Increasing Competition among Markets for Offshore Renminbi Business

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I. Publication of report "London: a center for renminbi business"

1. Issue of renminbi bond by HSBC

On 18 April 2012 HSBC announced that it had issued a renminbi bond in London. The issue amount was RMB2 billion; the maturity was three years; and the coupon was 3%. The issue amount was originally RMB1 billion. However, HSBC decided to double the amount in response to an unexpectedly large increase in demand. Renminbi bonds issued in Hong Kong are popularly known as "dim sum bonds." A number of large European companies such as BP and Volkswagen have issued such bonds. However, HSBC was the first company to issue a renminbi bond outside Hong Kong since an offshore renminbi market was established there in 2004 (see below).

According to a Bloomberg report on the same day as HSBC's announcement, 60% of the issue was sold to investors in Europe, 20% to investors in Hong Kong, 15% to investors in Singapore, 2% to investors in the Middle East, 2% to investors in Asia, and 1% to investors in the US. Furthermore, 46% of the issue was taken up by private banks, 37% by fund management companies, and 13% by banks.

In addition, the issue was listed on the London Stock Exchange. This was apparently to facilitate the bond's sale to retail investors as well as to private banks (see above). It will also enable the bond to be traded during London trading hours. The issue is significant in that it takes advantage of London's institutional infrastructure and position as an international financial center to offer a financial product to investors without a QFII license or quota. Moreover, as with issuing a dim sum bond in Hong Kong, it enables a global company to raise renminbi funds on more favorable terms than in mainland China.

2. Support from private-sector-led London-Hong Kong International RMB Forum

There were a number of events leading up to the HSBC bond issue. During the visit of the UK Chancellor of the Exchequer, George Osborne, to Hong Kong on 16 January 2012 the UK Treasury and the Hong Kong Monetary Authority (HKMA) announced that an agreement had been reached on forming a joint private-sector forum[1] to facilitate the development of offshore renminbi markets. The forum's members were to be representatives of HSBC, Standard Chartered, Deutsche Bank, Barclays, and Bank of China (BOC) from both London and Hong Kong.

It was also announced that the HKMA would extend the operating hours of its offshore renminbi payments system from 10 to 15 hours, closing at 11.30 instead of 6.30, in order to overlap better with trading in London and make it easier for renminbi transactions in London to be settled. As a result, there would be no risk of a shortage of renminbi funds in London (e.g., to pay for HSBC's renminbi bond).

3. Publication of report "London: a center for renminbi business"

The HSBC bond issue was not an isolated event. Its timing was coordinated with the publication by the City of London of a report ("London: a center for renminbi business")[2] intended to promote London as "the leading western renminbi hub," complementing the roles of Hong Kong and other offshore renminbi centers.

The driving force behind this was the five member banks of the London-Hong Kong International RMB Forum supported by the City of London ("City of London initiative on London as a center for renminbi business"). The UK Treasury, the Bank of England and the Financial Services Authority (FSA) have observer status at the forum.

The report identifies four advantages that, in its view, London would enjoy as a western renminbi center: (1) a working day (time difference) that overlaps with that of China and Hong Kong; (2) well respected legal and regulatory systems; (3) a global financial community with a strong history of innovation; and (4) massive institutional liquidity, one of the factors behind London's strong positions in the forex market and international bond issuance.

In the next section we summarize London's position as an offshore renminbi market, using data from the above report.

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1 For the UK Treasury press release, see http: //www.hm-treasury.gov.uk/press_04_12.htm. For the HKMA press release, see http://www.hkma.gov.hk/eng/key-information/press-releases/2012/20120116-3.shtml

2 http://www.cityoflondon.gov.uk/business/economic-research-and-information/research-publications/Documents/research-2012/London- a%20centre%20for_renminbi_ business_ accessiblePDF_Final5.pdf

II. London as an offshore renminbi center

1. London and the internationalization of the renminbi

Efforts by the Chinese authorities to internationalize the renminbi began several years ago in Hong Kong, which has close links with mainland China. Their main aims were to foster the use of the renminbi to settle transactions with East and Southeast Asian trading partners to reduce the foreign exchange risk faced by mainland Chinese companies and to establish an offshore renminbi market in Hong Kong to provide opportunities to invest in the renminbi offshore. As far as the first aim is concerned, the use of the renminbi to settle trade transactions was introduced in July 2009 and has been gradually extended. Most of the transactions are with Hong Kong. As far as the second aim is concerned, it has been possible to open a renminbi deposit account in Hong Kong since 2004 and to issue renminbi bonds there since June 2007. The number of issuers has gradually increased.

The internationalization of the renminbi has therefore been centered on Hong Kong (Figure 1) thus far. Since 2011, however, there have been moves to enable offshore trading in renminbi and establish offshore renminbi markets (in addition to that in Hong Kong). At the September 2011 UK-China Economic and Financial Dialogue in London Mr Osborne and Chinese Vice Premier Wang Qishan discussed the possibility of trading renminbi in the City of London, while, in January 2012, Mr Osborne and his Hong Kong opposite number, Norman Chan, Chief Executive of the HKMA, announced an agreement to cooperate on the development of offshore renminbi

Figure 1: Main developments in the internationalization of the renminbi from a London perspective

Date	Event
January 2004	・ Customers allowed to open renminbi deposit accounts in Hong Kong ・ Bank of China designated as clearing bank for renminbi business in Hong Kong
June 2007	Issuance of renminbi bonds permitted in Hong Kong
July 2009	Pilot scheme announced to use renminbi to settle trade transactions
Jun-Jul 2010	・ Scope of renminbi settlement of trade transactions widened ・ Companies allowed to open renminbi bank accounts ・ Rules governing offshore issuance of renminbi bonds relaxed
September 2010	Customers of offshore banks allowed to open renminbi accounts to settle transactions
January 2011	Chinese companies allowed to use renminbi to make outward direct investments
March 2011	Eight offshore banks given access to Chinese interbank bond market
August 2011	・ Vice Premier Li Keqiang supports proposal to establish offshore renminbi center in Hong Kong ・ Rules governing repatriation of renminbi for inward direct investment clarified ・ Renminbi qualified foreign institutional investor (RQFII) program allows mainland Chinese securities companies to invest in mainland Chinese securities via their Hong Kong subsidiaries
September 2011	UK Chancellor of the Exchequer George Osborne and his Chinese counterpart, Vice Premier Wang Qishan, welcome private-sector initiative to establish offshore renminbi center in London
December 2011	City of London announces initiative to establish renminbi center in London
January 2012	・ UK Chancellor of the Exchequer George Osborne and HKMA Chief Executive Norman Chan announce agreement to cooperate in developing offshore renminbi business ・ HKMA proposes to extend operating hours of offshore renminbi payments system

Source: Nomura Institute of Capital Markets Research, from City of London, “London: a center for renminbi business” (April 2012).

markets. With the internationalization of the renminbi about to expand from Hong Kong to the rest of the world, London is making a bid, as part of the City of London initiative on London as a center for renminbi business, to expand as an offshore renminbi center with the help of the Chinese and Hong Kong authorities.

2. London as an offshore renminbi center

1) Bank deposits

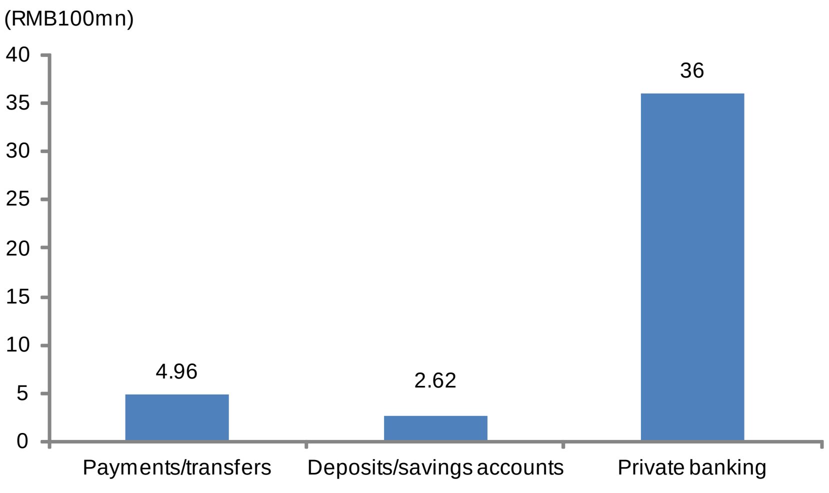
As of end-2011, more than RMB109 billion was deposited with banks in London. Of these, deposits in accounts for personal, corporate and institutional customers (customer deposits) amounted to RMB35 billion , while interbank deposits amounted to RMB74 billion. Although this is less than a fifth as much as the renminbi customer deposits in Hong Kong banks at end-2011 (RMB589 billion), the report points out that there has been a substantial increase in a relatively short space of time and considers that London has a promising future as a renminbi center not only in forex but also in investments provided the pool of renminbi liquidity continues to grow.

2) Retail banking

Of the banks surveyed in the report, 64% offer renminbi accounts to retail customers in London. Of these, 57% offer regular personal accounts while 43% offer private banking accounts. The only services offered to retail banking customers in renminbi at the moment are savings accounts (RMB155 million), deposits (RMB107 million), and payments/transfers (RMB496 million). However, credit card services are a potential new area as the demand for credit increases (Figure 2).

In contrast, the pool of private banking accounts is considerably larger (RMB3.6 billion), indicating strong demand from high net worth individuals for renminbi products and the ability to trade in them. At the moment, however, only one bank

Figure 2: Renminbi retail banking services (as of end-2011)



Source: Nomura Institute of Capital Markets Research, from City of London, “London: a center for renminbi business” (April 2012).

offers investment services in equities to its retail clients, and just two banks facilitate trading in dim sum bonds. There is therefore scope to offer a wider range of services.

3) Corporate banking

Most of London's corporate banking customers are likely to be companies with a trading or investment relationship with China. Of the banks surveyed, 64% offer corporate accounts in renminbi with the total amount of cash in these accounts at the end of 2011 being RMB31 billion. Of these, 36% offer treasury management services, 82% forex services (amounting to a total of RMB60 billion for 2011), and 36% overdraft facilities. During 2011 a total of RMB280 million in commercial loans was made to companies by four London-based banks.

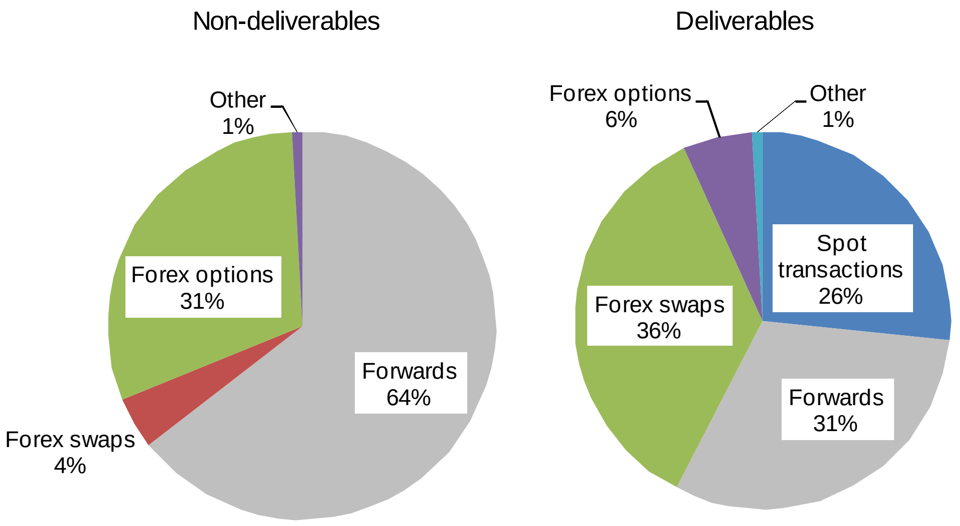
With regard to trade-related services in renminbi, 64% of the banks surveyed offer facilitated letters of credit, 45% offer supply chain services, and 73% import/export services. As an international business center, London enjoys a high demand for trade-related transactions in renminbi. The view is therefore that there are likely to more opportunities in corporate than retail banking.

4) Institutional and interbank market

(1) Foreign exchange services and risk management products

Because of currency controls, offshore trading in the renminbi is restricted. As a result, most trading of the renminbi in London is in non-deliverable products. In 2011 the average daily trading value of non-deliverable renminbi products in London was $8.53 billion, 64% ($5.5 billion) of which was in forwards (Figure 3).

Figure 3: Breakdown of renminbi forex transactions



Source: Nomura Institute of Capital Markets Research, from City of London, "London: a center for renminbi business" (April 2012).

In contrast, the average daily trading value of deliverables was $2.55 billion. Of this amount, $680 million was accounted for by spot transactions. This is 26% of the total for offshore spot transactions in renminbi and the second-largest amount after the estimated figure for Hong Kong ($1.5 billion). The total trading amount increased by 25% in the six months to October 2011. London is also an international center for trading in emerging market currencies. Trading in the renminbi has now reached a comparable level (Figure 4). As China eases its currency controls and offshore liquidity in renminbi increases, a shift from non-deliverable to deliverable products can be expected.

(2) Borrowing and financing products (renminbi bonds)

Of the banks surveyed, 36% offered a renminbi bond issuance service. This activity totaled RMB7.1 billion in 2011. All renminbi bonds issued outside mainland China prior to the HSBC bond were issued in Hong Kong, although there was some distribution to western investors through European sales desks. BP's renminbi bond issued in 2011 was the first such bond to be listed on the London Stock Exchange. Therefore, although the issuance of renminbi bonds in London has started, it is still at an early stage, as is the very issuance of renminbi bonds offshore.

(3) Investment products

The main renminbi financial products available to institutional investors in London are time deposits, certificates of deposit, and dim sum bonds. Of the banks surveyed, 45% offered time deposits and certificates of deposit in renminbi. The annual volume of this business in 2011 was RMB74 billion. Of the banks surveyed, 55% offered trading in dim sum bonds. The annual volume for this business in 2011 was RMB28 billion.

Figure 4: Forex transactions in emerging market currencies in London

	Average daily transaction volume ($mn)	
	Non-deliverable forwards	Non-deliverable options
Renminbi	5,500	2,600
Real	6,168	1,815
Won	6,309	1,151
Ruble	1,497	800
Rupee	4,627	492

Source: Nomura Institute of Capital Markets Research, from City of London, "London: a center for renminbi business" (April 2012).

(4) Custody and prime brokerage services

Of the banks surveyed, 18% offered custody services in renminbi, while 18% offered prime brokerage services.

The three main global custodian banks provide custody services in renminbi but act globally so they can serve clients from London without the need to open renminbi accounts in London. London is an important platform for custody services and is likely to see the demand for them grow if the renminbi becomes more widely used by investors.

The annual volume for 2011 in renminbi prime brokerage services was RMB94 billion. As London is a center for hedge funds and investment funds, the potential demand for these services is probably very large.

III. The Tokyo market and offshore trading in the renminbi

1. London's perception of its role

London's perception of its role as an offshore renminbi market appears to be that it should be complementary to that of Hong Kong and should focus on meeting and stimulating the demand for forex trading services and financial products such as bonds, especially from European investors.

HSBC, a member of the private-sector-led Hong Kong-London forum, has explained its decision to issue a renminbi bond in London as a contribution to both promoting London's status as an international center for renminbi business and to internationalizing the renminbi, and revealed that it consulted not only the UK and Hong Kong financial authorities but also the mainland Chinese financial authorities and mainland Chinese financial institutions.

Although the mainland Chinese financial authorities talk about "facilitating the use of the renminbi for trade and investment," we think they probably see the efforts by the UK government and private sector to extend the use of the renminbi for cross-border settlement from Hong Kong to other parts of the world as a major contribution to the renminbi's internationalization.

2. Efforts to establish an offshore renminbi market in Tokyo

As for establishing an offshore renminbi market in Tokyo, the Japanese prime minister, Yoshihiko Noda, and the Chinese premier, Wen Jiabao, agreed at their summit on 25 December 2011 to improve cooperation on developing the two countries' financial markets (Figure 5).

In the four months from end-December 2011 to April 2012 there were benefits for Japanese financial institutions and Japanese companies both specifically as a result of this agreement and as a result of more general deregulation in China.

Figure 5: Enhanced Cooperation for Financial Markets Development between Japan and China (Fact Sheet)

Preamble	To support the growing economic and financial ties between Japan and China, the leaders of Japan and China have agreed to enhance mutual cooperation in financial markets of both countries and encourage financial transactions between the two countries, specifically in the following areas, paying attention to the principle that these developments should be market-driven.
Items of agreement	I. Promoting the use of JPY and RMB in cross-border transactions between Japan and China. • Facilitating trade settlement in JPY and RMB to reduce foreign exchange risks and transaction costs for exporters/importers in both countries; and • RMB-denominated FDIs from Japan to Mainland China, including to subsidiaries of Japanese companies.
	II. Supporting the development of direct exchange markets between JPY and RMB;
	III. Supporting sound development of JPY and RMB bond markets. • ①RMB-denominated bonds issued by Japanese companies in Tokyo and other overseas markets; ②and RMB-denominated bonds issued by Japan Bank for International Cooperation in mainland China markets as a pilot program; and • Application process is underway for the Japanese authority to invest in Chinese government bonds.
	IV. Encouraging the private sector to develop JPY-denominated and RMB-denominated financial products and services in the overseas markets; and
	V. Establishing "Joint Working Group for Development of Japan-China Financial Markets" to promote mutual cooperation in the above-mentioned areas.
Other items	In addition, we agreed to accelerate the ASEAN+3 financial cooperation, including introducing the regional crisis prevention function and further strengthening the crisis resolution mechanism of CMIM.

Source: Nomura Institute of Capital Markets Research, from Ministry of Finance and PBOC data

Examples of the former are (1) Mitsubishi Corporation (China)'s registration in December 2011 of a program for issuing renminbi commercial paper in mainland China and subsequent use of that program (December 2011-January 2012), (2) Mizuho Corporate Bank's registration in February 2012 of a program for issuing renminbi bank debentures in mainland China, and (3) the granting of QFII licenses to individual financial institutions (Meiji Yasuda Asset Management, Sumitomo Mitsui Banking Corporation, Tokio Marine Asset Management, and Okasan Asset Management).

Examples of the latter are (1) an extension of the use of the renminbi for trade settlement to all mainland Chinese exporters (March 2012), (2) an increase in the investment quota for all QFIIs from $30 billion to $80 billion (April 2012), and (3) an increase in the investment quota for all renminbi qualified foreign institutional investor (RQFIIs) from $20 billion to $50 billion (April 2012).

In addition, the Japanese government has (1) arranged the first meeting of a joint working party to foster the development of financial markets in Japan and China in accordance with the December agreement (February 2012) and (2) obtained a quota from the Chinese authorities for purchasing Chinese government bonds (March 2012).

3. Potential of Tokyo market

Although these eight developments are evidence that the December agreement produced concrete results, either directly or indirectly, during those four months, it has yet, as the agreement envisages, to lead to the issue of renminbi bonds by Japanese companies on the Tokyo market.

However, China is both the largest destination for Japanese exports and the largest source of Japanese imports (Figure 6). Similarly, Japan is the largest source of Chinese imports. In 2010 China imported $176.7 billion worth of goods from Japan, equivalent to 12.7% of its total imports. Therefore, if a growing number of Chinese companies settle their purchases from Japanese companies in renminbi, the Tokyo market could see a corresponding increase in renminbi deposits. It is therefore possible to envisage a growing demand for renminbi bonds either in Tokyo or (via Tokyo) in Hong Kong as a means of investing the renminbi deposits in Tokyo. It is also possible to envisage that some of these deposits could flow back to the Chinese mainland in the form of direct investment rather than as bond investments. In 2011,

Figure 6: Japanese and Chinese imports and exports by source and destination (2010)

<Japanese export destinations>

Trading partner	Amount ($100mn)	Share
1 China	**1,491**	**19.4%**
2 US	1,182	15.4%
3 Korea	621	8.1%
4 Taiwan	522	6.8%
5 Hong Kong	421	5.5%
6 Thailand	341	4.4%
7 Singapore	251	3.3%
8 Germany	202	2.6%
9 Malaysia	176	2.3%
10 Netherlands	163	2.1%

<Japanese import sources>

Trading partner	Amount ($100mn)	Share
1 China	**1,528**	**22.1%**
2 US	672	9.7%
3 Australia	450	6.5%
4 Saudi Arabia	358	5.2%
5 UAE	292	4.2%
6 Korea	285	4.1%
7 Indonesia	281	4.1%
8 Taiwan	230	3.3%
9 Malaysia	226	3.3%
10 Thailand	210	3.0%

<Chinese export destinations>

Trading partner	Amount ($100mn)	Share
1 US	2,833	18.0%
2 Hong Kong	2,183	13.8%
3 Japan	**1,211**	**7.7%**
4 Korea	688	4.4%
5 Germany	681	4.3%
6 Netherlands	497	3.2%
7 India	409	2.6%
8 UK	388	2.5%
9 Italy	311	2.0%
10 Taiwan	297	1.9%

<Chinese import sources>

Trading partner	Amount ($100mn)	Share
1 Japan	**1,767**	**12.7%**
2 Korea	1,384	9.9%
3 US	1,020	7.3%
4 Taiwan	1,157	8.3%
5 China	1,068	7.7%
6 Germany	743	5.3%
7 Australia	609	4.4%
8 Malaysia	504	3.6%
9 Saudi Arabia	328	2.4%
10 Brazil	381	2.7%

Source: Nomura Institute of Capital Markets Research, from Japanese Ministry of Finance trade statistics and Chuugoku Jouhou Handobukku 2011 (China Data Handbook 2011) (in Japanese).

for example, inward direct investment in China by Japanese companies amounted to $6.35 billion, the third-largest amount after Hong Kong and Taiwan (Figure 7).

Unlike the agreement between the UK and China, the December agreement does not contain any reference to fostering an offshore renminbi market (in Tokyo). Whereas London has been promoting itself as an offshore renminbi market on the basis that its trading hours complement those of Hong Kong, we think Tokyo's potential lies in the scale of the likely non-speculative demand for renminbi (e.g., for trade and direct investment).

At a time when being able to offer products and services in renminbi adds to the attractiveness and competitiveness of any international financial center, it will be interesting to see to what extent Japanese companies and financial institutions use the Tokyo market to issue renminbi bonds.

Figure 7: Inward direct investment in China (2011)

Ranking	Country/region	Amount ($mn)	Share (%)
1	Hong Kong	77,011	66.4
2	Taiwan	6,727	5.8
3	Japan	6,348	5.5
4	Singapore	6,328	5.5
5	US	2,995	2.6
6	Korea	2,551	2.2
7	UK	1,610	1.4
8	Germany	1,136	1
9	France	802	0.7
10	Netherlands	767	0.7
(cf.)	EU	6,348	5.5
	Global total	116,011	100

Source: Nomura Institute of Capital Markets Research, from Chinese Ministry of Commerce data