Internationalisation of the RMB and Hong Kong’s Role as an Offshore Center

Romnesh Lamba
EVP and Head of Market Development, HKEx

Presentation to Asia Society
1 December 2010
Internationalisation of the RMB and Hong Kong’s Role

1. Why does China want to internationalise the RMB?
2. Why is Hong Kong the Offshore RMB Centre?
3. What are the three critical steps?
4. How big is the opportunity?
5. What does it mean for HKEx?
1. RMB Internationalisation
– Perspective and Feasibility

**Long-term Perspective**

- Preserve the value of China’s foreign exchange reserves
- Balance China’s growth, especially relating to the trade balance
- Increase China’s influence in geopolitical/economic affairs

RMB to become a global settlement, investment and reserve currency

**Short-term Feasibility**

- Trade settlement in RMB already open
- Pre-requisite – No whole-sale opening of the Capital Account
- Controlled and managed process experimenting in an offshore market is highly likely to succeed
2. Rationale for Hong Kong’s Role

China has designated Hong Kong as the official offshore RMB Centre
3. Three Critical Steps

Step 1: RMB flows out of the Mainland

Step 2: RMB circulates offshore

Step 3: RMB flows back onshore
3. Offshore RMB Liquidity Gaining Momentum

RMB Deposits

<table>
<thead>
<tr>
<th>Month</th>
<th>RMB billion</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dec-04</td>
<td>12</td>
</tr>
<tr>
<td>Jun-05</td>
<td>21</td>
</tr>
<tr>
<td>Dec-05</td>
<td>23</td>
</tr>
<tr>
<td>Jun-06</td>
<td>23</td>
</tr>
<tr>
<td>Dec-06</td>
<td>23</td>
</tr>
<tr>
<td>Jun-07</td>
<td>28</td>
</tr>
<tr>
<td>Dec-07</td>
<td>33</td>
</tr>
<tr>
<td>Jun-08</td>
<td>78</td>
</tr>
<tr>
<td>Dec-08</td>
<td>56</td>
</tr>
<tr>
<td>Jun-09</td>
<td>54</td>
</tr>
<tr>
<td>Dec-09</td>
<td>63</td>
</tr>
<tr>
<td>Jun-10</td>
<td>90</td>
</tr>
<tr>
<td>Sep-10</td>
<td>149</td>
</tr>
</tbody>
</table>

Source: HKMA

Cumulative RMB Trade Settlement

<table>
<thead>
<tr>
<th>Month</th>
<th>RMB billion</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sep-09</td>
<td>0.1</td>
</tr>
<tr>
<td>Dec-09</td>
<td>3.6</td>
</tr>
<tr>
<td>Mar-10</td>
<td>21.9</td>
</tr>
<tr>
<td>Jun-10</td>
<td>70.6</td>
</tr>
<tr>
<td>Sep-10</td>
<td>197.1</td>
</tr>
</tbody>
</table>

Source: PBOC Monetary Policy Execution Reports (2009Q3 - 2010Q3) (non-quarter-end figures are not available)

...yet less than 3% of total Hong Kong deposits

...and less than 1% of China’s total trade
3. Three Critical Steps – A Circular Loop

- **RMB Outflow**
  - 20k/account/day deposits, trade settlement

- **RMB Offshore Pool in Hong Kong**

- **RMB Inflow**
  - Sinobond proceeds, foreign banks' access to interbank bonds, Mini-QFII

- **Increase Liquidity**

- **Expand Capacity**

- **Regional / Global Trade Partners**
  - Trade settlement
    - China trade import and export volume in 2009 was over US$2.2 trillion

- **RMB products**
  - Corporate bonds, insurance products, funds, structured products, RMB futures, equities
4. Potential Size of the Opportunity

Phase 1: Redenomination of Hong Kong Capital and Trade Flow

Phase 2: Attract regional and global trade flows into Hong Kong RMB market

Phase 3: Mainland investors permitted to send RMB offshore
5. HKEx RMB Strategy
HKEx is laying the foundation to capture a second transformational opportunity

- Lobby for policy change
- Set up RMB infrastructure
- Expand Mainland Market Data
- Develop RMB Products
- Facilitate Mainland Connectivity
- Pursue OTC Clearing
Additional Questions to Consider

6. How important is the pace of currency convertibility?

7. What is the impact of expectations of an appreciating currency?

8. What are the risks of a controlled internationalisation to China?

9. What might be the impact on Hong Kong’s monetary policy?

10. What about Shanghai?