



HKIMR First International Conference on the Chinese Economy

# **The Chinese Approach to Capital Account Liberalization: What Do We Learn from Renminbi Banking in Hong Kong?**

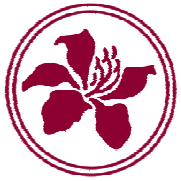
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\* The views expressed here do not represent those of the HKMA or the HKIMR

# Outline of Presentation

- I. **Questions to address**
- II. **The nature of renminbi banking in Hong Kong**
- III. **The Chinese approach to capital account liberalization**
- IV. **Conclusions**



## Questions to address

- ◆ What does the process of developing renminbi banking in Hong Kong tell about China's approach to capital account liberalization?
- ◆ Should we regard the degree of convertibility of the renminbi as black and white, or a spectrum?
- ◆ Are experiments with capital account liberalization “controllable”?
- ◆ Can authorities promote offshore use of their currencies (i.e., internationalization) while maintaining some degree of capital account restrictions?

# **The nature of renminbi banking in Hong Kong**



# Preconditions for offshore use of currencies

- ◆ Except for non-deliverable markets, offshore use of currencies is impossible without the cooperation of onshore banks
- ◆ Offshore use of currencies is an international financial transaction and requires *non-resident convertibility*
- ◆ Offshore banks need to be able to keep and have access to clearing balances (demand deposits) in onshore banks



## Does the renminbi have non-resident convertibility?

- ◆ No, in general
- ◆ Offshore banks cannot maintain working balances in renminbi with an onshore bank and cannot participate in the onshore foreign exchange market
- ◆ Renminbi banking in Hong Kong is made possible by a special channel, which allows for non-resident convertibility of the renminbi specifically for banks in Hong Kong



# Clearing arrangement

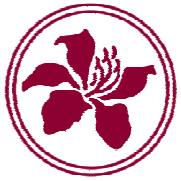
- ◆ For renminbi banking in Hong Kong, a “Clearing Bank” is appointed by the People’s Bank of China (PBoC) to be the conduit, which
  - accepts deposits from participating Hong Kong banks and in turn maintains balances with PBoC
  - acts as the counterparty of currency exchange transactions of the participating banks and in turn squares its own positions in the China Foreign Exchange Trading System in Shanghai



## Independent but cooperative relationship

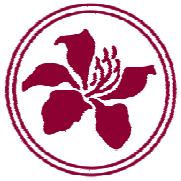
- ◆ Hong Kong was the first place outside Mainland China to have renminbi banking, supported by the special clearing arrangement provided by the PBoC
- ◆ Successful launch and smooth running of the business attest to productive cooperation between PBoC and the Hong Kong Monetary Authority (HKMA)





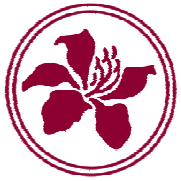
## Benefits are mutual

- ◆ For the Mainland, to channel renminbi banknotes already in circulation offshore to the banking system, which increases transparency, improves monetary statistics, and helps anti-money laundering
- ◆ Gain experience in handling internationalization of the renminbi
- ◆ For Hong Kong, to gain a “first mover” advantage in setting up a renminbi settlement system and lay the foundation to become an “Asian” renminbi banking centre



# Timeline

- ◆ November 2003 Announcement of clearing arrangement
- ◆ February 2004 Launch of deposit-taking, exchange, and remittance businesses
- ◆ December 2005 Expansion of business scope (e.g. cheques)
- ◆ June 2007 Introduction of renminbi bonds
- ◆ July 2009 Launch of trade settlement in renminbi



## Limits on business scope

- ◆ A contractual limit of RMB20,000 yuan per day per depositor is placed on the amount that a Hong Kong resident can convert into renminbi
- ◆ A contractual limit of RMB80,000 yuan per day per depositor is placed on the amount that a Hong Kong resident can remit to his/her bank account on the Mainland
- ◆ Renminbi open positions should not exceed the “Open Position Limit”, which is bank-specific and approved by the PBoC
- ◆ Other limits: deposit account can only be opened by Hong Kong resident individuals and “designated merchants”; bond issuers restricted to Mainland-incorporated financial institutions

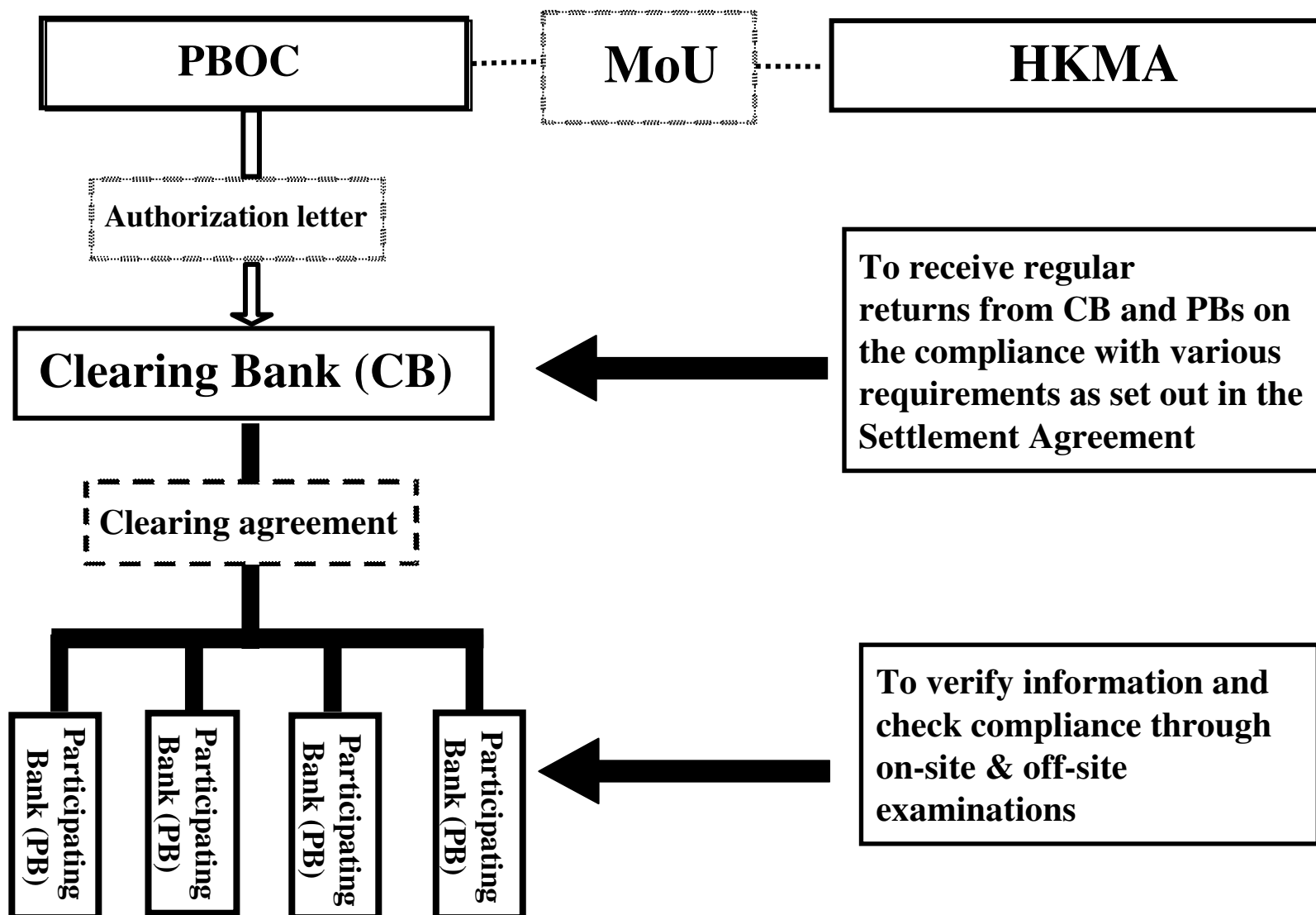


## Who decides the scope of permissible activities?

- ◆ The business scope is specified through contractual agreements. The limits are imposed as part of the terms and conditions for the provision of clearing services; and they are therefore not regulatory constraints imposed by the HKMA
- ◆ The HKMA exercises prudential supervision over participating banks that conduct renminbi business. It also has a developmental role, as part of its mandate to maintain Hong Kong's status as an international financial centre

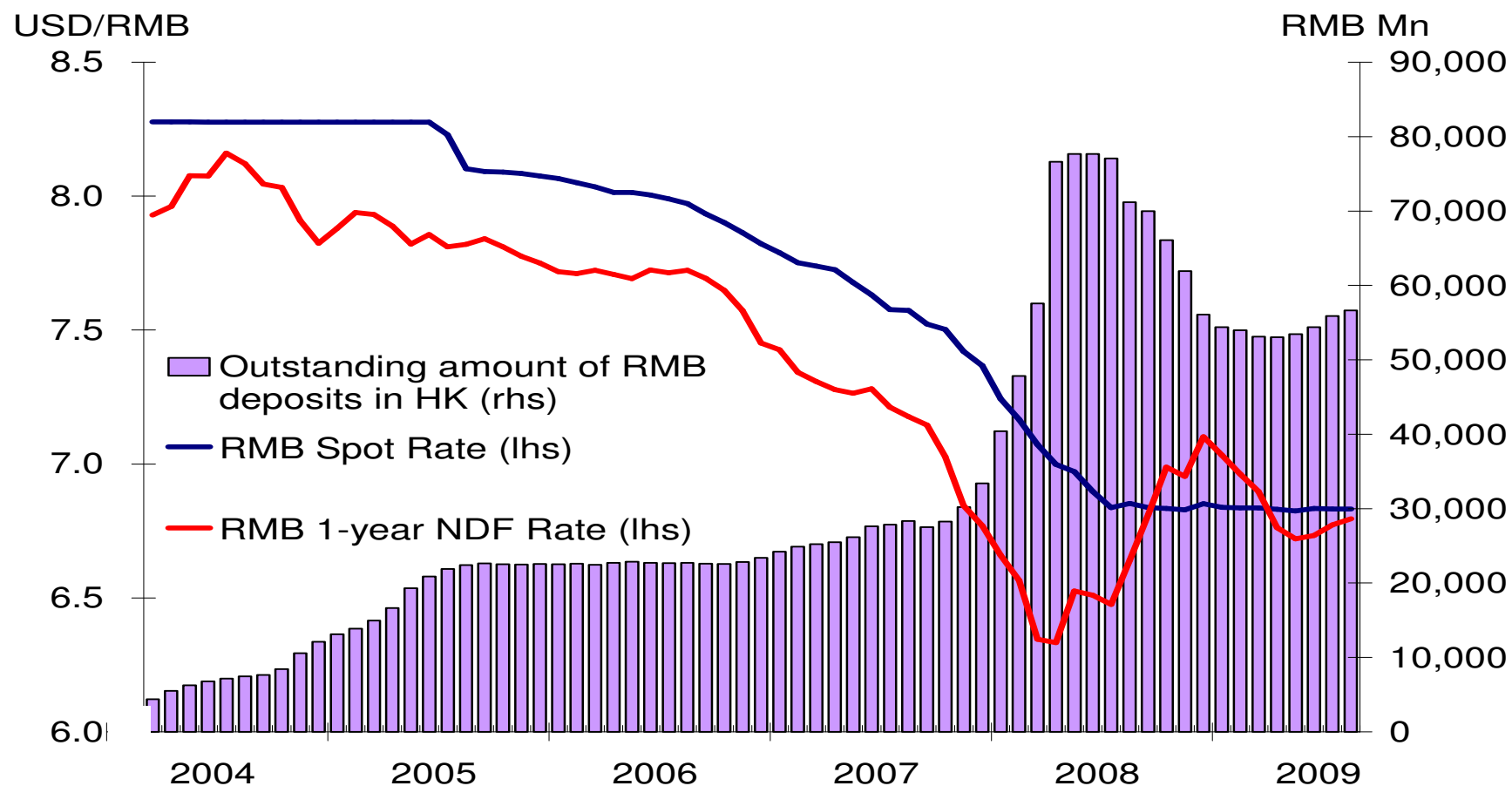


# Contractual and supervisory relationship





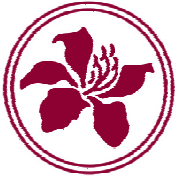
# Demand for renminbi deposits in Hong Kong



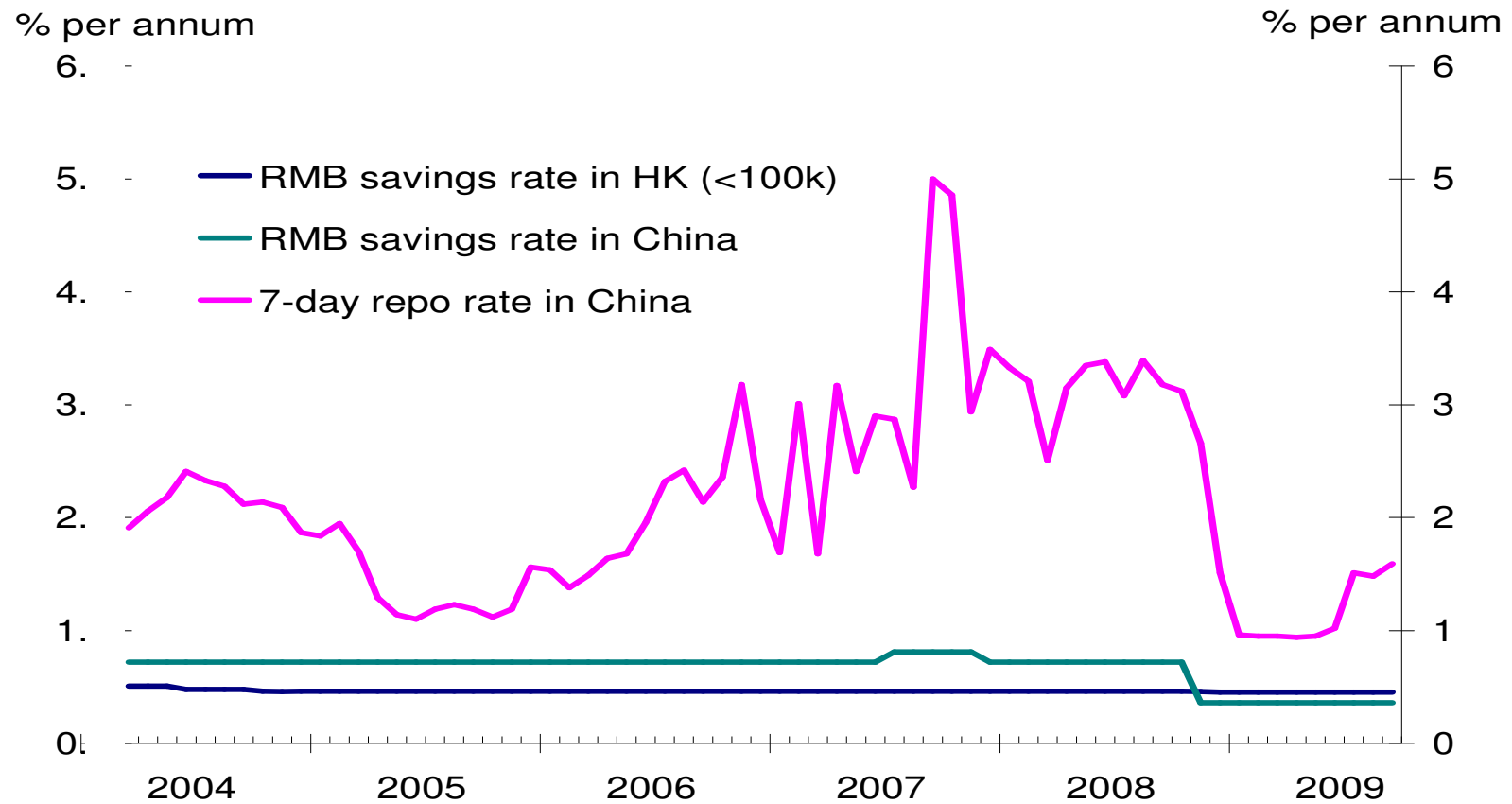


## Interest rates determination (I)

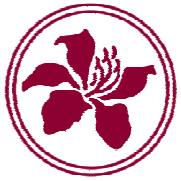
- ◆ The PBoC pays the clearing bank interest on its deposits at a rate that is fixed but adjustable at its discretion, taking into account monetary conditions both on the Mainland and in Hong Kong. This rate was set at 0.99% at launch of business and has not been changed
- ◆ The clearing bank pays the participating banks interest on their deposits at a rate that is determined by subtracting a spread from the PBoC rate
- ◆ The interest rates that participating banks pay their customers are commercially determined
- ◆ In effect, the PBoC determines a ceiling of renminbi interest rates in Hong Kong



# RMB deposit interest rates

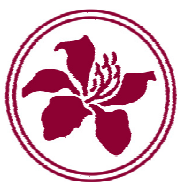






## Interest rates determination (II)

- ◆ However, with the progressive expansion of business scope and diversification of assets (e.g., RMB bonds and trade credit) on banks' balance sheet, the PBoC rate will gradually lose its role as a de facto ceiling of RMB interest rates in Hong Kong
- ◆ An NDF RMB yield curve has been already in existence anyway



# Renminbi bonds in Hong Kong

Renminbi-denominated bond issues in Hong Kong				
Issuers	Issuance date	Issuance size	Maturity	Interest rate
China Development Bank	July 2007	RMB 5 bn	2 years	3.00%
Export and Import Bank of China	July 2007	RMB 2 bn	2 and 3 years	3.05% and 3.2%
Bank of China	September 2007	RMB 3 bn	2 and 3 years	3.15% and 3.35%
Bank of Communication	July 2008	RMB 3 bn	2 years	3.25%
Export and Import Bank of China	September 2008	RMB 3 bn	3 years	3.4%
China Construction Bank	September 2008	RMB 3 bn	2 years	3.24%
Bank of China	September 2008	RMB 3 bn	2 and 3 years	3.25% and 3.4%
Bank of East Asia (China)	July 2009	RMB 4 bn	2 years	2.8%
HSBC (China)	July 2009	RMB 1 bn	2 years	38bp over 3M Shibor
China Development Bank	August 2009	RMB 1 bn	2 years	38bp over 3M Shibor
China Development Bank	August 2009	RMB 2 bn	2 years	2.45%
HSBC (China)	September 2009	RMB 2 bn	2 years	2.6%
Ministry of Finance	October 2009	RMB 6 bn	2, 3 and 5 years	2.25%, 2.7% and 3.3%
Source: Hong Kong Monetary Authority				



# How to think about renminbi banking in Hong Kong?

- ◆ An early and limited form of non-resident convertibility of the renminbi
- ◆ Can be seen as the emergence of an “Asian” renminbi market
- ◆ Such convertibility is location-specific: the renminbi’s non-resident convertibility is higher in Hong Kong than other places outside Mainland China
- ◆ Such convertibility is also business-specific: the renminbi’s non-resident convertibility is higher for certain authorized business activities

# **The Chinese approach to capital account liberalization**



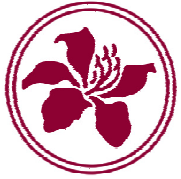
# The Chinese approach to economic reforms

- ◆ “Cross river by groping for stones”
- ◆ “Dual track”
- ◆ Location-specific policy experiments



# Capital account liberalization with Chinese characteristics

- ◆ What does the renminbi banking experience in Hong Kong tell about China's approach to capital account liberalization?
  - “Proactive, controllable, and gradualist”
  - “Quick small steps”
  - “Speed bumpers”



# The spectrum of convertibility

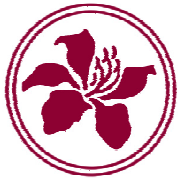
- ◆ Higher convertibility for collective investment schemes than for individuals (e.g., QFIIs and QDIIs)
- ◆ Higher convertibility for residents of certain geographical locations (e.g., Hong Kong)
- ◆ Higher convertibility for certain products and types of businesses (e.g. non-resident convertibility only for trade settlement)



# The art of bank account management

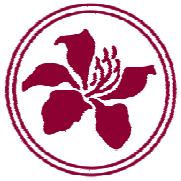
- ◆ At the heart of the spectrum of convertibility lies an elaborate system of bank account management
- ◆ Specific types of bank accounts are reserved for specific types of activities
- ◆ The spectrum of renminbi convertibility is achieved by controlling ownership and access rights to certain types of bank accounts, and imposing limits on the balances of accounts or the speed of change of such balances





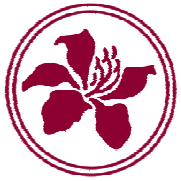
# Controlling potential risks of external use of renminbi

- ◆ Expanding domestic or onshore banking system liquidity
  - By imposing reserve requirements on offshore deposits
- ◆ Exchange rate pressures (since conversion of the Hong Kong dollar into and out of the renminbi represents capital inflows to and outflows from the Mainland)
  - By imposing daily conversion limits or aggregate conversion quota
- ◆ Gap between onshore and offshore yield curves?
  - There are precedents for the home central bank to do liquidity operations in the offshore markets to influence onshore-offshore yield gap



## How fast will it go?

- ◆ While the Mainland authorities are keen to reap the benefits that may come from a more open capital account, they are also conscious of the potential pitfalls associated with a fast pace of liberalization
- ◆ Capital account liberalization and domestic financial system reforms are an integral part of policy considerations
- ◆ The pace of capital account liberalization will not necessarily be a linear progression



## Concluding remarks

- ◆ Renminbi's capital account convertibility should be seen as a spectrum, not black and white
- ◆ The Chinese authorities have developed an elaborate system of bank account management, which allows them to conduct experiments with higher degree of convertibility
- ◆ Although the stated intention is to achieve full capital account convertibility, the pace of liberalization will be environment dependent
- ◆ An offshore market of the renminbi can flourish before full capital account liberalisation is achieved; Hong Kong is well positioned to further develop its renminbi market in the period ahead