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## RMB internationalization standing at an important breaking point in 2023 —— How can Hong Kong, the global offshore RMB business hub, seize new opportunities

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The report of the 20th National Congress clearly stated: “promote the RMB internationalization in an orderly manner”, which is obviously changed from the outline of the 14th Five-Year Plan to “promote the RMB internationalization prudently”. In the new stage of development, with the ever-changing external environment, the central government has a strategic perspective and insight of the situation, making timely strategic adjustments, and release an important signal of accelerating the RMB internationalization process to raise market attention. As a global offshore RMB business hub, the new changes will bring new opportunities to Hong Kong. Therefore, it is necessary to seize this favorable period to comprehensively improve RMB business capabilities, and better support and participate in the RMB internationalization.

### I. Favorable factors for accelerating RMB internationalization in 2022

2022 has been an extraordinary year. Various risk factors and uncertainties have played an important role, leading to changes in the global economic and financial environment.

#### 1. Financial instruments were becoming sanctions weapons, and emerging market countries were embracing local currency settlement

Since the outbreak of the Russia Ukraine conflict, Europe and the United States have implemented rounds of financial sanctions. By prohibiting the use of SWIFT, the opening of interbank settlement accounts, and making transactions, major commercial banks accounting for more than 80% of Russia’s financial assets have been excluded from the international financial market and the dollar payment system. As a major international payment currency, the US dollar has once again become a sharp tool for Europe and the US to fight against strategic rivals, and SWIFT has also been manipulated, violating the original intention of fairness, justice and non-politicization advocated at its establishment. Many countries have been terrified of the current international payment system, and the credibility of the US dollar and SWIFT has been questioned. Countries have to take some precautions.

Southeast Asia actively promoted bilateral local currency settlement (LCS). Indonesia, Malaysia and Thailand were the first to launch LCS, and then launched LCS cooperation mechanisms with China, Japan and other trading partners. Indonesia used its G20 presidency to host the LCS forum in 2022, calling for the mechanism to be replicated in the wider region to create a financial safety net. In 2022, India launched a rupee trade settlement scheme, which is responded by Luxembourg, Tajikistan, Cuba, Sudan and the United Arab Emirates, and is currently discussing how to implement it. Turkey has discussed bilateral local currency settlement with China, South Korea,

Russia, Qatar and the United Arab Emirates, and countries in South America have also reached local currency settlement agreements. Since the beginning of the RMB internationalization, more emerging market countries have participated. They not only understand RMB internationalization, but also learn from China's experience to enhance the international settlement function of their own currencies.

### **2. With abnormal US interest rate hike, higher US dollar financing costs, and tightening liquidity, countries strive to reduce their dependence on the dollar**

In response to the highest inflation since the 1980s, the Fed in March 2022 started rate hike cycle, raising rates by 425 basis points in just nine months. After more than a decade of quantitative easing around the world, global liquidity conditions suddenly reversed without any preparation by market participants. Emerging market countries used to cheap and liquid dollar funds suddenly found that dollar funding was no longer cheap. US dollar funds seemed to be flowing back to the US. US Dollar dependency on international payment have brought unpredictable macro risks. However, as the inflation momentum in Europe and the United States remains high, especially the labor market tensions have not eased, the pace of interest rate hikes has not completely stopped, high interest rates will last for a while, its spillover and negative effects will continue to increase. In this context, some emerging market countries are starting to think about structural adjustment to find alternative payment instruments, including accepting the local currencies of trading partners.

The high interest rate of the US dollar also has a profound impact on the process of RMB internationalization. The development of offshore RMB investment and financing business has been relatively slow in recent years, mainly because of relatively higher financing costs compare to US Dollar. US Dollar bond issuance and loans dominate global financing activity, even most Chinese companies' offshore financing are denominated in dollars. Comparing the RMB and US dollar government bonds market, the yield of 2-year RMB government bonds in 2021 was 2.3 percent higher than that of US dollar Treasury bonds of the same maturity on average. However, after the first interest rate hike by the Federal Reserve in March 2022, the US-China bond yield spread narrowed rapidly and became inverted. From October to November, the yield of US dollar Treasury bonds was 2.4 percent higher on average than that of RMB. Since the middle of the year, many Chinese enterprises have decreasingly using dollar financing. In the first 10 months of 2022, the dollar bond issuance of Chinese enterprises decreased by 55% year-on-year, while the offshore dim sum bond issuance increased by 1.06 times year-on-year in the same period. Chinese enterprises are significantly more interested in offshore RMB loans.

### **3. The global foreign exchange market has experienced a new round of strong dollar trend, while the RMB was relatively stable**

The exchange rates of major international currencies fluctuated significantly in 2022. From the beginning of the year to late September, the US dollar exchange rate index rebounded 19.2%. The euro fell as much as 15.1% this year, falling below 1 for the first time since 2000. The yen fell as much as 30.5% and briefly fell below the psychological 150 level. The Chinese currency was also under pressure. After the market gradually digested the Fed's interest rate hike, the appreciation expectation of the US dollar weakened and the strength of the US dollar was decreased. From the end of September to the end of December, the US dollar exchange rate index fell by 10%, while the euro and yen rebounded by 10%. The pressure on the RMB exchange rate was also easing.

While market still uncertain whether the dollar cycle has reached a turning point, the sharp divergence in other currencies caused by the dollar's extraordinary rally narrowed, with better market sentiment. After several rounds of market fluctuations in recent years, the RMB exchange rate formation mechanism has become more mature, showing two-way fluctuations, similar to other international currencies. Enterprises holds neutral view on exchange rate management, with a rational foreign exchange settlement and sale behavior. The basic stability of the RMB at an appropriate and balanced level has increased global confidence in the RMB and is conducive to the internationalization of the RMB.

## **II. The underlying reasons for the accelerated development of RMB internationalization**

Other than the mainland China, many emerging market countries are trying to introduce local currency settlement to facilitate foreign trade and investment. Even the eurozone and Japan are also making greater efforts to enhance the international currency functions of the euro and yen. In addition to the policy measures taken by various countries to prevent potential payment risks, the trend of using local currency settlement are driven by some more deeper reasons.

First, the fragility of the current international monetary system has become more obvious and calls for reform have been growing. After the dissolution of the Bretton Woods System in 1973, the US dollar still acted as the pillar of the international monetary system. After nearly 60 years of operation, its shortcomings were constantly emerging, and it was difficult to meet the needs of global economic development. Currently, the US dollar accounts for the majority of global payments. For some emerging markets, US dollar account for a higher proportion. For example, ASEAN countries use the US dollar for nearly 80% of their external payments. The US dollar accounts for nearly 60% of global foreign exchange reserves and over 90% of foreign exchange transactions. However, the US dollar, by which is highly depended in international trade, investment and financial activities, is only based on the credit of the United States. To be more specific, the stability of the dollar depends on the financial situation of the United States and the issuance of Treasury bonds, and has no direct bearing on the development of the world

economy. There have been calls for reform of the international monetary system, which calls for the main international payment instruments to be more broadly represented and endorsed by the largest economies in terms of GDP. On the other hand, the fluctuations in the dollar's exchange rate in recent years have shown that it is not a stable currency and is not conducive to an export-oriented recovery. In the context of economic multi-polarization, if more major international currencies enhance the international payment function, it can help market players achieve payment currency diversification to hedge exchange rate risks caused by fluctuations of single payment currency.

Second, the new global economic development pattern has new requirements in the financial and monetary fields. Over the past four decades, emerging economies in Asia, represented by mainland China, have risen rapidly. The global economic center has gradually shifted eastward. From 1980 to 2021, China's share of global GDP and total imports and exports rose from 2.7% and 0.9% to 18.5% and 13.5%, respectively. Over the past 20 years, the average annual GDP growth rate of the ten ASEAN countries has been twice the world average, accounting for 3.5 percent of the global total in 2021. The share of the United States and the European Union in global economy and trade continues to decline. Global supply, industrial, and value chains are being rebuilt at a faster pace. The market dominance of the US and the EU is weakening, and the importance of Asia in the world is rising. As their economic strength grows, emerging Asia's political and diplomatic influence, as well as their financial, monetary and political power, are also on the rise. At the micro level, not only European and American multinational enterprises organize global commodity trading and production, procurement and sales, but also Chinese enterprises participate in global logistics and resource allocation. While exporting consumer goods to Europe and America, they also facilitate European and American consumer goods to enter the Chinese mainland market and expand the RMB settlement opportunity. In recent years, the dollar settlement in commodities has also been loosened, and some commodities have been introduced into the RMB payment method.

Third, the new type of regional free trade agreement has become more extensive and member countries have promoted financial openness. Despite the headwinds of anti-globalization, unilateralism and trade protectionism, the Asia-Pacific free trade negotiations have been making continuous progress. In 2021, China and ASEAN announced the establishment of a Comprehensive Strategic Partnership (Version 3.0 of China-ASEAN Free Trade Area). In 2022, ASEAN officially launched the Regional Comprehensive Economic Partnership (RCEP) with China, Japan, the Republic of Korea, Australia and New Zealand. The RCEP is of great significance to the RMB internationalization. It not only promotes regional economic integration through zero tariffs and rules of origin, builds the world's largest free trade market, and promotes the free flow of production factors, thus expanding the scope of RMB settlement, but also makes breakthroughs in trade in services. Several member states have committed to greater openness in the financial sector under the RCEP framework, expanding access to financial institutions and encouraging financial innovation and risk prevention. In the RCEP region, Chinese banks have achieved full network coverage and continued to increase their market influence, driving the use of RMB to a new level. The PBOC has appointed eight RMB clearing banks in RCEP member states and reached bilateral currency swap agreements with nine central banks. The density of clearing banks and currency swaps ranks among the highest in the world. RCEP member states generally welcome the internationalization of the RMB, and the RMB business in Myanmar and other countries has made new progress.

Fourth, the mainland continued to open up its financial sector to create favorable conditions for RMB Internationalization. The report of the National Congress of the People's Congress called for "advancing opening-up at a high level" and pointed out the key directions of opening up on a larger scale. In recent years, the mainland has increased opening-up in financial sectors in order to better support the development of the export-oriented economy, enhance the ability of the financial sector to participate in international competition, and to build a new development pattern with the domestic cycle, reinforcing the international cycles mutually reinforcing. First, with IMF's inclusion of RMB in the SDR currency basket and weighting adjustment, China opened up its bond market continuously by comprehensively lowering the entry threshold of foreign institutions and increasing the investable products. Second, China promoted cross-border investment and financing and improved macro prudential management of cross-border financing and overseas lending policies; Third, China continuously improved the financial market connectivity mechanism by launching the Southbound Bond Connect, the Greater Bay Area Wealth Management Connect, and the Swap Connect. Fourth, China improved the cross-border RMB policy system and facilitate cross-border trade and investment settlement. These policy adjustments not only opened the cross-border flow channels of RMB and strengthened the basic conditions for the internationalization of RMB, but also directly enriched the business scope of RMB products and services.

The RMB Internationalization is a natural evolution. After its official launch in 2009, it experienced rapid growth, and experienced sharp adjustment after "811" in 2015. After bottoming out in 2017, it began to enter the stage of steady growth again. In these ups and downs, RMB has gradually been recognized and accepted by overseas market players, and various international currency functions have been continuously improved. The five-year period from 2017 to 2022 is quite critical. It is the accumulation period of RMB international business, and the main business indicators continue to rebound. According to SWIFT, over the past five years, the average monthly RMB payment has increased by 74%, the average monthly RMB foreign exchange transaction by 85%, the average monthly RMB trade financing by 31%, and the average monthly RMB bond transaction by 7.5 times, all higher than the world average. In addition, according to IMF, the global RMB foreign exchange reserves in the second quarter of 2022 amounted to \$220.9 billion, a 2.6 times increase compared with the fourth quarter of 2016

when it was just included in the SDR. In general, when there were positive changes in the external environment in 2022, it made the foundation of RMB internationalization more solid, thanks to China's adjustment on its RMB internationalization strategy.

### **III. Hong Kong offshore RMB business hub stands in an important period of opportunities**

The Hong Kong International Finance Center is the first stop and the center of the RMB Internationalization. Five years before the official launch of the RMB Internationalization, the mainland appointed the first clearing bank for RMB business in Hong Kong and launched four individual RMB business in Hong Kong. Over years, the mainland has been treating Hong Kong as a testing platform for the RMB Internationalization. Hong Kong financial institutions have completed many pilot offshore RMB business, thus gradually transforming Hong Kong from an international financial center to a global offshore RMB business hub. President Xi Jinping said at the commemorative meeting celebrating the 25th anniversary of Hong Kong's return to the motherland "The central government fully supports Hong Kong in maintaining its unique status and advantages in the long run and consolidating its position as an international financial, shipping and trade center," and "seizing the historical opportunities brought about by the country's development, and proactively align national strategies such as the 14th Five-Year Plan, the Guangdong-Hong Kong-Macao Greater Bay Area and the high-quality development of the Belt and Road initiative." The report to the 20th National Congress of the Communist Party of China put forward the idea of "promoting the RMB Internationalization in an orderly way". This is a very rare historical opportunity that Hong Kong must seize. It can be expected that in this round of development of offshore RMB market, Hong Kong, as the hub of global offshore RMB business, will play a more prominent role.

Reviewing the development of offshore RMB business in Hong Kong in recent years, the mainland attaches great importance to promoting the construction of offshore RMB market in Hong Kong, implementing the 14th Five-Year Plan to support Hong Kong in elevating its position as the three major international centers, and strengthening Hong Kong as a global offshore RMB business hub, an international asset management center and a risk management center. Despite the dramatic adjustment in the global economy and financial markets due to the COVID-19 pandemic, Hong Kong's offshore RMB business was stable and has experienced a rapid growth of major business indicators, continuous diversification of RMB products, further active RMB trading, and improved RMB market mechanism, making Hong Kong more confident to seize the important window of RMB internationalization.

**1. Continue to act as offshore RMB clearing hub.** The transaction amount of RMB RTGS in Hong Kong accumulated 384.3 trillion yuan in 2021, a year-on-year growth of 7.5%, the sixth consecutive year of positive growth, daily transaction amount reached 1.6 trillion yuan, ranking the first of Hong Kong's four RTGS (the other three are Hong Kong dollar, US dollar, euro RTGS). It shows that the RMB is already widely used in Hong Kong's banking system. According to SWIFT, in the first three quarters of 2022, the amount transacted in RMB in Hong Kong increased by 2.1% year-on-year, 64.5% higher than that five years ago, ranking first in the world, accounting for 71.6% of the global amount received and paid in RMB in the first three quarters of 2022.

**2. The offshore RMB liquidity pool in Hong Kong is ahead of others.** In 2022, the balance of RMB deposits in Hong Kong was 892.3 billion yuan, a year-on-year growth of 2.7% and a rebound of 75.9% from the low level in March 2017. Influenced by seasonal factors, RMB deposits fluctuated during the year and rebounded significantly after April. Financial institutions also issued RMB certificates of deposit (CDs) for funding purpose, with the balance of CDs at 151.2 billion yuan at the end of September, the highest level since 2015. If RMB deposits are added with RMB CDs, the RMB liquidity pool in Hong Kong has returned to more than one trillion yuan by the end of September, accounting for more than 60% of the global RMB liquidity pool.

**3. RMB foreign exchange trading is more active.** According to the Bank for International Settlements (BIS), the average daily amount of RMB foreign exchange transactions in Hong Kong reached 191.2 billion US dollars in April 2022, up 77.7% from the survey conducted three years ago (April 2019), accounting for 28.2% of the global RMB foreign exchange transactions, surpassing other offshore RMB centers such as the United Kingdom and Singapore and continuing to rank first in the world. Globally, the average daily amount of RMB foreign exchange transactions in April 2022 was 526.4 billion US dollars, an increase of 85.2% over three years ago, accounting for 7% of the global total foreign exchange transactions, and rising to the 5th place among major currencies from the 8th place three years ago.

**4. The RMB dim sum bond market continues to recover.** The issuance of RMB central bank bills in Hong Kong in 2022 was 120 billion yuan, the same as last year, bringing the total issued over the past five years to 560 billion yuan. The annual issuance of RMB government bonds reached 23 billion yuan, exceeding the amount issued last year and bringing the total issued over the past five years to 80.5 billion yuan. Driven by the regular issuance of RMB central bank bills and government bonds, the trading in dim sum bond market has been active. The issuance amount of dim sum bonds reached 976.8 billion yuan, up 85.3% year-on-year. According to HKMA, the amount of RMB dim sum bond transactions managed by Hong Kong's Central bond settlement System CMU in 2022 increased by 2.3 times year-on-year.

**5. Financial market connectivity is further improved.** In 2022, Shanghai-Hong Kong Stock Connect marked its eighth anniversary. As of November 30, the northbound Stock Connect and Shenzhen Stock Connect had a total transaction volume of 89.4 trillion yuan, and the southbound Stock Connect had a total transaction volume of HKD \$30.4 trillion. In the first 10 months of 2022, the transaction volume of Bond Connect (Northbound Connect) was 6.62 trillion yuan, up 26.8% year on year. New connectivity arrangements have been accelerated. In September 2021, the Guangdong-Hong Kong-Macao Greater Bay Area Cross-border Wealth Management Connect pilot was officially launched, and in the same month, the Bond Connect (Southbound) was also launched. In July 2022, exchange traded funds (ETFs) were included in the Shanghai-Shenzhen-Hong Kong Stock Connect for the first time, and the launch of the Swap Connect was announced immediately afterwards, bringing the two interest rate swap markets together.

**6. The RMB financial management market is becoming more mature.** As of March 2022, the CSRC had recognized 38 Hong Kong funds under mutual fund recognition arrangement with assets under management of 11.886 billion yuan, and 47 mainland funds with assets under management of 1.24 billion yuan. The CSRC recognized 692 RMB investment products in Hong Kong, with an investment scale of 21.7 billion yuan, up 19.9% and 6.4% respectively. The new standard premiums for RMB insurance in Hong Kong in the first three quarters of 2022 were HK \$2.552 billion. In the first 11 months of 2022, 3.19 million US dollar-RMB futures were issued on HKEx, more than twice that of the whole of last year.

## **IV. Hong Kong will make greater contribution to promote the internationalization of RMB in an orderly manner**

Hong Kong has unique conditions for developing offshore RMB business, including policy, market and geographical advantages. In the early stage of the establishment of offshore RMB market, Hong Kong benefited from the opening-up of the mainland's policies. Hong Kong conducted many pilot programs in accordance with the mainland's cross-border RMB policies, which is called the policy-driven development model. With the deepening of the internationalization of RMB and the growing market demand for use of RMB, it's then transformed to the market-driven development model, emphasizing the driving role of market players. The internationalization of RMB now enter into the orderly development stage, which requires more proactive, forward-looking and planning at the policy level.

To develop Hong Kong as a global offshore RMB business hub, it requires clear strategy and deep thinking before acting. The HKSAR government and the industry can jointly formulate RMB development strategies based on the research of market demand, and consciously guide market development in certain directions illustrated below.

**First, in line with the Mainland's economic reform and RMB internationalization strategy, to play a bridgehead role in connecting mainland and international markets,** further enhance Hong Kong's offshore RMB market mechanism, strengthen RMB clearing infrastructure, and develop Hong Kong's RMB foreign exchange market, bond market, repo market, derivatives market and syndicated loan market. Hong Kong continue to enhance the functions of RMB in trading, investment and financing, and risk hedging, provide policy support with Hong Kong characteristics, and support use of RMB by Chinese enterprises going global, multinational corporations and institutional investors going global in cross-border business.

**Second, to establish the "Belt and Road" RMB financing and risk management center.** Leveraging Hong Kong's talent resources, product innovation capability and huge business network in financial and professional service industry, to expand the RMB business to countries and regions along the Belt and Road, promote RMB settlement in infrastructure construction and production capacity transfer projects. Focusing on key areas such as contracting, industrial parks and commodities, making full use of the opportunities of integrated regional economic development and higher opening up of the financial sector among member states brought by the RCEP, to vigorously deepen the internationalization of the RMB.

**Third, to vigorously promote cross-border use of RMB in the Greater Bay Area,** by making good use of the close ties in humanities, culture, economic and trade exchanges among the three places, and guiding use of RMB in trade and investment payment activities. To constantly expand cross-border RMB channels such as cross-border loans, bond issuance, asset transfer, cash pooling and equity investment, so that RMB will not only become the largest but also the dominant cross-border settlement currency in the region. To improve services such as the Greater Bay Area Cross-border Wealth Management Connect, remote account opening and cross-border payment. To accelerate the opening of insurance service centres in Qianhai, Nansha and Hengqin, and facilitate the launch of Insurance Connect, to attract more cities in the Greater Bay Area to issue RMB bonds in Hong Kong.

**Fourth, to jointly build a global RMB asset management platform with Shanghai International Financial Center.** Hong Kong can vigorously support and actively participate in the establishment of Shanghai Petroleum and National Gas Exchange trading platform and the development of Shanghai as an international RMB asset management center, and enhance mutual market access programs (i.e. Shanghai/Shenzhen-Hong Kong Stock Connect, Bond Connect (southbound and Northbound Connect) and Swap Connect, and introduce renminbi-denominated stock trading in Stock Connect, facilitating RMB IPO for enterprises list in the Hong Kong Stock Exchange. Hong Kong can also further develop RMB wealth management products, insurance products and venture capital funds, as well as the dim sum bond market, with coordinated development effect with the panda bond market, to meet the increasing needs of overseas investors holding RMB assets.

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# 主要經濟指標 (Key Economic Indicators)

	2020	2021	2022/Q2	2022/Q3
<b>一. 本地生產總值 GDP</b>				
總量 (億元) GDP(\$100 Million)	26,757	28,454	6,681	6,899
升幅 (%) Change(%)	-6.5	6.3	-1.3	-4.5
<b>二. 對外貿易 External Trade</b>			<b>2022/11</b>	<b>2022/01-11</b>
外貿總值 (億元) Total trade(\$100 Million)				
總出口 Total exports	39,275	49,607	3,600	41,844
進口 Total imports	42,698	53,078	3,871	45,281
貿易差額 Trade balance	-3,422	-3,471	-271	-3,437
年增長率 (%) YOY Growth(%)				
總出口 Total exports	-1.5	26.3	-24.1	-6.4
進口 Imports	-3.3	24.3	-20.3	-5.4
<b>三. 消費物價 Consumer Price</b>				
綜合消費物價升幅 (%) Change in Composite CPI(%)	0.3	1.6	1.8	1.9
<b>四. 樓宇買賣 Sale &amp; Purchase of Building Units</b>			<b>2022/12</b>	<b>2022/01-12</b>
合約宗數 (宗) No. of agreements	73,322	96,133	3,565	59,619
年升幅 (%) Change(%)	-2.0	31.1	-49.6	-38.0
<b>五. 勞動就業 Employment</b>			<b>2022/08-2022/10</b>	<b>2022/09-2022/11</b>
失業人數 (萬人) Unemployed(ten thousands)	259.1	250.9	14.7	13.9
失業率 (%) Unemployment rate(%)	5.5	5.5	3.8	3.7
就業不足率 (%) Underemployment rate(%)	3.1	2.7	1.7	1.6
<b>六. 零售市場 Retail Market</b>			<b>2022/11</b>	<b>2022/01-11</b>
零售額升幅 (%) Change in value of total sales(%)	-24.3	8.1	-4.2	-1.1
零售量升幅 (%) Change in volume of total sales(%)	-25.5	6.5	-5.3	-3.6
<b>七. 訪港遊客 Visitors</b>				
總人數 (萬人次) arrivals (ten thousands)	356.9	9.1	11.4	44.4
年升幅 (%) Change(%)	-93.6	-97.4	1098.5	441.8
<b>八. 金融市場 Financial Market</b>			<b>2022/10</b>	<b>2022/11</b>
港幣匯價 (US\$100=HK\$)				
H.K. Dollar Exchange Rate (US\$100 = HK\$)	775.2	779.8	785	780.4
貨幣供應量升幅 (%) change in Money Supply(%)				
M1	30.1	8.0	-18.0	-19.7
M2	5.8	4.3	1.2	1.3
M3	5.8	4.3	1.2	1.3
存款升幅 (%) Change in deposits(%)				
總存款 Total deposits	5.4	4.6	1.4	1.5
港元存款 In HK\$	6.2	1.4	-2.8	-1.3
外幣存款 In foreign currency	4.6	7.9	5.5	4.2
放款升幅 (%) in loans & advances(%)				
總放款 Total loans & advances	1.2	3.8	-2.7	-3.0
當地放款 use in HK	1.7	4.7	-0.5	-0.6
海外放款 use outside HK	0.1	1.7	-8.0	-8.8
貿易有關放款 Trade financing	-6.2	14.2	-17.8	-16.5
最優惠貸款利率 (%) Best lending rate (%)	5.0000	5.0000	5.1250	5.3750
恒生指數 Hang Seng index	27,231	23,398	14,687	18,597