The Offshore Renminbi Market and Australia

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The Chinese authorities have continued to make progress in internationalising China’s currency, the renminbi (RMB). In particular, the use of RMB for cross-border trade and investment transactions has increased noticeably over recent years and the market for RMB in a number of jurisdictions outside of mainland China – known as ‘offshore centres’ – has developed further. As part of this broader trend, the use of RMB by Australian entities has also increased somewhat, although there remains considerable scope for further growth. In order to facilitate this, a number of policy initiatives designed to allow the local RMB market to develop have recently been agreed with the Chinese authorities. Most notably, these include the establishment of an official RMB clearing bank in Australia and a quota that will allow Australian-based entities to invest in mainland China’s financial markets as part of the RMB Qualified Foreign Institutional Investor (RQFII) program.

Background

The Chinese authorities have continued to make significant progress in liberalising China’s financial system. In addition to domestic financial market reform and development, the partial liberalisation of China’s exchange rate and cross-border capital flows have been key elements of the reform process.1 While cross-border trade flows have been subject to relatively few restrictions for some time, China’s cross-border capital flows have been managed much more closely. But in recent times, restrictions on direct investment flows have been relaxed, and the capital account liberalisation process has also extended to portfolio investment flows. In particular, the Chinese authorities have started to open up China’s debt and equity markets to foreign investment and have also allowed Chinese residents to invest more freely in offshore markets.

The substantial effects of China’s earlier trade liberalisation process on the global economy suggest that China’s ongoing capital account liberalisation process will also have significant implications for the global financial system.

Closely related to China’s ongoing ‘opening up’ process, the Chinese authorities have introduced reforms that aim to promote the Chinese renminbi (RMB) as an international currency.2 As outlined in Lowe (2014), there are two key conditions to be met before the RMB can be considered an ‘international currency’. The first is that the RMB is widely used in transactions between Chinese residents and non-residents. The second is that the currency is widely used in transactions between non-residents.3 While considerable progress has been made on the first condition, there is some way to go yet on the second.

An important feature of the RMB internationalisation process to date has been the development of a number of offshore RMB ‘centres’ outside of mainland China. The various restrictions on China’s capital account transactions mean that the flow of RMB between the onshore and offshore markets has, to date, been primarily the result of trade-related cross-border transactions between Chinese residents.

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* The authors are from International Department.
1 For more details, see Ballantyne et al (2014).
2 See Cockerell and Shoory (2012) and Ballantyne, Garner and Wright (2013) for details.
3 This includes non-residents choosing to transact in RMB despite ultimately requiring another currency, as well as non-residents being willing to hold unhedged exposures to the RMB.
and non-residents. Crucially though, there are no restrictions on the use of RMB within the offshore market. As a result, the offshore RMB market can be thought of as providing an environment in which a range of RMB banking products can be developed and in which firms outside of mainland China can begin using the currency, even if they do not have direct access to the onshore market.

The first – and still the most important – offshore RMB centre is Hong Kong, which was announced as an RMB centre by the Chinese authorities in 2003. In contrast, other RMB centres have typically been established at the instigation of the local authorities and market participants, in recognition of the RMB's significant potential as an international currency.

Against this background, the Australian authorities have worked together with the Chinese authorities to facilitate the development of the local RMB market. These steps recognise Australia’s already close economic relationship with China and the increasingly close financial linkages between the two countries. Most recently, these initiatives have included:

1. the establishment of an official RMB ‘clearing bank’ in Australia, which will make it easier for Australian residents to transact in RMB with their counterparts in mainland China
2. the establishment of a quota as part of the RMB Qualified Foreign Institutional Investor (RQFII) program, which will allow Australian-domiciled financial institutions to invest RMB obtained in the offshore market in China’s onshore bond and equity markets.

These announcements are in addition to existing initiatives, including: the local currency swap agreement between the Reserve Bank of Australia (RBA) and the People’s Bank of China (PBC) signed in 2012; the commencement of direct trading between the RMB and the Australian dollar in mainland China's interbank foreign exchange market in 2013; and the RBA’s investment of a portion of its foreign currency reserves in RMB-denominated assets in the past year. There has also been ongoing engagement on RMB internationalisation between Australian officials (including the RBA and Treasury) and the private sector through forums such as the Australia-Hong Kong RMB Trade and Investment Dialogue and the newly established ‘Sydney for RMB’ working group, which is a private sector led initiative.

This article discusses the recent announcements within the context of initiatives that have been implemented in other offshore RMB centres. In light of the importance of these offshore centres for China’s overarching goal of internationalising the RMB, the article then provides an update on the progress that has been made over the past year or so.

**An Official RMB Clearing Bank in Australia**

The key function of an official RMB clearing bank is to facilitate cross-border payments and receipts of RMB. An official RMB clearing bank is able to perform this function relatively efficiently, because its ‘official’ status grants it more direct access to China’s domestic payments system (including access to RMB liquidity from the PBC) and a dedicated quota to transact in China’s onshore foreign exchange market.

However, the official clearing bank channel is not the only means of facilitating cross-border RMB transactions. Indeed, RMB transactions between Australian and Chinese entities were effected prior to the establishment of an official RMB clearing bank in Australia, albeit through somewhat less direct channels. These alternative channels have included traditional ‘correspondent banking’ relationships with banks in mainland China, as well as RMB clearing ‘services’ offered by Australian branches of Chinese banks through their head offices in

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4 See ‘New Measures to Facilitate the Development of the Renminbi Market in Australia’ (RBA 2014a).

5 As well as providing a connection between the offshore and onshore markets, an official clearing bank can also clear and settle RMB transactions within the offshore market.
mainland China. Both of these channels ultimately rely on a mainland Chinese bank’s access to the Chinese interbank payments system. In addition, Australian banks have been able to make use of relationships with participants in other offshore RMB centres – most likely Hong Kong – or become direct participants in these other offshore centres’ RMB payments systems. These latter two channels ultimately rely on these other offshore centres’ clearing banks to effect transactions.

Although Australian financial institutions have had – and continue to have – a number of alternative options for effecting RMB transactions on behalf of their corporate clients, a local official clearing bank provides a more direct avenue. Over time, this has the potential to improve the efficiency of these transactions by reducing payment delays and/or lowering transaction costs. In addition, official clearing banks have also played an important symbolic role in establishing recognised offshore RMB centres. This is likely to confer some important additional benefits to the Australian market, particularly through raising awareness among Australian firms about the Australian financial sector’s capacity to facilitate RMB transactions. It could also increase the private sector’s confidence that the payments system infrastructure is capable of accommodating the development of the RMB market.

Taken together, these potential benefits could help to mitigate some of the impediments to increasing the share of Australia’s bilateral trade with China that is invoiced in RMB. In particular, a survey of Australian firms conducted by the Centre for International Finance and Regulation (CIFR) in late 2013 found that payment delays and uncertainty regarding the settlement process were significant impediments to increased use of RMB trade settlement (Eichengreen, Walsh and Weir 2014). The most recent data show that less than 1 per cent of Australia’s merchandise trade with China was invoiced in RMB in 2013/14, and although this share has been increasing over time, it remains low compared with a number of other economies (Graph 1). More disaggregated data indicate that the majority of RMB invoicing has been related to Australian firms’ imports of machinery and transport equipment, ‘miscellaneous manufactured articles’ (such as clothing), manufactured goods and chemicals. Australia’s exports of iron ore and coal continue to be invoiced almost entirely in US dollars, consistent with the prevailing global practice.

The official Australian clearing bank is one of thirteen such clearing banks worldwide, all of which are offshore branches of Chinese banks. The first official clearing bank was announced in Hong Kong in

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6 Under the ‘correspondent banking’ model, an offshore bank signs an agreement with a commercial bank in mainland China that offers international settlement services. The offshore bank can then open an RMB nostro account with its correspondent bank to access China’s domestic payments system. According to the PBC, by the end of 2013 foreign banks had opened 1,954 correspondent accounts with mainland Chinese banks.

7 Firms’ choice of invoicing currency (the currency used at the stage of contracts) is not necessarily the same as the settlement currency (the currency used at the stage of payments). Data on Australian firms’ choice of settlement currency are not available.

8 The CIFR survey found that some Australian mining companies had actively examined a range of RMB banking products in preparation for being asked to settle and invoice their exports in RMB. Some firms had also settled their imports of mining-related equipment from China in RMB.

9 Bank of China (Sydney) was designated as the official clearing bank by the PBC and will partly fulfil this function by making use of an agreement with the Australian Securities Exchange to clear and settle RMB payments between participant banks through the Austraclear system.
2003, then in Macau in 2004. This was followed by the establishment of official clearing banks in Taipei and Singapore in early 2013, and earlier this year in London, Frankfurt, Luxembourg, Paris and Seoul. In November 2014, plans to establish official clearing banks were also announced for Doha, Toronto, Kuala Lumpur and Sydney.

In 2013, Hong Kong’s clearing bank processed around 85 per cent of all cross-border RMB remittances between China and the offshore market. While this share is likely to decline somewhat as foreign entities increasingly make use of their local clearing bank arrangements, a range of other metrics (such as the value of RMB trade settlement and RMB deposits, discussed below) indicate that the Hong Kong RMB market remains substantially deeper and more sophisticated than other offshore centres.

It is possible that the role of clearing banks (along with the other current mechanisms for effecting cross-border RMB payments) could diminish somewhat over time. In particular, the Chinese authorities are in the process of developing the China International Payments System (CIPS), which is expected to give all offshore banks the opportunity to acquire access to China’s domestic payments system and foreign exchange market, rather than clearing banks alone. However, the development of CIPS may take some time.

The RMB Qualified Foreign Institutional Investor Program

The RQFII program allows approved foreign investors to buy and sell designated assets in China’s onshore financial markets using RMB obtained in the offshore market. As such, the scheme provides these investors with greater access to China’s capital markets. Therefore, the RQFII scheme can be thought of both as being part of China’s broader capital account liberalisation process and as an initiative which is designed to encourage broader participation in the offshore RMB market. Access to this program is obtained in two steps: first, the authorities in a given jurisdiction obtain an investment quota for that jurisdiction; and second, individual financial institutions which are domiciled in that jurisdiction apply to the Chinese authorities for an individual portion of that overall quota.10

In November, the Australian financial sector was granted an RMB 50 billion (around A$10 billion) RQFII quota, which will subsequently be allocated by the Chinese authorities to Australian-domiciled financial institutions. Although only around 2 per cent of Australia’s outward foreign portfolio investment assets were in China as at the end of 2013, there would appear to be significant potential for Australian fund managers to invest in China’s bond and equity markets as part of the RQFII program (Graph 2). Australia has a relatively large funds management industry by global standards, with around A$2.4 trillion worth of assets under management and around one-fifth of this currently invested overseas.11

The RQFII program was initially made available to Hong Kong-domiciled investors, with a quota of RMB 20 billion granted in 2011. Hong Kong’s quota has since been raised to RMB 270 billion in a number of steps. Since the middle of 2013, RQFII quotas

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10 After obtaining an RQFII licence from the China Securities Regulatory Commission, firms must then obtain an RQFII allocation from the State Administration of Foreign Exchange (SAFE).

11 The Australian Bureau of Statistics only publishes data on overseas investments for those assets that are managed on behalf of domestic clients, which currently total A$1.9 trillion.
totalling RMB 500 billion have also been granted to Singapore, the United Kingdom, France, Germany, Korea, Qatar, Canada and, most recently, Australia (Table 1).12

**Table 1: RQFII Quotas**

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<th>Allocation to date</th>
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</tr>
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<td>50</td>
<td>Nov 2014</td>
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</table>

(a) The activation of Taiwan’s RQFII quota is conditional on the finalisation of the Cross-Strait Trade in Services Agreement
(b) As at the end of November 2014
Sources: PBC; SAFE

As of November 2014, around 80 Hong Kong-domiciled entities had been granted RQFII licences totalling RMB 270 billion. Some of these firms have partnered with US- and European-domiciled financial institutions to launch RQFII exchange-traded funds on foreign stock exchanges, including the New York Stock Exchange and the London Stock Exchange, thereby allowing international investors without an RQFII quota to gain an exposure to China’s equity and bond markets. Outside of Hong Kong, only 14 financial institutions have so far been granted RQFII quotas.

The RQFII program is in addition to the Qualified Foreign Institutional Investor (QFII) program, which has been in place since 2003 and allows approved foreign investors to use foreign currency to invest in designated Chinese financial assets. Unlike the RQFII program, there are no jurisdiction-specific quotas under the QFII program. Indeed, to date there are at least three Australian-domiciled financial institutions with QFII quotas. However, from an investor’s perspective, the RQFII program has several potential advantages relative to the QFII program, including greater discretion in portfolio allocation and less restrictive rules regarding the repatriation of funds.

To date, the total value of allocated quotas under the RQFII scheme is around RMB 300 billion, with an additional RMB 470 billion worth of aggregate global RQFII quotas yet to be allocated, compared with around RMB 400 billion of allocation for the QFII scheme (Graph 3).

**Central Bank Initiatives**

Both the official clearing bank and the RQFII quota are designed to facilitate greater use of the RMB by the private sector. In addition to these initiatives, the Bank has increased its own use of the RMB in the past year by investing a portion of its foreign exchange reserves in RMB-denominated assets.13 As discussed in the RBA’s 2013/14 Annual Report, this portfolio shift recognises the growing importance of China in the global economy and the broadening financial relationship between Australia and China.

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12 Taiwan has also been granted an RQFII quota of RMB 100 billion, but its activation is conditional on the finalisation of the Cross-Strait Trade in Services Agreement.

13 The RBA’s investment makes use of a scheme commonly known as the China Interbank Bond Market scheme, which is separate to the QFII and RQFII programs and is typically used by central banks and sovereign wealth funds.
(RBA 2014b). From a portfolio perspective, the shift also increases the diversification of the Bank’s foreign currency investments and is expected to enhance returns over the long run. Moreover, the investment undertaken to date has allowed the RBA to deepen its own understanding of Chinese financial markets. The RBA also signed an RMB 200 billion (A$30 billion) local currency swap agreement with the PBC in 2012. The RBA’s swap agreement is one of 28 bilateral local currency swap agreements that have been signed with the PBC (Graph 4). From the RBA’s perspective, a key objective of the swap line is to provide market participants with confidence that liquidity in the Australian RMB market will be sufficient to enable market participants to meet their RMB-denominated payment obligations in the event of market dislocation. There has not yet been a need to activate the swap agreement other than for test purposes, although it can be used if required.

The MAS also allows participants in Singapore’s payments system to access three-month RMB loans for trade-related purposes. Further, in anticipation of additional demand for offshore RMB following the launch of the Shanghai-Hong Kong Stock Connect Scheme (discussed below), the HKMA introduced an intraday RMB repurchase agreement (repo) facility to provide up to RMB 10 billion to banks in Hong Kong.¹⁴

**RMB Initiatives in Other Offshore Centres**

Official RMB clearing banks, RQFII quotas and central bank foreign currency reserve investments and swap lines have now been introduced across a range of offshore centres. However, some of the more developed offshore RMB centres, particularly in Asia, have also taken additional steps to develop their local RMB markets. These initiatives – which include the Shanghai-Hong Kong Stock Connect Scheme and various cross-border RMB lending programs – aim to increase the linkages between the offshore RMB market and the onshore market.

**Shanghai-Hong Kong Stock Connect Scheme**

The Shanghai-Hong Kong Stock Connect Scheme, which began operating on 17 November 2014, allows eligible offshore investors to purchase approved stocks listed on the Shanghai Stock Exchange (SSE). Similarly, eligible onshore investors are able to purchase stocks listed on the Hong Kong Stock Exchange (HKEx). Purchases in both exchanges are subject to a quota, with offshore investors permitted to purchase a total of RMB 300 billion worth of SSE stocks and onshore investors permitted to purchase a total of RMB 250 billion worth of HKEx stocks.¹⁵

Some central banks have established RMB liquidity facilities to provide short-term RMB funds to offshore market participants, in some cases using their swap facilities with the PBC. In particular, the Hong Kong Monetary Authority (HKMA) and the Monetary Authority of Singapore (MAS) both offer eligible financial institutions access to overnight RMB loans.

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¹⁴ Additionally, the HKMA designated a number of banks as Primary Liquidity Providers (PLPs). The HKMA offers PLPs an RMB repo line (to obtain both intraday and overnight funds) to ensure that they have sufficient liquidity available to perform market-making functions in Hong Kong’s offshore market.

¹⁵ Onshore investors are also subject to a daily quota of RMB 10.5 billion on their net purchases of HKEx stocks, while offshore investors are subject to a daily quota of RMB 13 billion on their net purchases of SSE stocks.
The Stock Connect Scheme thus provides an additional avenue through which offshore investors can buy and sell Chinese equities (in addition to the RQFII and QFII schemes). Like the RQFII scheme, the currency exchange takes place in the offshore market (in Hong Kong), so, for example, investors must purchase RMB in the offshore market in order to buy mainland stocks.

**Cross-border RMB lending initiatives**

China has also sought to build connections between the onshore and offshore RMB markets through various pilot schemes that permit RMB-denominated lending between defined mainland cities or regions and various offshore centres. The first such scheme, established in January 2013, allows companies incorporated in Qianhai – which is a ‘special economic zone’ within the Chinese city of Shenzhen – to borrow RMB from banks in Hong Kong to fund investment projects in Qianhai. As interbank RMB interest rates have typically been noticeably lower in Hong Kong than in the mainland (notwithstanding some narrowing in the onshore-offshore spread in the latter half of 2014), it is possible the scheme has provided Qianhai firms with access to cheaper funding.16

In 2014, similar schemes were established between Singapore-based banks and firms in China’s Suzhou Industrial Park and Tianjin Eco-City as part of a broader range of initiatives between the Chinese and Singaporean Governments to develop these two regions. Entities in both regions have also been permitted to issue RMB-denominated bonds in Singapore and to undertake direct investment in Singapore-based corporations.

Another scheme with Taiwan, which was established in late 2013, follows a slightly different model. Under this scheme, subsidiaries of Taiwanese firms in the Chinese city of Kunshan are permitted both to borrow RMB from their offshore parent companies and to make RMB loans to them. In addition, most recently, non-bank financial institutions and enterprises domiciled in the Shanghai Free Trade Zone have been permitted to borrow RMB from any offshore centre, subject to certain conditions.17

**Recent Progress towards RMB Internationalisation**

Partly as a result of the policy initiatives outlined above, China has made significant progress in internationalising its currency over the past few years. In particular, China’s RMB-denominated current account transactions (mostly trade) have grown rapidly and now account for around one-fifth of China’s total current account transactions (Graph 5). RMB-denominated investment (particularly inward investment) has also increased noticeably in recent years but remains small relative to the value of RMB-denominated trade settlement.

By economy, Hong Kong continues to account for the majority of China’s RMB-denominated cross-border transactions, followed by Singapore and Taiwan (Graph 6). However, the launch of official RMB clearing banks in Singapore and Taiwan in early 2013 was followed by a substantial increase in the RMB-denominated share of each economy’s bilateral merchandise trade with China in 2013 (Graph 7). In

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16 Interest rates are privately negotiated between borrowers and lenders.

17 The funds must be put toward manufacturing operations and project construction within the zone and their value cannot exceed specified limits.
contrast, China’s share of RMB-denominated bilateral merchandise trade with economies excluding Hong Kong, Taiwan and Singapore increased slightly in 2013 and remained relatively low at around 3 per cent.

China’s cross-border RMB payments (e.g. for imports) have typically been larger than China’s cross-border RMB receipts (e.g. from exports), leading to a net outflow of RMB that, ultimately, supplies RMB to the offshore market (Graph 8). One reason for this is that the value of the RMB against the US dollar has typically been higher in the offshore market than in the onshore market. As a result, a Chinese importer (for example) would seek to convert RMB into foreign currency in the offshore market before paying its foreign supplier. Another reason why RMB payments have typically been greater than receipts is that there has been an expectation over the past few years that the RMB would appreciate, which has generally been the case except for a period earlier this year. Firms exporting goods and services to China have been generally more willing to accept RMB on the basis that they expect the RMB’s value against the US dollar to increase.

The net outflow of RMB from China over recent years has led to a rapid increase in the stock of RMB deposits in offshore centres (Graph 9). While Hong Kong continues to account for the majority of offshore RMB deposits, the stock of deposits in Taiwan and Singapore has increased rapidly over the past year, rising to around RMB 300 billion and RMB 260 billion, respectively, by the end of September 2014.18

As the pool of offshore RMB deposits has grown, so too has the offshore RMB-denominated bond market. Hong Kong remains the prime location for offshore RMB bond – or ‘dim sum’ bond – issuance, but the market is also growing rapidly in Singapore and Taiwan. The majority of issuers continue to be mainland Chinese companies or offshore subsidiaries of mainland Chinese companies, with the funds raised typically repatriated back to mainland China.

18 Time series data on RMB deposits in other offshore centres are generally not available.
Most of the dim sum bond issuance by non-Chinese firms has also been used to fund their operations in mainland China.

One reason for the prevalence of mainland Chinese issuers in the dim sum bond market is that the cost of funding has typically been lower in the offshore market than in the mainland. This is evidenced, for example, by the consistently lower yield paid on Chinese government bonds issued in the offshore market relative to those issued in the onshore market (Graph 11). This is partly because capital account restrictions limit the flow of offshore RMB back to the mainland, such that there is a large pool of RMB in offshore markets with relatively limited investment opportunities (and therefore strong demand for dim sum bonds from offshore investors). Another reason why mainland firms dominate the dim sum bond market is that there are some structural issues that potentially limit non-Chinese firms’ participation in the market. In particular, the tenors are relatively short (three years or less) for most dim sum bonds – which is partly related to the fact that markets for longer-term currency hedging products are relatively illiquid – and there is only limited issuance of benchmark bonds.

There have also been a small number of offshore RMB bond issues by foreign governments, with the UK Government raising RMB 1 billion in November. This followed the Canadian Province of British Columbia’s issuance of RMB 2.5 billion worth of dim sum bonds in late 2013. Alongside the increase in RMB-denominated trade and capital flows, turnover of RMB in global foreign exchange markets has risen markedly in recent years. According to the 2013 BIS Triennial Foreign Exchange Turnover Survey, average daily turnover in the RMB rose by 250 per cent over the three years to April 2013, with the RMB ranking as the ninth most traded currency in the world (BIS 2013). The rapid growth was evident not only in the turnover of spot foreign exchange, but also in derivative products such as deliverable forwards, options and
cross-currency swaps. Around three-quarters of total global turnover occurred in the offshore market, with Hong Kong, the United Kingdom and Singapore the largest individual offshore markets (Graph 12).

**Graph 12**

**RMB Turnover by Economy**

Average daily trading volume in April 2013

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Source: BIS

**Conclusion**

The international use of the RMB continues to increase, facilitated by policy initiatives within mainland China and in offshore centres. While the use of RMB by Australian entities has also increased, there remains considerable scope for future growth. In order to facilitate the development of the Australian RMB market – and allow Australian entities to more readily transact in RMB – a number of policy initiatives have recently been announced. In particular, the designation of an official Australian RMB clearing bank by the PBC should provide a more direct mechanism for settling Australian firms’ RMB-denominated transactions with their Chinese counterparts. In addition, the establishment of an RQFII quota will allow Australia’s funds management industry to offer its customers exposure to China’s financial markets, which could, in turn, lead to further development of the local RMB market.

**References**


