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Contents

Editors：

Lynn Zhang
Tel ： +852 2826 6586
Email : zhanghualin@bochk.com

Sharon Tsang
Tel ： +852 2826 6763
Email: sharontsang@bochk.com

Matthew Leung
Tel：+ 852 3982 7177
Email: matthewleung@bochk.com

Offshore RMB Market Maintains Its Growth Trend

In 1H 2020, the progress of RMB internationalization hasn't slowed down with the global outbreak of COVID-19 and economic slowdowns. The RMB exchange rate maintained two-way fluctuations, and was relatively stable compared to other currencies, showing flexibility and resilience of RMB. Major offshore RMB business indicators rose against the trend. The international use of RMB continued to rise, where RMB's market share as an international reserve currency rose to a record high of 2.02%. With the China capital market continuing to open up, foreign institutions continued to increase China bond holdings. With more institutions entered China's bond market through Bond Connect, trading volume and daily average trading volume broke record highs, and liquidity continued to increase. The trend of net capital inflow to China's capital market is expected to continue.

I. Offshore RMB business grew steadily

1. RMB exchange rate remained two-way fluctuations.

In 1H 2020, the RMB exchange rate remained two-way fluctuations, as movements were mainly affected by the COVID-19 and the progress of US-China trade war. In the beginning of the year, China and the US reached a phase one trade deal, and the market was looking forward to phase two deal negotiations, supporting the RMB exchange rate. CNH once rose to 6.9 level. In March, the virus outbreak led to a slump in financial markets. Risk-off conditions led to increasing demand for USD, sending the dollar index to 103 in March, a multi-year high, posing pressure to RMB. CNH remained stable but relatively weak after March. Until middle of Q2, US-China trade disputes restarted, and RMB exchange rate depreciated to 7.18 and stabilized at a low level as of end of May. During the financial turbulence, RMB performed relatively stable compared to other currencies, showing flexibility and resilience of RMB. As of June 30, the RMB's central parity rate against the USD closed at 7.0795, down 1.7% compared to beginning of the year. CNH closed at 7.0686, down 1.5% compared to beginning of the year. CNY closed at 7.0655, down 1.5% compared to beginning of the year.

As of June 30, the O/N, 1-week and 3-month CNH HIBOR rates were 1.4245%, 2.1475% and 2.49717% respectively.

2. Major offshore RMB business indicators rose against the trend

Major offshore RMB business indicators rose against the trend in 1H 2020, indicating market confidence in RMB. RMB liquidity pool rose to around RMB 700 billion, RMB liquidity management for Hong Kong's banking sector remained sound, and the usage of the RMB Liquidity Facility was at normal levels. As of May 2020, RMB deposits in Hong Kong amounted to RMB 694.9 billion, reached 4 years high, up by 11.3% YoY. RMB loans outstanding in Hong Kong were RMB 164.7 billion, up by 53.4% YoY.

The total remittance of RMB for cross-border trade settlement was RMB 521.5 billion in May, up by 9.3% YoY. The accumulated remittance of RMB for cross-border trade settlement amounted to RMB 2.59 trillion, up by 22.9% compared to same period in 2019. Total RTGS turnover amounted to RMB 139.8 trillion in the first 6 months of 2020, up by 8% compared to same period in 2019. As of June 2020, dim sum bond issuance amounted to RMB 83.0 billion (including RMB 80 billion central bank bills), similar to same period last year.

As for other offshore RMB markets, RMB deposits in Taiwan totalled RMB 279.3 billion (including negotiable certificates of deposit) as of May 2020, down by 8.2% YoY, while RMB deposits in Singapore were RMB 121.0 billion as of March 2020, up by 4.3% YoY.

3. RMB's market share as an international reserve currency rose to record high 2.02%

According to IMF statistics on July 2, as of the 1Q 2020, RMB assets' share of the official foreign reserves of central banks rose to 2.02% (USD 221.48 billion), which was higher than the 1.96% in Q4 2019 and reached a record high since IMF started reporting RMB reserve assets in October 2016. The increasing share of RMB allocation in central banks' official reserves shows that interests in RMB assets continue to rise.

4. The international payments market share of RMB rebounded to 1.79%

According to a SWIFT report in May 2020, the RMB was the sixth most active currency for domestic and international payments by value, with a share of 1.79%, up from 1.66% last month, behind USD, EUR, GBP, JPY and CHF. RMB payments value decreased by 3.4% compared to the previous month, while in general all payments currencies decreased by 10.3%.

5. Foreign institutions continued to increase China bond holdings

China capital market continues to open up. In recent years, foreign investors' China bond holdings have been increasing by almost 40% per year. Global bond yields declined significantly as major central banks around the world maintains loose monetary policies, widening the interest rate spread between China and other countries. With the re-introduction of quantitative easing program from the US, interest rate spread between China and the US widened, attracting foreign investors to increase their holdings in RMB bonds (China's 10-year government bond yield was about 215 basis points above 10-year U.S. government bond yield recently, a 10-year high. As of May 2020, foreign holdings in Chinese bonds reached RMB 2.43 trillion, increased significantly by 29.1% YoY (increased RMB 546.4 billion), accounting for 2.6% of total bonds holdings, with a record high monthly net inflow of RMB 114.6 billion, surpassing net inflow of RMB 110.3 billion in 2018 June.

Foreign capital inflow was significant since Bond Connect went live three years ago. More institutions entered China's bond market through Bond Connect, leading trading volume and daily average trading volume to record highs. Increasing liquidity helped to provide a more convenient channel for international investors to invest in China's bond market. In June 2020, trading tickets totalled 5318 for the month, while average daily turnover reached RMB 21.1 billion. Policy bank bonds, Chinese government bonds, and NCDs drew the most interests, accounting for 53%, 32%, and 12% of the monthly trading volume respectively. In the same month, the scheme welcomed 68 new investors, and expanded its coverage to 33 jurisdictions (first batch of investors from Russia) across the globe with 2,012 global institutional investors, including 72 of the top 100 global asset management companies.

The increasing attractiveness of RMB assets and the inclusion of China Bonds in several international indices further boosted the confidence of international investors to invest in China bonds. During the financial turbulence in 1H 2020, China bonds remained relatively stable compared to assets of other countries. Also, increasing China bonds holding could diversify risks and returns of investment portfolios. Therefore, foreign investors are expected to be more active in participating in China's financial markets.

II. RMB internationalization making steady and continuous progress

In 2020, the offshore RMB market remained resilient under the impacts of COVID-19, increasing global financial market volatility, and surge of risk aversion. The RMB exchange rate continued to remain stable at a reasonable level. The opening up of capital markets led to more variety of RMB assets to satisfy international investors' demand. With increasing economic cooperation between China and other countries, RMB's functions in payments, investments, and financings, reserves etc. will continue to increase. Hong Kong will continue be act as an offshore RMB hub, and seize the opportunities arising from the national strategic activities of Belt and Road and the Guangdong-Hong Kong-Macao Greater Bay Area, and continue to promote RMB internationalisation in offshore markets.

The RMB exchange rate is expected to remain stable in 2H 2020. COVID -19, global monetary policies and the US-China trade war developments will be the main drivers of RMB exchange rate. CNH mostly fluctuated between 6.90 and 7.15 in first half of the year. The range was about 2,500 basis points. With China's economy gradually recovering, RMB started rebounding to 7.05. in 2H 2020, RMB exchange rate will continue to be affected by multiple internal and external factors, such as economic fundamentals and monetary policies of China, the US, and major European countries. COVID-19 and US-China trade war developments will be the main drivers of RMB exchange rate. USD is expected to remain at high levels given high level of uncertainties and global central banks adopting loose monetary policies. RMB exchange rate is expected to remain stable, with the possibility of increasing volatility.

The internationalization of financial markets satisfies international investors' need. In January 2020, SAFE introduced several measures regarding FX hedging for offshore investors. In February, the PBOC affirmed the allowance of foreign institutions to decide whether to sign the derivatives agreement between NAFMII, SAC, and ISDA. In May, the PBOC and SAFE introduced another measure that simplified the capital requirements of offshore institutional investors and RMB QFII to invest in onshore securities and futures, and removed the quota limits for QFII and RQFII. These measures help to meet demands from international investors and promote China capital market reform.

South East Asia is a key region of promoting RMB internationalization. With quick developments of the China economy, enterprises actively executed 'Go Global' strategy in order to increase their presence globally, especially in developing countries, which could boost the usage of RMB while also helping economic development of these countries. The operation of 'Belt and Road' projects and enterprises would need the support of financial infrastructures and services. Chinese banks have been supporting Chinese enterprises in 'Go Global' strategy, providing services such as payments and settlements, investments and financing, foreign exchanges and risk hedging, etc. In order to reduce exchange rate costs and risks, it is necessary to increase RMB usage and the local demand of local currency settlements. Besides, south east Asian countries have the intention to reduce reliance on USD and promote local currencies usage, which can be done through increasing RMB usage and the development of RMB internationalization

Hong Kong continues to act as an offshore RMB hub. The Outline Development Plan for the Guangdong-Hong Kong-Macao Greater Bay Area re-iterated Hong Kong role as an offshore RMB hub, including supporting Hong Kong to develop more offshore RMB and risk management products. Under the "Belt and Road" initiative and increasing cooperation between China and Belt and Road countries, the usage of RMB while conducting bilateral trades and investments will continue to increase. The capital management of RMB settlements and financing need to be enhanced. Hong Kong has the capabilities and potentials to continue to serve these purposes. Hong Kong continues to be one of the forerunners in terms of RMB deposits, dim sum bond issuance, FX trading, financial and insurance products, etc. Hong Kong RMB market development will continue to thrive with the increasing offshore RMB financial activities.

RMB Internationalization Updates

SAFE further facilitates forex risk management of foreign institutional investors

SAFE released Huifa No. 2 [2020] Circular in order to offer more foreign exchange hedging channels to foreign institutional investors in the interbank bond market. Key measures include allowing foreign non-banking investors to enter the interbank foreign exchange market by dealing with domestic financial institutions over the counter or indirectly through becoming a prime broker..

ISDA to attract more foreign investment in China

Chinese government made a series of moves to open up its financial sector, including allowing foreign institutions to freely choose to sign NAFMII, SAC or ISDA master agreements to conduct onshore OTC derivatives transactions.

Implementation Plan for China (Guangxi) Pilot Free Trade Zone announced

The Guangxi government announced the "Implementation Plan for the China (Guangxi) Pilot Free Trade Zone", featuring pilot scheme between China and ASEAN, opening up of financial markets and cross-border use of RMB.

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Beijing strengthened financial support against COVID-19

The Chinese government issued a total of 30 measures to boost financial support, such as simplifying the procedures for FX and cross border RMB settlement, during efforts to combat the spread of COVID-19.

PBoC issued 10 billion yuan bills in HK

PBoC issued 10 billion yuan 6-month central bank bills in Hong Kong, with the interest rate standing at 2.19% and the bid amount 2.8 times the circulation.

U.S. dropped currency manipulation charge against China

According to the US Treasury Department, the United States has dropped its designation of China as a currency manipulator.

PBoC issued 30 billion yuan bills in HK

PBoC issued two tranches of central bank bills in Hong Kong, including RMB 20 billion 3-month bills and RMB 10 billion 1-year bills, with the interest rate standing at 2.55% and 2.60% respectively.

PBOC cut RRR

PBOC announced to cut the reserve requirement ratio by 0.5 percentage point with effect from January 6, injecting over RMB 800 billion of long-term liquidity into market.

NDB financed emergency loan to China

New Development Bank raised RMB 5 bn from a Panda bond public offering to help China finance increased expenditures on public health. It is the first coronavirus-themed Panda bond from a multilateral financial institution.

BOCHK Phnom Penh Branch became CIFM member

PBoC approved Bank of China (Hong Kong) Limited, Phnom Penh Branch to become a member of the China Inter-bank Foreign Exchange Market and to conduct regional FX transactions between Yuan and Riel.

PBOC & SAFE removed QFII/RQFII investment quotas

Beijing issued PBOC & SAFE Announcement〔2020〕No. 2, with key points including the removal of restrictions on investment quota of QFII/RQFII investors and the limits on the number of custodians etc.

China released Hainan free trade port plan

The plan aims to build Hainan province into a free trade port, which will be "basically established" by 2025, becoming "more mature" by 2035, showcasing the country's commitment towards both post-pandemic recovery and long-term growth.

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China unveiled guideline on improving market-based allocation of production factors

According to the guideline, China will expedite the development of the bond market through a variety of measures, including promoting the connectivity with offshore bond markets, and strengthening the access management of credit rating agencies to the bond market.

PBoC issued 10 billion yuan bills in HK

PBoC issued 10 billion yuan 6-month central bank bills in Hong Kong, with the interest rate standing at 2.22% and the bid amount 3.4 times the circulation.

PBoC issued 30 billion yuan bills in Hong Kong

PBoC issued two tranches of central bank bills in Hong Kong, including RMB 20 billion 3-month bills and RMB 10 billion 1-year bills, with the interest rate standing at 1.77% and 1.78% respectively.

China issued guidelines to boost financial support for Greater Bay Area

The guideline put forward 26 specific measures for these five areas: promoting the Greater Bay Area's cross-border trade and facilitating investment and financing, expanding the opening-up of the financial sector, promoting the connectivity of financial markets and financial infrastructure, boosting innovation of the Greater Bay Area's financial services, and preventing cross-border financial risks.

The Significance, Direction and Implementation of LCS in ASEAN

Ying Jian, Principal Strategist

In December 2016, the Bank of Indonesia (BI), Bank Negara Malaysia (BNM) and the Bank of Thailand (BOT) signed an LCS framework agreement with each other. The service was officially launched in February 2018. According to the ACCD Rupiah (IDR) - Ringgit (MYR) Local currency Settlement Framework Guidelines jointly issued by BI and BNM, the LCS main contents are as follows: 1. SNA account opening and fund management, 2. Sub-SNA account opening and fund management, 3. Exchange and hedging, 4. Trade financing, 5. Closing positions and foreign exchange exposures, 6. Reporting.

Overall, central Banks of Indonesia and Malaysia jointly created a set of LCS guideline, providing a comprehensive solution for local currency settlement in bilateral trades between the two countries, including account setup, capital allocation, currency exchange, trade finance, risk hedging, and cross-border investment, ensuring flexibility to choose between two local currencies in settlements and payments. The two central Banks would strictly supervise the process and ensure smooth operation in local currency settlements through account management and reports submission.

LCS mechanism refer to Fig. 1 and Fig. 2:

Figure 1 SNA and Sub-SNA Account Opening

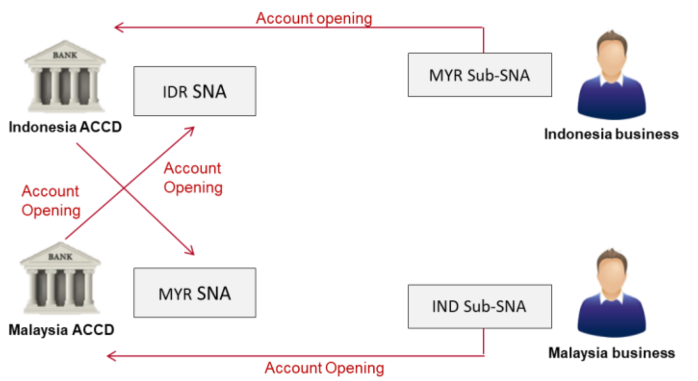
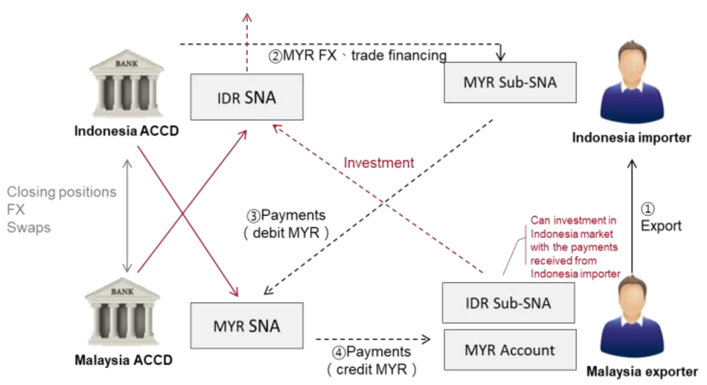


Figure 2 LCS exchange and capital flow
(e.g. Indonesian importer payments to the Malaysian exporter)



Source: BOCHK

I. The positive meaning

ASEAN is important to the global economy with its rapid economic growth and growing importance in the world economy. The average GDP growth rate of the 10 ASEAN countries was 5.2% annually between 2012 and 2018, higher than the global average growth rate of 3.6%. As a single economy, ASEAN is the world's fifth-largest economy. ASEAN is also a major international trading economy, with total trading volume only behind China, the United States, and Germany. ASEAN maintains close economic and trade relations with China. In 1Q 2020, ASEAN became China's largest trading partner as bilateral trades between ASEAN and China surpassed trades between EU and China for the first time.

However, ASEAN is also a rather fragile economy. First, it is a highly export-oriented economy. In 2018, ASEAN's foreign trade dependence rate was 96.3%, higher than the EU's 69.3%. Second, ASEAN relies on the European and American markets. In 2018, ASEAN's imports and exports with the United States and the European Union accounted for 29.4% of its total trade, while some countries are heavily dependent on Europe or the United States on their exports. Third, it is highly dependent on USD, which has become a dominant currency for outward payments from ASEAN. Fourth, ASEAN is relatively weak in encountering economic downturns and other financial risks. ASEAN economy will be hit first when there is an international financial crisis or global economic adjustment.

ASEAN countries have made structural adjustments to increase the resilience and sustainability of their economic growth in recent years. At the same time, they have also accelerated the cultivation of diversified foreign trade markets, with emphasis on the development of intra-regional trades and trading activities with neighboring countries. As supporting policies and measures, ASEAN countries have studied the introduction of local currency settlement in order to get rid of the macro risks caused by over-reliance on single currency outside the region, and to inject more vitality into the real economy by developing local financial markets. Promoting LCS between Indonesia, Malaysia, and Thailand has practical significance at a time when trade frictions between China and the US are intensifying, along with the massive outbreak of COVID-19:

1. It is conducive to reduce ASEAN countries' dependence of on USD and promote intra-ASEAN trades and trades with neighboring countries through local currency settlement;

2. It helps export-oriented enterprises in ASEAN and neighboring countries to control exchange rate risks, reduce exchange costs and improve hedging abilities;

3. It is conducive for ASEAN countries to enhance the international monetary function of local currencies, the pricing ability of local currencies, and healthy development of local financial markets;

4. It is conducive to promote ASEAN's authority in international financial affairs and the reform of the international monetary system.

II. Advancing direction

ASEAN countries have been actively exploring local currency settlement in recent years. Indonesia has played a major role in constructing the LCS mechanism. Its goal is to reflect LCS mechanism to the whole ASEAN region and extend it to the neighboring countries which have economic and trade relations with ASEAN, including China, Japan and South Korea.

Within the ASEAN region, the Philippines announced joining the LCS mechanism in April 2019, and the Bangko Sentral ng Pilipinas (BSP) signed bilateral LCS agreements with BI, BNM and BOT respectively. At the same time, Indonesia submitted the Guiding Principles for Local currency Settlement (draft) to the ASEAN Secretariat, including the background, objectives and framework of LCS, hoping to be approved by the central Banks of all countries before being submitted to the joint meeting of ASEAN Finance Ministers and Central Bank Governors for formal approval and publication.

The existing LCS mechanism is also persistently enhancing. The original LCS agreement signed by Indonesia, Malaysia and Thailand mainly applies to trade in goods and services. In December 2017, Malaysia and Thailand signed a supplementary agreement to extend the scope of LCS to direct investment and income transfer. BI is also working to optimize LCS agreements with the other two countries, including integrating direct investment and income transfer into the LCS settlement framework; Allowing local currency settlements with small amount without support of real trade background; Allowing ACCD to open SNA account with more than one ACCD; Extending the duration of hedging from six months to one year, etc.

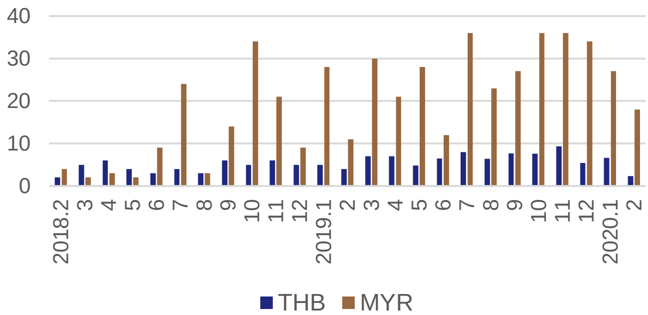
For neighboring countries, the Bank of Indonesia and the Bank of Japan signed the LCS memorandum of understanding in December 2019. A similar memorandum of understanding was signed between the Bank of Thailand and the Ministry of Finance of Japan in March 2018 to facilitate local currency settlement in bilateral trades and investments, involving direct quotations and transactions between the JPY and the THB.

III. Practical effect

It has been more than two years since the official launch of LCS among Indonesia, Malaysia and Thailand. According to the statistical data provided by BI, the use of LCS has the following effects and difficulties.

1.The trading volume of LCS in Indonesia, Malaysia and Thailand increased relatively quickly, but the total volume was not large. The transaction volume of LCS competed by Indonesia and Thailand in 2019 was USD 66.374 million, up 35% compared with USD 49.156 million in 2018; Indonesia and Malaysian LCS traded at USD 225 million, up 79.2 % from USD 126 million in 2018. However, from the introduction of LCS mechanism in the three countries to February this year, the total trading volume of LCS was only USD 629 million, which is only a small fraction compared to the use of local currency in the three countries, and monthly fluctuations were large.

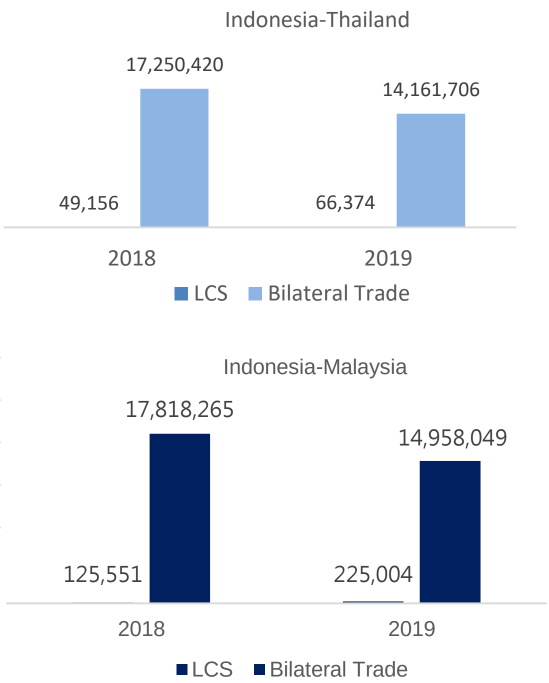
Figure 3 Monthly turnover of THB and MYR in Indonesia-Thailand, Indonesia-Malaysia (USD mn)



Source: BI, BOCHK

2.The effects of promoting trades in local currencies was small although the penetration rate of LCS has increased. From 2012 to 2019, USD accounted for 87.9% of Indonesia's foreign trade settlement, IDR accounted for 1.91%, while MYR and THB accounted for 0.17% and 0,16% respectively. After the introduction of LCS, bilateral trades which settled in local currencies between Indonesia and Thailand accounted for 0.28%, rising to 0.47% in 2019. In the same period, the proportion of local currency settlement in bilateral trades between Indonesia and Malaysia rose from 0.7% to 1.5%, which is still not high.

Figure 4 The scale of using LCS in bilateral trades between Indonesia- Thailand, Indonesia-Malaysia (USD thousands)



Source: BI, BOCHK

3. The market has limited knowledge of LCS although LCS users continued to increase. After signing LCS agreements with Malaysia and Thailand, Indonesia has done a lot of education in the market to promote the use of LCS. Indonesia ACCD had 1,448 customers using LCS in 2019, up 16% from 2018. However, according to the survey conducted by BI, only 15% and 12% of respondents knew about the signing of LCS agreements between Indonesia and Malaysia and between Indonesia and Thailand. Most of them had never heard of it, thus affecting the utilization rate.

4. The price discovery function of LCS is not strong, and lacks competitiveness compared with cross-exchange. Before the introduction of LCS mechanism, Indonesian commercial Banks could cross-exchange two local currencies through USD. Whether the direct quotation of LCS is competitive is crucial to attracting customers. According to the statistics of BI, the cross-exchange rate of THB to INR in 2019 is 446.6, and the direct quotation of LCS is 446.2, with a discount of only 0.4 basis point. The cross rate of MYR to INR is 3497, and LSC direct quotation is 3504, which shows that LCS quotation mechanism is not mature enough.

Figure 5. LCS direct quotation and cross exchange rate of MYR and THB to INR

Source: BI, BOCHK

The Overview of Foreign Exchange Market and the Analysis of RMB Foreign Exchange Restrictions in ASEAN Region

Matthew Leung, Strategic Planner
Lynn Zhang, Strategic Planner

ASEAN nations and China are very close neighbors connected by mountains and rivers. ASEAN region is a strategically important area for the internationalization of RMB. In recent years, the economic and trade cooperation between China and ASEAN was growing further, but the development of cross border RMB business was relatively slow, especially RMB use in foreign exchange and bond transactions.

I. Overview of ASEAN foreign exchange Market

1. Foreign exchange turnover: According to the Triennial central bank survey of the Bank for International Settlements (BIS) in 2019, the average daily global OTC forex turnover reached USD$6.6 trillion in April 2019, a record high and an increase of 30.2% compared with April 2016. Singapore, as the front-runner in ASEAN forex market, saw an average daily forex turnover of US$639.9 billion in April 2019, up 23.7% from April 2016 and lagging behind the overall global forex turnover growth rate (30.2%). Its market share also slightly declined to 7.7% from 7.9% in 2016, which was likely to be overtaken by Hong Kong ong in the near future. The other four, participating countries, i.e. Thailand, Malaysia, Indonesia and the Philippines (ranking by volume), had a combined market share of less than 0.5% (Figure 1). Cambodia, Laos, Vietnam, Brunei and Myanmar were not included in the statistics.

Figure 1: FX turnover in UK, Hong Kong and major ASEAN countries

Country/ Region	Daily averages in April 2019 (USD bn)	Growth compared to April 2016（%）	Global market share（%）	Major foreign currencies in local FX market (ranking by volume)
UK	3576.4	48.6%	43.1%	USD、EUR、JPY
Singapore	639.9	23.7%	7.7%	USD、JPY、EUR
Hong Kong	632.1	44.8%	7.6%	USD、RMB、JPY
Thailand	14.4	36.8%	0.2%	USD、EUR、JPY
Malaysia	10.1	32.4%	0.1%	USD、EUR、GBP
Indonesia	6.7	44.2%	0.1%	USD、SGD、EUR
Philippines	3.8	45.8%	0.05%	USD、EUR、JPY

Source: BIS

2. Trading currency: the share of RMB in global forex turnover rose to 4.3%, the Singapore dollar remained at 1.8%, and the currencies of the other four ASEAN countries as a whole only accounted for less than 2%. The US dollar is the absolute dominant currency in the ASEAN forex market, accounting for more than 90%, followed by Euro, Pound and Yen (Figure 2). Few economies, such as Cambodia, are a typical "dollarized" country. The US dollar has replaced the local currency to become the most used currency in the market.

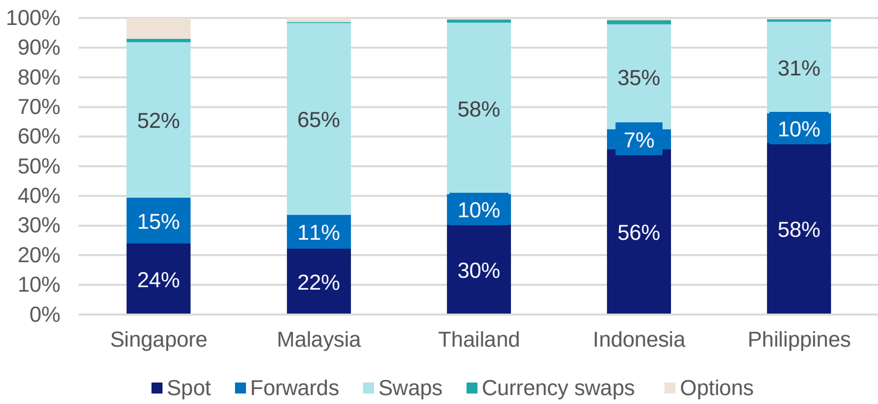
3. FX instrument: In April 2019, forex swaps and spot transactions are two major instruments in global forex market, accounting for 49% and 30% respectively. In ASEAN region, forex swaps in Singapore, Malaysia and Thailand accounted for more than 50% of the total market turnover; In the Philippines and Indonesia, the majority were spot transactions, accounting for 58% and 56% respectively (Figure 3).

Figure 2: Currency distribution of OTC forex turnover in UK, Hong Kong and major ASEAN countries

Country/Region	CNH	USD	EUR	JPY	Others*
UK	1.6%	89.5%	36.0%	15.4%	57.5%
Singapore	6.7%	93.8%	16.8%	24.5%	58.2%
Hong Kong	17.0%	96.6%	14.5%	15.8%	56.1%
Thailand	1.2%	93.9%	8.0%	5.5%	91.4%
Malaysia	2.4%	95.8%	8.5%	3.5%	89.8%
Indonesia	1.5%	93.4%	5.4%	2.2%	97.5%
Philippines	1.1%	97.6%	6.1%	6.0%	89.2%

*Because two currencies are involved in each transaction, the sum of the percentage shares of individual currencies totals 200% instead of 100%. Source: BIS

Figure 3: Instrument structure of OTC forex turnover in UK, Hong Kong and major ASEAN countries



Source: BIS

II. Current situation of RMB forex in ASEAN region

As can be seen from the figure below:

1. The growth of RMB forex turnover in ASEAN region has slowed down, and its global market share has decreased. RMB forex turnover in Singapore, the ASEAN RMB forex hub, remained same compared to three years ago. Few countries, such as Thailand, recorded decent growth, but the size of forex turnover is too small. In 2019, RMB forex turnover in ASEAN market only accounted for 12% of the global total, down 5 percentage points from 17% in April 2016, and its market share was crowded out by the rapid growth of RMB forex turnover in the UK and Hong Kong.
2. ASEAN's RMB forex transactions are concentrated in Singapore. In 2019, Singapore accounted for more than 95% of ASEAN RMB forex turnover, and the market share of other ASEAN countries is minimal.
3. The market share of RMB in ASEAN forex market is much lower than that of the US dollar. The USD accounted for more than 90% of ASEAN forex turnover, followed by Euro and Yen.

III. RMB forex restrictions in ASEAN region

RMB forex market in ASEAN region is still underdeveloped, and it has become a weak link in the development of offshore RMB business in this region. Here is a brief analysis of RMB forex restrictions in ASEAN region:

1. The trades between ASEAN countries are mostly settled in US dollars. The US dollar is the major currency for trade settlement in ASEAN region, and the acceptance of RMB remains to be improved.

Figure 4: RMB forex turnover in UK, Hong Kong and major ASEAN countries

Country/Region	Daily averages in April 2019 (USD bn)	Growth compared to April 2016（%）	Global market share （%）
Hong Kong	1076	39.4%	29.8%
UK	567	44.7%	15.7%
Singapore	426	0.2%	11.8%
Malaysia	2.4	9.0%	0.1%
Thailand	1.8	113.3%	0.05%
Indonesia	1	-9.8%	0.03%
Philippines	0.4	66.7%	1.0%

Source: BIS

The trades settled in RMB is far out of line with the trades between China and ASEAN. Except Singapore, the trades settled in RMB in the other nine ASEAN countries only accounts for about 3% of their total trade with China, hindering the development of RMB forex business.

2. The RMB liquidity pool is hovering at a low level in ASEAN region. Since the 811 Exchange Rate Reform in 2015, the offshore RMB liquidity pool has shrunk significantly. Although offshore RMB deposits have rebounded in recent years, ASEAN countries have not fully recovered their confidence in RMB. At the end of December 2019, the balance of RMB deposits in Singapore stood at RMB 118 billion, down by more than half from the peak level of RMB 256 billion in June 2015.

3. Forex controls and lack of supervision restricts the development of RMB forex business in ASEAN member countries. Strict forex controls hindered the cross-border use of RMB in ASEAN region, making market participants reluctant to hold RMB or to increase the use of RMB. For example, the use of RMB is still limited to some specific areas by the Vietnamese government. In addition, there are a large number of illegal private forex traders in the cross-border region, making it difficult for ASEAN governments to collect accurate market data, to improve anti-money laundering and risk management framework, and to conduct effective monitoring of RMB forex transactions.

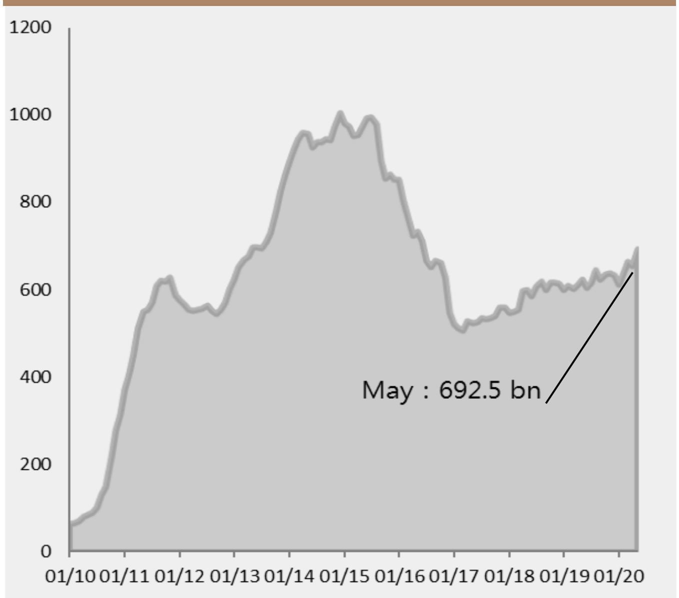
4. The exchange rate formation mechanism and the offering of forex products need to be improved. The exchange between RMB and small currencies lacks a direct exchange rate formation mechanism and relies on the middle price of US dollar. In addition, the existing RMB financial products and risk hedging facilities are not mature, which further increases exchange rate risks. On the other hand, the low cost, high flexibility and convenience of ASEAN private exchangers make it more difficult for surrounding Banks to carry out RMB foreign exchange business, which is not conducive to the formation mechanism of standardized exchange rate and increases the difficulty for the development of ASEAN RMB foreign exchange market.

5. The epidemic has further slowed down the development of offshore RMB business in ASEAN region. The demand for RMB forex in ASEAN region is mainly driven by trade, investment, tourism, overseas remittance and labor service etc. Since the beginning of this year, the spread of COVID-19 around the world has disrupted the normal economic and trade activities and mutual visits, which is expected to greatly reduce the demand for RMB forex.

ASEAN region is a strategically important area for "Belt and Road" initiative. According to the statistics of China's Ministry of Commerce, in 2019, the trade between China and ASEAN member states reached USD641.46 billion, accounting for more than half of the total trade between China and "Belt and Road" countries. With a large number of Chinese enterprises, visitors and investment projects, ASEAN region has a great potential for offshore RMB business. In recent years, ASEAN member states have pursued the "de-dollarization" approaches, and some of them signed and implemented the "Local Currency Settlement" Agreement, which has created favorable market conditions for the promotion of RMB use in ASEAN region. The next step should be to strengthen financial cooperation between China and ASEAN and explore the potential demand for cross-border RMB use. Chinese state-owned commercial banks shall give full play to its role in promoting the internationalization of RMB, especially in terms of improving forex trading capabilities and product offerings in ASEAN markets. It will provide the simplicity and convenience of FX conversion in RMB, which is key to release the RMB business potential, steadily pushing forward the internationalization of RMB in the ASEAN region.

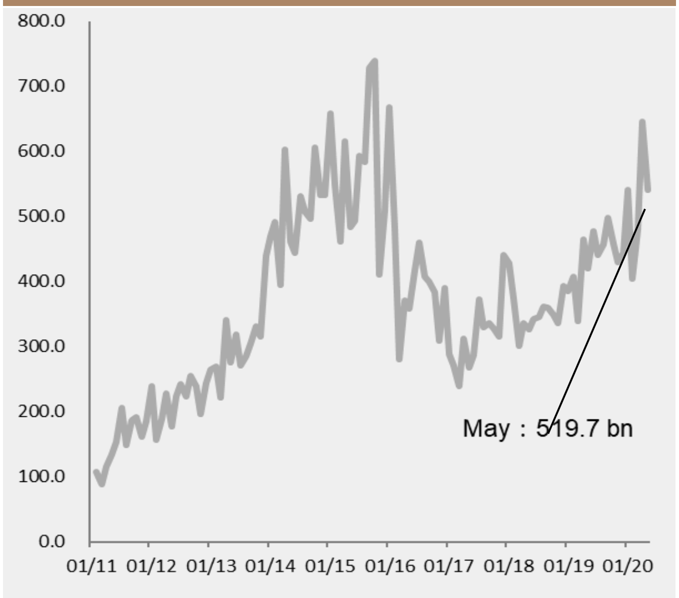
Market Trends

Hong Kong RMB Deposits (in RMB bn)



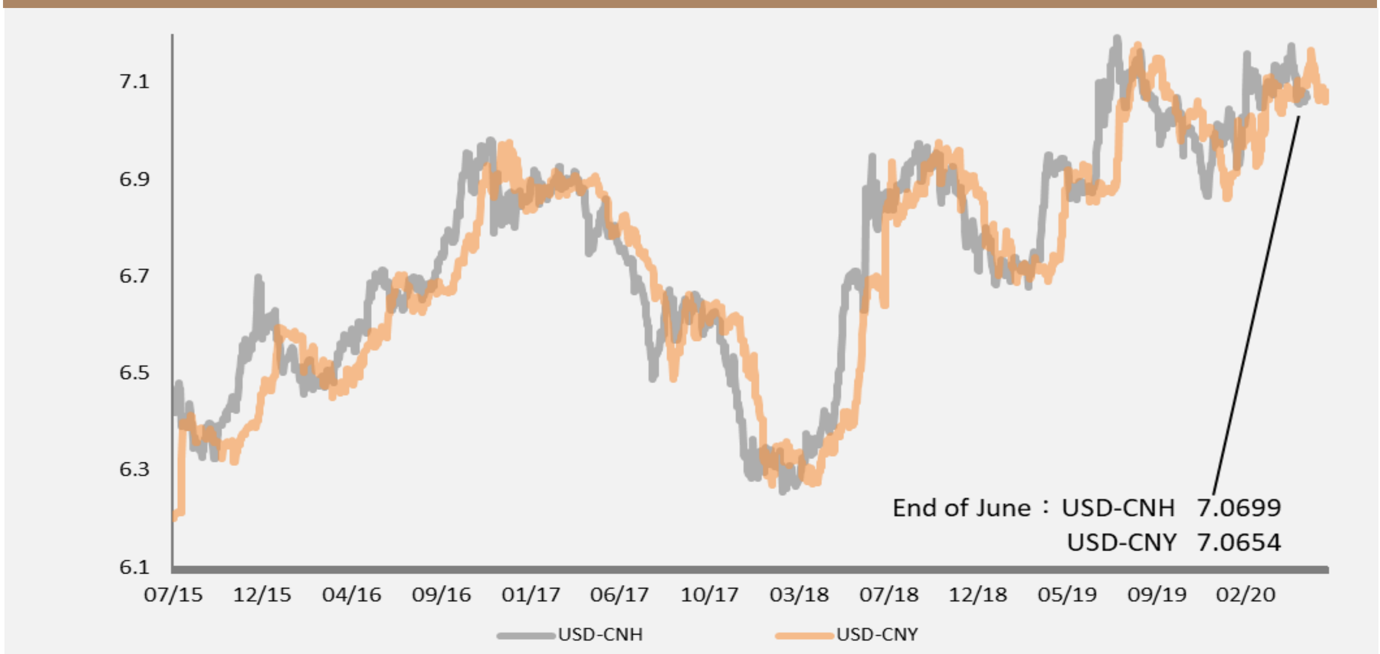
Source: HKMA

RMB Cross-border Trade Settlement (RMB bn)



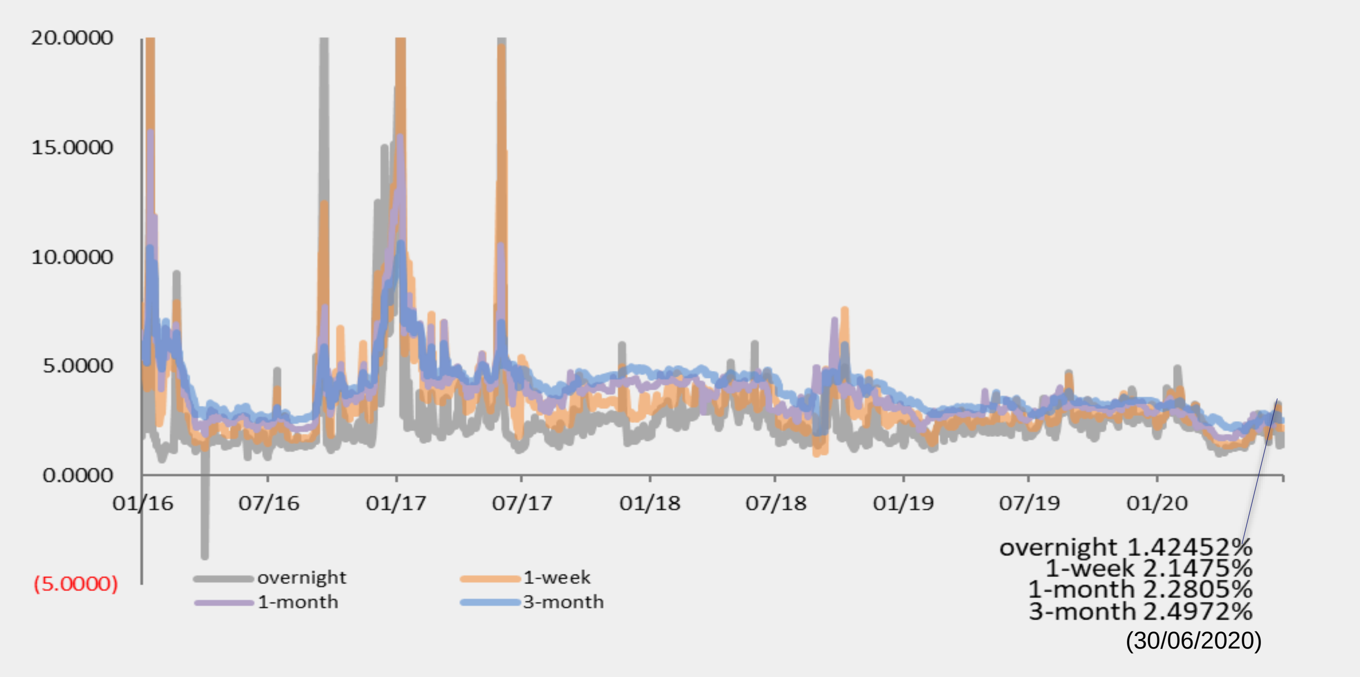
Source: HKMA

USD-CNH and USD-CNY Exchange Rates



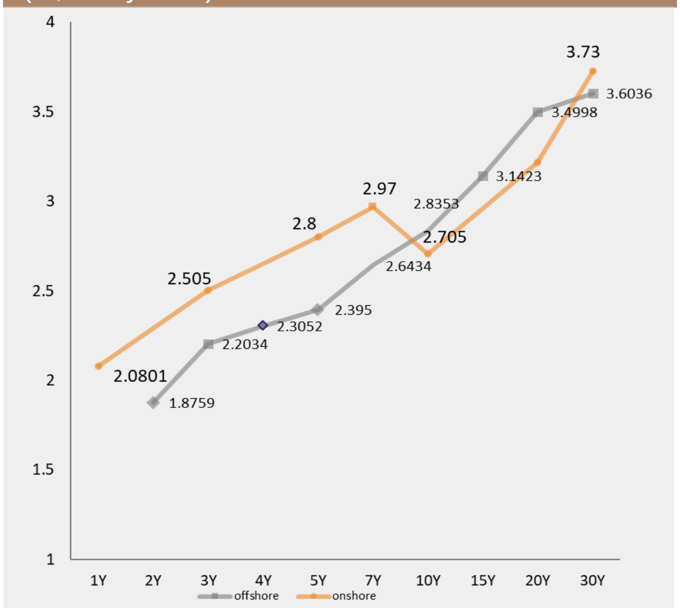
Source: Bloomberg

CNH HIBOR Fixing (%)



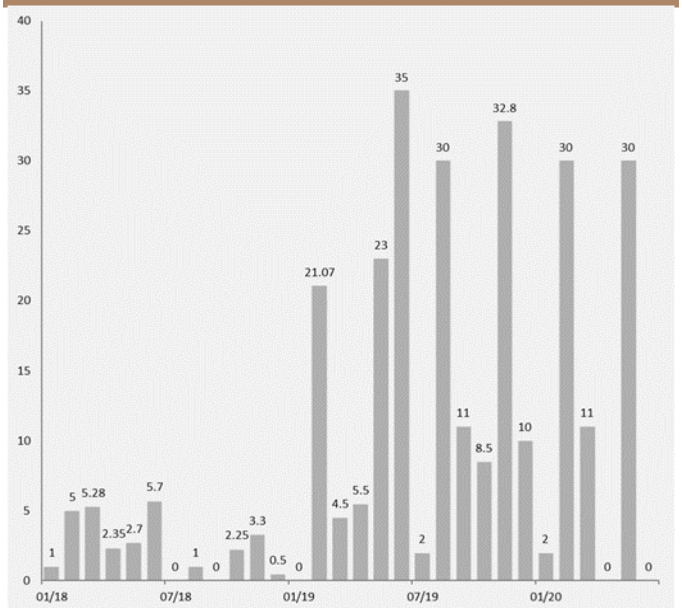
Source: Bloomberg

CNH & CNY China Sovereign Curve (%, 9 July 2020)



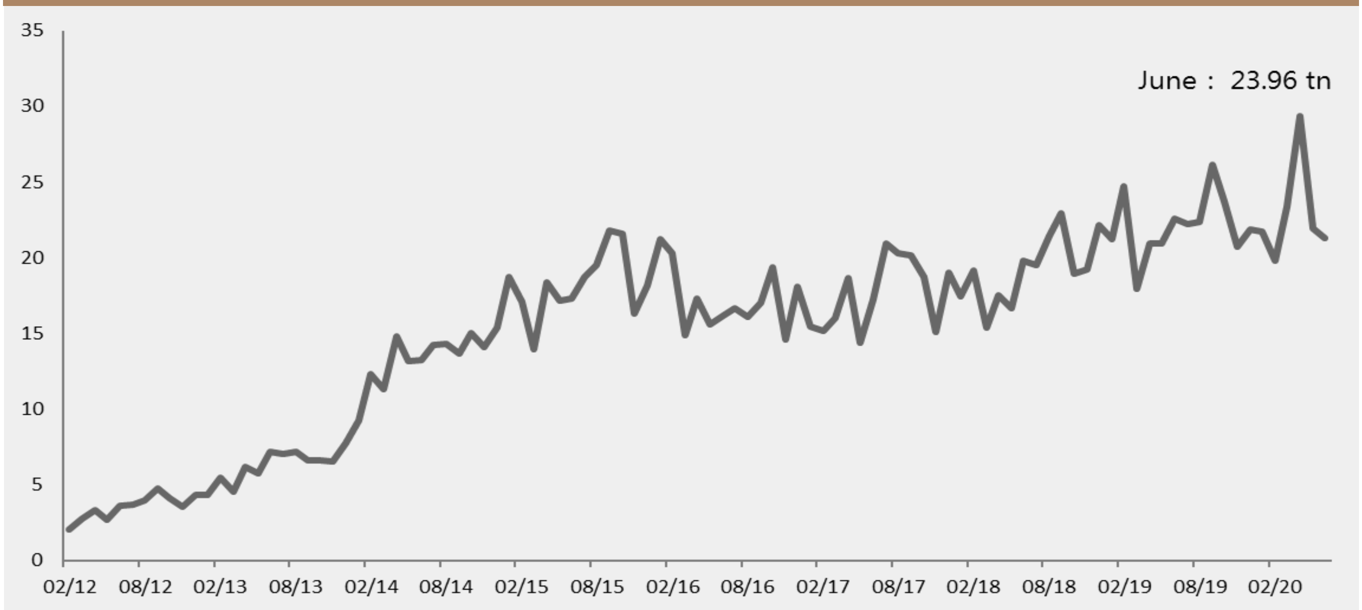
Source: Bloomberg

Hong Kong Offshore RMB Bond Issuance (RMB bn)



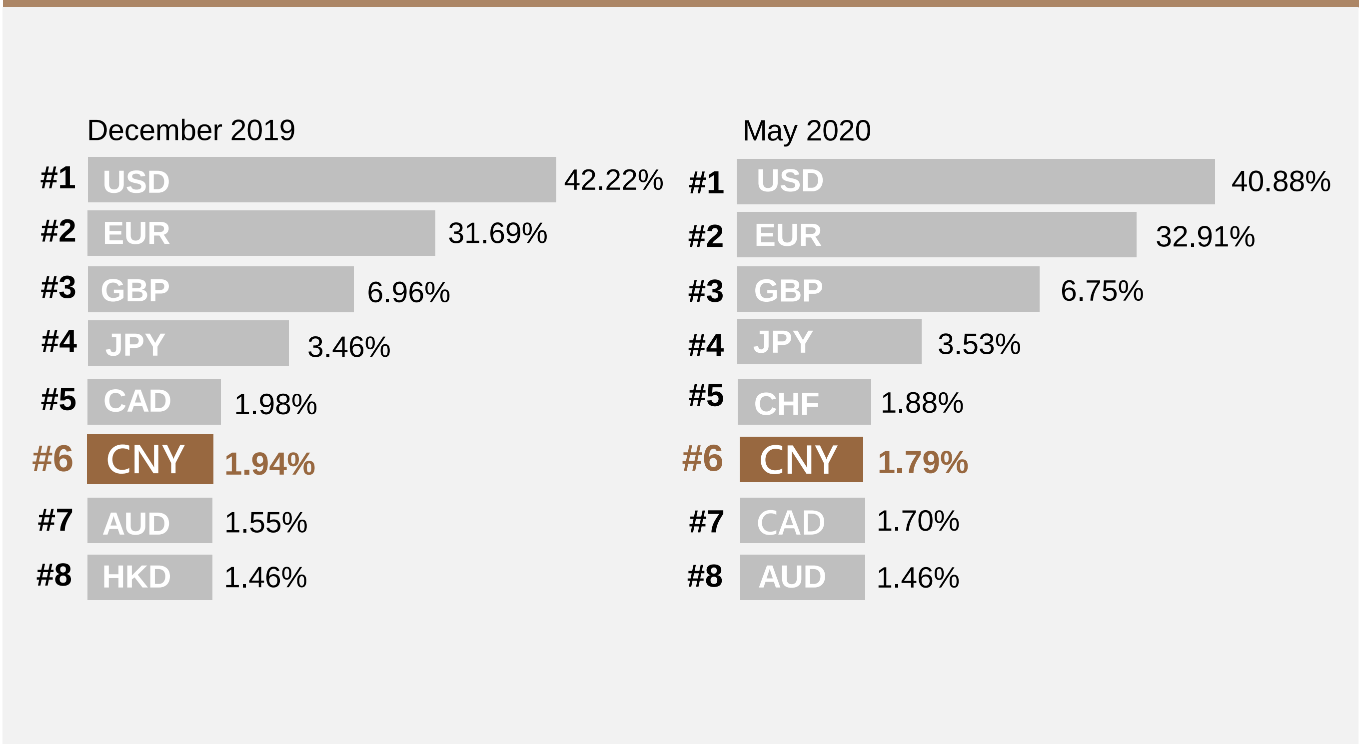
Source: BOCHK Global Market estimate

RMB Clearing Transaction Value (RMB tn)



Source: HKICL

SWIFT World payments currency ranking & market share



Source: SWIFT

Market Data

	Hong Kong RMB Deposits (RMB bn) (Year-end / Month-end)	RMB Cross-border Trade Settlement (RMB bn) (Yearly / Monthly)	RMB Clearing Transaction Value (RMB tn) (Yearly / Monthly)	Overnight CNH HIBOR Fixing (%) (Year-end / Month-end)	1-week CNH HIBOR Fixing (%) (Year-end / Month-end)	3-month CNH HIBOR Fixing (%) (Year-end / Month-end)
2016	546.7	4542.0	201.57	12.813	11.817	9.131
2017	559.1	3926.4	212.63	1.729	3.000	4.803
2018	615.0	4208.9	233.98	1.726	2.795	3.582
2019	632.2	5376.3	265.81	1.929	2.400	3.260
6/2019	604.24	440.6	22.21	2.099	2.533	3.071
7/2019	616.0	455.9	22.35	1.940	2.386	2.915
8/2019	644.2	497.3	26.14	2.727	3.136	3.538
9/2019	623.4	458.2	23.69	2.612	2.906	3.347
10/2019	636.4	429.4	20.70	2.535	2.759	3.252
11/2019	637.8	444.5	21.88	2.696	2.977	3.422
12/2019	632.2	541.1	21.73	1.929	2.400	3.260
1/2020	612.5	404.7	19.82	4.936	3.722	3.352
2/2020	638.7	481.0	23.38	2.115	2.546	2.956
3/2020	664.2	645.7	29.38	0.963	1.446	2.471
4/2020	654.3	540.2	21.97	1.317	1.455	2.247
5/2020	692.5	519.7	21.28	2.160	2.441	2.623
6/2020	/	/	23.96	1.4245	2.1475	2.49717

Source: HKMA, Bloomberg, HKICL, BOCHK

	USD-CNH Exchange Rates (Year-end / Month-end)	USD-CNY Exchange Rates (Year-end / Month-end)	HK Offshore RMB Bond Issuance (RMB bn) (Yearly / Monthly)	10Y CNH China Sovereign Bond Yield (%) (Year-end / Month-end)
2016	6.981	6.952	42.2	3.637
2017	6.515	6.507	24.9	4.140
2018	6.870	6.879	29.1	3.602
2019	6.963	6.963	183.37	3.189
6/2019	6.868	6.867	35	3.488
7/2019	6.910	6.884	2	3.408
8/2019	7.162	7.157	30	3.029
9/2019	7.141	7.148	11	3.022
10/2019	7.047	7.039	8.5	3.141
11/2019	7.033	7.033	32.8	3.091
12/2019	6.963	6.963	10	3.189
1/2020	6.997	6.911	2	3.046
2/2020	6.979	6.992	30	2.752
3/2020	7.094	7.082	11	2.765
4/2020	7.082	7.063	0	2.650
5/2030	7.133	7.137	30	2.943
6/2020	7.0699	7.0654	0	2.835