Internationalising the renminbi

INTERVIEW WITH PROFESSOR K C CHAN AND NORMAN CHAN

SECRETARY FOR FINANCIAL SERVICES AND THE TREASURY AND CHIEF EXECUTIVE, HONG KONG MONETARY AUTHORITY, RESPECTIVELY

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Hong Kong has always been a bridge between China and international markets, and since 1979 that role of intermediation in trade and finance has grown exponentially. Thanks to its status as a Special Administrative Region (SAR) of the People's Republic of China it has retained its free market economy, a separate currency pegged to the US dollar and a legal system based on common law – all of which makes it an attractive base for international corporates and financial institutions seeking to expand their business with what is now the second largest, and certainly the fastest growing, economy in the world. "It combines a very efficient financial market," says Frank Lai, CFO of China Resources Enterprise (CRE), "with an easy to understand legal system which western business-people, in particular, appreciate. They feel comfortable when they sign contracts based on Hong Kong law. There is also the human resource talent pool, with individuals who understand western protocols and appreciate the Chinese culture. I think this is highly important. When our Premier, Wen Jiabao visited the UK recently, he stressed the importance of understanding different cultures."

Mr Lai believes that "it is due to this mutual cultural interest that the Chinese enjoy a reputation of being ideal business partners." As evidence of this he points to CRE's many partnerships with international companies. "We have, for example, had a joint-venture partner, SABMiller, in the beer business for nearly 20 years," he says, adding that "we have also enjoyed a partnership of some two decades with Sanyo. And more recently, we have joined up with the Japanese beer company Kirin. So you can see that with all these international partnerships, the company has a multiple culture. The Group has six listed companies in Hong Kong. Of those six, three are Hang Seng Index constituent stocks. As far as state-owned companies in China are concerned, we are the only one to have achieved that."

CRE is only one of many Chinese enterprises that have been taking advantage of Hong Kong's sophisticated financial services as a platform for expanding into the rest of the world, whether that be through trade finance or raising funds from international investors by listing on the Hong Kong Stock Exchange (HKSE).

More recently, Hong Kong's role as financial intermediary has taken a quantum leap forward because of Beijing's decision to move towards the internationalisation of the renminbi (Rmb) or yuan by allowing a pool of the currency to be held in offshore deposits, notably in Hong Kong. As Norman Chan, Chief Executive of the Hong Kong Monetary Authority explains: "In 2009 China started a policy framework allowing Rmb to be used in cross-border trade settlement, and Hong Kong has been developing into a settlement platform and offshore Rmb business centre." Given that the yuan is not yet a fully-convertable currency, the authorities were keen to accord priority to the use of these offshore funds to real economic purposess such as trade settlement and finance or repatriating Rmb earned overseas through foreign direct investment (FDI).

Hong Kong has been the prime channel through which this gradual internationalisation of the Rmb is taking place. But as Mr Chan points out, Hong Kong does not have a monopoly. "There are in fact two channels," he says, "to support cross-border trade between China and its trading partners. Hong Kong's Rmb clearing platform is not not the only one. The other channel is through the correspondent

Photo courtesy of HKTB

The sky's the limit: Hong Kong's offshore renminbi deposits could reach a trillion by the end of this year

Expanding Hong Kong's role as an offshore Rmb platform can only have a beneficial effect on other modes of fundraising it already provides

banks." Nonetheless, during his recent visit to Hong Kong Vice Premier Li Keqiang announced a number of measures designed to reinforce Hong Kong's role in this step-by-step process of internationalising the Rmb. These include authorising Hong Kong financial institutions to invest up to Rmb 20 billion in mainland securities while, on the other hand, allowing Chinese companies to raise up to 50 billion Rmb in yuan-denominated bonds issued in Hong Kong.

As Professor KC Chan, Secretary for Financial Services and the Treasury, explains: "Currently, investments by qualified foreign institutional investors (QFII) in the mainland equity market must be made through the US dollar-denominated quota approved by mainland regulators. The Rmb QFII (RQFII) to be introduced, by making possible investment in the mainland equity market through a pre-set Rmb-denominated quota, enhances the circulation of onshore and offshore Rmb funds and facilitates the launch of more innovative Rmb-denominated products, benefiting investors, financial institutions and the financial markets as a whole."

As for Rmb-denominated bond issuance in Hong Kong by mainland institutions, their size will be raised to Rmb 50 billion as of this year. Roughly half of these bonds are to be from financial institutions, the other half from non-financial enterprises, and this is likely to provide a further boost to the already flourishing market in so-called dim mum bonds in Hong Kong. For, as Prof Chan notes, "by allowing non-financial mainland enterprises to issue Rmb-denominated bonds in Hong Kong, the range of issuers from the mainland will be enlarged." As a result, he believes that "investors will be provided with more diversified choices, and the breadth of the Rmb bond market in Hong Kong will be further extended."

Similarly, three recent issuances of Rmb sovereign bonds in Hong Kong by the Ministry of Finance have been well received. "The amount of Rmb 20 billion for the current issuance of Rmb sovereign bonds," says Prof Chan, "exceeds the aggregate of bond issuances in the last two years." Nonetheless he notes that, despite its size and low coupon, "the institutional tranche of the tender was 4.6 times oversubscribed, which demonstrated the enthusiastic response of investors to the sovereign bonds." An Rmb-denominated sovereign debt market in Hong Kong provides both new opportunities for investors and depth to the broader offshore Rmb market, and this is likely to expand further. "We are working closely with various authorities of both sides," say Prof Chan, "to explore ways to expand Rmb circulation channels between Hong Kong and the mainland, and support the innovation and development of offshore Rmb financial products in Hong Kong."

Then again, there is Hong Kong's role as a conduit for FDI into China. As Mr Chan explains, "Hong Kong has always been, since 1979, the biggest source of direct investment for mainland China. Even though it has grown hugely in recent years – last year it was US$100 billion in total – 57 per cent of that came from Hong Kong – not just the Hong Kong indigenous investor, but from British, Danish, or Americans who have chosen Hong Kong as a domicile for their companies." At the same time, he notes, "China is also making huge investments overseas. Mainland companies making direct investments overseas has grown from almost nothing 7-8 years ago to nearly US$60 billion in 2010. And of that, over 50 per cent came to Hong Kong or through Hong Kong, even though it is intended to invest in Australia or Brazil or Africa." As a result, he sees Hong Kong as "the key hub for both FDI into China and DI from China. And when you have direct investment flows, you have finance, you have structuring, you have additional services."

And now there is scope for further expansion through Rmb-denominated FDI. "Last year," explains Prof Chan, "the mainland authorities allowed direct investments in Rmb by certain foreign enterprises on a trial basis. Then, this August, the Ministry of Commerce issued a consultation document on cross-border Rmb settlement for foreign direct investment. These measures provide more business opportunities for a growing pool of Rmb funds in Hong Kong, further boosting the development of Hong Kong's Rmb bond and equity markets." Similarly, plans to form a joint venture between Hong Kong Exchanges and Clearing Limited (HKEx) and its counterparts in Shanghai and Shenzhen are advancing although, as Prof Chan points out, "there is no binding agreement yet." However, he sees "possible areas of business operation of the joint venture company to include (but not limited to) the development of index and other equity derivative products and the compilation of new indices." In summary, he believes "the proposed joint venture is an important step towards closer co-operation among the Exchanges in Hong Kong and the mainland" and that it will "further strengthen financial co-operation between Hong Kong and the mainland and pave the way for more new business opportunities."

Expanding Hong Kong's role as an offshore Rmb platform can only have a beneficial effect on other modes of fundraising it already provides for mainland enterprises such as IPOs. In this, Hong Kong has expanded rapidly to become the world's largest listing market by fundraising size, having launched 114 IPOs last year, mostly of Chinese and international companies, which taken together raised a record HK$445 billion. Over the past two years a larger share of this business has been generated by global companies such as Rusal, Prada and Samsonite choosing the

Hong Kong Stock Exchange for their initial listing or, in the case of international commodities group Glencore for a secondary listing, so as to build up both their corporate profile and investor base close to their largest and fastest growing market, namely China. But according to PricewaterhouseCoopers (PwC), which has been involved in 42 per cent of Hong Kong IPOs over the past decade, the driving force behind the growth in this market over the longer term has been fundraising by mainland enterprises, especially SMEs. As PwC partner Benson Wong puts it: "Chinese SMEs are keen to expand their brands overseas and they view Hong Kong as the ideal platform for this international reach." A new development has been the first Rmb-denominated IPO lunched by a mainland real estate development company which, though not so enthusiastically received by investors, nonetheless went off without a hitch. Again, Hong Kong is well-placed as a financial intermediary to serve the two-way traffic of international companies seeking to grow their footprint in the mainland and Chinese companies expanding overseas.

Mr Chan believes Hong Kong will continue to play a key role in this "because we offer a one-stop service, including trade finance for when a customer needs to make payments in Rmb but does not have the funding, though to a range of Rmb-denominated products – bonds, shares, unit trusts – designed to enhance returns over and above the deposit rate should a customer have been paid in Rmb that is surplus to their requirements. Hong Kong, as an off-shore Rmb centre, offers a lot of facilities and services, from the funding or financing side to the investment side." As well as having 'first mover' advantage, he notes that "we also enjoy the natural advantage of being part of China. We are the trading hub for mainland China. Some 25 per cent of our GDP is actually trade intermediation – intermediating not just Hong Kong and the rest of the world, but mainland and rest-of-the-world trade – while 30 per cent of the mainland's trade is intermediated by or through Hong Kong (including re-exports to and from the mainland plus off-shore trade)."

Closer financial links with China naturally have beneficial impacts on other parts of Hong Kong's economy, according to Greg So, Secretary of Commerce and Economic Development, who points out that Hong Kong's merchandise trade was worth a record US$823 billion in 2010. That represents close to 370 per cent of the SAR's total GDP. At the same time visitor numbers – again, mainly Chinese – increased to 36 million last year and are expected to reach 40 million in 2011, providing further impetus for Hong Kong's flourishing retail and hospitality industries. So, while financial intermediation is the key, there are many other ways in which Hong Kong provides a bridge between China and the rest of the world. F

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Hong Kong financial sector in numbers

Rmb business (up to July 20111) — **Rmb billion**

Year	Rmb reposits (period-end)		Trade settlement (from July 2009)		Bond Issuance (from July 2007)	
	Value	YOY growth	Value	YOY growth	Value	YOY growth
2009	62.7	11.9%	1.9	N/A	16.0	33.3%
2010	314.9	402.1%	369.2	19815.4%	35.8	123.5%
2011 YTD	572.2	81.7% (YTD)	953.0	2442.5%	49.6	3442.9%
Cumulative			1324.1		123.4	

Security market (up to July 2011) — **US$ billion**

Year	Market capitalisation (period-end)			No. of listed companies (period-end)	
	Value	YOY growth	World ranking	Value	YOY growth
2009	2,305.1	73.5%	7	1319	4.6%
2010	2,711.3	17.6%	7	1413	7.1%
2011 YTD	2,731.8	0.8%	7	1463	3.5 (YTD)

Insurance Market (up to June 2011) — HK$ billion

Year	Gross premium income of Hong Kong					
	General		Life		Total	
	Premium	YOY growth	Premium	YOY growth	Premium	YOY Growth
2009	28.5	6.9&	156.1	-3.6%	184.6	-2.1%
2010	31.4	9.8%	175.8	12.6%	207.2	12.2%
2011 YTD	18.7	12.7%	96.0	14.3%	114.7	14.0%