



The Emerging Marketization of RMB

Offshore Finance

—A Case Study of RMB Offshore Financial Market



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Summary

Under the influence of neoliberalism, economic exchanges between countries have become increasingly close. Neoliberalism emphasizes opening up the international market and the importance of free markets and free trade. And it opposes unnecessary intervention by the state and government. International market and trade has prompted the emergence of international currencies to facilitate the settlement of international trade. The internationalization of currency not only brings the income of the coinage tax to the country, but also reduces financial risks, promoting the economic development and enhancing the country's position in the international money market. Therefore, the world's economic powers are seeking internationalization of their currencies.

In recent years, the China economy has maintained a high growth rate. With the rapid development of the economy, China began to promote the internationalization of the Renminbi (RMB). Under the trend of RMB internationalization, how to promote it has become one of the important research topics. When comes to the driving factors of RMB internationalization, the increasing of RMB cross-border trade and settlement, the implement of Belt and Road Initiative and joining the SDR Currency Basket are important factors.

Under the trend of RMB internationalization, China has established some RMB offshore financial markets. Historical experience shows that the development of offshore financial market plays an important role in the monetary internationalization. China's capital account is not open totally, and the construction of RMB offshore financial market is an optimal way to realize the RMB internationalization in this situation.

Thereby, this thesis uses the neoliberalism and the financial innovation theory to analyze the driving forces for the internationalization of the RMB and reasons for the emergence of offshore financial centers. A theoretical discussion was held on the overall situation of the Chinese economy and microscopic events, which paves a way

to data analysis on the cross-border trade settlement and "Belt and Road Initiative (OBOR)". The data is from the official source of Chinese and foreign authoritative institutions, including Monetary and Financial stability report released by the Hong Kong Monetary Authority and IMF. Taking the offshore financial market of Hong Kong as an example, this paper analyzes the background, development path and significance of the offshore financial market. And the thesis illustrates the financial innovation in RMB offshore financial market including Shanghai-Hong Kong Stock Connect, Shenzhen-Hong Kong Stock Connect and Dim Sum Bonds. After that, the paper puts forward offshore financial market' implications on the internationalization of the RMB to solve the main problem formulation. In the process of RMB internationalization, the development of the offshore RMB market has played an indelible role. In general, the construction of offshore financial markets is conducive to the development of the internationalization of the RMB.

1. The Introduction

1.1 Research Questions

After the industrial revolution, economic exchanges between countries have become increasingly close. Due to the completion of industrialization, the United Kingdom (UK) became a world power — “the sun never set” empire. The economy of UK was extremely developed at that time and the first international currency was the British pound. However, the United Kingdom was hit by the world war and the economy declined rapidly, which gave an opportunity for the United States to promote the internationalization of the dollar. After the Second World War, the United States pushed the dollar to the international market and completed the process of internationalization successfully relying on its strong military, political and economic strength (Palan, 2010). Since then, the US dollar has replaced the pound as the international currency of the world.

Since the reform and opening up, China's economy has developed at a speed that is rare in the history of world economic development. In just a few decades, it has surpassed Japan and become the second largest economy in the world after the United States (Benson, 2016). With the rapid development of the economy, China began to promote the internationalization of the RMB.

In 2008, the outbreak of the subprime mortgage crisis in America finally evolved into the global financial crisis, causing great impact to the economic development of the world. It exposed the defects of the international monetary system (Sidaway, 2008). As a result, the reconstruction of the international monetary system has been a broad consensus of all countries in the world. This provides an opportunity for the internationalization of China's RMB. In recent years, the proportion of RMB settlement in China's foreign trade has been increasing and the RMB has also been welcomed in the international market. China seized this opportunity to establishment the offshore RMB market in Hong Kong, Singapore, London and other places (Zhang,

2018). However, there is still a long way to go before the RMB becomes a real international currency.

As an international financial center, Hong Kong enjoys unique advantages such as superior geographical position, advanced science and technology, complete financial infrastructure and legal supervision system. In addition, Hong Kong's economic and trade exchanges with the mainland are becoming more and more close. Therefore, the construction of Hong Kong's RMB offshore financial markets becomes an indispensable link in the process of RMB internationalization.

Hong Kong formally launched an offshore RMB business in February 2004. And Hong Kong's RMB offshore financial market has developed rapidly for more than ten years (Zhang, 2018). The scale of RMB deposits has steadily expanded and the amount of cross-border trade settlement has increased rapidly. The offshore bond market and the foreign exchange market have also gradually improved. In addition, the internationalization of RMB has gained more impetus through the joining of SDR, the “Belt and Road Initiative”, the Shanghai-Hong Kong Stock Connect (SHSC) and the Shenzhen-Hong Kong Stock Connect.

Given all we have been concerned about as above, the thesis formulates the research questions as one main question and two sub-questions:

“Under the background of the internationalization of the RMB, what are the offshore financial market’ implications on it?”

-What are the driving forces for the internationalization of the RMB

-and why is the offshore financial market of RMB appearing?”

1.2 Literature Review

Domestic and foreign scholars have studied and analyzed the offshore financial market and the internationalization of the RMB from various angles.

Research on the conditions of RMB internationalization. Some scholars believe that the issue of RMB internationalization should be studied in the context of the

reform of the international monetary system. The gradual realization of the capital account liberalization of the RMB has a significant role in promoting the internationalization of the RMB (Wu, 2002). Li believes that capital project control not only limits the potential of RMB regionalization, but also gradually makes residents and non-residents lose confidence in the held RMB. And the liberalization of RMB capital project control will promote the regionalization of RMB and even internationalization (Li, 2004). Huang believes that China already has the conditions for the internationalization of the RMB. As the US dollar declines, the world will enter the era of diversification of reserve currencies, which is a suitable time for the internationalization of the RMB. Because China implements a conservative exchange rate policy, the price of RMB is continuously undervalued. Furthermore, economic reform in China has created basic conditions for the internationalization of the RMB. The international acceptance of the RMB is relatively high especially in Asian countries. (Huang, 2011)

According to the **research on Offshore Financial Centers (OFCs)**, some scholars believe that the Offshore Financial Centers are an integral part of globalization.

“They facilitate growing mobility of finance by facilitating no/low tax, no/low regulation, secrecy and anonymity to enable footloose capital to roam the world. Their policies play a key role in tax avoidance/evasion, money laundering, flight of capital, degradation of regulation, instability and economic underdevelopment, and have serious consequences for people everywhere.” (Sikka, 2003)

Regarding **whether to support the construction of the offshore financial market in Hong Kong**, many scholars expressed support for this initiative. Some scholars believe that the construction of the offshore financial market in Hong Kong is conducive to consolidating Hong Kong's status as an international financial center. It can provide opportunities for Hong Kong's economic growth, and it will help improve the international competitiveness of China's financial industry and open up a broader platform for economic development in the Mainland (Chen, 2012). Other scholars believe that Hong Kong has the advantage of building an RMB offshore financial market. Hong Kong has a well-developed financial infrastructure with many financial

talents and experience in developing financial markets. In addition, Hong Kong has a geographical advantage and is close to the mainland. (Dai, 2010)

Besides, some scholars have studied **the relationship between the construction of the offshore financial market and the internationalization of the RMB**. Ba Shusong believes that the improvement of the offshore financial market in Hong Kong is conducive to promoting marketization of interest and exchange rates in the mainland financial market, thus further accelerating the pace of internationalization of the RMB (Ba, 2012). Wang introduces the relationship between the internationalization of the British pound, the US dollar, the Japanese yen and the euro and its corresponding offshore financial market construction process. It confirms the positive effect of the development of offshore financial markets on the internationalization of currencies. He also points out it is necessary to build the offshore financial market of Hong Kong to provide conditions for the internationalization of the RMB (Wang, 2013) .

2. Methodology

The following sections mainly describe the research methods utilized in this paper in order to solve the problem formulation pointed out in the introduction – *under the background of the internationalization of the RMB, what are the offshore financial market’ implications on it.* And two sub-questions: *what are the driving forces for the internationalization of the RMB and why is the offshore financial market of RMB appearing.* The research methods include case study and data collection. Furthermore, this section illustrates the purpose, structure and limitation of this paper based on the problem formulation.

2.1 Research Strategy

The paper can be divided into six chapters. The first chapter is introduction, which presents a brief introduction of internationalization of the RMB, the offshore financial market and the problem formulation of this thesis. The second chapter points out the methodology, illustrating the purpose, structure and data sources of this paper based on the problem formulation. The third chapter discusses the theory that are utilized in the paper. The fourth chapter concentrates on analysis. In this chapter, we use the neoliberalism to analyze the cases of “RMB cross-border trade and settlement”, “Belt and Road Initiative” and “SDR Currency Basket” in order to figure out the driven forces of the internationalization of RMB. And then, this paper illustrates the develop path and process of offshore financial market under the theory of financial innovation. After that, the thesis analyzes offshore financial market’ implications on the internationalization of RMB mainly based on the case of Hong Kong. The fifth chapter is conclusion. The sixth chapter is reference.

2.2 Choice of Theory

Neoliberalism is the macro theory used in this paper to explain that the trend of RMB internationalization is driven by the idea of free market. Neoliberalism opposes

socialism, trade protectionism, environmentalism and populism, which it believes hinders individual freedom. The basic view of neoliberalism holds that free choice is the most basic principle of economic and political activity (Thorsen, 2006). Since the establishment of the offshore RMB financial market in Hong Kong, it has achieved the expected goal of diversifying and expanding the RMB business, promoting the internationalization of the RMB. However, affected by the Sino-US trade war and the dominance of the US dollar, the international market demand for the RMB has shown a downward trend, which has brought constraints to the offshore financial market in Hong Kong.

The theory of financial innovation is a microscopic theory that can be used to explain the reasons for the emergence of offshore financial markets. The pursuit of maximum profit is the eternal goal of financial enterprises. In order to pursue a free and open capital project market, “Shanghai-Hong Kong Stock Connect” and “Shenzhen-Hong Kong Connect” were created as new financial instruments. Reducing or even avoiding the adverse effects of government constraints and internal constraints is the driving force for financial companies to make financial innovations. And the evasion of supervision is an important reason for the emergence and development of dim sum bonds.

2.3 Choice of Data

2.3.1 Case Study

Case study research, through past researches, complex problems can be explored and understood. Case studies explore and study contemporary real-life phenomena through detailed background analysis of a limited number of events or conditions and their relationships. (Zainal, 2007)

This thesis selects some different levels cases to do the research. The cases of “RMB cross-border trade and settlement”, “Belt and Road Initiative” and “SDR Currency Basket” explain the background of the internationalization of the RMB. And the case of Hong Kong RMB offshore financial market is demonstrated the development patterns of RMB offshore financial markets. Otherwise, there are some cases

illustrating the creative development in Hong Kong RMB offshore financial market, such as the cases of “Shanghai-Hong Kong Stock Connect”, “Shenzhen-Hong Kong Connect” and “dim sum bonds”.

2.3.2 Data Collection

In order to get a comprehensive command of RMB internationalization, a number of qualitative data are adopted in the paper. This thesis makes full use of the official source of Chinese and foreign authoritative data, including digital and paper media authoritative reports, etc., and then analyze it as the data of this article, such as the *Monetary and financial stability report* released by the Hong Kong Monetary Authority. The figure of Gross Domestic Product of China from 1999 to 2018 and the table of RMB settlement under the current account can be applied to investigate the following questions: what are the driving forces for the internationalization of the RMB.

2.4 Limitation

We also have limitation when looking for information. For example, there are 22 offshore financial markets in the world. However, this article mainly analyzes the cases of offshore financial centers in Hong Kong. In addition, there are many factors driving the internationalization of the RMB. This article only selects the three perspectives of RMB cross-border trade and settlement, the Belt and Road and SDR currency basket for analysis, and has a certain one-sidedness. The analysis is not very comprehensive.

3. Theory

3.1 Neoliberalism

In order to adapt to the new political requirements, T.H. Green first proposed a new theory that adhered to the British liberal tradition and implemented state intervention to give full play to the role of the state (Schwarzmantel, 2005). After the 1990s, many radical intellectuals inside and outside the British Liberal Party who claimed to be "collectivists" advocated the establishment of a new society of equality and cooperation, and demanded that the state play a decisive role in reducing the growing unemployment and poverty. They looked for the theoretical basis for action from Green's writings (Turner, 2007). "New liberalism" became synonymous with the theory they admired. The neoliberalism at this time is in fact New Liberalism, because neoliberalism has a significant difference between "freedom" interpretation and classical liberalism. Freedom should be freedom within the institutional framework, not laissez-faire (Thorsen, 2006). The earliest neoliberal representatives are mostly professors, scholars and researchers at Oxford University. At the beginning of the 20th century, neoliberalism gradually became an important foundation of British official policy. Its influence spread throughout the British Isles and extended to Western Europe, causing profound changes in Western political thought and political practice. The world war seriously hindered the spread of neoliberalism in Europe, but its ideological principles were reflected in North America. After the Second World War, in the 1950s and 1960s, the "welfare state" policy flourished in the West, and the influence of neoliberalism continued to expand.

Neoliberalism is an economic and political trend of thought that opposes unnecessary intervention by the state and government of the economy and emphasizes the importance of free markets. But unlike classical liberalism, it advocates a social market economy, that is, the government only regulates the economy and stipulates the conditions for the framework of market activities. In international policy, it emphasizes opening up the international market and supporting global free trade and international division of labor. (Thorsen, 2006)

Neoliberalism opposes socialism, trade protectionism, environmentalism and populism, which it believes hinders individual freedom. The basic view of neoliberalism holds that free choice is the most basic principle of economic and political activity. People should be free to own private property and be free to trade, consume and find employment (Harvey, 2007). Neoliberalism believes that market self-regulation is the most superior and perfect mechanism for allocating resources. Under the centralized decision-making system, it is impossible to realize the effective allocation of scarce resources, because the government cannot have sufficient information to make informed decisions. Therefore, free competition in the market is the only way to achieve optimal allocation of resources and achieve full employment.

Neoliberalism also believes that the state's planned economy undermines economic freedom, eliminates the enthusiasm of "economic man" and reduces production efficiency. Therefore, the government should not interfere too much. They believe that privatization is the basis for ensuring that the market mechanism can fully play its role. Private enterprises are the most efficient enterprises and require privatization reform of existing public resources.

Neoliberalism has a positive impact on the establishment of China's market economic system (Kipnis, 2007). Neoliberalism emphasizes the use of market dominance. In the 1980s, China borrowed this theory, which influenced the development of China's economy. Through continuous exploration and practice, a socialist market economy with Chinese characteristics has been established, and the planned economy has been creatively integrated with the market economy.

In addition, neoliberalism opposes Keynesian fiscal policy. It advocates reducing government spending, improving government efficiency, and realizing the growth of the national economy. Neoliberalism has a positive effect on China's flexible monetary and fiscal policies.

Therefore, under the influence of neoliberalism, China's economy has made significant progress. The comprehensive national strength has been significantly enhanced, and the scale of trade has gradually expanded. It is imperative for the internationalization of the RMB. In addition, neoliberalism has had a great impact on China's foreign trade and the Belt and Road Initiative. Neoliberalism opposes trade

protectionism. Therefore, China actively promotes the Belt and Road Initiative to strengthen economic and trade cooperation with countries along the Belt and Road. And now the United States has begun to implement trade protectionism. The Chinese government has a firm opposition to the trade war.

3.2 Limitation of Neoliberalism

While using neoliberalism to analyze problems, we also need to see the flaws and shortcomings of it. Neoliberalism emphasizes marketization, liberalization and privatization. It believes that market mechanisms are the only spontaneous mechanism that can effectively regulate the economic activities. However, it ignores the shortcomings of the market.

The limitations of neoliberalism have emerged in China's state-owned enterprise reform. Under the influence of the privatization theory, at the end of the 20th century, some economists promoted the privatization reform of state-owned enterprises in the name of deepening the reform in China. However, the privatization reform of state-owned enterprises cannot solve all problems, and even caused great problems.

Under the influence of neoliberalism, globalization has further developed. In order to speed up the pace of globalization, China has adopted a series of policies to attract foreign investment. This has led to the influx of capital from abroad, Hong Kong and Taiwan area into mainland China. Foreign direct investment has become an indispensable part of our economy. However, compared with the preferential policies of foreign-funded enterprises, the local enterprises have been subject to some policy restrictions. Therefore, compared with foreign-funded enterprises, the national enterprises are less competitive. This reduces the power to resist market crises. If Chinese economy rely too much on foreign investment, once foreign investors reduce or withdraw investment in the future, the growth rate of the China will decline. While neoliberalism promotes the foreign capital flowing into China, it also threatens the survival and development of Chinese domestic enterprise.

3.3 Financial Innovation Theory

The concept of financial innovation was first proposed by Schumpeter. He believes that the combination of various financial elements in the financial sector can stimulate the emergence of financial innovation. The traditional approach to technological innovations, introduced by J. Schumpeter, distinguish the following groups of innovations: (1) new products, (2) new methods of production, (3) opening new markets, (4) new sources of supply of raw materials, (5) new organization forms and business structures and (6) new methods of management (Błach, 2011). On this basis, the OECD believes that financial innovation includes four aspects: (1) products, (2) processes, (3) marketing and (4) business organizations (Karabulut, 2015).

The theory of financial innovation explains the reasons for the emergence of offshore financial markets. This theory contains the theory of constraint. Silber believes that the pursuit of maximum profit is the eternal goal of financial enterprises. Reducing or even avoiding the adverse effects of government constraints and internal constraints is the driving force for financial companies to make financial innovations (Silber, 1983). For example, the European dollar market is a financial innovation to avoid the high costs brought about by government constraints.

Keynes believes that both government regulation and financial innovation are mutually reinforcing. On the one hand, government regulation increases the operating costs of financial institutions and reduces operating profits, making financial institutions have to seek new development paths and carry out financial innovation. On the other hand, financial innovation often has more uncertainties. When financial innovation poses a threat to a country's financial stability, it will trigger more control by the government departments on the financial system. As a result, the interaction between government regulation and financial innovation has led to the continuous development of financial markets. (Merton, 1992)

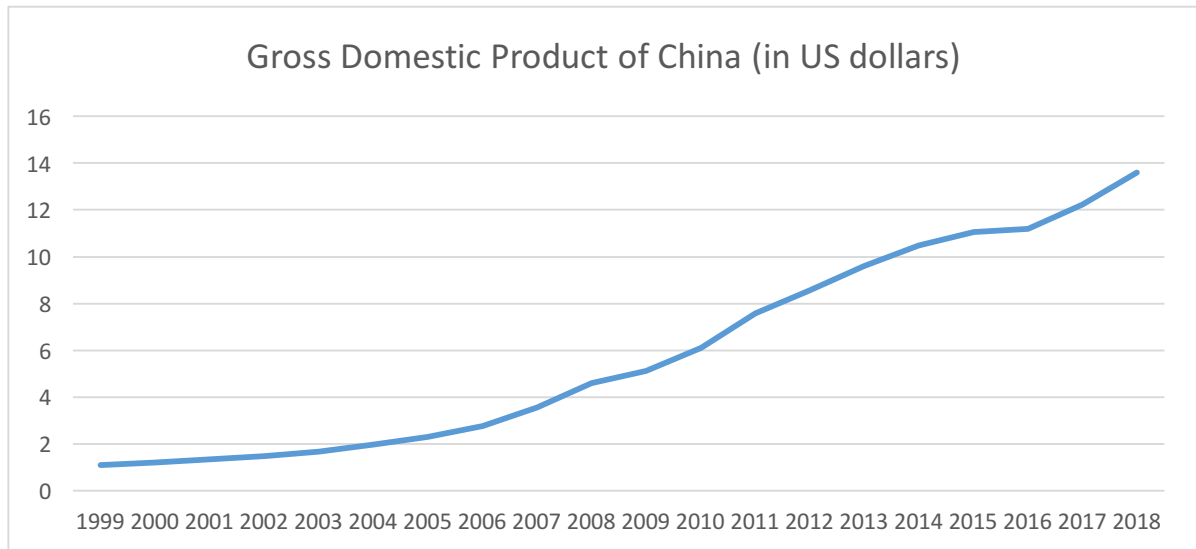
Hicks proposes that the main purpose of financial institutions for financial innovation is to reduce transaction costs. And advances in science and technology are conducive to reducing transaction costs. (Hicks, 1989)

4. Analysis

4.1 The Internationalization of the RMB

The steady growth of China's economy is the most fundamental and important driving force for the internationalization of the RMB. We can see from the figure 1, China's GDP increased by 6.6% to reach 13.6 trillion US dollars (about 90.03 trillion yuan) in 2018. China continues to be the second largest economy in the world and the largest economy in Asia.

Figure 1 Gross Domestic Product of China from 1999 to 2018 Unit: trillion US dollars



Source: National Bureau of Statistics website

Since the 1990s, the RMB has been used as a settlement currency in the border trade between China and neighboring countries. On January 20th 2009, the People's Bank of China and the Hong Kong Monetary Authority signed a bilateral currency swap agreement with a scale of 200 billion yuan. On February 28th of the same year, the People's Bank of China signed a bilateral currency swap agreement with the National Bank of Malaysia with a scale of 80 billion yuan (about 40 billion ringgit). Since 2009, China has opened the era of RMB internationalization, which has been around for ten years. Over the years, the internationalization of the RMB has made rapid progress.

From a domestic perspective, China's economic strength and international influence have greatly promoted the internationalization of the RMB. The reform of the economic system and the establishment of the Shanghai Free Trade Zone in China are

all contributed to the internationalization of the RMB. From an international perspective, the cross-border trade and settlement of RMB, "Belt and Road Initiative" and the participation of Special Drawing Rights (SDR) currency basket have greatly promoted the internationalization of the RMB.

4.1.1 RMB Cross-Border Trade and Settlement

Since the beginning of the 21st century, more and more countries and regions have chosen RMB for settlement of border trade settlement payments. So far, the central banks of Russia, Belarus, Malaysia, Kyrgyzstan and Kazakhstan have signed bilateral settlement payment agreements with the Central Bank of China. In neighboring countries and regions, the RMB as a settlement currency has greatly promoted the development of tourism and trade. The expansion of trading volume has accelerated the process of RMB internationalization.

In 2009, China began to implement RMB settlement of cross-border trade in some cities. The RMB settlement pilot has expanded from several cities to more than 20 regions, including Beijing, Yunnan, Tianjin and Jilin. The RMB has taken a crucial step towards internationalization, and the status of the RMB has increased significantly over the world. Table 1 lists the total amount of RMB settlement under the current account from 2010 to 2017.

Table 1 RMB Settlement under the Current Account Unit: 100 million yuan

Year	Total Amount	Growth Rate
2010	3501	/
2011	15889	354%
2012	28797	81%
2013	46368	61%
2014	65510	42%
2015	72344	10%
2016	52275	-28%
2017	43700	-17%

Source: People's Bank of China website

As can be seen from Table 1, the total amount of RMB settlement in the 2010 under the current account is 350.1 billion yuan, and it will grow to 1.589 trillion yuan in 2011, with a growth rate of three times. The maximum value reached 7.234 trillion yuan in 2015. In 2016, the total amount of RMB settlement under the current account decreased to 5.227 trillion yuan. And the number of 2017 is 4.37 trillion yuan. The total amount of RMB settlement has been maintained at a large amount, indicating that under the theory of neoliberalism encouraging free trade, China and countries have maintained frequent trade exchanges.

4.1.2 The Belt and Road Initiative

The Belt and Road Initiative, abbreviated as the ‘Silk Road Economic Belt’ and the ‘21st Century Maritime Silk Road’, is a cornerstone of modern Chinese development strategy. The concept of the ‘Silk Road Economic Belt’ was first mentioned on September 7th 2013, when President Xi Jinping delivered a speech in Kazakhstan. In it he states that in order to make economic relations closer between Europe and Asia, mutual cooperation should be deepened and the space of development broadened. The “Silk Road Economic Belt” was thus proposed as an innovative model of achieving that goal. (Wei 2013)

This was followed up with the concept of the ‘Maritime Silk Road’ during a speech at the Indonesian Parliament, on October 3, 2013. In his speech, Xi Jinping declared that China is willing to develop a marine partnership with Association of Southeast Asian Nations (ASEAN) countries to jointly build a ‘21st Century Maritime Silk Road’. From there, the National Development and Reform Commission of China, the Ministry of Foreign Affairs and the Ministry of Commerce jointly proposed the Belt and Road Initiative strategy, as an organization of regional economic integration.

The Belt and Road Initiative covers three main areas: Asia, Africa and Europe. The Belt and Road would cover 4.4 billion people (about 63% of the world's population), and have a total production value is about 23 trillion US dollars, accounting for 29% of world GDP (Hong 2017). The Belt and Road Initiative is not just a simple economic plan, it is “a consistent and ambitious Eurasian strategy” (Pop 2016).

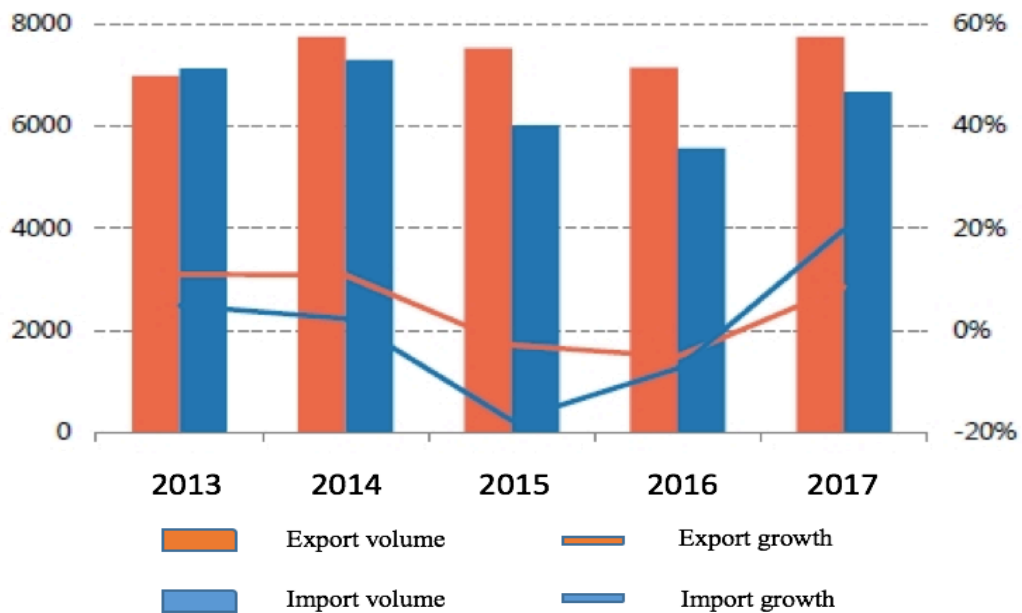
Foreign scholar John Mearsheimer believed that the Belt and Road Initiative has a profound impact on the world and amounts to a geopolitical and diplomatic invasion (Mearsheimer, 2001). However, Chinese official government argues that it is an open and cooperative policy that builds a “community of interests, destiny and responsibility” (Pop 2016).

The Belt and Road Initiative adheres to the principles of mutual cooperation, sharing and co-construction. And the Initiative aims at integration of “five areas”: policy communication; transportation connectivity; unrestrained trade; investment flow and cultural communication among the related countries. The stated intention of the Belt and Road Initiative is the promotion of cooperation and common development to achieve common economic growth. It is an initiative to increase peaceful diplomatic relations that enhance understanding, trust and strengthens all-round exchanges.

Due to the growing tension between China and neighboring countries, Chinese policy is to find new opportunities for cooperation in the south and west. The Chinese government proposes to take the initiative to cope with domestic and foreign challenges under the new situation. The Belt and Road Initiative is not only a regional policy, but also an important step in realizing the Chinese dream. (Aoyama 2016)

In order to achieve the goals of the Belt and Road Initiative, China needs a lot of financial support. This is why China has proposed and established financial institutions such as the Asian Infrastructure Construction Bank and the Silk Road Fund (Hai 2016).

Figure 2 Total Imports and Exports of China and the “Belt and Road” Countries Unit: 100 million US dollars



Source: National Information Center

Under the influence of neoliberalism, the export volume, import volume and total import and export volume of the “Belt and Road” countries and China in 2017 increased compared with 2016. From figure 2, we can see the total import and export volume of China and the “Belt and Road” countries reached 1,440.32 billion dollars in 2017, accounting for 36.2% of China's total import and export trade. The import value was 666.05 billion dollars, an increase of 19.8%; the export volume reached 774.26 billion dollars, an increase of 8.5%.

The Belt and Road Initiative interacts with the internationalization of the RMB. The construction of the Belt and Road Initiative can effectively enhance economic and trade exchanges between China and the countries along the Belt and Road in infrastructure construction, international goods and services trade. This creates the conditions for the local use of the RMB and strengthens the bilateral currency cooperation. The Belt and Road Initiative provides a rare opportunity for the localization, regionalization and final internationalization of RMB. The deepening of the internationalization of RMB has made it become an accepted reserve currency in the world. At the same time, it provides financial support for settlement, clearing, investment and financing for the construction of the Belt and Road. The

internationalization of the RMB complements the Belt and Road Initiative and develops together.

4.1.3 SDR Currency Basket

4.1.3.1 The Role of the SDR

The SDR is an international reserve asset, created by the International Monetary Fund (IMF) in 1969 to supplement its member countries' official reserves. So far SDR 204.2 billion (equivalent to about 291 billion dollars) have been allocated to members, including SDR 182.6 billion allocated in 2009 in the wake of the global financial crisis. The value of the SDR is based on a basket of five currencies: U.S. dollar, the euro, the Chinese renminbi, the Japanese yen, and the British pound sterling. (IMF, 2019)

The SDR was created as a supplementary international reserve asset in the context of the Bretton Woods fixed exchange rate system. The collapse of Bretton Woods system in 1973 and the shift of major currencies to floating exchange rate regimes lessened the reliance on the SDR as a global reserve asset. Nonetheless, SDR allocations can play a role in providing liquidity and supplementing member countries' official reserves. In 2009, IMF allocated 182.6 billion SDR to the members amid the global financial crisis.

4.1.3.2 A basket of Currencies Determines the Value of the SDR

The SDR basket is reviewed every five years. If necessary, it may be reviewed in advance to ensure that the SDR reflects the importance of money in the world trade and financial system. The review covered key elements of the SDR valuation methodology, including criteria and indicators for selecting the SDR basket currency, and determining the number of each currency (units) in the basket. (Obstfeld, 2011)

During the last review concluded in November 2015, the Board decided that the Chinese renminbi met the criteria for inclusion in the SDR basket. Following this

decision, the Chinese RMB joined the US dollar, euro, Japanese yen, and British pound sterling in the SDR basket, effective October 1, 2016.(IMF, 2015)

Figure 3

SDR Basket

Currency	Weights determined in the 2015 Review	Fixed Number of Units of Currency for a 5-year period Starting Oct 1, 2016
U.S. Dollar	41.73	0.58252
Euro	30.93	0.38671
Chinese Yuan	10.92	1.0174
Japanese Yen	8.33	11.900
Pound Sterling	8.09	0.085946

Source: IMF website

4.1.3.3 Impact of Joining SDR on RMB Internationalization

After the RMB joins the SDR, it can be used freely in international trade and used for payment and settlement in international trade. This has prompted the RMB to gradually become an investment currency, a financial currency, a settlement currency and a trade-denominated currency, as well as an international reserve asset currency. After the participation of SDR, it increased the international recognition and trust of the renminbi and had a positive impact on the internationalization of the RMB. This article will analyze from the macro and micro aspects.

From a micro perspective, the addition of RMB to SDR has a positive impact on financial consumers. For financial consumers, this has expanded the scope of RMB settlement. Many countries have increased their recognition of the RMB, and the RMB can be freely exchanged and used internationally. Domestic residents do not have to go to the bank to buy foreign currency when traveling abroad or studying abroad. It saves the exchange fee which makes the consumption of residents abroad cheaper, making it easier for Chinese residents to spend overseas.

In addition, the inclusion of RMB in SDR has a positive impact on China's financial institutions. The RMB has joined the SDR, which has accelerated the internationalization of the RMB. The financial institutions headed by the banking industry in China will have an in-depth understanding of international business. The addition of RMB to SDR has made China's financial market and capital market more open. Our residents can not only invest in foreign assets, but also make foreign capital flow into China. At that time, international business such as foreign exchange business will continue to increase, and investment and financing will make banks and other financial institutions have more development opportunities. However, the increase in the internationalization of the RMB requires financial institutions to continue to innovate, which will inevitably explore the development potential of financial institutions such as the banking industry.

From a macro perspective, the RMB participation in SDR has a positive impact on the RMB exchange rate. The exchange rate system implemented in China is a “managed floating exchange rate system”. In other words, this exchange rate system is based on market supply and demand, with reference to a basket of currencies, and the government intervenes. As the RMB joining the SDR, the International Monetary Fund demands that the RMB be freely available. The central bank will continue to loosen interest rate controls and reduce the intervention of RMB interest rates, which will undoubtedly lead to a larger fluctuation range of the RMB exchange rate. Moreover, the continuous advancement of the internationalization of the RMB will cause more foreign investors to pay attention to the domestic capital market, and more foreign exchange inflows maybe cause greater fluctuations in the RMB exchange rate. However, domestic economic development is the potential factor affecting the RMB exchange rate. China's financial market and economic prosperity are the basic ways to help the stability of the RMB.

However, the addition of RMB to SDR also poses many challenges. The addition of special drawing rights has increased the international recognition of the RMB, making foreign investors and investment institutions pay more attention to the Chinese capital market. If foreign capital wants to flow in, it will put forward higher requirements for the RMB and China's financial markets. Foreign capital wants to flow in, and China's

capital wants to flow out. The frequent flow of capital requires China's capital flow to remain smooth, and it has challenged China's existing financial market system.

4.2 Offshore Financial Market

Since the advent of the concept of offshore financial markets, it has evolved with the development of offshore business. Therefore, in different stages of economic development, the specific meaning of offshore financial markets is different. This paper uses the financial innovation theory to analyze the reasons for the formation of offshore financial markets.

4.2.1 The Concept of Offshore Financial Market

An Offshore Financial Centre (OFC) is defined as a country or jurisdiction that provides financial services to nonresidents on a scale that is incommensurate with the size and the financing of its domestic economy (Zoromé, 2007). “Offshore” does not refer to the location of the OFC, but the largest user of the OFC is “offshore”. For example, Luxembourg and Hong Kong are located on the “land”.

In April 2007, IMF released a total of 22 offshore financial markets in the world in 2007. And then IMF pointed out that 8 major offshore financial markets were responsible for 85% of OFC's financial flows, including the Netherlands, Luxembourg, Hong Kong SAR, the British Virgin Islands, Bermuda, the Cayman Islands, Ireland, and Singapore (Damgaard, 2018).

Euro-dollar refers to the US dollar that is deposited outside the US border and is not subject to US financial regulatory agencies. It is the earliest form of offshore finance, and the European dollar market is also the original offshore financial market. Therefore, the offshore financial market only operates in the European region. Later, as trade between countries became more and more close, the scope of offshore financial markets gradually expanded to other regions outside Europe. In addition, the operating currencies of offshore financial markets were gradually diversified, including the British pound, Japanese yen, German mark and other currencies.

This definition mainly emphasizes two main characteristics of the offshore financial market: First, the participating entities are non-residents. The person involved in the offshore financial business of the overseas financial market cannot be a resident of the country or region where the currency is issued. Second, the regulation of offshore financial markets is more lenient than that of onshore financial markets. Whether it is divided into offshore financial market is an important factor to see whether the development of the business is not subject to the regulations of the currency issuing country and the country in which the business is conducted, and whether it enjoys preferential tax collection policies. It is not simply the location where the business is carried out.

The offshore market has the advantages of tax incentives and loose regulation to develop international financial services. In addition, the offshore financial market also includes the characteristics of strong liquidity and high profitability.

4.2.2 The Process of the Development of Offshore Financial Market

The development of offshore financial markets can be divided into four processes.

The first stage is the germination. The offshore financial market began in the early 1950s. After World War II, the United States implemented a reconstruction plan for Europe. Due to the UK's permission of the US dollar business and the relaxation of foreign exchange in some European countries, the European dollar market had developed rapidly and the currency has been freely circulated. At the same time, expenditures of US were bigger than income, so there was a serious deficit at that time. Countries with a balance of payments surplus deposited US dollars into the European dollar market in order to obtain the benefits of interest and investment. This had promoted the growth of offshore financial markets. The offshore financial market at this stage is in germination because of the limited size of the transaction.

From the late 1950s to the late 1960s, the offshore financial market was a stage of growth. In the late 1950s, the United States used financial means to intervene in economic construction, which objectively promoted the rapid development of the

European dollar market. Furthermore, some countries in Europe have experienced inflation and the government encourages residents to hold foreign currency. At the same time, the hegemonic status of the United States has gradually declined, and the pound, franc and mark have gradually become active in international credit transactions, which has greatly promoted the growth of offshore financial markets.

The maturity stage is from the late 1960s to the end of the 1970s. The development of offshore financial markets during this period has broken through geographical boundaries and not only served the European currency market. The huge US trade deficit and the growing demand for financing in developing countries have made many governments and companies aware that offshore financial market was an ideal choice. In order to adapt to the diversified market demand, the offshore financial market has a tendency of decentralization and differentiation.

The late 1980s can be defined as the stage of prosperity. In the early 1980s, International Banking Facilities (IBFs) were opened in the United States. It became the first offshore financial market to offer offshore financial services where money was issued. In the mid-eighties, Tokyo's offshore financial markets began operations. With the promotion of IBFs, offshore financial transactions were no longer limited to offshore financial centers. At this stage, a global and specialized offshore financial market model had matured.

4.2.3 The Trend of Offshore Financial Market

Offshore financial markets have enormous potential for development. Due to the economic recovery in developed countries and the rapid development of multinational corporations, offshore financial markets have great potential. In addition, the expansion of international trade and the strong demand in the international financial market have greatly promoted the rise of offshore financial markets.

Firstly, offshore financial services are showing a diversified trend. The Jamaican system established by the International Monetary Fund requires the diversification of monetary reserves. Moreover, in order to adapt to the changing international situation, a variety of new offshore business forms are emerging. Diversification is mainly reflected in the variety of offshore financial services that provide governments or

companies with more options to avoid risks and maintain value, such as offshore trusts, offshore funds, and offshore asset securitization.

Secondly, offshore financial services are showing a trend of specialization. Specialization is mainly reflected in the regional offshore financial market. Due to the sensitive response to market changes and the ability to change, it is better to provide offshore financial services.

4.3 Case of Hong Kong's RMB Offshore Financial Market

After the 2008 financial crisis, China actively promoted the internationalization strategy of the RMB to seek new development opportunities and enhance China's position and voice in the world economic system. China's capital account has not yet been fully opened, and the establishment of the offshore financial market of the RMB is an optimal path to accelerate the internationalization of the RMB.

The current domestic and international political and economic environment and Hong Kong's own advantages have promoted its establishment. Therefore, the construction of the offshore financial market in Hong Kong has not only promoted the in-depth development of the internationalization of the RMB, but also consolidated the economic status of Hong Kong as an international financial center.

4.3.1 The Background

China may face the danger of entering the trap of a moderately developed country now. At this time, the establishment of the offshore financial market in Hong Kong can reduce the cost of foreign investment in China's economic construction and raise the level of foreign investment. On the one hand, it can adapt to different backgrounds and needs, and on the other hand, it provides an opportunity for accelerated development. The background of the construction of the offshore RMB financial center in Hong Kong has the following points:

First of all, it is necessary to establish an offshore financial market for RMB in Hong Kong in order to comply with the international economic development trend. Since the financial crisis in 2008, the United States has adopted a quantitative easing

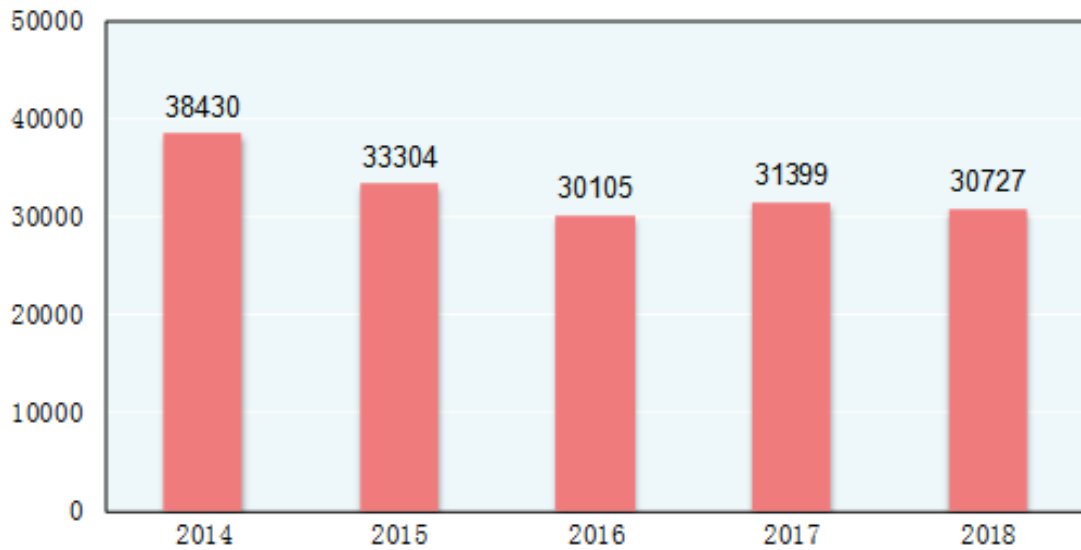
monetary policy to impose a monetary and inflation tax on other countries, relying on the international currency advantage of the US dollar. This has caused trade wars on a global scale, resulting in excessive money supply and frequent exchange rate fluctuations, which have seriously damaged the interests of developing countries. As the largest creditor country of the US dollar, China suffered huge losses in this crisis.

But the global financial system cannot make changes in short time. Therefore, in order to minimize the losses caused by the dependence on the US dollar system, China adopts cross-border trade and Hong Kong RMB offshore financial market strategy. It not only helps to enhance China's right to speak in the international economic arena, but also to make the international currency diversify.

Furthermore, the establishment of the offshore financial market in Hong Kong is an important measure to promote the internationalization of the RMB. The RMB internationalization strategy needs to be gradually implemented and promoted. Geographically, it expands from “peripheralization” to “regionalization” and then to “internationalization”. In terms of functions, it follows the steps of RMB settlement, investment and reserve. The establishment of the offshore financial market in Hong Kong is a transitional arrangement for the internationalization of the RMB. It is beneficial to control potential capital flow risks and maintain the stability of domestic financial markets within the offshore market. At the same time, it is also conducive to promoting deep financial reform and innovation in China and improving China's financial internationalization.

Developed countries cannot lead the economic recovery after the financial crisis, but emerging economies dominated by developing countries have flourished. As an indispensable part of the emerging market economy, China's influence is improving. At present, China has become the world's second largest economy and foreign exchange reserves is huge. At the end of 2018, the state's foreign exchange reserves amounted to 3072.7 billion US dollars (Figure 4), which laid a solid foundation for accelerating the internationalization of the RMB.

Figure 4 China's foreign exchange reserve value from 2014 to 2018 Unit: 100 million US dollars



Source: National Bureau of Statistics website

The last point is that Hong Kong has the natural geographical advantages and financial environment for establishing the RMB offshore financial market. Firstly, Hong Kong has a good location. It is located between the United States and Europe and has a good time zone. It has a moderate geographical distance from a powerful country and is also a strong economy. Secondly, Hong Kong owns a good economic and financial environment. Hong Kong, which is dominated by an export-oriented economy, holds a well-developed financial infrastructure and banking system. Thirdly, Hong Kong enjoys a sound legal supervision system and an administrative judicial system. Finally, due to frequent exchanges with the mainland, Hong Kong's RMB supply and demand are increasing. In this context, the offshore financial market of RMB in Hong Kong was established.

4.3.2 The Development Path

Under the guidance of the government's policies, the offshore financial market in Hong Kong was established. Its business development has also been promoted from easy to difficult, from offshore RMB personal business, bond business, deposit business, loan business to financial innovation products. Since 2003, the establishment of the offshore financial center of Hong Kong has experienced three stages of germination, development and comprehensive construction.

The first stage of the offshore financial market in Hong Kong is from the end of 2003 to the end of 2008. The main business is the personal business and the bond business issued by mainland financial institutions. In June 2003, the central government signed a bilateral economic and trade cooperation agreement with the local government of Hong Kong. The central bank then began to provide clearing services for Hong Kong's personal RMB deposits, exchanges and remittances. The clearing bank is Bank of China Hong Kong Limited (BOC Hong Kong). The first personal business was operated in February 2004 and the first RMB bond was issued by the China Development Bank in July 2007. In the same month, the Real Time Gross Settlement (RTGS) was officially launched. It is designed to meet the needs of real-time settlement between RMB, Euro, USD and other currencies.

After the development of first five years, the size of the RMB fund pool in Hong Kong has increased to 56.06 billion yuan and the number of bond issuance has risen to 22 billion yuan. Compared with the major international offshore financial markets, the scale of the market in Hong Kong is relatively small. But this is the first attempt by Hong Kong to carry out offshore renminbi business, which provides a good start for the construction of the offshore financial market in Hong Kong.

From 2009 to 2011, it was the formation stage of the offshore financial market in Hong Kong. The movements of the offshore financial market were closely related to the policies of the central government. In order to provide sufficient financial support for the offshore financial market, the central bank and the Hong Kong Monetary Authority signed a currency swap agreement in January 2009. In April, the cross-border trade RMB settlement business was first launched in five pilot areas, including Shanghai, Guangzhou, Shenzhen, Zhuhai and Dongguan. In February 2010, the Hong Kong Monetary Authority allowed Hong Kong banks to freely use RMB funds that did not return to the Mainland. In June, the pilot area of cross-border trade RMB settlement business increased again and restrictions on overseas areas were also cancelled. During this period, the offshore RMB fund pool expanded and the offshore RMB financial market in Hong Kong was initially formed.

Since August 2011, it is the third stage of Hong Kong offshore financial market. This period is mainly to improve the RMB return channel and build the RMB asset market.

In order to turn Hong Kong into a mature RMB offshore business and asset management center, the Chinese government has given a number of support policies. The first RMB Exchange Traded Funds (ETF) was released at Hong Kong Stock Exchange in February 2012. In December of the same year, a policy was approved, which provided favorable interest rates for mainland enterprises to raise funds in the offshore financial market of Hong Kong.

Subsequently, the launch of “Shanghai-Hong Kong Stock Connect” and “Shenzhen-Hong Kong Connect” facilitated the interconnection between Hong Kong and the Mainland. In July 2015, the Mutual Recognition of Funds (MRF) was formally implemented. The MRF is a bilateral regulatory framework which allows mutual funds of both countries or areas to be distributed to retail investors in each market through a streamlined authorization process. These policies have promoted the comprehensive construction of the offshore financial market in Hong Kong. However, due to the fact that China's capital projects have not yet been fully opened, it is difficult for Hong Kong to build a mature and efficient offshore financial market in the short-term.

4.3.3 The Significance

The construction of the offshore financial market in Hong Kong is conducive to the development of the internationalization of the RMB.

First of all, the construction of the offshore financial market in Hong Kong makes the market play a fundamental role. Since China has not completed the market-oriented reform of interest rates and exchange rates, and the pricing mechanisms in domestic and foreign financial markets are different, it provides an opportunity for RMB arbitrage. This has led to an increase in the number of offshore RMB settlements, which brings more uncertainty to the domestic market. With the continuous maturity and improvement of the offshore financial market in Hong Kong, the market-oriented reform of interest rates and exchange rates will be further promoted, which will narrow the space for arbitrage. In addition, the development of the offshore financial market in Hong Kong can also reduce the systemic risks of financial markets and

provide a more stable market environment for the opening of capital accounts in the Mainland.

Secondly, the construction of the offshore financial market in Hong Kong is conducive to expanding the output of the RMB. Among the channels of RMB output, the proportion of trade is quite large. However, due to the aftermath of the global financial crisis, the economic growth powers of various countries have been weak, and international economic and trade exchanges have also shown a downward trend. In addition, due to China's large trade surplus, the output of the RMB has been hindered. The RMB bond business, foreign exchange business, deposit and loan business in the offshore RMB market in Hong Kong can provide a good platform for the export of RMB. Taking advantage of the strong liquidity of the RMB offshore market to increase the output of the RMB is conducive to the steady growth of the Chinese economy.

Thirdly, the soundness and perfection of the offshore financial market in Hong Kong can increase the overseas demand of the RMB. As the circulation of the RMB overseas continues to expand, overseas investors have increased the standards of quality for offshore financial services which require diverse types of business. The offshore RMB financial market in Hong Kong will innovate the offshore RMB business and provide a better operating system for futures, options and other financial derivatives transactions. Furthermore, it can improve the service quality of the offshore financial business to meet the large-scale and high-standard overseas demand.

Finally, the RMB financial markets can enhance the competitiveness of Hong Kong's international financial centers. Although Hong Kong has developed into a highly liberalized international financial center in the 1980s, it still has some problems. The improvement of the offshore financial market of the RMB can make up for the shortcomings of Hong Kong. On the one hand, the issuance of bonds by large domestic financial institutions in Hong Kong can promote the development of the Hong Kong bond market and realize the interaction between mainland enterprises and the Hong Kong stock market. On the other hand, it can further strengthen the political and economic cooperation between Hong Kong and the Mainland. Hong Kong will be

built into an offshore trading and investment center of RMB and enhance the competitiveness of Hong Kong's international financial centers in global financial markets.

4.3.4 The Financial Innovation in RMB Offshore Market

Although the definition of financial innovation is quite different, financial innovation can be attributed to two levels. The first level is the macro level: the history of the development of the entire financial industry is a history of continuous innovation, and every major development of the financial industry is inseparable from financial innovation. Financial innovation at this level has a long time span and covers a wide range. It includes not only innovations in financial technology, but also innovations in financial markets and the international monetary system. Offshore financial markets are financial innovations at the macro level.

From the micro level, financial innovation refers to the innovation of financial instruments and financial services. It can be divided into four types: credit innovation, risk transfer innovation, liquidity increase innovation and equity creation innovation. In order to make the capital project market in Mainland China more free and open, “Shanghai-Hong Kong Stock Connect” and “Shenzhen-Hong Kong Connect” were created as new financial instruments. The innovation of these two financial instruments enables domestic capital to operate under the protection of the law, and ultimately achieve healthy and orderly development of economy. In the theory of financial innovation, the pursuit of maximum profit is the eternal goal of financial enterprises. Reducing or even avoiding the adverse effects of government constraints and internal constraints is the driving force for financial companies to make financial innovations. Evasion supervision is an important reason for the emergence and development of dim sum bonds.

4.3.4.1 Shanghai-Hong Kong Stock Connect and Shenzhen-Hong Kong Stock Connect

Launched in 2014, the Shanghai-Hong Kong Stock Connect (SHSC) was the first mutual access channel between the Chinese and Hong Kong equity markets. The

scheme allowed Hong Kong and international investors to purchase eligible Shanghai-listed shares, while at the same time permitting eligible Chinese investors to purchase eligible Hong Kong-listed shares. (Chong, 2019)

The Shenzhen-Hong Kong Stock Connect program was officially launched on December 5, 2016. It was mutually linking the two stock exchanges and giving the investors in Hong Kong and overseas a chance to trade Chinese stocks listed on the Shenzhen Stock Exchange (SZSE) more easily. The Shenzhen-Hong Kong Stock Connect is a Shenzhen version of Shanghai-Hong Kong Stock Connect. (Wang, 2016)

According to data from the Shenzhen Stock Exchange, the total transaction volume of Shenzhen-Hong Kong Stock Connect reached 4.15 trillion yuan (\$605 billion) on December 5, 2018. Among them, the total amount of funds invested from Hong Kong reached 266.84 billion yuan, while the net purchase from the mainland to Hong Kong was 156.54 billion yuan.

Investors can enjoy the perfect financial infrastructure of Hong Kong and take a share from the economic development process in the Mainland. These advantages have attracted many overseas investors to participate in the construction of the offshore RMB market in Hong Kong. In addition, the operation of “Shanghai-Hong Kong Stock Connect” and “Shenzhen-Hong Kong Stock Connect” enables the participating entities in the domestic capital market to expand the scale of transactions, increase the frequency of capital flows, and achieve optimal allocation of capital elements. This provides a solid economic foundation for the further development of offshore RMB finance in Hong Kong.

“Shanghai-Hong Kong Stock Connect” and “Shenzhen-Hong Kong Stock Connect” are innovations that help the internationalization of the RMB. It opens a new channel for the capital account of the mainland. In this channel, RMB funds can be freely circulated, and the risk can be controlled within a certain range. The stock business in the offshore RMB financial market in Hong Kong started relatively late. After canceling the restrictions on stock market transactions, Hong Kong can be linked to the Shanghai and Shenzhen markets as a common market, which has a market value about 70 trillion yuan.

The offshore RMB financial market in Hong Kong can be regarded as the trading gateway of this common market. On the one hand, it helps the RMB funds to achieve optimal distribution at the international level. On the other hand, international capital utilizes Hong Kong's financial infrastructure to invest in domestic capital markets. With the continuous deepening of the interconnection mechanism, the future can be extended to the bond market and commodity market. The variety of businesses in the offshore financial market in Hong Kong is more diverse. Of course, the Hong Kong Monetary Authority has also introduced a number of measures to help banks manage RMB liquidity and strengthen market infrastructure to promote the smooth development of offshore RMB business in Hong Kong.

4.3.4.2 Dim Sum Bonds

Dim sum bonds are bonds denominated in RMB issued in Hong Kong. Compared to the entire RMB bond market, the scale of this kind of bonds is small. Therefore, they are named after dim sum, a popular style of cuisine in southern China. (Li, 2011)

Unlike financial instruments in mainland, the issuance of dim sum bonds is basically unregulated, regardless of the issuer or the price of bond. But if you want to put the money to the mainland, you need permission from the regulatory authorities in domestic. In contrast, issuing bonds in domestic has many qualifications. Generally, only state-owned enterprises and large private enterprises can issue bonds on the mainland. The foreign enterprises can not meet the qualifications.

In June 2007, China Development Bank (CDB) issued its first offshore RMB bond in Hong Kong. From 2010 to 2014, the dim sum bond market experienced a rapid development period. In 2014, Hong Kong's RMB dim sum bonds issued about 183.1 billion yuan, an increase of 89% compared with last year. Among them, 90% are financial bonds and corporate bonds, and more than 75% of them are short-term bonds of one to three years. Dim Sum debts were very popular. Because Hong Kong residents can only exchange 20,000 yuan a day, many elderly people who do not know how to trade online queued up outside the bank in the morning to exchange RMB for bonds.

From 2015, the issuance of dim sum bonds decreased. The total issuance of dim sum bonds in 2015 was 91.7 billion yuan, almost half of the circulation in 2014. In 2016, the issuance of dim sum bonds was further reduced. On December 5, 2016, the issuance of dim sum bonds was only 32.7 billion yuan, basically returning to level of 2010.

4.3.5 The Expansion of the Offshore RMB Market

In the process of RMB internationalization, Hong Kong's offshore RMB market is the first to develop. After years of development, the trading volume of the offshore RMB market in Hong Kong has developed rapidly. This has led to the development of the offshore market in other regions, and Singapore and London are examples.

4.3.5.1 Singapore Offshore RMB Market

The type of Singapore offshore financial market is different from that of New York and London. The offshore market in Singapore was established with the initiative of the government. In 1965, after Singapore's independence, problems such as the domestic economic downturn, high unemployment rate and the decline of international trade appeared. Therefore, the Singapore government has begun to intentionally turn Singapore into an international financial center.

At the same time, in 1968, the United States intended to establish a dollar offshore market in Asia in order to alleviate the balance of payments deficit. Originally preferred is Hong Kong. However, Hong Kong is reluctant to give up foreign currency interest tax and is not willing to issue licenses to foreign banks. Singapore seized this opportunity to take the initiative to cancel the foreign currency tax and issue licenses to foreign banks with preferential policies. This prompted foreign banks such as Citibank and Standard Chartered Bank to conduct business in Singapore. This opened the way for Singapore to become an international financial center. Since then, the Singapore government has continuously introduced a series of preferential measures to cancel the US dollar control and the deposit reserve, which has prompted the continuous increase of the currency currency circulation of the US dollar, mark,

pound, yen and other in the offshore market in Singapore. This has established Singapore's status as an international financial center.

With the development of China's economy and the increasing international status of the RMB, the Singapore government has gradually realized that the RMB will challenge the dollar's position in Asia. The offshore market in Singapore has also begun to actively participate in the development of businesses that use RMB settlement. In July 2010, the Singapore Monetary Authority and the People's Bank of China signed a currency swap agreement of RMB 150 billion. With the development of trade between the two countries and the increase of the RMB in Singapore's financial market, in 2013 the two countries raised the amount of the RMB currency swap agreement to 300 billion yuan.

In 2013, the Industrial and Commercial Bank of China Singapore Branch was appointed by the People's Bank of China as the Singapore RMB Clearing Bank. This marks the development of the offshore RMB market in Singapore. On May 27, 2013, Singapore's RMB offshore clearing service and banking services were officially launched. In June 2013, the first RMB bond was issued in Singapore. On October 22, 2013, China granted Singapore a RMB 50 billion qualified foreign institutional investor quota to accelerate the construction of the offshore RMB market in Singapore. On March 7, 2016, the People's Bank of China and the Singapore Monetary Authority renewed the bilateral currency swap agreement with a scale of RMB 300 billion, valid for three years.

The development of the offshore RMB market in Singapore not only prospered Singapore's financial market, but also promoted the internationalization of the RMB.

4.3.5.2 London Offshore RMB Market

Compared to Singapore, the development of London's offshore RMB market is late, but the speed of development is fast. London's offshore RMB market has become one of the most important RMB offshore markets.

From the history of the formation of the international financial center, London as an international financial center was earlier than New York, Tokyo, Hong Kong,

Singapore and other cities. In the 18th century, Britain first completed the industrial revolution. Driven by neoliberalism, the UK has become an international financial center, transportation center and payment center. At the same time, the British pound completed the internationalization process and became the earliest international currency. As the capital of the United Kingdom, London has always been the political center and financial center of the United Kingdom. After the United Kingdom became the greatest power in the world, London has undoubtedly become an international financial center.

However, it is unfortunate that a world war broke out in Europe. Due to the geographical location of the United Kingdom, the impact of the World War on the British economy is enormous. After the Second World War, the British economy was in recession. The United States seized the opportunity to rise rapidly and replaced Britain's international economic status. Since then, the US dollar has replaced the British pound as the world's most extensive international currency. New York has gradually replaced London as a new financial center.

In the 1960s, the British government supported the establishment of an offshore market in London. London's offshore financial business has grown rapidly and has become the largest European dollar market. In the 1980s, the British government carried out liberalization reforms in the financial services industry, and London was consolidated and strengthened as an international financial center.

As one of the major international financial centers, London is very concerned about the potential RMB business and has been closely watching the internationalization of the RMB. In April 2012, London officially announced the launch of the offshore RMB market. The RMB business volume in London is growing rapidly. In order to further strengthen the RMB market cooperation between China and the United Kingdom, on June 22, 2013, the People's Bank of China and the Bank of England signed a 200 billion yuan (20 billion pounds) bilateral local currency swap agreement. This is the first bilateral currency swap agreement that China has signed with Western developed countries officially. The signing of this agreement has further promoted the development of the offshore RMB market in London. On October 15 in the same year, in the fifth Sino-British economic and financial dialogue, the Chinese government

month to RMB 2009.35 billion. The balance of RMB time deposits increased to RMB 417.89 billion, compared with RMB 412.48 billion at the end of last month. Although the growth of deposits has other factors, it cannot ignore the role of the offshore market. The offshore market in Hong Kong has promoted the internationalization of the RMB from cross-border investment and financing.

In October 2014, the British government issued the first RMB sovereign bond with a scale of RMB 3 billion, a three-year term and a 2.7% interest rate, which was listed on the London Stock Exchange. This is the first large-scale RMB sovereign bond issued by Western countries. It not only indicates that the RMB is officially included in the British foreign exchange reserve currency, but also indicates that the reserve function of the RMB has been affirmed by Western countries. In terms of the international reserve currency, the London offshore market promoted the internationalization of the RMB.

At the same time, the internationalization of the RMB has in turn prompted the establishment of more offshore RMB markets and business. The scale of China's RMB overseas business and China's foreign trade are still not matched. For example, many countries and regions have trade relations with China, but the RMB settlement center has not yet been established. In the process of continuous internationalization of the RMB, the RMB settlement centers in these countries and regions will gradually develop and even establish an offshore RMB market.

In the process of the people's internationalization, the development of the offshore RMB market has played an indelible role. The impact of the offshore market on the internationalization of the RMB can be summarized as follows.

4.5.1 Expand the Scope of RMB Circulation

The offshore RMB market helps to expand the scope of RMB circulation abroad. In the case that the RMB exchange rate has not yet been fully marketed, the exchange rate pricing of the RMB abroad is basically based on the black market cross exchange rate, which is not conducive to the expansion of the RMB circulation. Strengthening exchanges with other countries through the offshore market of the RMB and opening RMB business with more countries will also expand the circulation of the RMB. At

the same time, since the RMB 's overseas circulation is not regulated by the People's Bank of China and the Ministry of Finance, this has also increased the risk of the RMB's overseas circulation to a certain extent. However, due to the existence of the offshore RMB market, the freedom of RMB exchange has been increased, and the risk of RMB circulation has also been reduced. These advantages have accelerated the internationalization of the RMB.

4.5.2 Increase the Liquidity of RMB

The offshore market has increased the liquidity of the international RMB. From the perspective of the concept of offshore market, the offshore market has transcended the geographical distinction, but the distinction between institutions and management methods. The difference between an offshore market and an onshore financial market is not the location of the market, but whether it is subject to the financial rules and related laws and regulations of the country in which the currency is issued. To put it simply, the onshore financial market is a country's domestic financial market, which must follow domestic financial rules and national laws and regulations, while the offshore market is the opposite. Driven by financial innovation theory, the nature of “offshore” determines that it is not subject to these constraints. On the other hand, the offshore market has the following characteristics: deposit reserve is not restricted or has been canceled, is not subject to foreign exchange control, interest rate control is not subject to the upper limit, credit limit is unlimited or the amount is large.

In the early days of the development of the offshore market, the “non-residents” of the transaction entities were not emphasized. For example, the offshore market in London is an integrated offshore market. It combined the offshore market and the domestic financial market into one market. The offshore account and the onshore account are merged into one account. And the deposit and loan business of residents and non-residents can be operated in the same conditions. This realized the unified management and operation of currency transactions, investments, and securities under the normative system. At the same time, funds can flow freely from abroad to the territory, and can also flow from the inside to the outside. The offshore market and domestic financial markets complement and promote each other. However, with the development of the offshore market, the offshore market has increasingly emphasized

the “non-residents” of the trading entities. For example, in the offshore market in New York, the market is a separate offshore market, characterized by a strict separation of shore financial accounts and onshore financial accounts. Offshore transactions and onshore transactions are isolated, and it is strictly forbidden to circulate between offshore and onshore accounts.

Due to the various characteristics of the offshore market, the offshore market provides a channel for non-residents to hold and distribute RMB. Compared with the domestic financial market, the offshore market is not subject to space restrictions because it transcends geographical boundaries. Since the offshore market is available 24 hours a day, it is not subject to time constraints, which facilitates the holding and trading of RMB by non-residents.

Based on these advantages, compared with the domestic financial market, the RMB has a low cost of raising funds in the offshore market and high investment returns. This has provided economic incentives for non-residents to hold RMB, and laid the foundation for the circulation of RMB in the international financial market. The offshore market itself is an innovation in the financial system. In the context of neoliberalism advocating a free market, the offshore market is extremely liberal and open, and it provides a hotbed for innovation in other financial products. In the development of the offshore market, we have continuously created some innovative financial products, such as forward rate agreements and floating rate bonds. This provides more choices for non-residents to hold and trade RMB, thereby increasing the willingness of non-residents to hold RMB. In the national financial market, people are more willing to hold the RMB to share the dividends brought about by China's economic development.

In addition, offshore financial markets can expand overseas RMB return channels. With the continuous development of China's economy and the stability of the value of the RMB, when trade settlement with neighboring countries or regions, people are increasingly inclined to choose RMB settlement during trade settlement. The development of the offshore RMB market provides a convenient channel for these RMB. This balances the balance of the international balance of the RMB. On the

other hand, it also provides a channel for the return of the RMB and promotes the liquidity of the RMB.

The characteristics of the offshore market ensure that the RMB has good liquidity and extensive exchangeability. This provides a guarantee for the RMB to flow internationally and store in foreign countries, which can further promote the internationalization of the RMB.

4.5.3 Enhance the Foundation of RMB Internationalization

The offshore market can enhance the foundation of the internationalization of the RMB. Currency internationalization does not happen overnight. It requires certain conditions and foundations. In general, the internationalization of RMB needs to be based on the rapid growth of the domestic economy and developed financial institutions and markets.

The development of the offshore market promotes the growth of the domestic economy. First of all, the offshore market is good for Chinese companies to invest overseas. Due to China's financial regulation, China's funds are not free to invest overseas. If the offshore RMB market is established, then when domestic companies want to make overseas investments, they can raise funds through the offshore RMB market. This not only circumvents domestic financial regulation but also avoids the consumption of funds in the currency exchange process.

Secondly, the offshore market is good for foreign companies to invest in China. The investment of foreign companies in China is generally funded by RMB, and the offshore market of RMB can provide a platform for RMB to raise funds. Whether it is Chinese enterprises investing abroad or foreign companies investing in China, it is the driving force for the development of China's economy. Among them, the offshore market of the RMB provided them with convenient conditions.

Finally, the development of the offshore market can promote the reform and development of China's domestic financial market, so that it can be further integrated with the international market. In the exchange and competition between the domestic financial market and the offshore market, the domestic financial market will expose

various shortcomings. Therefore, the establishment of the offshore market can force the reform of the domestic financial market, and promote the operation rules and supervision system of domestic financial market. At the same time, the domestic financial market can learn the experience of infrastructure construction and management from other offshore market, thereby further improving the management level and professional skills of employees in the domestic. The domestic financial market is in line with the offshore market, providing a suitable domestic financial environment for the internationalization of the RMB, and further promoting the internationalization of the RMB.

5. Conclusion

In this section, I would like to summarize what has been discussed in this thesis. The thesis focuses on the one main research questions: under the background of the internationalization of the RMB, what are the offshore financial market' implications on it; and two sub-questions: what are the driving forces for the internationalization of the RMB and why is the offshore financial market of RMB appearing. Two sub-problems help to understand and solve the main problem. First, find out the driving forces of RMB internationalization, and then study the causes and operational mechanisms of offshore financial markets. On this basis, the case of Hong Kong is used to illustrate the impact of the offshore financial market on the internationalization of the RMB.

There are many forces driving the internationalization of the RMB, among them, the steady growth of China's economy is the most fundamental and important driving force for the internationalization of the RMB. In addition, from the domestic perspective, the economic system reform and the establishment of the Shanghai Free Trade Zone have contributed to the internationalization of the RMB. From an international perspective, the expansion of trading volume, cross-border trade and settlement of RMB accelerated the internationalization of the RMB. Secondly, the construction of the “Belt and Road Initiative” can promote economic and trade exchanges between China and the countries along the Belt and Road in infrastructure construction and international trade in goods and services. This provides a driving force for the localization, regionalization and final internationalization of the RMB. Thirdly, after RMB has joined the special drawing rights, it has increased the international recognition and the trust of the Chinese yuan. It also has had a positive impact on the internationalization of RMB. From a micro perspective, the participation of SDR has had a positive impact on financial consumers and financial institutions. From a macro perspective, the participation of the RMB in special drawing rights has a positive influence on the RMB exchange rate.

Under the trend of RMB internationalization, China has established some offshore financial markets for RMB to increase the recognition of the RMB. The offshore RMB market in Hong Kong is gradually formed under the leadership of Chinese

government policies and is a policy-driven offshore financial market. It can be said that the internationalization of the RMB is one of the reasons for the emergence of the offshore RMB market.

From the perspective of financial innovation theory, it can also provide some ideas for the emergence of offshore financial markets. The theory of financial innovation believes that reducing or even avoiding government restrictions is the driving force behind financial innovation. The difference between an offshore market and an onshore financial market is not the location of the market, but whether it is subject to the financial rules and related laws and regulations. The onshore financial market is a country's domestic financial market, which must follow the rules, while the offshore market is the opposite. In addition, Hong Kong's geographical advantages and financial environment are also the reasons for the establishment of the offshore financial market in Hong Kong.

In general, the construction of offshore financial markets is conducive to the development of the internationalization of the RMB. Under the trend of RMB internationalization, the government encourages the establishment of offshore financial business of RMB, and in turn the offshore financial market has further accelerated the process of RMB internationalization. First, the offshore RMB market helps to expand the circulation of the RMB abroad and reduces the risk of RMB circulation. Secondly, the offshore market ensures that the RMB has good liquidity and extensive exchangeability, which provides guarantee for the circulation of the RMB internationally and its business abroad. In addition, the offshore market has a positive impact on Chinese companies' overseas investment and foreign companies' investment in China. Finally, the offshore market can promote the reform and development of China's domestic financial market. It can be said that in the process of RMB internationalization, the development of the offshore RMB market has played an indelible role. The internationalization of RMB and the RMB offshore financial market promote each other and develop together.

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