can potentially be priced and settled in RMB. According to the BIS report, Singapore was the third largest foreign exchange center in 2013 accounting for 5.7% of global trades. Singapore lagged behind London but ranked higher than Hong Kong, which came in the sixth. Although RMB non-deliverable future (NDF) market in Asia is contracting, average daily transaction is still nearly USD 3 billion. Singapore is the most important offshore RMB trading market, accounting for 80% of the total. Furthermore, Singapore is an important treasury and asset management center in Asia, which generates demand for settlement, financing and investment in RMB.

## **3. Having relevant experience and being well-equipped for developing offshore foreign currency market.**

The Singaporean government has implemented measures including financial reward, cancelling foreign exchange control and 20% liquidity reserve requirements etc since the late 60s. Such measures helped attract the banks to join the Asian Clearing Union (ACU), establishing separate account and using separate model to minimize risk level etc. As a result, an Asian dollar market emerged. Nowadays, Singapore is a major offshore market for USD, EUR, JPY, GBP and CHF in Asia. In addition, many institutional investors and hedge funds have businesses in Singapore. 90% of multinational financial institutions regard Singapore as Asia's bond trading center. Also, design and implementation of housing policy in Singapore is arguably better than Hong Kong. The resulting relatively low rental cost is attractive to corporations. Such relevant experience and conditions would be beneficial to offshore RMB business center development.

## **4. Advantage of improving foundations and conditions for developing offshore RMB center.**

Firstly, the PBOC appointed the Singapore branch of Industrial and Commercial Bank of China the Clearing Bank in February 2013. Secondly, the Chinese and Singaporean governments have re-signed the bilateral local currency swap agreement that amounted to RMB 300 billion / SGD 60 billion, which make bilateral trade and investment more convenient. Thirdly, the implementation of direct trading between RMB and SGD would help reduce transaction costs. Fourthly, the RQFII scheme has extended to Singapore RMB 50 billion quota. Such measures will provide new investment opportunities for corporations and investors. It will also increase bilateral flow of RMB.

In summary, Hong Kong, London and Singapore have similar advantages of developing offshore RMB businesses. More importantly, they also have unique comparative advantages. By playing to their strengths and enhancing cooperation among each other, these three markets all have a bright future and will play a major role in RMB internationalization.

# 主要經濟指標(Key Economic Indicators)

<b>一. 本地生產總值 GDP</b>	<b>2012</b>	<b>2013</b>	<b>2013/Q3</b>	<b>2013/Q4</b>
總量(億元) GDP (\$100 Million)	19,644	20,372	5,124	5,416
升幅(%) Change (%)	1.5	2.9	2.8	3.0
<b>二. 對外貿易 External Trade</b>	<b>2012</b>	<b>2013</b>	<b>2014/2</b>	<b>2014/1-2</b>
外貿總值(億元) Total trade (\$100 Million)				
港產品出口 Domestic exports	588	544	33	76
轉口 Re-exports	33,755	35,053	2,096	5,087
總出口 Total exports	34,343	35,597	2,129	5,163
進口 Total Imports	39,122	40,607	2,666	5,898
貿易差額 Trade balance	-4,778	-5,010	-537	-735
年增長率(%) YOY Growth (%)				
港產品出口 Domestic exports	-10.4	-7.6	-0.3	-2.6
轉口 Re-exports	3.2	3.8	-1.3	-0.8
總出口 Total exports	2.9	3.6	-1.3	-0.8
進口 Imports	3.9	3.8	6.8	1.4
<b>三. 消費物價 Consumer Price</b>				
綜合消費物價升幅(%) Change in Composite CPI (%)	4.1	4.3	3.9	4.3
<b>四. 樓宇買賣 Sale &amp; Purchase of Building Units</b>			<b>2014/3</b>	<b>2014/1-3</b>
合約宗數(宗) No. of agreements	115,533	70,503	4,184	13,988
年升幅(%) Change (%)	6.2	-29.9	-38.8	-43.6
<b>五. 勞動就業 Employment</b>	<b>2012</b>	<b>2013</b>	<b>2013/11-2014/1</b>	<b>2013/12-2014/2</b>
失業人數(萬人) Unemployed (ten thousands)	12.45	11.84	11.3	11.3
失業率(%) Unemployment rate (%)	3.2	3.2	3.1	3.1
就業不足率(%) Underemployment rate (%)	1.5	1.4	1.3	1.2
<b>六. 零售市場 Retail Market</b>	<b>2012</b>	<b>2013</b>	<b>2014/2</b>	<b>2014/1-2</b>
零售額升幅(%) Change in value of total sales (%)	9.8	11.0	-2.3	6.6
零售量升幅(%) Change in volume of total sales (%)	7.2	10.6	-2.3	7.9
<b>七. 訪港遊客 Visitors</b>				
總人數(萬人次) arrivals (ten thousands)	4,862	5,430	442	987
年升幅(%) Change (%)	16	11.7	9.8	14.1
<b>八. 金融市場 Financial Market</b>	<b>2012</b>	<b>2013</b>	<b>2014/1</b>	<b>2014/2</b>
港幣匯價 (US\$100 = HK\$)	775.05	775.4	776.6	776.1
H.K. Dollar Exchange Rate (US\$100 = HK\$)				
貨幣供應量升幅(%) change in Money Supply (%)				
M1	22.2	9.7	7.7	16.1
M2	11.1	12.3	9.6	12.8
M3	11	12.4	9.6	12.9
存款升幅(%) Change in deposits (%)				
總存款 Total deposits	9.3	10.6	7.6	10.6
港元存款 In HK\$	11.7	5.1	1.2	8.2
外幣存款 In foreign currency	7	16.2	14.2	13
放款升幅(%) Change in loans & advances (%)				
總放款 Total loans & advances	9.6	16	17.8	21.9
當地放款 use in HK	7.1	13.8	15.7	20.9
海外放款 use outside HK	16.5	21.4	23	24.1
貿易有關放款 Trade financing	10.2	43.8	49.6	48.2
最優惠貸款利率(%) Best lending rate (%)	5.0000	5.0000	5.0000	5.0000
恆生指數 Hang Seng index	22,657	23,306	22,035	22,837