

Hong Kong's renminbi business two years on

by the External Department

The scale of renminbi business in Hong Kong has increased steadily. The differential between Hong Kong dollar and renminbi deposit rates and expectations for an appreciation of the renminbi were two important factors affecting the growth of renminbi deposits last year. The new Renminbi Settlement System, launched to coincide with the introduction of the expanded renminbi business, has further improved the robustness and efficiency of renminbi settlement.

Introduction

The launch of renminbi business in February 2004 marked the beginning of one of the most notable developments in Hong Kong's financial system in recent years.¹ Banks in Hong Kong now offer five types of banking services in renminbi, including deposit taking, currency exchange, remittance, debit and credit cards, and personal cheques. At the end of 2005, 38 banks in Hong Kong were engaged in renminbi business, representing nearly all major retail banks in the territory. Their active participation demonstrates a strong belief in the growth potential of this new line of business. This article gives an overview of the development of the business and its recent expansion, and discusses future prospects.

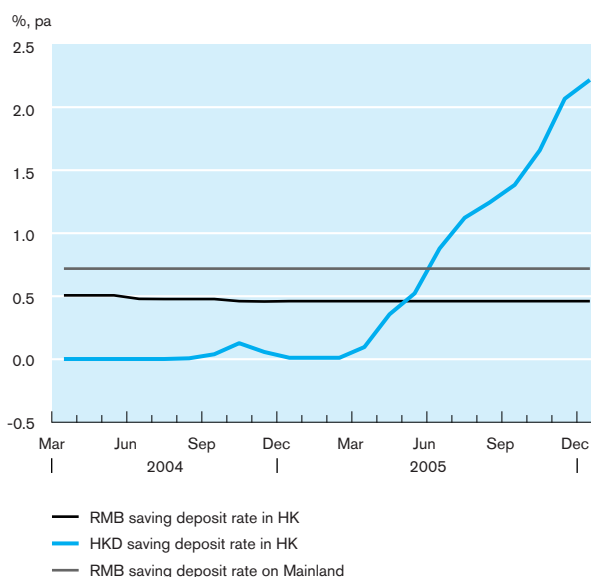
Developments

Deposits

The outstanding amount of renminbi deposits increased markedly in the first half of 2005, but the pace of increase moderated somewhat in the second half. Higher renminbi interest rates over Hong Kong dollar interest rates and the expectation of a renminbi appreciation sustained rapid growth in deposits

(Box). With the implementation of the three refinements of the Hong Kong dollar Linked Exchange Rate system in May 2005, the Hong Kong dollar deposit rates rose in tandem with the increases in US interest rates, while renminbi deposit rates remained largely unchanged. Hong Kong dollar deposit rates have therefore exceeded that of renminbi since June 2005 (Chart 1). Expectations of a renminbi appreciation also eased after the reform of the renminbi exchange rate regime on 21 July 2005. As a result, the growth in renminbi deposits slowed.

CHART 1
Hong Kong dollar and renminbi savings deposit rates



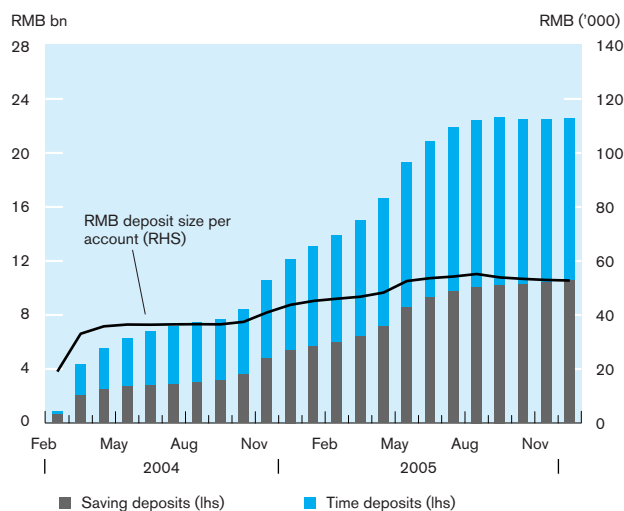
Source: HKMA

¹ The March 2005 issue of the *HKMA Quarterly Bulletin* contains details of the clearing arrangement.

At the end of 2005, outstanding renminbi deposits in Hong Kong amounted to RMB22.6 billion yuan, with an average size of about RMB53,000 yuan per account (Chart 2). Savings deposits accounted for

CHART 2

Renminbi deposits

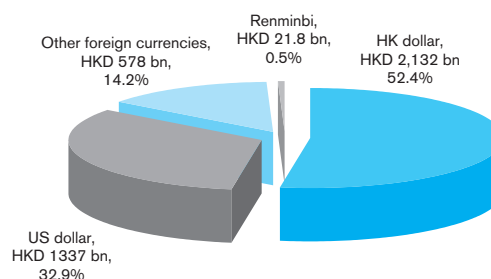


47% of the total deposits and the rest were time deposits. The size of renminbi deposits remained relatively small, accounting for only 0.5% of total deposits in Hong Kong's banking system (Chart 3).

CHART 3

Share of total deposits in Hong Kong

Outstanding deposits in Hong Kong at the end of 2005:
HKD 4,068 bn



Box: Explaining the growth of renminbi deposits

Major incentives for holding renminbi deposits *as opposed to* deposits denominated in other currencies include the differential in deposit rates and the potential increase in the exchange value of the renminbi. To examine empirically the relationship between growth in renminbi deposits and these two factors, we regressed the month-on-month change of renminbi deposits (Δd) on the Hong Kong dollar-renminbi deposit rate differential ($i_t - i_t^{\text{renminbi}}$) and the discount of the one-year renminbi non-deliverable forwards (e_t^{ndf} , the more negative the variable, the stronger the expectation for a renminbi appreciation). The results are as follows:

$$\Delta d = -0.874 - 0.490 (i_t - i_t^{\text{renminbi}}) - 0.006 e_t^{\text{ndf}}$$

(-2.84) (-4.02) (-6.04)

Sample period – 2004:4 to 2005:12

Adjusted $R^2 = 0.69$

LM test for serial correlation: F-statistics = 1.91 [0.17]

Jarque-Bera test for normality: $\chi^2(2) = 0.93$ [0.63]

White test for heteroskedasticity: F-statistics = 2.3 [0.11]

Ramsey RESET test for model specification: F-statistics = 0.020 [0.89]

Note: Figures in () are t-statistics unless specified otherwise, and those in [] are p-values.

All variables show the expected signs and are statistically significant. The model is well specified and it passes all the diagnostic tests. The findings support our observation that growth of renminbi deposits was influenced by the deposit rate differential between Hong Kong dollar and renminbi deposits and the expected movement of the renminbi exchange rate.

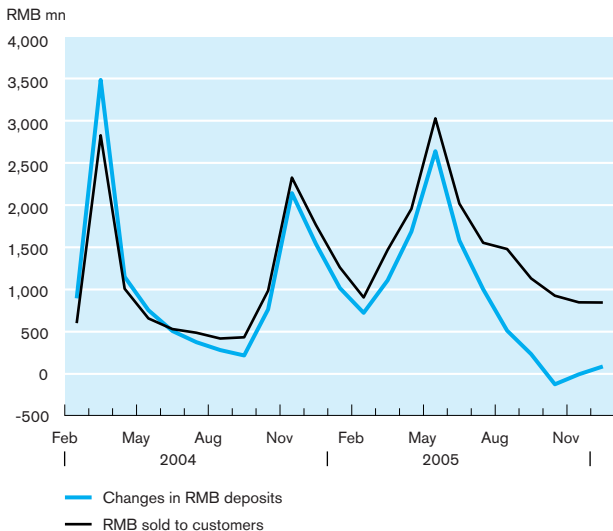
Currency exchange

The conversion from Hong Kong dollars to renminbi by Hong Kong residents has been used to satisfy the demand for holding renminbi deposits and to meet the needs of visitors to make cash payments for spending on the Mainland. In the first half of 2005, the trend in the amount of renminbi bought through banks largely followed that in growth of renminbi deposits, as the expectation of a renminbi appreciation and positive interest rate differential dominated the demand for renminbi deposits. In the second half of 2005, the volume of renminbi bought through banks moderated because the incentive to hold renminbi deposits weakened as expectations of a further renminbi appreciation eased and the interest rate differential turned negative.

At the same time, it was observed that there was a strong demand for renminbi cash. This could be explained by a change in the behavioural pattern of Hong Kong residents, who increasingly were using banks instead of money changers to convert into renminbi for meeting their payment needs on the Mainland. Among other factors, competitive exchange rates offered by banks and convenience of conversion through banks' automated teller machines, contributed to this change. Consequently, there was a divergence between the changes in deposits and the volume of currency conversion (Chart 4).

CHART 4

Monthly change in renminbi deposits and renminbi sold by banks during the month

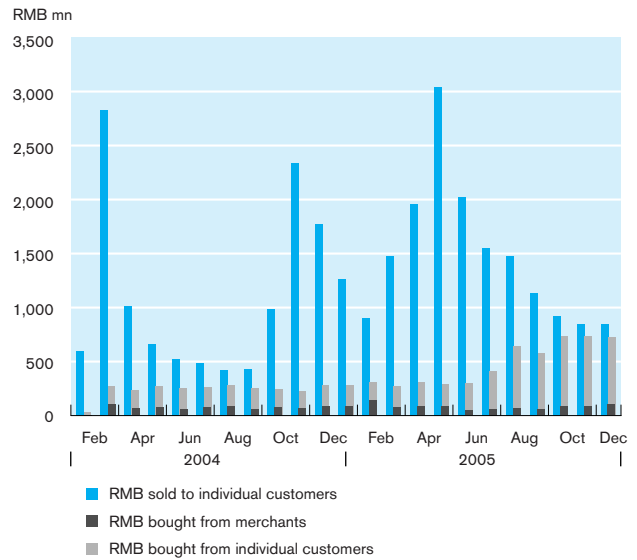


Source: HKMA

There was a noticeable increase in the amount of renminbi sold by customers to banks in the second half of 2005, reflecting in part decisions by individual customers to reduce the allocation of their deposits in renminbi (Chart 5). The increase might also have been supported by more favourable exchange rates offered by banks compared with those of moneychangers (Chart 6).

CHART 5

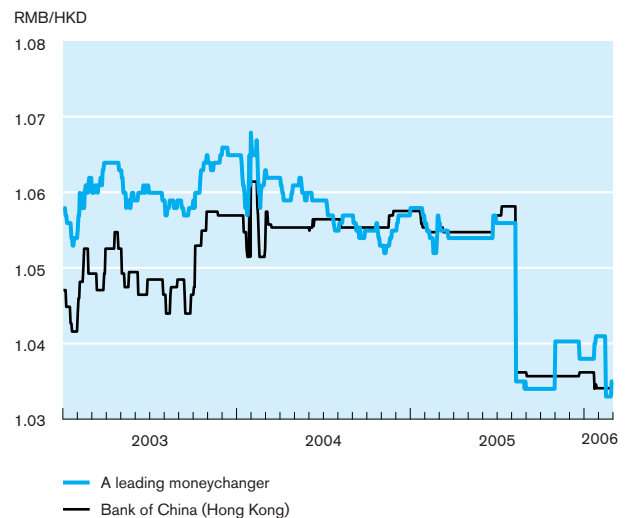
Currency exchange



Source: HKMA

CHART 6

Renminbi exchange rate



Source: CEIC

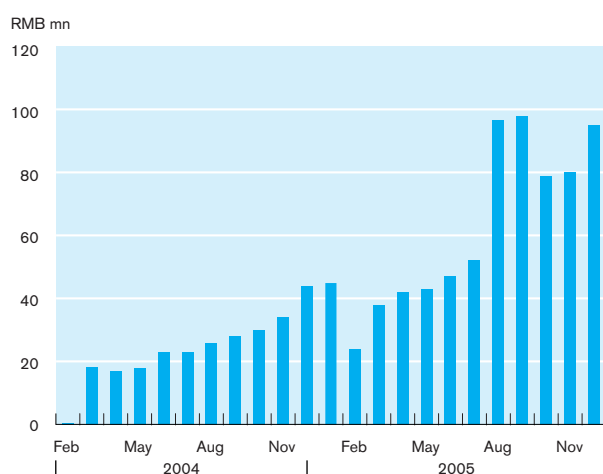
In aggregate terms, RMB17.5 billion yuan was bought through banks and RMB5.6 billion yuan was sold by bank customers during 2005. This represented a net inflow of foreign exchange of RM11.9 billion yuan (equivalent to US\$1.5 billion) into the Mainland, which was small when compared with the US\$208.9 billion increase in Mainland foreign reserves during the same period.

Remittance

The volume of remittance business has increased steadily as customers have adapted to using this service to transfer funds for use on the Mainland as opposed to carrying cash. By the end of 2005, Hong Kong residents remitted a total of RMB1 billion yuan to the Mainland, with an average remitted amount of RMB 41,344 yuan per transaction (Chart 7). The amount remitted back from the Mainland to Hong Kong was negligible.

CHART 7

Remittance



Source: HKMA

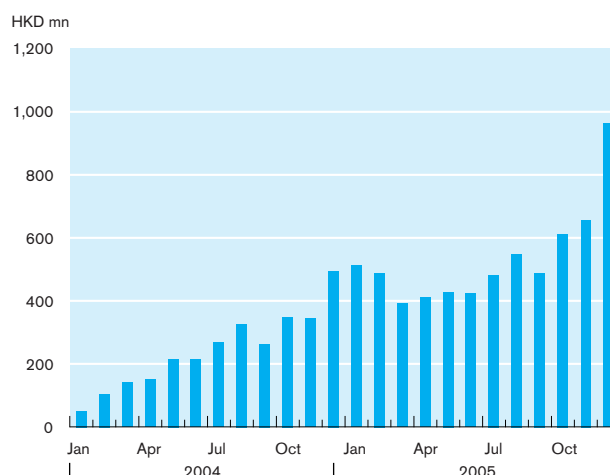
Debit and credit cards

The use of renminbi credit and debit cards in Hong Kong by Mainland residents has also been rising steadily since the launch in January 2004 (Chart 8). By the end of 2005, Mainland visitors had spent a total of HK\$7.2 billion by using renminbi cards and withdrawn HK\$2.2 billion from automated teller machines. The average size of credit card spending was about HK\$2,800 per transaction. The convenience provided by the use of bank cards greatly facilitated spending by Mainland visitors.

Hong Kong residents had spent and withdrawn a total of RMB370 million yuan on the Mainland using renminbi debit and credit card issued by Hong Kong banks since the middle of 2004 (Chart 9).

CHART 8

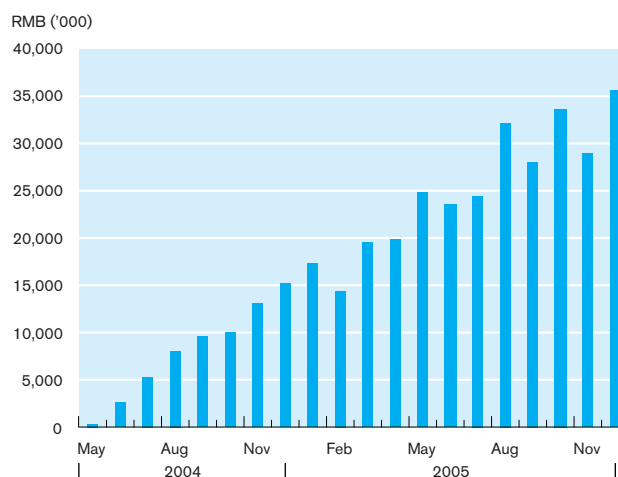
Use of Mainland-issued renminbi cards in Hong Kong



Source: HKMA and others

CHART 9

Use of Hong Kong-issued renminbi cards on the Mainland



Source: HKMA and others

Looking ahead

As part of its mandate to maintain Hong Kong's status as an international financial centre, the HKMA holds regular dialogue with the People's Bank of China (PBoC) and other Mainland authorities to review the development of renminbi business. In view

of the favourable public response to this new line of business, discussions on possible ways to further improve the arrangements began shortly after the initial launch.

On 1 November 2005, the PBoC announced its agreement to provide clearing services for an expanded scope of renminbi business, and the related measures were implemented from 5 December 2005 in phases. Details are as follows:

- (i) **Widening the definition of designated merchants and allowing them to open renminbi deposit accounts:** Four categories of business entities – those operating in transportation, communication, medical, and education services – were added to the definition of designated merchants, which originally comprised merchants operating in retail sales, catering, and accommodation. Designated merchants can now open renminbi deposit accounts and conduct one-way exchange of their renminbi deposits into Hong Kong dollars. This helps to facilitate spending by Mainland tourists by providing a convenient way for the designated merchants to handle their renminbi receipts. It will also help diversify the depositor base of renminbi deposits.
- (ii) **Relaxing the limits applicable to renminbi currency exchange and remittance:** The limit for exchange of renminbi cash by Hong Kong residents was increased from RMB6,000 yuan to RMB20,000 yuan per person per transaction. The limit for renminbi remittance was increased from RMB50,000 yuan per day to RMB80,000 yuan per day.
- (iii) **Removing the cap on credit limits for renminbi cards:** The cap of RMB100,000 yuan on credit limits for renminbi cards issued by Hong Kong banks was removed. Credit limits are now determined by the issuing banks according to market practice.
- (iv) **Introducing renminbi cheques:** Hong Kong residents are able to open renminbi current accounts and make payments for consumer

spending in Guangdong Province by cheque, subject to a daily limit of RMB80,000 yuan per account. This will provide an additional means of payment by Hong Kong residents.

To cater for the expanded renminbi business, a new Renminbi Settlement System was launched on 6 March 2006. The automated platform provides an efficient and robust settlement system for renminbi involving currency exchange, remittance, credit card payment and cheque clearing between the clearing bank and banks participating in renminbi business. It also lays a foundation for the future development of a fully-fledged renminbi payment system that would put Hong Kong in a competitive position in relation to other financial centres.

The dialogue between the HKMA and Mainland authorities to further expand the scope of Hong Kong's renminbi business is continuing, and presently focuses on two proposals:

- provision of appropriate renminbi banking services for trade and other current account transactions between Hong Kong and the Mainland
- issuance of renminbi-denominated bonds in Hong Kong.

These proposals, if implemented, will help diversify renminbi assets of the banks and improve the profitability of renminbi banking services. Nevertheless, as these new lines of business will have implications for the convertibility of the renminbi and capital account management on the Mainland, the pace of expansion has to tie in with the pace of financial sector liberalisation and reforms on the Mainland.

Conclusion

The development of Hong Kong's renminbi business has helped promote economic integration between Mainland China and Hong Kong, facilitated cross-border spending, and improved the mechanism for channelling renminbi in Hong Kong back to the Mainland. Over time, the continued expansion of renminbi business in Hong Kong is

expected to strengthen the capacity of Hong Kong's financial system to handle renminbi-denominated transactions, which is an important step in consolidating Hong Kong's status as an international financial centre.