



WWJMRD 2021; 7(11): 11-14  
www.wwjmr.com  
International Journal  
Peer Reviewed Journal  
Refereed Journal  
Indexed Journal  
Impact Factor SJIF 2017:  
5.182 2018: 5.51, (ISI) 2020-  
2021: 1.361  
E-ISSN: 2454-6615  
DOI: 10.17605/OSF.IO/KHT3F

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## Offshore RMB Market and RMB Internationalization

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### Abstract

With the development of China's foreign trade and the expansion of international exchanges, RMB gradually plays the role of measure of value, means of payment and store of value in the world, and an efficient offshore market is a prerequisite for RMB to play the role of international currency. Hong Kong RMB (renminbi) offshore market plays a key role in cross-border renminbi payments. With the expansion of offshore RMB market, its spillover effect is obvious and its influence on RMB pricing is gradually enhanced. It is necessary to deepen the reform and opening of financial market to coordinate the development of onshore and offshore markets, so as to further promote the internationalization of RMB.

**Keywords:** RMB Onshore Market; RMB Offshore Market; RMB Internationalization; Risk Hedging; Capital Account

### Introduction

With the development of China's foreign trade and the expansion of the cooperation with other countries, RMB gradually plays the role of measure of value, means of payment and store of value in the world. Particularly, Hong Kong, China, currently plays a key role in cross-border renminbi payments. As an important step in RMB internationalization, RMB offshore market has been expanding quickly. With the improvement of China's economic strength and the expansion of its foreign trade, especially after China takes the lead in controlling the epidemic and resuming production, international capital continues to flow in, RMB exchange rate remains strong, the offshore RMB market is developing rapidly, and RMB internationalization has been accelerated.

### I. Development of offshore RMB market

Bank of China (BOC) has played an important role in the development of the offshore yuan market. In December 2003, BOC HK (Bank of China (Hong Kong)) was qualified as a clearing bank for RMB business in Hong Kong.

In February 2004, BOC HK launched RMB clearing service to provide deposit, exchange, remittance and RMB bank card clearing services for licensed banks in Hong Kong that participated in individual RMB business, and the offshore RMB capital pool began to accumulate slowly.

In July 2009, the Administrative Measures for Pilot Cross-border Trade RMB Settlement came into effect. BOC HK and the PBOC (People's Bank of China) signed the Agreement on RMB Business Clearing to provide RMB trade clearing services for participating banks in RMB business.

In July 2010, PBOC and BOC HK signed a new revision on the settlement agreement of RMB business, the business scope of clearing has expanded from Hong Kong & Macao, the Association of South-East Asian nations (Asean) to the rest of the world. Since then, offshore renminbi pool accumulated quickly, foreign exchange market of deliverable offshore yuan began to run and the offshore RMB interest rate curve has been improved. All these achievements have accelerated the expansion of derivatives markets such as forward, swap, option and currency swap contract (CCS).

### 1.1 Offshore Renminbi Pool

Offshore Renminbi deposits in Hong Kong, Macao and Taiwan constitute the main part of the global Offshore Renminbi deposits, and there is also a certain amount of offshore RMB deposits in Singapore, the United Kingdom, Japan, South Korea and other places. The global offshore RMB deposit peaked at 2.1 trillion yuan in 2015, and then gradually declined.

By the end of 2020, the global offshore RMB deposit still remained at about 1.6 trillion to 1.8 trillion yuan. By the end of 2020, the balance of Offshore Renminbi deposits in Hong Kong was 721.7-billion-yuan, accounting for about half of the global balance of offshore RMB deposits. Offshore RMB deposits in Taiwan totaled 244.1 billion yuan; Singapore offshore RMB deposit had a balance of 152 billion yuan; The balance of offshore RMB deposits in London was 64.6 billion yuan with the balance of offshore RMB loans 45.4 billion yuan. Offshore RMB deposits in Macao totaled 61.2 billion yuan.

### 1.2 Amount of Settlement

Hong Kong was the first to start offshore RMB business. The financial infrastructure related to offshore RMB is perfect and plays a key role in RMB cross-border payment. About 75 per cent of global offshore renminbi payments are settled in Hong Kong, according to SWIFT. Hong Kong's position in offshore RMB payment and clearing has strengthened in recent years due to the scale effect of payment and clearing systems.

The REAL-TIME RMB Payment and Settlement System (RTGS) in Hong Kong, operated by BOC Hong Kong, provides services for banks around the world to make RMB payments. In recent years, the settlement volume of real-time RMB payment and settlement system in Hong Kong has been increasing, reaching the highest monthly settlement of 35.52 trillion yuan in March 2021.

### 1.3 Trading Volume

According to the global foreign exchange market report released by the Bank for International Settlements (BIS), the average daily trading volume of the global foreign exchange market in 2019 was 6.59 trillion US dollars (bilateral trading volume), an increase of 30.08% compared with the average daily trading volume of 5.07 trillion US dollars in 2016, ranking the UK first and Hong Kong the fourth by region.

According to the BIS, Hong Kong remains the world's largest market for offshore renminbi foreign exchange and over-the-counter interest rate derivatives. In 2019, offshore RMB foreign exchange trading volume in Hong Kong accounted for 41%, up 3 percentage points from 2016. Singapore offshore RMB foreign exchange trading volume accounted for 16%, down 5 percentage points from 2016 and UK offshore RMB forex trading volume accounted for 22 per cent, up 2 percentage points from 2016.

According to BIS, the average daily trading volume of offshore RMB foreign exchange in Hong Kong increased 39.6% from 77.1 billion US dollars in April 2016 to 107.6 billion US dollars in April 2019. In April 2019, the average daily trading volume of offshore RMB forex in the UK was \$56.7 billion.

According to SWIFT statistics based on MT300 messages, 38.18% of offshore RMB spot foreign exchange transactions are settled in the UK and 8.95% in Hong

Kong. The Statistical Criteria of SWIFT is significantly different from that of BIS, which more reflects the dimension of the place where the transaction takes place. SWIFT confirms the amount involved in RMB foreign exchange and derivatives exchange according to specific messages, and calculates the transaction volume of relevant places according to the SWIFT address of the sender and receiver of the messages. The SWIFT address does not necessarily reflect the actual place where the relevant foreign exchange transaction is conducted or executed. Therefore, when it comes to trading volume statistics, the market relies more on BIS data.

### 1.4 Transaction Time

Most of the offshore RMB business is carried out based on domestic demand, so the offshore RMB trading is more active in the Asian time and the first half of Europe, especially in the trans-Asian and European time zones from 2 PM to 5 PM Beijing time. For example, in February 2021 on a famous trading platform, Asia, EMEA and the Americas accounted for 51%, 40% and 9% of trading volume, respectively.

### 1.5 Dim Sum Bond Issuance

The issuance of dim sum bond is closely related to the capital pool stock in the offshore RMB market, reflecting the willingness of market participants to conduct bond financing through the offshore RMB market. Dim sum bond has become an investable product for the offshore RMB market. The size of dim sum bond market is one of the important indicators for the development of the offshore RMB market. After issuance, some bonds will be listed and traded on exchanges around the world, with a total of 597.9 billion yuan of dim sum bonds outstanding at the end of April 2021. At present, dim sum bonds are mainly listed on the Hong Kong Regional Exchange, Luxembourg Exchange, London Exchange, Frankfurt Exchange, Singapore Exchange and other places (the same bond can be listed on more than one exchange).

## II. Offshore market As an Important Basis for RMB Internationalization

International currency refers to the currency used as a measure of value and means of settlement and payment in international transactions of financial assets, goods and services trade, and held by private economic sectors and monetary authorities as international liquid assets and reserve assets. With the development of China's foreign trade and the expansion of international exchanges, RMB will necessarily play the role of value scale, payment means and value store in the world, and the offshore market is an important support for RMB to play this role

### 2.1 More Efficient Market Price Discovery Function for RMB

The most important function of price discovery is the market-oriented pricing mechanism, which provides information about the market interest rate, exchange rate, to help all the participants in their decisions. The offshore RMB market has the advantage of more sensitive price discovery, which can provide more efficient and diversified information sources for market participants to make decisions. Meanwhile, the price difference between the offshore market and the onshore market is also an

important market information, reflecting the market's judgment on the direction of RMB to a certain extent.

## 2.2 To Provide Support for RMB to Play the Role of International Settlement

The offshore RMB market can provide conditions for the RMB to play the role of trade settlement and trade financing. In March 2003, *the Notice of the State Administration of Foreign Exchange on Issues Concerning the Use of RMB as the Currency of Foreign Trade by Domestic Institutions* stipulated that "Domestic institutions may use RMB as the currency of foreign trade when signing import and export contracts", which kicked off the use of RMB as the currency of foreign trade pricing and settlement. In recent years, China's foreign trade priced and settled with yuan has surged. Continuous improvement of the offshore yuan market has provided transparent effective price information and a variety of derivatives for risk hedge for goods and service trade. So RMB has become more attractive for market players to choose the renminbi as a trade settlement currency. The offshore RMB market also provides international investors with hedging tools and helps enterprises take advantage of two markets and two resources to reduce their financial costs.

## 2.3. To Provide Support for the RMB as an International Pricing Currency for Commodities

The offshore renminbi market could underpin the renminbi's role as a commodity-denominated currency. As a major importer of bulk commodities, China almost has no voice and market influence in the pricing of international bulk commodities. At present, promoting the transaction of bulk commodities denominated in RMB is one of the important targets in the overall strategy of RMB internationalization. The offshore RMB market is more sensitive to information, with its high degree of liberalization, diversified types of market participants can provide pricing basis and risk hedging means for RMB-denominated commodity transactions and surely will enforce influence of RMB in the field of commodity pricing. At the same time, a developed offshore market itself is the important platform to attract international investment, a part of which focus in forex market trading for profit. On this platform, market participants are from all sources, financial products are more diversified with high level of liquidity. All these factors make the offshore RMB market more attractive for international investors to involve in RMB trading. Moreover, it has strong spillover effect and can effectively improve the domestic financial market.

## 2.4 To Provide Support for RMB to Play the Role of International Reserve Currency

The offshore RMB market can provide an important channel for the RMB to play its role as an international reserve currency. At present, the US dollar is still the most important reserve currency in the world, which is facilitated by the flexible and efficient USD market around the world. International investors can easily buy and sell u.s. dollars to adjust their assets and liabilities. No doubt, as the offshore RMB market gradually expands, it can provide a convenient and reliable channel for overseas monetary authorities to obtain RMB, and strengthen the function of RMB as an international reserve currency. At present "land port Connect" and "Bond Connect" under the capital

account control both depend on the offshore RMB market in meeting the needs of financing and risk hedges.

## III. Future Prospects

Although the offshore RMB market has made great progress, it still needs to solve several problems in the future, otherwise the development of RMB internationalization will inevitably be hampered.

Due to the existence of the offshore market in Hong Kong, RMB has two parallel pricing systems: the relatively closed onshore RMB exchange rate controlled by the central bank, and the relatively free and opened-up offshore RMB exchange rate driven by the market force. At present, under the influence of a variety of factors, the exchange rate difference between the two markets continues to exist. However, in view of inconvertibility of RMB and ongoing the domestic market-oriented reform, the offshore RMB market plays a passive role in the RMB internationalization process.

With the increasing influence of the offshore market and the gradual relaxation of capital account controls, the relationship between offshore and onshore exchange rates has become increasingly complex. However, with the expansion and deepening of the offshore RMB market, the price discovery function of the Offshore RMB market in Hong Kong is increasingly perfect. Compared with the development mode of "market + policy" in the onshore market, the operation and adjustment mechanism of the offshore RMB market is more flexible and naturally will have more influence on RMB exchange rate. One potential problem will arise that the offshore market may erode the yuan's pricing power of onshore market. At the same time, the development of offshore market may produce some impacts on the domestic monetary policy and macroeconomic operation. Therefore, in order to facilitate the positive interaction between the offshore and onshore markets, the onshore market must speed up financial reform including further easing the barriers of cross-border capital flow of RMB, deepening the reform of the exchange rate system, strengthening the construction of financial infrastructure, implementing financial prudential supervision, etc., so as to enable the healthy development of the RMB offshore market.

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