

## **Task Force on Economic Challenges**

### **Discussion Paper**

#### **Accelerating the Development of Hong Kong as a RMB Settlement Centre**

##### **1. Objective**

To enhance Hong Kong's role as a financial centre, and to minimize the adverse impact of the coming recession.

##### **2. Background**

- (a) With China's high export volume and a growing foreign interest in China's investment opportunities, there is considerable demand for RMB in overseas markets.
- (b) The recent financial tsunami casts doubt on the traditional status of US dollar as an international currency; there is room for RMB to play a more significant role in this respect.
- (c) In view of the current global credit contraction, if China is willing to engage in overseas lending, the negative impact of global recession can be alleviated.
- (d) China has already built up a considerable foreign exchange reserve; accumulating more will further expose China to exchange rate risks. It may be better to take this opportunity to promote RMB as a settlement currency in international markets.
- (e) Among China's major cities, Hong Kong has the most established and healthy financial system, enabling it to play an active role in the internationalization of RMB.
- (f) The Central Government has voiced support for Hong Kong to contribute more in

this area.

### **3. Detailed Proposals**

- (a) Try to urge the Central Government to encourage China exporters to demand for RMB instead of US dollar as settlement currency.
- (b) Try to urge the Central Government to lend RMB to overseas, enabling foreign enterprises to use these RMB to buy China products and services, or come to China for investment opportunities. This will relieve the problem of over capacity arising from inadequate foreign demand, thus allowing a continual growth in the China economy.
- (c) Loans in national level should of course be handled by the Central Government, but loans in private sectors may be provided through banks in Hong Kong. In practical terms, the People's Bank of China lends RMB to banks in Hong Kong, which in turn lend RMB loans to foreign enterprises. Banks in Hong Kong will take the responsibility for risk management, while earning profits from interest difference.
- (d) RMB obtained through the above channel may be freely convertible in offshore market, but exchange transactions must be carried out and centrally registered in Hong Kong. As such, Hong Kong will effectively become an offshore RMB borrowing, lending, exchange and settlement centre, thus strengthening Hong Kong's status as an international financial centre.

### **4. Benefits for China**

- (a) China can use this as an excuse for not purchasing more US bonds. If the United States wants to borrow, China may help by lending RMB and demanding the future settlement of such loans only by RMB. This will reduce China's potential

risk in case of US dollar depreciation.

- (b) If the United States owes debt to China repayable only in RMB, there would be less pressure from the United States to urge for RMB appreciation.
- (c) Foreign countries owing RMB debts to China would also need to sell more and better-quality goods (including high-tech goods) to China for repayment of these debts.
- (d) Through overseas lending, China may increase foreign demand for its own exports. This helps solving the problem of over capacity in production, preventing China factories from shutdown or output reduction due to inadequate foreign demand. While there remains a risk of bad debts arising from increased overseas lending, the China economy can at least be saved from a possible standstill brought about by market shrinkage in the Western economy. Chinese workers can retain their jobs, and social stability can be maintained.
- (e) The more foreign countries owe debts to China, the more influential China will be in international affairs.
- (f) This will also allow RMB to play a more active international role, gradually becoming an international settlement currency with increasing acceptability.
- (g) For the time being, China needs not open its domestic RMB market for free exchange; convertibility will only be allowed for duly registered offshore RMB. This enables China to gradually familiarize with the workings of western financial systems while maintaining its own. When China's internal financial system grows sound and healthy, consideration may then be given to merging of the domestic and offshore RMB market.
- (h) This proposal opens a development outlet for the Hong Kong economy and strengthens Hong Kong's prospect as an international financial centre.

## **5. Action Plan**

- (a) We need to have faith that this proposal is beneficial to China, so that we may use our best endeavor through repeated efforts to obtain policy endorsement from the Central Government.
- (b) We may appoint academic institutions to conduct in-depth study and research on this area. Public seminars may be organized, inviting the participation of renowned Mainland and international scholars, with wide media publicity to enlist public support for the government's action.
- (c) The HKSAR government may then submit formal feasibility report for consideration and approval by the Central Government.
- (d) We may mobilize influential personalities from various sectors to join effort in lobbying support from Beijing.
- (e) We may also request Hong Kong deputies to the National People's Congress to put forward this proposal formally as a motion for discussion at the next NPC session.

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