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Offshore RMB Market - 2018 Review and Outlook

In 2018, RMB exchange rate entered a period of depreciation following appreciation. Affected by the macro environment, we saw mixed performances in major RMB business indicators. Hong Kong RMB liquidity pool has experienced ups and downs with an overall upward trend, while RMB loans decreased by 22.0% YoY. The Dim Sum bond market and RMB trade settlements both rebounded. In general, supported by macro-prudential management improvements and increasingly rational market sentiment, depreciation in 2018 did not cause market panic. Breakthroughs have been made in capital market reform. In terms of investment quotas and functions, improvements have been made for both Stock Connect and Bond Connect, which lead to increasing RMB trading activities. Compared to previous years, foreign institutions have shown rising interests in increasing their RMB bond holdings and the international use of RMB. The RMB internationalization process is steadily entering a new phase.

I. Offshore RMB market stabilized after adjustment

1. The RMB exchange rate was largely stable with two-way fluctuation

In 2018, after a period of appreciation, RMB exchange rate began to depreciate after April. RMB exchange rate has experienced two-way fluctuations with increasing flexibility. As a result of accelerated interest rate hikes by the Federal Reserve, the depreciation of emerging market currencies, and the escalation of China-US trade tensions, the RMB's central parity rate against the USD depreciated by 5.0% in 2018. Both CNH and CNY once recorded depreciation of over 7% in 2018 before narrowing to within 5%. The depreciation of the RMB against a basket of currencies was around 3% and remained stable. In 2018, offshore RMB market rates remained stable and tightening liquidity in the offshore market eased. The O/N CNH HIBOR rate once surged to 6.1% but mostly remained below 4.0% and dropped to less than 2.0% before the end of 2018, a similar level compared to the beginning of the year.
2. Central bank policies to support RMB business development

Since the beginning of 2018, the PBOC has introduced and adjusted several RMB cross-border policies. In general, the policies in 2018 can be categorized into two types. The first category focuses on improving the market environment. Measures include switching the “counter-cyclical factor” back to neutral and introducing counter-cyclical adjustments of RMB cross-border account financing for commercial banks, in order to maintain the stability of RMB exchange rate and flexibility of capital flow management and safeguard the development of RMB internationalization. The second category focuses on promoting the RMB’s international usage. In “No. 3 Document of the People’s Bank of China”, various measures were introduced to improve and optimize cross-border RMB activities, addressing different needs from different market entities. In November, the PBOC issued RMB 20 billion of bills in Hong Kong for the first time to enhance market liquidity management. Such cross-border RMB policies also serve as new approaches to promote RMB internationalization and efficient guidelines for market participants.

3. Major RMB indicators remained stable

In 2018, the offshore RMB market delivered mixed performance. As of November 2018, RMB deposits in Hong Kong amounted to RMB 617.5 billion, up by 10.4% YoY. Including RMB deposit certificates of about RMB 45 billion, Hong Kong’s RMB liquidity pool rebounded to RMB 660 billion. Meanwhile, the outstanding amount of RMB loans in Hong Kong was RMB 116 billion, down by 22.0% YoY. Dim Sum bond market rebounded in 2018 as well. As of December 2018, the issuance amounted to RMB 59.1 billion (including the first issuance of RMB 20 billion bills by the PBOC in Hong Kong in November). From January to November 2018, cumulative RMB cross-border trade settlement remittance was RMB 3.82 trillion, up by 9.3% YoY. RTGS turnover was RMB 232.45 trillion for the year, up by 9.3% YoY.

4. International status of the RMB was enhanced further

With increasing interest of overseas central banks to include the RMB in their foreign exchange reserves, RMB’s status as an international reserve currency has gradually grown. In 2016, the IMF began to separately identify the RMB in the Currency Composition of Official Foreign Exchange Reserves (COFER) Report. According to IMF statistics, RMB accounted for 1.80% (USD 192.5 billion) of total foreign exchange reserves in 3Q 2018, up by 0.57% or USD 69.1 billion compared to 4Q 2017, exceeding the AUD’s share of 1.69% for the first time and slightly behind the CAD’s share of 1.95%.
According to SWIFT data, RMB was the 5th largest currency in international payments by value, with market share of 2.09% in November 2018 (1.75% in November 2017), ranked after USD, EUR, GBP and JPY. In November 2018, RMB payments by value increased by 13.7% MoM, while the total amount of all currencies payments fell by 7.4% MoM.

5. Capital market opening up continues

For the bond market, Bloomberg announced in March 2018 that RMB denominated bonds would be included in the Bloomberg Barclays Global Aggregate Index. In August, Delivery versus Payment (DvP) settlement was fully implemented for transactions under Bond Connect. In late November, Bloomberg announced joining the Bond Connect as a second e-trading platform (global investors could make transaction in China’s interbank bond market via Bloomberg Terminal on January 17, 2019). In the same month, taxation policy was further clarified by the Ministry of Finance and State Administration of Taxation, setting out the temporary exemption of corporate income tax and value-added tax for interest income of overseas institutions investing in the onshore bond market from 7 November 2018 to 6 November 2021, creating a more friendly investment environment for foreign investors. As of November 2018, foreign holdings of RMB bonds reached RMB 1.65 trillion, up by RMB 538.9 billion (or 48.7%) YoY.

For the stock market, breakthroughs have been made for "Shanghai-Hong Kong Stock Connect", including daily quota expansion, inclusion of A-shares into the global indices, and the introduction of the Northbound Investor ID Model. Investor structure and A-Share’s internationalization are expected to further improve. As of November 16, 2018, the total turnover of Shanghai-Hong Kong Stock Connect in the past four years amounted to RMB 10.31 trillion. Since the commencement in 2016, the turnover of Shenzhen-Hong Kong Stock Connect has been growing steadily. As of December 5, 2018, total turnover was RMB 4.15 trillion and the cumulative cross-border net inflow was RMB 110.3 billion. The Shenzhen-Hong Kong Stock Connect and played an active role in enhancing the A-share investor structure.

According to the State Administration of Foreign Exchange (SAFE), by the end of December 2018, the approved quota for RQFII (RMB Qualified Foreign Institutional Investors) was RMB 646.7 billion, up by RMB 41.6 billion YoY, while the approved quota for the Qualified Foreign Institutional Investors (QFII) increased by USD 3.9 billion YoY to USD 101.1 billion. The approved
quota for QDII (Qualified Domestic Institutional Investors) totaled USD 103.2 billion, with a total of 152 Qualified Domestic Institutional Investors (QDII) approved, up by USD 13.2 billion and 20 institutional investors YoY respectively.

**II. 2019 RMB internationalization will steadily advance in 2019**

RMB internationalization in 2019 should steadily advance toward mutual cooperation, and becoming an international reserve currency remains the ultimate objective. Looking forward, the RMB exchange rate shall remain stable at a reasonable level, China's capital market opening process shall continue, and policy frameworks for cross-border usage will continue to improve. Meanwhile, the currency function of the RMB will be further strengthened with the continuous promotion of the Belt and Road Initiative and relative project development. The continuous improvement of the offshore RMB market liquidity service framework will also help strengthen Hong Kong’s position as an offshore RMB center.

Maintain the stability of RMB exchange rate at a reasonable and equilibrium level. In 2019, the RMB exchange rate will continue to face downside pressure from China’s economy adjustment, China - US tensions and monetary policy divergence. However, the PBOC’s continuity of a prudent and neutral monetary policy, the use of the counter-cyclical adjustment factor, and the control on capital outflow and promotions on inflow shall continue to support the RMB exchange rate in the short term.

We expect the PBOC to continue to enforce macro-prudential regulation and to improve the “Double pillar” regulatory framework of monetary policy and macro prudential policy, to guide and stabilize market expectations of the RMB exchange rate. Overall, we expect the RMB exchange rate against US dollar will fluctuate between 6.8 and 7 in 2019, with limited risk of falling below 7. The RMB exchange rate against a basket of currencies will continue to remain stable.

Financial market opening measures are in line with foreign exchange reserve management. The PBOC has demonstrated determination to further open up China’s financial markets in recent years, with efforts including removing capital repatriation limit for QFIs; removing the investment principal lock-up period requirements under QFIs and RQFIs and allowing QFIs and RQFIs to enter into FOREX hedging transactions in China to hedge currency risks deriving from investing in China; increasing the quota of QDIs. On January 14th, 2019, State Administration of Foreign Exchange (SAFE) announced that it would increase the quota
for the QFII program to USD 300 billion from USD 150 billion previously to meet investment demand from overseas investors. With market opening being accelerated, the PBOC will also strengthen the management of key areas, fight against illegal foreign exchange activities, diversify the foreign exchange reserves as to maintain the stability of macro-economic control and regulation system.

**The currency function of the RMB will continue to increase.** As the scope of the opening of China's financial market continue to increase, financial infrastructures such as the rating system and taxation will continue to improve, bringing more convenience for foreign investors to participate in the Chinese financial market. It is expected that more and more market players will accept RMB as a payment currency, especially in the “Belt and Road” region. Further development of Stock Connect and Bond Connect will also facilitate more overseas investors to enter the onshore capital market. Such changes shall drive the strengthening of RMB's function as both a payment currency and an investment currency, further promoting the use of RMB in trade finance, project investment and cross-border loans.

Hong Kong will continue to function as an offshore RMB financing and professional service hub. As an offshore RMB center, Hong Kong is one of the major platforms for foreign investors to increase their holdings of RMB assets and one of the most important RMB cross-border payment markets. Hong Kong's unique position will continue to strengthen in the future. Hong Kong can provide companies and governments along the “Belt and Road” economies with a diversified financing platform as well as diversified asset allocation tools for investors. Meanwhile, the PBOC strongly supports Hong Kong to strengthen its status as a global offshore RMB center. Looking ahead, the PBOC will continue to add to its bill issuance in the offshore market, further improving the offshore RMB market liquidity services, offering more opportunities to Hong Kong.
RMB Internationalization Updates

PBOC improved policies for cross-border RMB business
Major policies included: 1) encouraging enterprises to settle cross-border trade deals in the RMB; 2) supporting foreigners’ use of the RMB for direct investments in the country; 3) encouraging foreign investors to participate in carbon emission trading in China with the RMB; 4) authorizing Chinese firms to transfer RMB funds raised through issuing bonds or equities overseas back home; 5) allowing individuals to remit funds from overseas, and vice versa.

Counter-cyclical factor has been suspended
Media reported that the PBOC told some quotation banks to adjust their use of counter-cyclical factor in such a way that it would have no impact on the mechanism.

JPMorgan Chase became the second RMB Clearing Bank in the US
The People’s Bank of China authorized JPMorgan Chase & Co. as the RMB Clearing Bank in the US, making it the second RMB Clearing Bank in the US following BOC New York branch.

China to merge CBRC and CIRC
The China Banking Regulatory Commission (CBRC) would be merged with the China Insurance Regulatory Commission (CIRC). The merged entity would report directly to the State Council, and take an integrated role in regulating banking and insurance sectors. Meanwhile, the function of making important laws and prudential regulatory system by the merged entity would be transferred to the People’s Bank of China (PBOC). Other than that, the China Securities Regulatory Commission would remain a separate entity.

BOC assisted Philippines to issue RMB 1.46 billion sovereign panda bonds
Bank of China (BOC), with the mandate as lead underwriter and bookkeeper, assisted the Philippines government to issue RMB 1.46 billion panda bonds in China’s interbank market. The bonds carried a coupon rate of 5.00% with maturity of 3 years.

2018

Sharjah of UAE issued RMB 2 billion sovereign panda bonds
The Government of Sharjah, one of the members of the United Arab Emirates (UAE), issued RMB 2 billion panda bonds with 3-year tenor in China’s interbank market. Bank of China was the bookkeeper and one of the joint underwriters for the issuance, joining with Industrial and Commercial Bank of China, HSBC (China) and Standard Chartered Bank (China).

BOC Macau branch issued RMB 4 billion bonds abroad
Bank of China (BOC) Macau branch completed pricing of RMB 4 billion bonds issued abroad, including RMB 1.5 billion 1-year bonds and RMB 2.5 billion 3-year bonds. The funding costs were lower than those onshore bonds for the same tenors.

Chinese bonds to join Bloomberg Barclays Global Aggregate Index
Bloomberg announced that it will add Chinese RMB-denominated government and policy bank securities to the Bloomberg Barclays Global Aggregate Index. The addition of these securities will be phased in over a 20-month period starting April 2019.

China’s crude oil futures officially launched
China’s crude oil futures was listed on the Shanghai International Energy Exchange. The futures contract is denominated in the RMB with trading unit of 1,000 barrels per contract. It would be available to foreign investors, exchanges and petroleum companies.
PBOC announced measures to further open financial sector

Yi Gang, the Governor of the People’s Bank of China (PBOC), made an announcement in the Boao Forum for Asia Annual Conference that the PBOC will implement the following measures in the next few months: 1) Remove the foreign ownership cap for banks and asset management companies; 2) Lift the foreign ownership cap to 51% for securities companies, fund managers, futures companies, and life insurers, and remove the cap in three years; 3) Abolish the requirement for joint-venture securities firms to have at least one local security firm as a shareholder; 4) the daily quotas under Stock Connect increased by 4 times.

PBOC cut RRR for some financial institutions to replace outstanding MLF

The PBOC cut the required reserve ratio (RRR) of large commercial banks, joint stock commercial banks, city commercial banks, rural commercial banks and foreign banks by 1 percentage point. The aforementioned banks used funds released from the RRR cut to repay outstanding Medium-term Lending Facility (MLF) borrowed from the central bank on a “first borrow, first repay” basis.

Daily quotas of the Stock Connect between the Mainland and Hong Kong increased

The daily quotas under Stock Connect increased by 4 times. The new daily quota for each of the northbound trading links increased to RMB 52 billion from RMB 13 billion, while the new daily quota for each of the southbound trading links increased to RMB 42 billion from RMB 10.5 billion.

234 A-shares would be included in the MSCI indexes

In the first step of inclusion, there would be 234 A-shares added at 2.5% of Foreign Inclusion Factor (FIF)-adjusted market capitalization, representing aggregate weights of 1.26% and 0.39%, respectively, in the MSCI China Index and the MSCI Emerging Market Index.

State Administration of Foreign Exchange eased restrictions on QFII

Major policies included: 1) Lifting 20% cap on the funds that investors have been allowed to take out of China; 2) removing lockup periods for investment principal; 3) allowing investors under QFII and RQFII schemes to make foreign exchange hedging on their investments onshore.

“MOF issued RMB 5 billion sovereign bonds in Hong Kong

The Ministry of Finance (MOF) issued RMB 5 billion sovereign bonds in Hong Kong. Amongst which RMB 4.5 billion have been issued to institutional investors. This included RMB 3 billion 2-year bonds and RMB 1.5 billion 5-year bonds. Another RMB 0.5 billion bonds have been sold to central banks and monetary authorities overseas. This included RMB 0.3 billion 2-year bonds and RMB 0.2 billion 5-year bonds. All 2-year bonds and 5-year bonds priced at 3.65% and 3.8%, respectively.

PBOC further improved cross-border fund flow management

Major measures covered: 1) the existing policy framework under which offshore RMB business clearing banks and participating banks can tap RMB liquidity from the onshore market to support offshore RMB business development; 2) duly implementing Hong Kong Monetary Authority’s bilateral currency swap agreements; 3) adjusting the required reserve ratio of RMB deposits placed by Hong Kong’s RMB business clearing bank in the settlement account in the PBOC’s Shenzhen sub-branch to zero percent; 4) further enhancing the currency conversion mechanism for the Shanghai-Hong Kong Stock Connect and Shenzhen-Hong Kong Stock Connect.
RMB Internationalization Updates

DvP settlement has been fully implemented in Bond Connect
There had been strong market demand for Delivery versus Payment (DvP) settlement since Bond Connect was launched. DvP settlement would increase efficiency and reduce settlement risks, providing greater convenience to international investors investing through Bond Connect.

RMB/USD central parity rate quoting banks have resumed counter-cyclical factor
China Foreign Exchange Trading System said the foreign exchange market has seen some pro-cyclical behaviors recently. Based on the assessment of market conditions, the RMB/USD central parity rate quoting banks have, since the beginning of August, successively adjusted the counter-cyclical coefficient to adequately hedge the pro-cyclical sentiments of RMB depreciation.

PBOC raised reserve requirement on FX trading to 20%
The foreign exchange market has shown signs of volatility amid trade frictions and changes in global foreign exchange markets. In order to prevent macro financial risks, the PBOC decided to raise reserve requirement on foreign exchange forwards trading to 20%.

MOF issued sovereign bonds in Hong Kong
The Ministry of Finance (MOF) issued RMB 5 billion sovereign bonds in Hong Kong. Amongst which RMB 4.5 billion was issued to institutional investors. This included RMB 3 billion 2-year bonds and RMB 1.5 billion 5-year bonds priced at 3.65% and 3.80%, respectively. Another RMB 0.5 billion bonds were sold to overseas central banks and monetary authorities, including RMB 0.3 billion 2-year bonds and RMB 0.2 billion 5-year bonds priced the same as those for the same tenors.

SSTP will be required for the inclusion of WVR shares in Stock Connect
As Mainland investors are not yet familiar with weighted voting rights (WVR) companies, there is a need to consider the maturity and regulatory practices of the two markets when including WVR companies in the list of eligible securities for Southbound trading under Stock Connect. Therefore, Special Stability Trading Period (SSTP) will be required for Hong Kong-listed WVR companies.

A share inclusion in global indexes accelerates
FTSE Russell announced that the inclusion of A shares in FTSE Global Equity Index Series will begin from June 2019 to March 2020 over three tranches. Upon completion of the first phase, A shares would be expected to constitute 5.5% of the total FTSE Emerging Index, representing initial net passive inflows of USD 10 billion of assets under management. Within the FTSE Global All Cap Index, A shares would be projected to have a weight of 0.57%.

PBOC cut RRR for financial institutions to replace outstanding MLF again
The PBOC cut the RRR of large commercial banks, joint stock commercial banks, city commercial banks, rural commercial banks and foreign banks by 1 percentage point. The banks used funds released from the RRR cut to repay maturing Medium-term Lending Facility (MLF) loans with outstanding amount of RMB 450 billion.
China announced a three-year tax exemption on bond interest for overseas investors

China’s Ministry of Finance and the State Administration of Taxation jointly announced that overseas institutional investors would be exempted from corporate income tax and value added tax on interest income derived from investment in onshore bond market. The tax exemption would be effective from November 7, 2018 to November 6, 2021. However, the tax exemption would not be eligible for institutions setting up by overseas institutions in onshore market.

PBOC issued sovereign bills in Hong Kong

The PBOC issued RMB bills through the Central Moneymarkets Unit of the Hong Kong Monetary Authority. The issuance contained RMB 10 billion 3-month bills and RMB 10 billion 1-year bills priced at 3.79% and 4.20%, respectively.

China and Japan step up efforts in financial co-operation

The PBOC signed the Memorandum of Understanding with the Bank of Japan (BOJ), and Bank of China Tokyo branch has been designated as the RMB Clearing Bank in Japan. In addition, the PBOC and the BOJ entered into an RMB 200 billion / JPY 3.4 trillion bilateral currency swap agreement, which would be effective for 3 years and could be extended upon mutual agreement.

BOC supports the development of RMB business in the Philippines

Bank of China (BOC) and the Philippines’ Department of Finance signed the Memorandum of Understanding that they will continue to co-operate the issuance of new sovereign panda bonds for the Philippines. Moreover, BOC accepted the license from the Central bank of the Philippines to initiate RMB/PHP direct trade market. BOC Manila Branch completed the first deal on the platform.

PBOC announced to cut RRR

In order to support real economy and reduce funding cost, the PBOC would cut the RRR by 1 percentage point in two phases with net liquidity injection of RMB 800 billion.

BOC assisted Hungary to issue sovereign panda bonds again

BOC, as joint lead underwriter and bookkeeper on the offering, assisted Hungary to issue RMB 2 billion 3-year panda bonds in China’s interbank bond market.

QFII quota doubles to USD 300 billion

The quota for the Qualified Foreign Institutional Investor (QFII) program increased from USD 150 billion to USD 300 billion, said the State Administration of Foreign Exchange. It was the first expansion since July 2013. At present, about USD 101 billion of the quota is in use by overseas institutions.
The RMB’s Exchange Rate: Largely Stable with Two-way Fluctuation

Onshore RMB (CNY) against the USD depreciated by 5.2% in 2018, ranging from 6.2431 to 6.9799. The RMB exchange rate experiences two-way fluctuation with increasing flexibility. Against a basket of currencies, it was largely stable. As of December 28, CFETS RMB Index dropped 1.68% to 93.28 points from the end of the previous year.

The RMB’s depreciation against the USD was a result of the accelerated pace of rate hikes by the Fed, strengthening US Dollar Index, the depreciation of emerging market currencies, and escalating Sino-US trade frictions. In order to stabilize expectation in the market, the People’s Bank of China (PBOC) has enhanced macro-prudential management, strengthened communication with the market, resumed reserve requirement on foreign exchange forwards trading, introduced “counter-cyclical factor” in the central parity rate fixing mechanism, issued sovereign bills in Hong Kong, and strengthened liquidity management in the offshore markets, etc., defending the crucial level of “7” yuan to a dollar. Recently, US Dollar Index has retreated. The purchase of foreign exchange by individuals has become rational, and foreign exchange settlement has become more balanced. The RMB’s exchange rate has stabilized with slight appreciation.

The trend of CNY exchange rate against the USD

Sources: Bloomberg, BOCHK Research

1 This article first appeared on “2019 Hong Kong Economic and Global Market Outlook”, BOCHK. Market data have been updated.
Looking ahead, major factors affecting the RMB’s exchange rate may demonstrate the following changes:

Firstly, restructuring of China’s economy continues, and GDP growth is likely to slow from 6.6% in 2018 to 6.4% in 2019. Although China and the US reached a consensus on suspending new tariffs at the “Xi-Trump summit”, issues of trade frictions in the future are difficult to resolve given structural contradictions between the two nations. China advocates easing trade imbalance through expanding imports. In the future, growth for imports is likely to surpass exports, resulting in narrowing trade surplus.

Secondly, the divergence of monetary policy between China and the US will shape the expectations on interest rate policy, resulting in changes in interest rate spread. China will continue to implement prudent monetary policy with sufficient liquidity. There is room for further reserve requirement ratio (RRR) cuts, and there are opportunities to implement “targeted RRR cuts” via targeted lending facilities. On the other hand, the Fed will continue to promote monetary policy normalization and will raise interest rate one or two times this year. However, the US economic growth is expected to slow down, as stimulation from tax cut and fiscal policy will fade out. The US inflation pressure will be eased, given the price of WTI Crude Oil futures has been range-bound in medium-to-low levels. Moreover, President Trump will continue to exert influence and oppose the Fed’s rate hike. The pace of interest rate hike is likely to slow when the benchmark rate reaches neutral level in the second half of this year.

Thirdly, the euro accounts for 57.6% of weight in US Dollar Index. The euro would be relatively weak driven by emerging structural problems in the currency bloc, supporting the elevation of US Dollar Index. Therefore, the RMB still face passive depreciation pressure. US Dollar Index is expected to adjust in the second half of this year, since the rate hike cycle will approach the end and structural problems in the eurozone should be mitigated. As a result, the RMB’s passive depreciation pressure could ease.

Fourthly, the major channels for China’s capital outflows, such as forged imports and exports by corporations, overseas travel expense items under services trade, etc., are manageable. China’s high-quality economic development will make new progress with deepening reforms and opening up. With more Chinese financial markets joining global indices, there will be more overseas capital inflows.
Fifthly, the PBOC stated in the latest “China Monetary Policy Implementation Report” that it will “strengthen macro-prudential management when necessary”, “closely monitor the impact of changes in international environment on capital flows and improve macro-prudential policy on cross-border capital flow”. It is expected that the PBOC will continue to strengthen macro-prudential management and guide the stable expectation in the foreign exchange market.

To summarize, it is estimated that the RMB’s exchange rate against the USD will experience two-way fluctuation between 6.8 and 7, and it is unlikely to weaken beyond the “7” threshold this year. The RMB’s exchange rate against a basket of currencies will continue to remain largely stable.
China’s Economy: Accelerating Transformation and Upgrading while Coping with Trade Frictions

China’s economic growth was steady in 2018, averaging 6.7% in the first three quarters, slightly lower than the 6.9% in the same period of the previous year. The main driving force came from stable consumption, which contributed 78.0% to growth in the first three quarters, 46.2 percentage points higher than that of gross capital formation. Another driving force was the stabilization of fixed asset investment. Thanks to global economic recovery, manufacturing investment grew 8.7% in the first three quarters, 1.9 percentage points higher than that in the first half of the year and faster than the growth of total investment. It is expected that China would reach its economic growth target in 2018, with GDP growth estimated at around 6.6%.

Looking ahead, China would accelerate economic transformation and upgrading in 2019 to better deal with trade frictions. In the past six months, China-US trade dispute intensified. The US levied tariffs on USD 250 billion worth of Chinese goods and imposed restrictions on China’s scientific and technological investment, which may affect bilateral trade balance, China’s scientific and technological development, the opening-up policy, and even long-term strategic relationship between the two countries. China also imposed countermeasures to US tariffs. At the same time, with intensifying trade protectionism and continuing interest rate hikes, the USD strengthened and put pressure on the currencies (including the RMB) and financial markets in emerging markets.

Although China and the US have recently reached a consensus on trade war truce, it is not easy to solve the structural problems of trade conflicts. Trade disputes between the two countries may last for a long time and could have impacts on not only merchandise trade but also investment confidence and financial markets. In addition, the long period of ultra-loose monetary policy is coming to an end, and financial volatility in emerging markets has increased significantly, which would add more uncertainties to the global economy. Against this backdrop, external demand could soften in 2019, and the growth of China’s merchandise trade would slow down dramatically.

2 This article first appeared on “2019 Hong Kong Economic and Global Market Outlook”, BOCHK. Market data have been updated.
China’s economic restructuring will further accelerate amid China-US trade frictions. Recently, the National Bureau of Statistics announced the new kinetic energy index of China’s economic development, which increased by 23.5%, 26.9% and 34.1% annually between 2015 and 2017. This indicates that new growth engine of China’s economy has strengthened and economic vitality has been further unleashed, which could cushion the downward pressure on the economy and promote high-quality development. With increasing investment in research and development and rising proportion of highly-skilled talents, China would accelerate economic transformation with strategic emerging industries and high-tech manufacturing industries, and maintaining rapid growth. Currently, “Internet Plus” has been deeply integrated into various industries, promoting rapid development of new business models, digital economy, platform economy and sharing economy, which will become new engines for China’s economy in 2019, and pave the way to economic upgrading and efficiency improvement.

With increasing downward pressure on the Chinese economy, the government listed “six stabilizing tasks” on employment, financial markets, external trade, foreign investments, business investments and expectation management. The introduced measures include improving the export tax rebate policy, reducing import tariffs and implementing targeted reserve requirement ratio cuts, ensuring the economy operate within a reasonable range with stability and enhanced efficiency. It is expected that the government will continue to adopt proactive fiscal policy and neutral monetary policy in 2019. With more active fiscal policy, the government would pump up spending on infrastructure and accelerate the implementation of tax cuts. Monetary policy will be more forward-looking, flexible and effective, and will be preset or fine-tuned based on changing situations, to keep liquidity at a reasonable and abundant level.

Considering the favorable and unfavorable factors at home and abroad, it is expected that China’s economic growth would only slightly moderate to 6.4% in 2019.
Market Trends

Hong Kong RMB Deposits (in RMB bn)

RMB Cross-border Trade Settlement (RMB bn)

USD-CN and USD-CNY Exchange Rates

Source: HKMA

Source: HKMA

Source: Bloomberg
**Market Trends & Data**

### SWIFT World payments currency ranking & market share

**December 2015**

1. **USD** 43.89%
2. **EUR** 29.39%
3. **GBP** 8.43%
4. **JPY** 2.78%
5. **CNY** 2.31%
6. **CAD** 1.70%

**November 2018**

1. **USD** 39.56%
2. **EUR** 34.13%
3. **GBP** 7.27%
4. **JPY** 3.55%
5. **CNY** 2.09%
6. **CAD** 1.71%
7. **AUD** 1.60%
8. **HKD** 1.36%

Source: SWIFT

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**RMB Clearing Transaction Value (RMB tn)**

Source: HKICL
## Market Data

<table>
<thead>
<tr>
<th>Year</th>
<th>Hong Kong RMB Deposits (RMB bn) (Year-end / Month-end)</th>
<th>RMB Cross-border Trade Settlement (RMB bn) (Yearly / Monthly)</th>
<th>RMB Clearing Transaction Value (RMB tn) (Yearly / Monthly)</th>
<th>Overnight CNH HIBOR Fixing (%) (Year-end / Month-end)</th>
<th>1-week CNH HIBOR Fixing (%) (Year-end / Month-end)</th>
<th>3-month CNH HIBOR Fixing (%) (Year-end / Month-end)</th>
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<tbody>
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<td>1003.6</td>
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<td>3.413</td>
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<td>1.763</td>
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<td>2017</td>
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<td>2.290</td>
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Source: HKMA, Bloomberg, HKICL, BOCHK
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<th>Year</th>
<th>USD-CNH Exchange Rates (Year-end / Month-end)</th>
<th>USD-CNY Exchange Rates (Year-end / Month-end)</th>
<th>FTSE-BOCHK Offshore RMB Bond Composite Index (Year-end / Month-end)</th>
<th>HK Offshore RMB Bond Issuance (RMB bn) (Yearly / Monthly)</th>
<th>10Y CNH China Sovereign Bond Yield (%) (Year-end / Month-end)</th>
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