离岸人民币产品发展的前瞻
Prospects of Renminbi Offshore Products

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「加强香港、内地与世界连系，创建更稳健市场」

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Introduction

- What do we mean by the "Internationalisation of the Renminbi"? It can mean many different things:
- The Renminbi is used as a "unit of account" and/or a medium of exchange outside of the Mainland.
- The Renminbi is used as a store of value outside of the Mainland.
- The Renminbi is fully convertible, that is, both "current accounts" convertible and "capital accounts" convertible—both inbound and outbound capital controls are lifted.
- The Renminbi and Renminbi assets are held by foreign central banks as a reserve currency.

The Internationalisation of the Renminbi

- International trade and other international transactions are normally denominated in a limited number of currencies principally because the citizens of most countries do not wish to accept or to hold the currencies of other countries than the few recognised as "reserve" or "hard" currencies (e.g., US$, Euro, Japanese Yen, Swiss Franc, British Pound). (Gold is possibly an exception.) "Hard" currencies are currencies that are widely accepted and held. Not all fully convertible currencies are hard currencies but almost all hard currencies are fully convertible currencies.
- The major share of World trade is denominated in U.S. Dollars. The U.S. Dollar is used by many countries as the medium of exchange in their international transactions. As world trade and capital flows grow, the demand for U.S. Dollars for transaction balances increases.

The Internationalisation of the Renminbi

- The willingness to accept and to hold a non-local currency depends, but not exclusively, on whether the currency is fully convertible, that is, there are no inbound or outbound capital controls. A person may be quite willing to accept and to hold a non-local currency if he or she knows that the next person he or she comes across is also likely to accept and hold the currency even though the currency may not be fully convertible. There can be wide general acceptance without full convertibility.
- Even though the Renminbi is not de jure fully convertible, it has gradually become de facto convertible in many economies in East Asia because of its wide general acceptance. For example, the Renminbi is widely accepted and used in Hong Kong, Macau, Laos, Myanmar, and other East Asian economies and in border areas on a voluntary basis even though it is not legal tender in these places.

The Internationalisation of the Renminbi

- The global financial crisis of 2007-2009 has paradoxically accelerated the pace of internationalisation of the Renminbi. Neither the U.S. Dollar nor the Euro are perceived as “risk-free” currencies that they once were. The Renminbi has gained in stature relative to the U.S. Dollar and the Euro.

The Renminbi as a Unit of Account and Medium of Exchange

- For some time now, qualified Chinese traders have been allowed to settle their international transactions in Renminbi instead of U.S. Dollars or another fully convertible currency on a voluntary basis. It is anticipated that eventually all traders will be allowed to settle their international transactions in Renminbi.
- However, the long-term market expectation of the future Renminbi/U.S. Dollar exchange rate is uni-directional, that is, the Yuan is expected to appreciate relative to the U.S. Dollar, and hence also relative to the Hong Kong Dollar. Rightly or wrongly, everyone expects the Renminbi to appreciate with respect to the U.S. Dollar.

The Renminbi as a Unit of Account and Medium of Exchange

- Given this expectation, Mainland importers and service demanders have no incentive to offer to place their orders or settle in Renminbi—they would much prefer to use U.S. Dollars or Hong Kong Dollars (unless they receive an appropriate discount).
- Also, while a Chinese exporter would like to quote their prices and invoice in Renminbi, a foreign importer of the Chinese goods would not want to place an order in Renminbi and agree to settle in Renminbi for fear that it might cost much more in terms of U.S. Dollars by the time the goods arrive in the U.S. or elsewhere several months later.

The Renminbi as a Unit of Account and Medium of Exchange

- Currently, the cost of hedging against a Renminbi appreciation is high and can only be done in the non-deliverable-forward market. That is one reason why even though it is now possible for the settlement of Chinese trade transactions in Renminbi, only a very small proportion of Chinese trade is denominated and settled in Renminbi. The most recent estimate is that it amounts to no more than US$10 billion a year, less than 0.05 percent of aggregate Chinese international trade.

The Renminbi as a Unit of Account and Medium of Exchange

- In order to accelerate the transition of Chinese international trade to Renminbi denomination and settlement from U.S. Dollar denomination and settlement, it may be useful for the People's Bank of China to offer a low-cost exchange rate hedge to bona fide exporters and importers.
- This can be as simple as selling and buying Renminbi forward (say, at 3 months, 6 months and 12 months) to and from bona fide traders engaged in Chinese international trade with established track records and with amounts limited to no more than the full value of the merchandise or service.
- The purpose of the forward market is to provide "insurance" to those bona fide traders against fluctuations in the Renminbi exchange rate and not to provide an instrument for speculation.

The Renminbi as a Unit of Account and Medium of Exchange

- For example, Hong Kong importers of Mainland goods and services may be permitted to purchase Renminbi forward not exceeding the value of the invoice. Such Renminbi will not be transferrable and can only be paid to the specific Mainland exporters of the goods and services.
- Chinese importers of goods and services will probably insist on settling in U.S. Dollars but they should also be permitted to buy forward foreign currencies from the People's Bank of China to reduce the exchange rate risk.
- The Yuan, which had been de facto pegged to the U.S. Dollar since the collapse of Lehman Brothers in mid-September of 2008, was freed up on 19th June 2010 and returned to a "managed floating rate" regime. The "managed floating rate" regime of the Renminbi does mean that in the short term the Renminbi can go both up and down relative to the U.S. Dollar (even though the long-term direction is clearer).

The Renminbi as a Unit of Account and a Medium of Exchange

- The “Renminbi Clearing and Settlement Agreement” just concluded between the People’s Bank of China and the Hong Kong Monetary Authority means that the Renminbi can be used in many more types of transactions in Hong Kong.
- Under this agreement, financial institutions and almost all other enterprises in Hong Kong are permitted to maintain Renminbi accounts and conduct transactions in Renminbi, for examples, in the settlement of trade transactions, the granting of Renminbi-denominated loans, and eventually, for buying and selling shares of Chinese enterprises on the Hong Kong Stock Exchange in Renminbi.

The Renminbi as a Unit of Account and a Medium of Exchange

- How do households and enterprises outside of the Mainland acquire Renminbi?
- Permanent residents in Hong Kong can purchase up to 20,000 Yuan per day per bank account from their commercial banks in Hong Kong. With a population of 7 million, in principle, the Hong Kong households can collectively purchase as much as 140 billion Yuan a day (or more, since it is per bank account and not per person).
- With 250 business days a year, we are talking about 35 trillion Yuan, or approximately US$5 trillion a year, which is more than double the entire foreign exchange reserves of the People's Bank of China of US$2.5 trillion in 2009!

The Renminbi as a Unit of Account and a Medium of Exchange

- Of course, we are nowhere close to this level. For one thing, there are not too many people who have the resources to be purchasing 20,000 Yuan per day only to be placed in very low-interest-rate savings accounts.
- One estimate is that the net inflow of foreign exchange is at this time probably no more than US$5 billion a year from this source, but it can increase in the future as the returns to Renminbi assets rise in Hong Kong.
- The total stock of Renminbi deposits in commercial banks in Hong Kong has been estimated at no more than US$15 billion, a minuscule figure compared to total Renminbi deposits on the Mainland itself, but it can also rise in the future.

The Renminbi as a Unit of Account and a Medium of Exchange

- There are many Hong Kong enterprises with direct investment in the Mainland, and thus they will have some Renminbi revenue, but while they can repatriate their profits by purchasing foreign exchange from the People's Bank of China with their Renminbi balances, their Renminbi per se cannot be taken out of the Mainland without special permission.
- They may be able to receive Renminbi in payment for their exports of goods and services to the Mainland, if the Mainland importers/service demanders are so willing.
- Renminbi is sometimes also brought into Hong Kong across the border in the form of cash, possibly in violation of the Mainland government regulations.

The Renminbi as a Unit of Account and a Medium of Exchange

- Chinese trade with East Asia is approximately 35% of its total international trade. Eventually it is possible that the bulk of the Chinese trade with East Asia may be denominated in Yuan. This trade alone amounts to more than US$1 trillion each year, with most of it currently denominated in U.S. Dollars.
- Mainland exports to Hong Kong, excluding re-exports, amounted to US$160 billion in 2009. Hong Kong domestic exports to the Mainland amounted to US$3 billion in 2009. If only trade between Hong Kong and Mainland are settled in Renminbi, it would amount to US$163 billion, a sizeable number.

The Renminbi as a Store of Value and an Inflation Hedge

- Given the expected long-term appreciation of the Renminbi relative to the U.S. Dollar, and the fact that the Hong Kong Dollar is pegged to the U.S. Dollar, the Renminbi is a good store of value for Hong Kong households and enterprises.
- It also provides a long-term inflation hedge—while there are risks of inflation in both the U.S. and the Mainland, it is likely that China will be more able to keep inflation under control than the United States because it does not have a large budget deficit and a large and rising public debt as the U.S. does.
- Renminbi is also liquid, unlike gold and other precious metals.
- Thus far, however, the Renminbi balances held by households in Hong Kong are largely idle, as there is a dearth of financial instruments denominated in Renminbi. But this situation is likely to change very quickly with the settlement agreement in place.

The Renminbi as a Store of Value and an Inflation Hedge

- With financial institutions and enterprises being permitted to hold and transact in Renminbi, many possibilities are opened up. For example, the Renminbi held by households in their bank accounts can be used to purchase other Renminbi-denominated assets—bonds, stocks, convertible bonds, or financial instruments linked in whole or in part to A-share indices, when these become available. Eventually Hong Kong households may also be able to use their Renminbi balances to purchase shares listed on the Hong Kong Stock Exchange but traded in Renminbi.

The Renminbi as a Store of Value and an Inflation Hedge

- Of particular interest are long-term financial instruments that are denominated in Renminbi. Looking ahead 10, 20 or 30 years, the Renminbi is bound to appreciate relative to the U.S. Dollar as productivity rises in Mainland China.
- The purchase of long-term Renminbi-denominated bonds by Mandatory Provident Funds and other retirement funds in Hong Kong is therefore a good idea. It helps to protect the long-term purchasing power of the retirement assets of employees.

The Renminbi as a Store of Value and an Inflation Hedge

- Mainland financial institutions can tap the Hong Kong market for long-term Renminbi bonds that can be used to finance long-term mortgages for owner-occupied residential housing on the Mainland itself. (This is predicated on the possibility of a return flow back into the Mainland of the Renminbi raised in Hong Kong.)
- Mainland and Hong Kong insurance companies can also offer Renminbi-denominated annuity products to permanent residents of Hong Kong, providing retired individuals with a long-term inflation hedge. They can use the proceeds from selling the annuity contracts to purchase long-term Renminbi-denominated bonds.

The Mainland Concerns—Too Much Capital Inflow

- Too much foreign capital inflow into the Mainland can be a problem because it will create pressure for the Renminbi exchange rate to rise too rapidly, unless the People's Bank of China buys the additional foreign exchange with more Renminbi, but that in turn will increase the domestic money supply and hence increase inflationary pressure on goods and services as well as assets on the Mainland. The People's Bank of China will have to undertake sterilisation measures by trying to mop up the excess Renminbi through the issuance of additional bonds and notes. At this juncture, China does not need more foreign exchange.

The Mainland Concerns—Too Much Capital Inflow

- However, the return flow of the offshore Renminbi, whether raised by Hong Kong or Mainland enterprises, will also increase the effective money supply on the Mainland and should therefore be carefully monitored. The more ideal situation is for the Renminbi balances to be held and used in Hong Kong and elsewhere. In particular, if settlement of transactions in Renminbi is widely practiced, then enterprises and households in Hong Kong will have an incentive to maintain a certain level of Renminbi balances for transactions purposes and correspondingly reduce their level of U.S. Dollar balances (this is a phenomenon known as "currency substitution").

The Chinese Concerns—Too Much Capital Outflow

- However, China is also concerned that there may be too much capital outflow if capital controls are totally lifted.
- What useful indicators are there to assess the extent of pent-up demand for capital inflow or outflow?
- One useful indicator is of course the gap between the black market exchange rate and the official market exchange rate of the Renminbi, if any.
- Another possible indicator is the average premium/discount between the price levels of the same stocks traded on both Chinese and foreign (including Hong Kong) stock exchanges.

The Chinese Concerns—Too Much Capital Outflow

- The listing of the depositary receipts of a foreign stock in the Mainland creates only an one-off outflow of capital. Subsequent trading of the depositary receipts on Mainland stock exchanges will be done entirely in Renminbi and does not create capital inflow or outflow.
- It may therefore be more prudent to proceed with the relaxation of capital controls gradually, in a controllable, orderly manner, for example, by allowing dual listing of shares on both Hong Kong and Shanghai Stock Exchanges (in whatever forms—H shares, CDRs, HKDRs), and to use the average premium/discount between the price levels of the same underlying stocks as an indicator of the extent of excess demand or supply of foreign assets.

The Chinese Concerns—Too Much Capital Outflow

- If there is a premium on the Shanghai Stock Exchange, it means capital will likely flow out of China if controls are lifted. If there is a premium on the Hong Kong Stock Exchange, it means capital will likely flow into China if controls are lifted. If there is very little premium or discount, it means there is already approximate equilibrium and lifting of capital controls will not have a large impact.
- Recent data on prices of stocks available on both Hong Kong and Shanghai Stock Exchanges suggest that the premia/discounts have largely disappeared, indicating that there is effective arbitrage between the two markets by investors trading in both markets.

The Chinese Concerns—Offshore Renminbi Creation

- Another potential concern is that the increased offshore Renminbi activities may lead to the creation of additional offshore Renminbi through credit creation by commercial banks. This can be controlled by restricting the ability of commercial banks with Renminbi deposits to make loans denominated in Renminbi. For example, they may be allowed to make Renminbi loans, but only up to a certain percentage of their total Renminbi deposits—in effect, a reserve requirement on Renminbi deposits. (They are, however, allowed to make loans against their own capital to the extent that they are held in the form of Renminbi.)

The Chinese Concerns—Offshore Renminbi Creation

- Not imposing something akin to a reserve requirement on Renminbi deposits in Hong Kong may lead to an unlimited and un-controlled expansion in Renminbi-denominated credit offshore, which is not subject to regulation by the People's Bank of China.
- The degree of separation between the on-shore and off-shore Renminbi markets depends on the successful enforcement of capital control by the Mainland, both inbound and outbound. Otherwise, there is bound to be substitution and competition and regulatory as well as interest rate arbitrage between the Mainland and Hong Kong.
- Thus, the entire set of problems of whether to allow return flows and how much to allow, and under what conditions, apart from settlement of transactions, need to be studied as the return flows become large. (The flows are too small to be worth worrying right now.)

The Chinese Concerns—Offshore Renminbi Creation

- A further issue is whether it is possible for the offshore Renminbi to have a different exchange rate from that of the onshore Renminbi. In principle, individual Hong Kong residents can buy and sell Renminbi at the official exchange rate up to HK$20,000 per bank account per day. However, these flow amounts are small in the aggregate, and may be insufficient to equilibrate the offshore Renminbi market. So there may be a possibility for a deviation between the offshore and onshore Renminbi exchange rates. Mechanisms should be devised to assure that this situation can only occur very temporarily and infrequently.

Price and Tax Equalisation of Common Stocks

- The prices of the same stocks traded on both the Hong Kong and Shanghai exchanges, albeit sometimes in different forms, have recently begun to equalise in the sense that any premium or discount has begun to diminish or disappear. What this means is that arbitrage between the two markets is taking place, by investors trading in both Hong Kong and Shanghai, and the two markets are gradually becoming one, with increased capacity and liquidity for all.

Price and Tax Equalisation of Common Stocks

- However, the tax treatment of cash dividends is at this time different between Hong Kong and the Mainland. In Hong Kong, cash dividends are not taxable. In the Mainland, they are subject to a tax at a fixed rate of 20 percent. As long as there are minimal cash dividends, and the investors are short-term oriented, this difference does not matter too much.
- For long-term investors, and as cash dividends are increased over time, the tax treatment of cash dividends will begin to make a difference. Perhaps one possible way of reconciling this difference is for both Hong Kong and the Mainland to (1) allow cash dividend payments to be deductible at the enterprise level, that is, treated in the same way as interest payments; and (2) tax cash dividends received by individuals as part of consolidated individual income. This scheme has other advantages such as making equity financing just as attractive as debt financing, and in the Chinese case removing double taxation of corporate profits and making individual income taxation more equitable. But this is something for the future.

Concluding Remarks

- There are many opportunities for the development of Renminbi-denominated offshore financial products in Hong Kong.
- In particular, they will help to fulfill the needs for a medium of exchange for transactions, international or otherwise, credible store of value and a reliable inflation hedge for Hong Kong and perhaps other East Asian households.
- Trading of some shares on the Hong Kong Stock Exchange, especially the Mainland-related shares that are also traded in Shanghai or Shenzhen, in Renminbi makes sense and will encourage Hong Kong households and enterprises to maintain Renminbi balances for transactions purposes.
- One manifestation of internationalisation of the Renminbi is that households and enterprises and even Central Banks elsewhere will begin to want to hold Renminbi balances for transactions and savings purposes. Thus, it is not necessary to focus on the return flows as a priority. The return flows, if they become large and significant, may actually complicate Mainland monetary policy, regulatory policy and exchange rate policy in a major way.