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Contents

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The Offshore RMB Market Remained Resilient

CNH appreciated below the 6.5 level in December, reaching a 2.5 year high. Major offshore RMB business indicators recovered. RMB deposits in Hong Kong reached RMB 700 billion level, reaching 4.5 years high. Foreign holdings in Chinese bonds surpassed RMB 3 trillion level. Bond Connect daily turnover reached record highs. USD market share of official foreign reserves of central banks fell in two consecutive quarters.

I. RMB exchange rate rose below 6.5 in December and reached a 2.5 year high

CNH appreciated below 6.5 in December and reached a 2.5 year high. The RMB exchange rate remained resilient, as the China economy recovered steadily, with the latest official manufacturing purchasing managers' index (PMI) staying above the 50 level for 10 consecutive months. CNH appreciated to 6.4895 level (highest level since 2018 June) on December 17, and fluctuated at around 6.50 level in rest of the month. As of December 31, the RMB's central parity rate against the USD closed at 6.5249, down 0.8% MoM, down 6.3% compared to beginning of the year. CNH closed at 6.5077, down 1.1% MoM, down 6.5% compared to beginning of the year. CNY closed at 6.5267, down 0.7% MoM, down 6.3% compared to beginning of the year.

With market expecting the US to introduce more stimulus policies, investors reduce their USD holdings, which drove down the DXY index to below 90 level in December, without any signs of bouncing back. On the other hands, the China-US interest rate spread widened to over 200 basis points, which continue to attract foreign capital inflow to onshore market. In addition, the demand for RMB settlement increased as Lunar New Year approaches. Therefore, it is expected that RMB will continue to remain strong, with gradual increasing volatility.

Regarding the CNHHIBOR in December, as of December 31, the O/N, 1-week and 3-month CNH HIBOR rates were 4.0305%, 2.9582% and 2.8823% respectively.

II. Major offshore RMB business indicators rebounded after holidays

By the end of November 2020, RMB deposits in Hong Kong rose above RMB 700 billion, reaching a 4.5 year high, amounting to RMB 718.3 billion, up by 5.6% MoM and 12.6% YoY. RMB loans outstanding in Hong Kong were RMB 164.3 billion, up by 5% MoM and 4.3% YoY. After being affected by holiday factors last month, the total remittance of RMB for cross-border trade settlement was RMB 526.3 billion in October, up by 27.1% MoM and 18.4% YoY. RTGS turnover was RMB 25.1 trillion in December 2020, up by 3.5% MoM and 15.7% YoY. As of December 2020, dim sum bond issuance amounted to RMB 188.85 billion, including RMB 155 billion of central bank bills.

According to a SWIFT report in November 2020, the RMB was the fifth most active currency for domestic and international payments by value, with a share of 2.09%, behind USD, EUR, GBP and JPY. RMB payments value increased by 19.8% compared to the previous month, while in general all payments currencies decreased by 0.6%.

III. Foreign holdings in Chinese bonds surpassed RMB 3 trillion level. Bond Connect daily turnover reaches record high

As of December, the China-US interest rates spread remained at around 240 basis points. The widening of interest rates spread continued to attract capital inflow to onshore bond market, also supporting RMB exchange rates. As of November 2020, foreign holdings in Chinese bonds reached RMB 3.1 trillion, increasing significantly by 40.7% YoY, with a monthly net inflow of RMB 96.7 billion. As of today, foreign holdings in China bonds only accounted to around 3% of total China bonds, indicating a huge potential to grow. With strong RMB and low return of US and European bonds, it is expected that foreign investors would continue to increase China bonds holdings to diversify risk.

Bond Connect trading tickets totaled 5648 in December, while trading volume and average daily turnover reached RMB 447.8 billion and RMB 19.5 billion respectively. Bond Connect trading volume reached a new single-day record breakthrough at RMB 36.9 billion on Dec 16. Policy bank bonds, Chinese government bonds and NCDs drew the most interests, accounting for 33%, 43%, and 21% of the monthly trading volume.

In the same month, the scheme welcomed 47 new investors, and expanded its coverage to 34 jurisdictions across the globe with 2,352 global institutional investors, including 75 of the top 100 global asset management companies.

IV. RMB's market share as an international reserve currency rose to record high

According to IMF statistics, the COFER report, as of the 3Q 2020, reserves held in RMB was US 244.52 billion, compared to US 233.09 billion last quarter, an increase for 7 consecutive quarters. RMB assets' share of the official foreign reserves of central banks rose to 2.13%, a record high since IMF started reporting RMB reserve assets in October 2016.

USD remains the largest reserve currency, but market share has dropped from 61.26% in 2Q to 60.46%, marking a fall in two consecutive quarters.

Six Chinese government departments reunited to optimize cross-border RMB policies

On 4 January the Chinese central bank in tandem with the Ministry of Commerce (MOFCOM), the China Banking and Insurance Regulatory Commission (CBIRC), the State Administration of Foreign Exchange (SAFE) and the National Development and Reform Commission (NDRC) jointly issued the “Notice on Further Optimising Cross-border Renminbi Policy and Supporting the Stabilisation of Foreign Trade and Foreign Investment” (Yinfa[2020] No.330).

The Notice is scheduled to come into effect on 4 February 2021, and its release follows a three-month feedback period following the issuance of a draft version on 18 September.

The "Notice" consists of five parts and fifteen articles, covering: 1. Raising the convenience of renminbi settlement for trade and investment. 2. Further simplifying cross-border renminbi settlement procedures. 3. Optimising cross-border renminbi investment and finance regulation. 4. Raising the convenience of individual renminbi cross-border payments and receipts under the capital account. 5. Raising the convenience of offshore institutions using renminbi bank settlement accounts.

In terms of specific measures, the Notice loosened restrictions on the usage of some renminbi revenue under the capital account. The capital account renminbi revenue of domestic institutions – including funds from foreign direct investment and funds from cross-border financing and offshore listing, can be used within the business scope approved by authorities as long as certain conditions are satisfied. The Notice also cancels specialist account requirements for foreign direct investment. This means that offshore investors who wish to reinvest domestic renminbi profits can directly transfer renminbi funds from enterprise accounts to the accounts of enterprises receiving investment or parties transferring equity, without the need to open a special “renminbi re-investment deposit account.”

Hong Kong, mainland studying framework of Southbound Bond Connect

Discussions have begun to allow Chinese investors to trade bonds in Hong Kong, a move that will “generate enormous opportunities” for the city’s financial services industry and has the potential to strengthen its status as an international financial centre.

The Hong Kong Monetary Authority (HKMA) and the People’s Bank of China (PBOC) are looking at expanding the current Bond Connect scheme. They will form a working group to study the framework for the so-called southbound leg of the current Bond Connect scheme, a HKMA spokesperson confirmed on December 2nd 2020 without providing a timeline.

Overview of the Yuan in 2020 and forecast for 2021

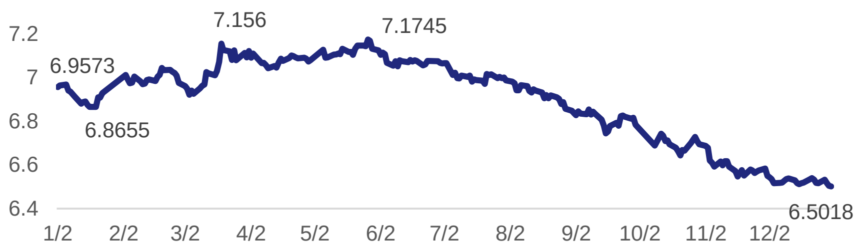
Ying Jian, Senior Strategist

I. Overview of the RMB Exchange Rate in 2020

The RMB exchange rate in 2020 can be clearly divided into two phases. In the first phase, the yuan came under great selling pressure from the beginning of 2020 to the end of May by multiple adverse factors, with CNH depreciating from 6.9573 at the beginning of 2020 to 7.1745, the lowest point of the year. In the second phase, the yuan had rebounded along with other major currencies from the end of May to the year-end, with "new normal" of co-existence with virus and a weakening USD as safe-haven currency.

Looking back at the RMB exchange rate in 2020, the epidemic and the worst global recession since Great Depression directly triggered the volatility of the yuan. The governments and central banks have taken various measures to control the crisis and investor confidence and financial markets. China is the only major economy to report economic growth for 2020, fueling expectations of a stronger yuan. For the whole year, CNH has rebounded 4,573 basis points, up 7.4%, slightly more than the CNY (6.7%) and the central parity rate of RMB against the US dollar (6.9%). The CFETS yuan index rose 3.8 percent for the year.

Overview of the Yuan in 2020



Source: Reuters, BOCHK

II. Major factors affecting the RMB exchange rate in 2021

Overall speaking, internal factors continues to dominate the fundamentals of the RMB exchange rate, such as the recovery of the Chinese economy after success in suppressing the outbreak of COVID-19 disease, as well as macro-control and monetary policy in mainland China. In terms of external factors, those ones that had a great impact on the global foreign exchange market in 2020 are being transformed and restructured to form new variables, affecting major international currencies and the yuan. The major factors are highlighted below:

1. The development of the COVID-19 disease and the vaccine

The novel coronavirus epidemic was still raging throughout the globe at the end of 2020, but vaccine breakthrough brings hope that the Covid-19 battle can be won.

Whether or not a vaccine can effectively control the outbreak depends on several factors, including availability of vaccine, procurement process, and duration of protection.

The pandemic might play out next year in different scenarios: one is that with mass vaccine procurement, the widespread of the pandemic will be contained effectively, or the virus might be eliminated worldwide, like SARS, and global economic activities and social mixings return to normal.

Another scenario is that due to various reasons, e.g. a limited supply etc., vaccine procurement is not available for the whole population. The virus continues to spread at a slower space or under control to a certain extent. Intermittent lockdowns and restrictions are the new normal, while the world economy suffers for years to come.

In addition, because of how widespread the virus has become and the new variants, the first scenario is near impossible – we cannot completely rule out the possibility that the new variants might harm the effectiveness of current vaccines and cases might rise again.

In the best-case scenario, the epidemic will be gradually brought under control, which is conducive to restoring market confidence and narrowing market fluctuations. As a result, the safe-haven function of the US dollar will be further weakened, while non-US dollar currencies will be stronger, including the yuan.

2. Biden cabinet's economic and China-related policies

It is expected that the Biden administration is relatively moderate and practical, as well as predicable in handling internal and foreign affairs, which is helping to ease market volatility. It's not easy for Biden to stimulate the economy while improving virus response and vaccine roll-out. Cases have been rising again recently and it could cause another slowdown in economic growth in the fourth quarter, creating a "double dip" recession and diminishing the weakening U.S. dollar. In terms of China-US relations, it is estimated that Biden will be in no hurry to undo many Trump administration's China decisions and will be tough on the alleged yuan undervaluation issue.

3、 Joint virus control in Europe and the trend of Euro

The main reason for the strong Euro recently is due to joint virus control actions taken by European countries, restoring market confidence. In early June, the European Central Bank decided to expand its emergency purchase plan from EUR 750 billion to EUR 1.35 trillion. In July, the European Commission reached an agreement to launch the “EU Next Generation Economic Recovery Fund”, which will issue EUR 750 billion of bonds, amounting to 2% of EU GDP.

Looking forward, EU policies would continue to support the Euro. The European central bank also said it would take every measure, including negative interest rates, to ease the impacts from virus, according to a survey conducted by Reuters in December. Most analysts estimated the USD to remain weak for 6 months, while banks such as Deutsche bank and BNP Paribas estimated the Euro to rebound towards 1.25 - 1.3 level.

4. China's economic performance and direction of macro-control

China has been recovering well from the virus. Major economic indicators show signs of recovery and is likely to continue in 2021. There are good development opportunities in 2021. For example, intensive investment projects might be introduced during the start of 14th Five-Year Plan period. Also, internal consumption market continuously provides momentum to the economy, boosting economic growth.

In terms of macro-control adjustment, China has accelerated the formation of internal circulation as the primary focus, while leveraging the national – international dual circulation to foster development.

The continuous improvement of macro-control ensures sustainable development of the economy and helps boost market confidence.

5、The function of PBOC monetary policy and exchange rate policy

The PBOC made it clear that China monetary policy will remain focused and prudent, and maintain normal monetary policy as long as possible.

In terms of exchange rate policy, China will continue to improve the RMB exchange rate setting mechanism, maintaining the RMB exchange rate at a reasonable level instead of promoting depreciation. PBOC will continue to provide clear policy signals to the market, which has already posed an impact to market expectations and investment behavior in onshore and offshore markets.

6、Opening up of the financial market and RMB internationalization

The RMB was officially included in the IMF's currency basket in 2015, and has become an international reserve currency. In 2021, central banks and foreign investors will continue their pursuit of RMB assets, which is conducive to the stability of RMB exchange rate. The internationalization of the RMB has been maintaining a sound momentum, and a clearer plan to promote RMB internationalization was laid out in the 14th Five-Year Plan. Various favourable results will be shown in 2021, boosting market confidence in the RMB.

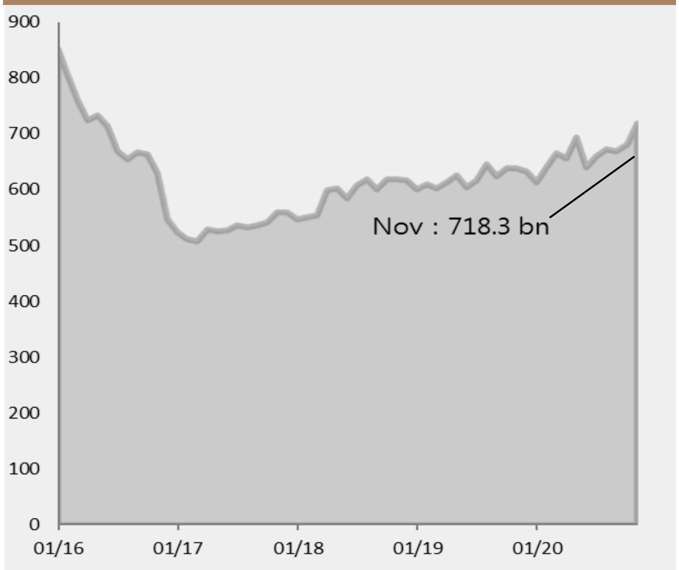
III. Summary

To sum up, the global financial market will encounter huge uncertainties in 2021, where there are variables in causing RMB to appreciate or depreciate. The RMB exchange rate would continue to see large volatility due to various favourable and non-favourable factors. If the vaccine can achieve the desired effect that creates favourable conditions for recovery of the global economy, and if Biden takes moderate and pragmatic policy towards China, then the volatility of CNH may narrow to 3000 to 4000 basis points.

The direction of CNH fluctuation mainly depends on the trend of USD against other major currencies such as EUR and JPY. Due to the exchange rate policy that aims to maintain RMB at a reasonable level, RMB exchange rate may appreciate less than EUR and JPY, at approximately 2% to 3%.

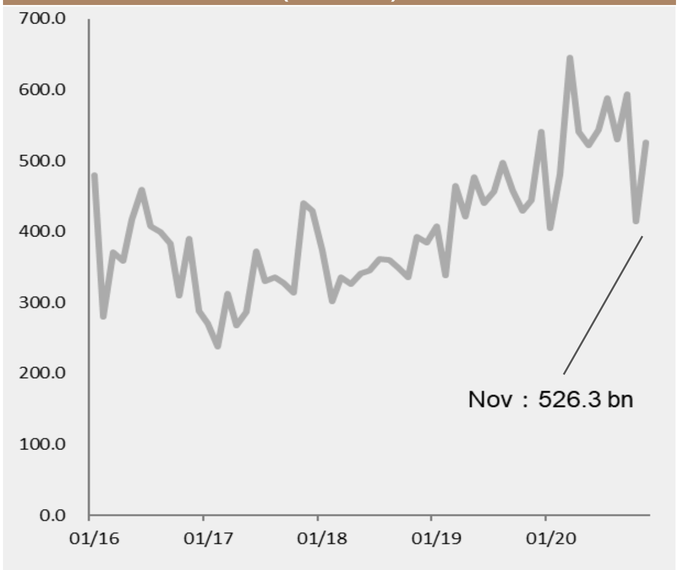
Market Indicators

Hong Kong RMB Deposits (RMB bn)



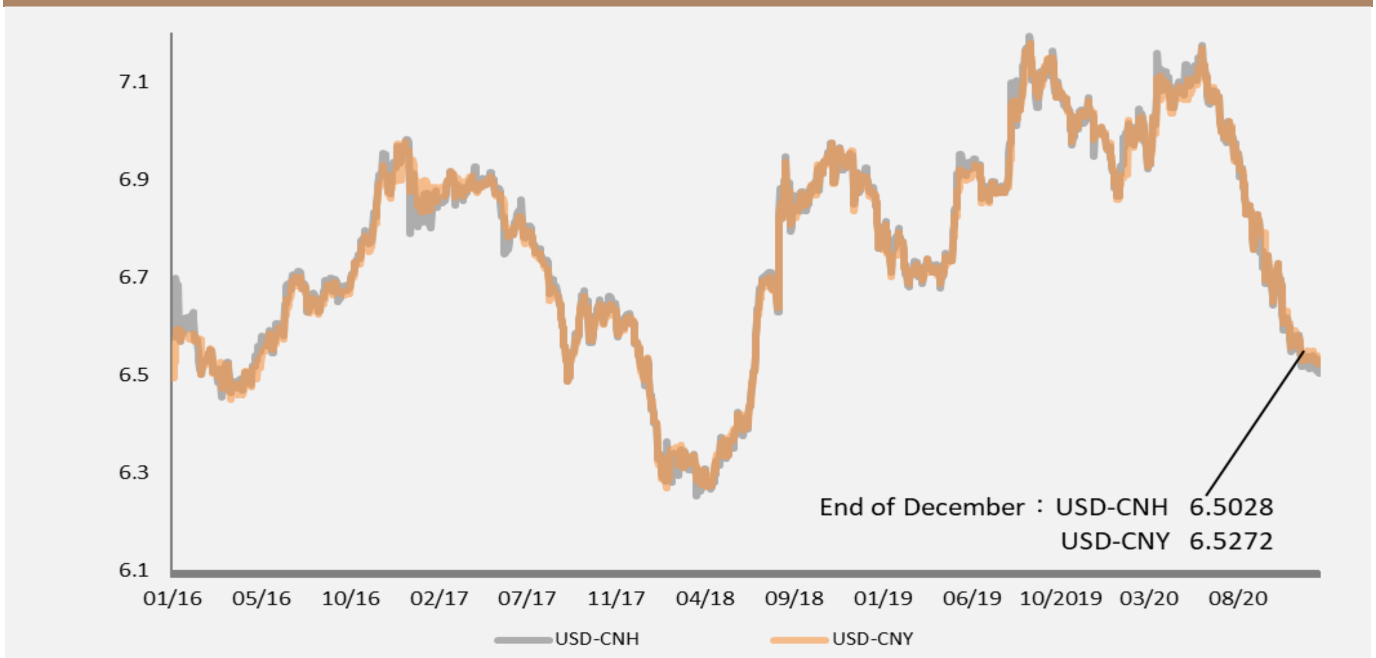
Source: HKMA

Hong Kong RMB Cross-border Trade Settlement (RMB bn)



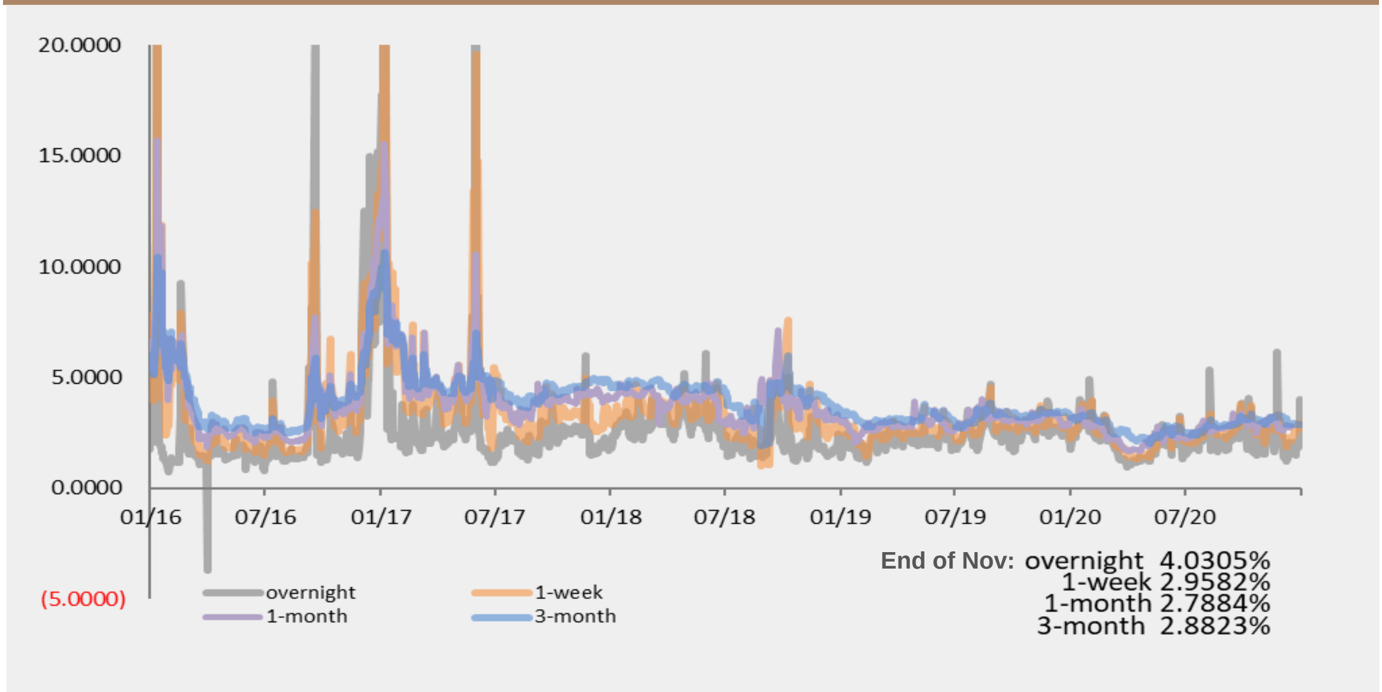
Source: HKMA

USD-CNH and USD-CNY Exchange Rates



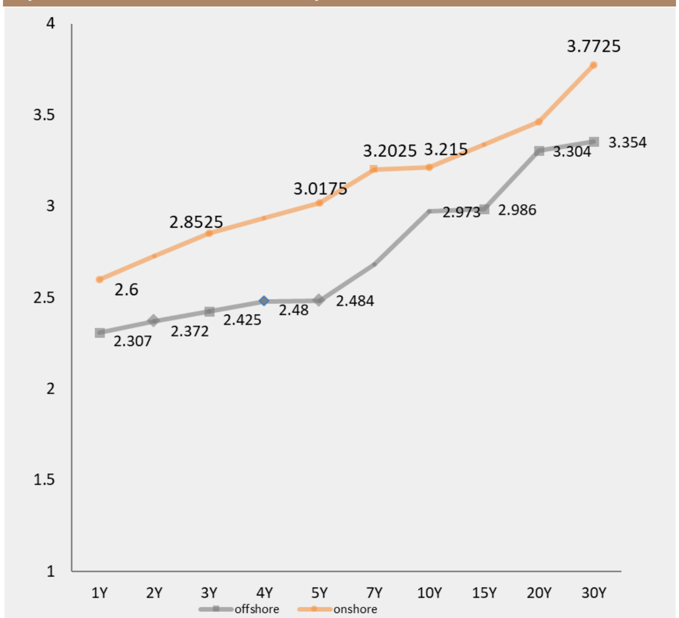
Source: Bloomberg

CNH HIBOR Fixing (%)



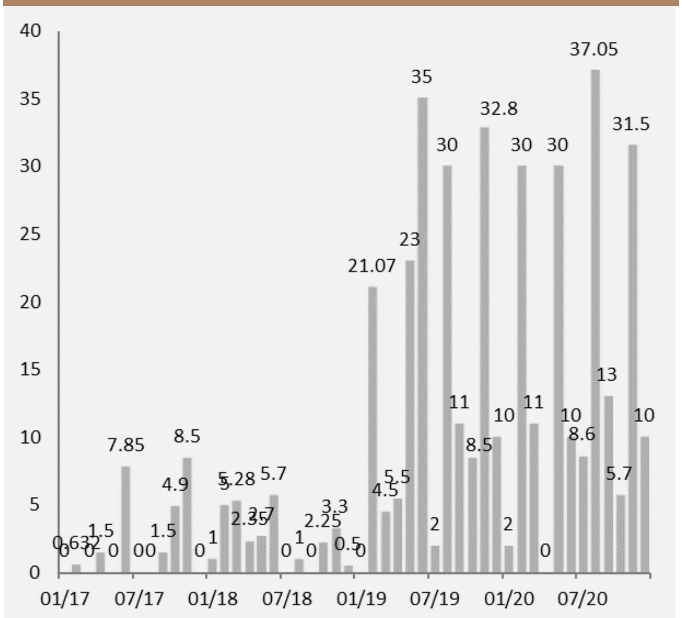
Source: Bloomberg

CNH & CNY China Sovereign Curve (%, 27 November 2020)



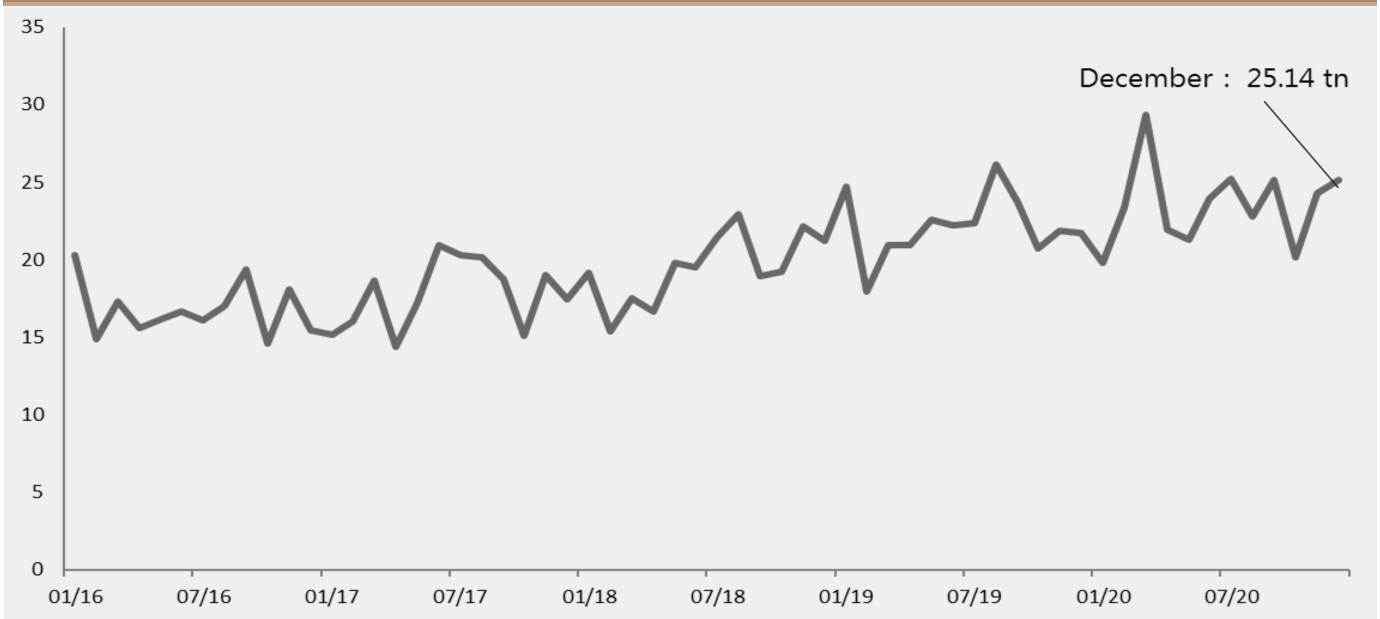
Source: Bloomberg

Hong Kong Offshore RMB Bond Issuance (RMB bn)



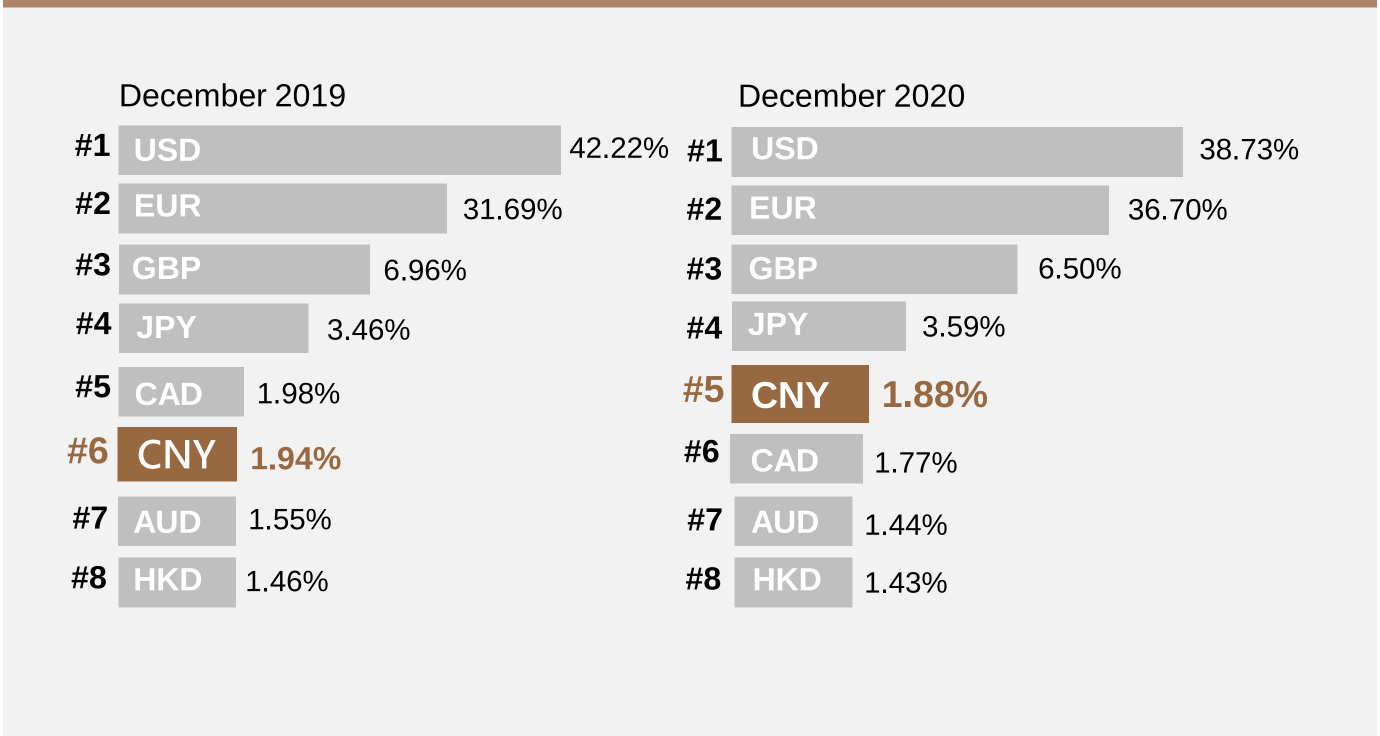
Source: BOCHK Global Market estimate

RMB Clearing Transaction Value (RMB tn)



Source: HKICL

SWIFT World payments currency ranking & market share



Source: SWIFT

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