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Offshore renminbi trading: Findings from the 2013 Triennial Central Bank Survey

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ABSTRACT

Using foreign exchange transaction data reported in the Triennial Central Bank Survey by the Bank for International Settlements, we find that offshore renminbi (RMB) trading activity is affected by both the host economy's characteristics and links with China. For instance, the occurrence of offshore RMB trading is determined by the economy's GDP, stage of financial development, equity market capitalization and free trade agreement with China. When an economy hosts offshore RMB trading, the trading volume is affected by the size of its foreign exchange market, equity market capitalization, as well as the bilateral link with China through FDI flows.

1. Introduction

Since the launch of economic reform in 1978, China has been consciously revamping its economic structure to promote growth and integration into the global economy. The accomplishment is quite astonishing. In about three decades, China has transited from a closed economy afflicted by inefficiencies to the largest trading nation and, by some measures, the largest economy in the world. The status of China's currency, the renminbi (RMB), however, is not commensurate with the country's global economic prowess.

As part of its financial liberalisation strategy, China has strengthened its efforts to promote the use of its currency overseas. Similar to its other reform measures, China has taken a gradual approach in seeking the RMB's global status. An early step was taken in 2003 that included the assignment of the first RMB clearing bank outside Mainland China, and the launch of started the offshore RMB business in Hong Kong.¹

In the midst of Global Financial Crisis, China broadened its policies encouraging the use of its currency for cross-border transactions. Various measures, including the scheme of cross-border trade settlement in RMB, the bilateral local currency swap arrangement, the development of the Dim Sum bond market, and the RMB qualified foreign institutional investor scheme, have been quite effective in introducing the RMB to the global financial market. Indeed, according to the data provided by SWIFT, the Society for Worldwide Interbank Financial Telecommunication, the global use of the RMB has surged in the past few years. The ranking of the RMB in the league of world payments currency by value advanced from being the 17th most commonly used currency by the end

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¹ Despite Hong Kong being politically part of China, its economy is segregated from Mainland China and is a *de facto* offshore market for RMB transactions.

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of 2011 to the top five currency in November 2014 (SWIFT, 2012, 2016). Since then, the RMB has generally retained the rank of fifth most commonly used currency.

Anecdotal evidence suggests that offshore RMB markets can play an important role in advancing the currency's global status. The US dollar is a case in point; the extensive network of markets for offshore dollar transactions underpins the prominence of the dollar in the global monetary system. Hong Kong, which benefited from its unique relationship with China, has enjoyed the first mover advantage in developing its offshore RMB businesses. The potential of the nascent offshore business has not been ignored by other financial centres, which are eager to compete for a piece of action (Strauss, and Romann, 2014, 2015). At the same time, it is of China's interest to set up a global offshore RMB network to facilitate the global uses of the RMB.

Despite China's clear intention of seeking the RMB's global status, it has not given up capital controls and has maintained a tight grip on its currency. To a large extent, China has closely monitored and managed the scale and scope of offshore RMB activities, and China's policy plays a significant role in nurturing the use of the RMB overseas.

Against this background, we study factors that affect offshore RMB trading activity. Since China actively implemented policies to promote cross-border uses of the RMB, there are studies on, say, the prospects and implications of a globalised RMB, and the interactions between onshore and offshore RMB exchange rates. The focus of this exercise is on what contributes to the activity of offshore RMB trading, which is related to offshore RMB business opportunities.

We anticipate that the development of an offshore RMB centre is affected by both pull and push factors that include economic attributes of the host economy and China's preferences. Our exercise will shed some insights into factors that are relevant for policy-making on developing an offshore RMB centre and to attract RMB business to the centre.

For instance, some economic attributes of an economy can influence offshore RMB trading activity in its financial centre. The economic attributes considered in this study are the size of GDP, real GDP growth rate, the turnover of the foreign exchange market, the equity market capitalization, the size of the international bond market and the stage of financial development captured by the [Financial Development Index \(2012\)](#).

Moreover, it is anticipated some economic and political links with China, specifically the size of the bilateral local currency swap arrangement, the bilateral trade and bilateral foreign direct investment (FDI) with China, the presence/absence of a free trade agreement and a political partnership agreement with China can affect offshore RMB trading activity at the 52 financial centres.

In general, there is a paucity of data on offshore RMB trading that is typically conducted in over-the-counter markets. Our empirical exercise draws upon relevant data from the 2013 Bank for International Settlements (BIS) Triennial Central Bank Survey. It is arguably the most comprehensive source of information on global foreign exchange trading ([Bank for International Settlements, 2013](#)). In the next section, we offer a brief discussion of offshore RMB markets, describe the BIS data, and present the results based on the Tobit qualitative response specification and Heckman two-step procedure. For comparison purposes, we also consider the experience of the Mexican peso, which is an emerging market currency that has a similar ranking in the 2013 BIS survey. Some concluding remarks are provided in [Section 3](#).

2. Offshore RMB

2.1. The nascent offshore RMB network

Hong Kong, given its well-developed financial sector and unique political link with China, was chosen as a testing ground of offshore RMB businesses. Although Hong Kong is legally an integral part of China, there are specific rules and procedures instituted to segregate the two economies and, in particular, regulate RMB movements between their borders.

By February 2004, selected financial institutions in Hong Kong were allowed to conduct a defined set of RMB businesses. After the 2007–8 global financial crisis, China has gradually broadened and deepened the offshore RMB activity. In July 2010, the trading of spot and forward RMB and RMB-linked structural products in Hong Kong was officially endorsed ([Hong Kong Monetary Authority, 2010](#)). Because the RMB traded in Hong Kong (or later overseas in general) is not subject to China's capital control rules and regulations, market practitioners labelled it the CNH rather than the usual RMB's trading symbol CNY. Nonetheless, CNY remains the only official ISO currency code used internationally (SWIFT, 2011).

Since then, various policies and RMB-denominated investment products that promote global uses of the RMB have been introduced. Financial centres around the world have recognised the growth potential of transactions in RMB, and have made efforts in attracting offshore RMB businesses. Offshore RMB trading is quickly spreading to different parts of the global financial market.

The RMB is not fully convertible and is subject to effective capital controls.² China's endorsement is crucial for financial centres overseas to set up the infrastructure and to acquire the liquidity for their offshore RMB businesses. At the same time, to promote the RMB's global status and acceptance, China is strategically building a network of offshore RMB centres across different geographic locations and time zones.³ By 2015, China had assigned an offshore RMB clearing bank in about 18 offshore RMB centres, listed in [Appendix A](#).⁴

² See, for example, [Ma and McCauley \(2008\)](#) and [Cheung et al. \(2016\)](#).

³ This strategic consideration is well recognised in the study and two proxy variables, namely time zone and distance from Beijing, have been explored in empirical investigation. However, these two variables are insignificant and, for brevity, they are not reported in the empirical results in this paper.

⁴ The bilateral local currency swap arrangement and the RMB qualified foreign institutional investor scheme are considered as two other important symbolic endorsements of an offshore RMB market.

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