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Contents

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The Offshore RMB Market Remains Resilient

RMB exchange rate remained stable in February, with recent rising trend weakened due to the rebound of DXY. Major offshore RMB indicators increased steadily, RMB deposits in Hong Kong reached RMB 700 billion level for 3 consecutive months. Foreign holdings in Chinese Government bonds rose above RMB 2 trillion level for the first time. Bond Connect activities remained robust.

I. RMB exchange rate remained stable in February

CNH remained stable in February. RMB exchange rates strengthened and approached 6.4 in the beginning of the month, but then weakened after Chinese New Year as the demand for RMB settlements decreased. CNH fluctuated narrowly within 6.4-6.5 in rest of the month. On the other hand, DXY index strengthened after a round of depreciation, rose and maintained at 91 above in end of the month, which hindered the rise trend of RMB. As of February 26, the RMB's central parity rate against the USD closed at 6.4713, remaining flat MoM, and down 0.3% compared to beginning of the year. CNY closed at 6.4782, down 0.8% MoM, down 0.2% compared to beginning of the year. CNH closed at 6.4821, down 0.6% MoM, and down 0.4% compared to beginning of the year.

The recent rise trend of RMB weakened due to the rebound of DXY. US Nonfarm payrolls data was better than expected, U.S. Treasury yields rose, and the progress of the stimulus bills, etc., has driven the DXY index past 92 in early March, a 3-month record high, causing RMB to erase all its gains against USD this year. In short term, the recent strong USD will continue to pressurize the RMB exchange rate, however, there are RMB buying orders once RMB dropped below 6.5. Therefore, a sharp depreciation is unlikely to happen in short term. In medium to long term, China's economy continues to rebound, foreign capital continues to increase its holdings of RMB, and measures to encourage the two-way balanced flow of cross-border capitals will enhance the RMB exchange rate to remain stable with two-way fluctuations.

Regarding the CNHHIBOR, as of February 26, the O/N, 1-week and 3-month CNH HIBOR rates were 2.6872%, 2.8350% and 3.0270% respectively.

II. Major offshore RMB business indicators increased steadily

According to HKMA, as of the end of January 2021, Hong Kong's RMB deposits reached RMB 797.7 billion, rising above RMB 700 billion for 3 consecutive months, amounting to RMB 718.3 billion, an increase of 10.5% compared to end of 2020. Hong Kong's RMB loans balance was RMB 159 billion, an increase of 4.6% compared to end of 2020. According to PBOC, RMB cross-border trade settlement continued to rise. The total remittance of RMB for cross-border trade settlement was RMB 581.3 billion in January, up by 8.5% compared to end of 2020. According to HKICL, RTGS turnover was RMB 25.4 trillion in January 2021, down by 16.3% compared to historic high last month, up by 0.9% compared to end of 2020. As of February 2021, dim sum bond issuance amounted to RMB 285 billion.

According to the latest SWIFT RMB Tracker, in January 2021, the RMB has retained its position as the fifth most active currency for global payments by value, with a share of 2.42%, behind USD (38.26%), EUR (36.6%), GBP (6.8%) and JPY (3.49%). RMB payments value increased by 21.3% compared to the previous month, while in general all payments currencies decreased by 5.9%.

III. Foreign holdings in Chinese Government bonds rose above RMB 2 trillion level for the first time. Bond Connect activities remained robust

Although the China-US interest rate spread narrowed due to a rise in US treasury yield, China bonds remain relatively attractive compared to other countries' bonds and continues to attract foreign capital investments. As of February 2021, foreign holdings in Chinese bonds reached RMB 3.5 trillion, increasing significantly by 56.6% YoY, with a monthly net inflow of RMB 89.5 billion, recording net inflow of RMB 312.3 billion YTD. Also, total holdings of Chinese government bonds by foreign investors stood at RMB 2.06 trillion, a historic high, surpassing RMB 2 trillion for the first time. With low return of US and European bonds, it is expected that foreign investors would continue to increase China bonds holdings to diversify risk.

Despite the long holiday in onshore market during Chinese New Year, Bond Connect trading remained very active in February, trading tickets totalled 3731, while trading volume and average daily turnover reached RMB 310.3 billion and RMB 20.7 billion respectively. Chinese government bonds and policy financial bonds are investors' major focus, accounting for 43% and 37% of monthly trading volume respectively.

In the same month, the scheme welcomed 24 new investors, and expanded its coverage to 34 jurisdictions across the globe with 2,428 global institutional investors, including 76 of the top 100 global asset management companies. To further enhance the settlement process for global investors, CMU extended the cut-off time for Bond Connect securities instructions and HK RTGS funding instructions from 2:00 p.m. to 3:00 p.m., which will take effect from 18th February, 2021.

China Mulls Easing Capital Controls on Offshore Investments

China is considering relaxing restrictions to allow its citizens to invest in securities outside its mainland in a bid to facilitate two-way capital flows as it opens its own capital markets to more foreign participation.

The State Administration of Foreign Exchange will conduct a study to see if it can allow domestic investors to use their $50,000 annual forex quota for purchases of securities and insurance offshore, Ye Haisheng, director of its capital account management department, wrote in an article published in China Forex Magazine. It also plans to remove the quota limit for individuals who take part in stock incentive programs of offshore-listed firms. If implemented, the move would be a big leap in China's push for a two-way opening of its financial markets.

To cater to a growing need for offshore asset allocation, China is also looking at boosting the quota for its Qualified Domestic Institutional Investors program in a "timely" manner, according to the article. Restrictions may be eased in the derivatives market, where futures trading is limited to hedging for financial institutions.

Still, the regulator pledged to step up monitoring of cross-border flows and crack down on violations against its forex rules, Ye said, adding challenges are "inevitable" in the course of opening up capital accounts.

PBOC issued RMB 25 billion central bank bills in Hong Kong

PBOC issued RMB 25 billion central bank bills in Hong Kong on February 19. Among the total, RMB 10 billion worth of bills will mature in three months, with interest rates standing at 2.7%, 15 basis points less than last time; RMB 15 billion worth of bills will mature in one year, with interest rates standing at 2.74%, 15 basis points less than last time. The issuance was well-received by investors in the offshore markets, with the total bid amount reaching about RMB 76 billion, more than three times the amount in circulation.

BOCHK launched the Hong Kong PBOC bills repo business market-marking mechanism from 27 Jan 2021 as a participating bank in RMB business in Hong Kong, which further increases the trading activity and expands the scope of usage of PBOC bills in the secondary market in Hong Kong.

Why Is The RMB Still Attractive At Lower Yield Differentials?

David Zhang, Senior Economist

As mentioned in our quicktake from Jan 12th, the RMB bull is likely to stall given PBOC's macroprudential measures on cross-border flows and narrowing China-US interest rate differentials. Since then, the RMB has been range-bound (6.4-6.5), as was the case with the US dollar index (89.5-91.5). Furthermore, the China-US 10-year interest rate differential narrowed by another 10 bps to around 190 bps. In this quicktake, we see why the RMB may be still attractive to foreign investors despite narrowing yield differentials.

FX-hedged RMB yields are still high

Since making new highs in the last two months of 2020, 10-year and 5-year nominal China-US yield differentials have narrowed by about 60 and 40 bps respectively. However, their FX-hedged counterparts using offshore cross-currency swaps have only narrowed by about 30 and 25 bps to 86 and 62 bps respectively (exhibit 1 and 2). US dollar investors tend to use offshore cross-currency swaps to hedge their FX exposure when investing in long-term RMB bonds, as FX swaps tend to be available only at shorter tenors. Hedging FX risk of RMB bonds involves swapping fixed RMB interest for floating US dollar interest through a cross-currency swap, and then converting the floating US dollar interest to fixed through an interest rate swap.

Exhibit 1: China-US 10Y yield differential

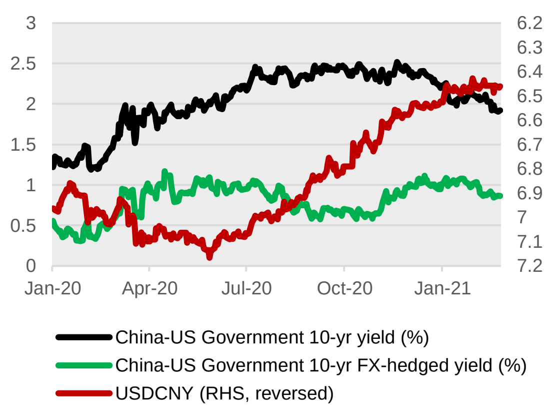
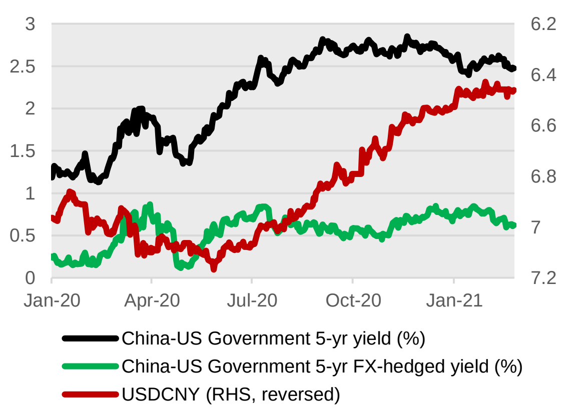


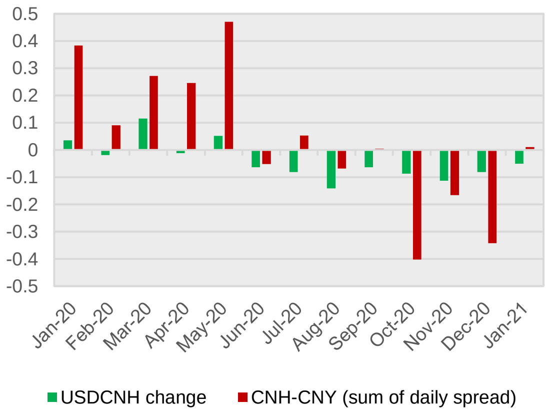
Exhibit 2: China-US 5Y yield differential



Source: Bloomberg, BOCHK

FX basis risk still apply given the mismatch of coupon payment frequency between RMB bonds and offshore cross-currency swaps. The difference between CNH and CNY may also make the FX hedge less effective. However, given a low likelihood for the RMB to trend significantly in any particular direction this year, CNH-CNY differences may be less of a concern (exhibit 3).

Exhibit 3:
CNH-CNY differences are higher when RMB trends



Source: Bloomberg, BOCHK

RMB's lower volatility and correlation to US dollar

In addition to having higher FX-hedged yields than the US dollar, the RMB also boosts lower volatility and correlation to the US dollar when compared to other SDR currencies (exhibit 4). Before 2020, RMB's volatility and correlation to USD were distinctly lower than those of SDR currencies. In 2020, RMB's volatility increased 13%, but is still about half of the average volatility among SDR currencies. Furthermore, correlation with DXY stayed below 0.5 for the RMB in 2020, while they were above 0.6 for other non-USD SDR currencies.

Exhibit 4: RMB Return/Volatility/Correlation Relative to SDR Currencies

Exhibit 4: RMB Return/Volatility/Correlation Relative to SDR Currencies

2016-2019	Return (annualized)	Volatility (annualized)	Correlation with DXY
DXY	-0.6%	6.0%	1.00
EURUSD	0.8%	7.0%	-0.92
GBPUSD	-2.6%	10.0%	-0.63
JPYUSD	2.7%	8.5%	-0.47
CNYUSD	-1.7%	3.9%	-0.38

2020	Return	Volatility	Correlation with DXY
DXY	-6.7%	7.1%	1.00
EURUSD	9.0%	7.8%	-0.93
GBPUSD	3.1%	11.0%	-0.75
JPYUSD	5.1%	8.9%	-0.59
CNYUSD	6.7%	4.4%	-0.47

RMB market outlook

We continue to hold a neutral short-term view on the RMB, where sound economic fundamentals in China is offset by PBOC's macroprudential measures on the exchange rate and its patient monetary policy normalization stance. Externally, the US dollar index is likely to remain resilient, where an unprecedented twin deficit is offset by the US economic outperformance, higher fiscal policy support, slower pace of monetary easing, and faster vaccination progress relative to the Eurozone. A more significant run in the RMB may not occur until either the Fed or the PBOC starts to normalize monetary policy significantly or when the Biden administration is ready to negotiate with China on lowering trade barriers from a more holistic, systematic, and long-term vantage point.

GBA Wealth Management Connect on the Horizon

Xi Shuai, Strategic Planner

On February 5, the People's Bank of China (PBOC), China Banking and Insurance Regulatory Commission (CBIRC), China Securities Regulatory Commission (CSRC), State Administration of Foreign Exchange (SAFE), and the Hong Kong Monetary Authority (HKMA), Securities and Futures Commission of Hong Kong (SFC), Monetary Authority of Macao (AMCM) signed a Memorandum of Understanding (MOU) on the launch of the cross-boundary wealth management connect pilot scheme (the Scheme) in the Guangdong-Hong Kong-Macao Greater Bay Area (GBA). The MOU specifies their respective statutory functions and remits in order to establish sound supervisory cooperation arrangements and liaison mechanism, which is an important step taken since the joint announcement of the PBOC, HKMA and AMCM on the launch of the Scheme in June 2020. With the current pandemic, authorities in the three places reached a consensus on the above contents, which effectively boosted market confidence with a view to launching the scheme early.

I. Preliminary preparations for the cross-boundary Wealth Management Connect

In February 2019, the Outline Development Plan for the Guangdong-Hong Kong-Macao GBA was released, aiming to "widen the scope for cross-boundary investment by Hong and Mainland residents and institutions, and steadily expand the channels for Mainland and Hong Kong residents to invest in financial products in each other's market".

In November 2019, the Leading Group for the Development of the GBA announced a series of measures including exploring the establishment of a "cross-boundary wealth management connect scheme", where it was officially introduced and has attracted significant interests.

In May 2020, the Opinions on Financial Support for the Construction of the Guangdong-Hong Kong-Macao GBA jointly issued by the PBOC and other Mainland financial regulators reiterated that they would facilitate Mainland residents in the GBA to invest in financial products sold by banks in Hong Kong and Macao, and vice versa.

In June 2020, the PBOC, HKMA and AMCM jointly announced that they have decided to implement the cross-boundary wealth management connect pilot scheme in the GBA, revealing more details, such as the usage of designated investment accounts for the purchase of eligible investment products, the adoption of closed-loop through the bundling of designated remittance and investment accounts, and that cross-boundary remittances will be carried out in renminbi with currency conversion conducted in the offshore markets, as well as that cross-boundary fund flows will be subject to aggregate and individual investor quota management adjusted through a macro-prudential coefficient.

The MOU mainly clarifies the principles of supervisory cooperation between authorities of the three places, laying a good foundation for the smooth operation of the scheme and the protection of investors' interest. With details being finalized, it is believed that the Scheme will roll out before long.

II. Main contents of the MOU

The MOU consists of seven chapters in total. Chapter 1 General Provisions and Chapter 7 Taking Effect provides in principle that authorities in the three places will, within their respective statutory functions and remits, provide each other with supervisory assistance to the greatest possible extent, and the MOU shall take effect upon the launch of the Scheme.

Chapter 2 is the basic principles, in which the opening clarified the jurisdiction principle of " management of where business takes place ". Under the management of the place where the business takes place, which the "northbound trading" shall be subject to the measures taken by the domestic regulatory authorities, the People's Bank of China, the China Banking and Insurance Regulatory Commission and the China Securities Regulatory Commission to ensure the compliance of the investment scope; The "southbound trading" involves measures taken by regulators in Hong Kong and Macao to ensure that the scope of business investment meets the requirements. Furthermore, under the "northbound trading" and "southbound trading", the review of "qualified financial products", the provision of investor protection measures, the implementation of anti-money laundering and anti-terrorist financing, etc., shall be completed respectively by domestic and overseas regulatory authorities.

The inflow and outflow of funds has always been a core concern of the Wealth Management Connect. The MOU emphasized on the consensus between the three places on account management to ensure that funds are transferred exclusively and that the funds are repatriated across the border from the original RMB route to achieve closed-loop management. Ensure funds and wealth management products shall not be used for pledge, guarantee and other purposes, and shall meet the management requirements of pilot business quota and individual investor quota.

Chapter 3 is regulatory information exchange, including regular data sharing, information collection and notification mechanisms, etc. Chapter 4 is law enforcement, law enforcement cooperation in the financial sector is an important way to raise the cost of violations of laws and regulations, especially when it comes to cross-border capital flows. The MOU clarifies the important information request and notification mechanisms in law enforcement cooperation. Chapter 5 is investor protection, including the specific content of investor complaint handling, investor protection and investor education. Chapter 6 is the liaison and consultation mechanism, including regular liaison meetings, clarifies that other parties should be consulted in advance for changes or amendments to regulatory rules and policies.

III. Issues of priority concern to regulatory authorities

Judging from the MOU and previous policies, the regulatory authorities of the three places mainly consider the following aspects in the implementation of the “Wealth Management Connect":

First is to fully respect the existing regulatory systems and practices of the three places. The MOU sets out a general principle that the "Wealth Management Connect" is an innovation, but the premise of innovation is to respect the existing rules and seek common ground and operating space for the three places. In accordance with the jurisdictional principle of "management of where business takes place", it provides a clear basis for how to apply and follow the relevant laws and regulations on financial products and sales supervision in the three places, and effectively avoid the occurrence of a rule vacuum caused by the differences in regulatory systems.

Second is to ensure that the risk is manageable, funds should be managed in a closed loop. Promote step by step is the principle that has been adhered to since the establishment of the Interconnection mechanism. From the experience of Stock Connect and Debt Connect, it is beneficial for product operation by promoting conservatively.

Under the "Wealth Management Connect", the regulator has clarified that "investors should open remittance accounts and investment accounts respectively in the banks of two places, and implement one to one pairing; The closed-loop transfer and quota management of RMB cross-border funds will be implemented. If the closed-loop management of funds is implemented, the risk could be controlled within a limited scope. At the same time, the MOU also stipulates that the three places prohibit the use of funds and financial products in the pledge, guarantee and other aspects of business management, and the attitude of seeking stability in the initial stage is very clear.

Third, we will pay attention to protecting the legitimate rights and interests of investors. From the entire content of the MOU, the front parts covered investors education and investment products scopes, which are relatively low-risk, simple investment products, and then moved on to parts involving investor protection and legal cooperation topics, shows that the regulatory authorities undoubtedly put the protection of investors' rights and interests on a very important position. There are differences in regulatory regimes between the three places, also, "Cross-border Investors" is the first time for retail investors to directly open and operate investment accounts across the border. The establishment of regulatory cooperation arrangements, liaison and negotiation mechanisms and other necessary measures allow investors to enjoy greater freedom to conduct asset management. At the same time, they also have the right to fully protect their legitimate interests.

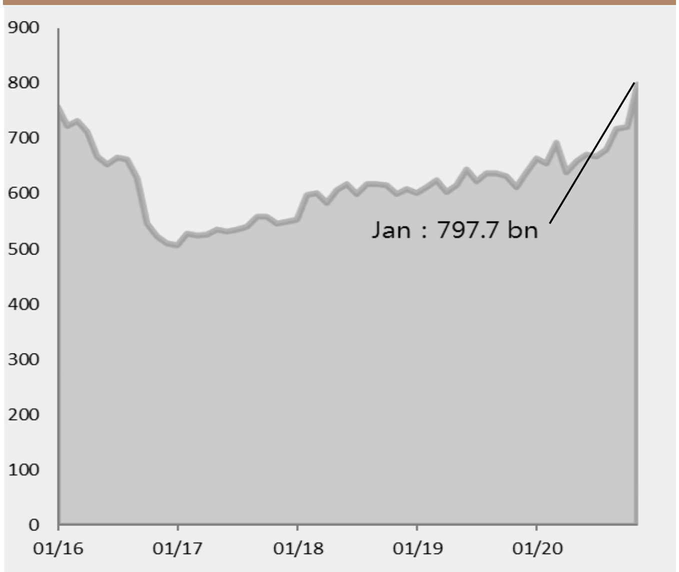
IV.The launch of "Wealth Management Connect" is imminent

"Wealth Management Connect" is another milestone in deepening cooperation between the Guangdong-Hong Kong-Macao GBA, connects the three places in one goal, providing a new channel for residents of Guangdong, Hong Kong and Macao to conduct cross border wealth management. "Wealth Management Connect" has further enriched the connectivity between the financial markets of the two places. It is another bridge of connectivity after the Stock Connect and Bond Connect, and will help deepen financial cooperation between Hong Kong, Macao and the Mainland. For Hong Kong, "Wealth Management Connect" can not only attract more mainland visitors to Hong Kong and business, but also expand wealth management business in Hong Kong, and further reflects throughout the bay area, this will provide more incentive for international financial institutions to allocate resources in Hong Kong, to further consolidate the status of Hong Kong as an international financial center and offshore RMB business center.

Since the announcement of "Wealth Management Connect" by the three places in June 2020, the market has been expecting when will the pilot be officially launched. However, due to the pandemic last year, cross-border personnel flow was being disrupted and it was difficult to open account in person, which to some extent also caused institutions worry about whether the Connect can be successfully launched according to the original plan. The MOU has sent a positive signal to the market that the progress of regulators' joint study on the implementation of the plan has not been affected. The MOU has clarified the rights and responsibilities of all parties and operational responsibilities, also convenient for further negotiations on implementation details in the future, laying a solid foundation for the launch of "Wealth Management Connect". We believe that "Wealth Management Connect" will be implemented in due course.

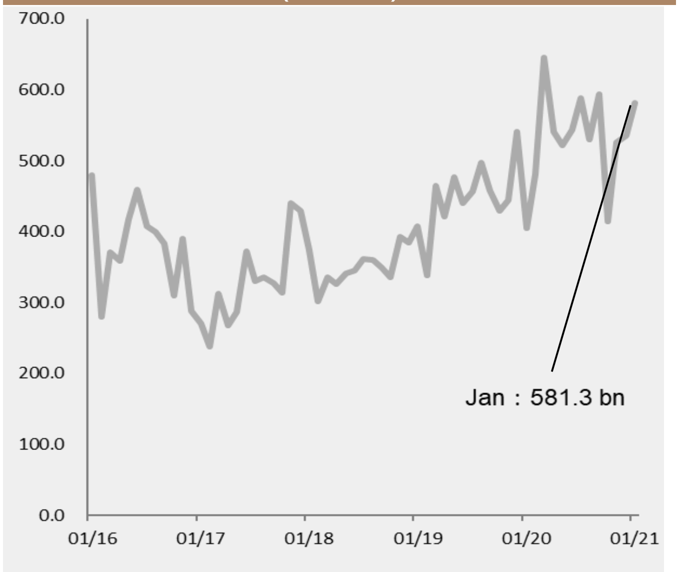
Market Indicators

Hong Kong RMB Deposits (RMB bn)



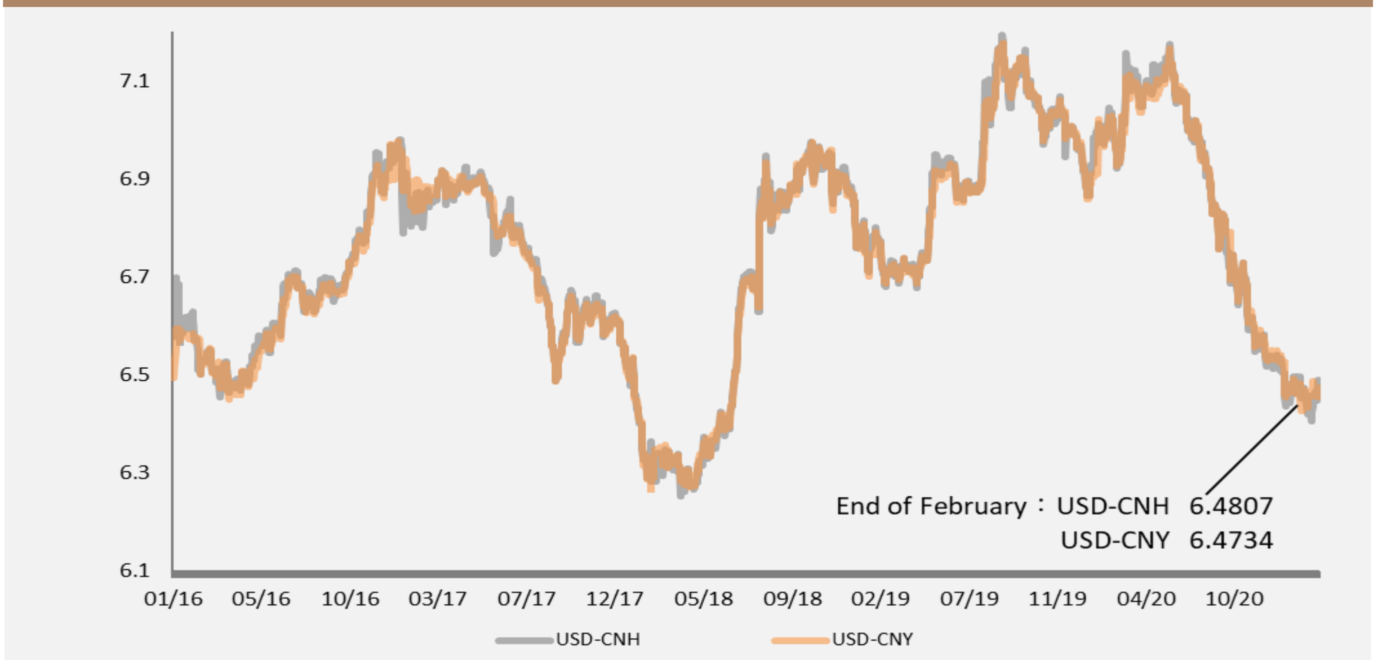
Source: HKMA

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



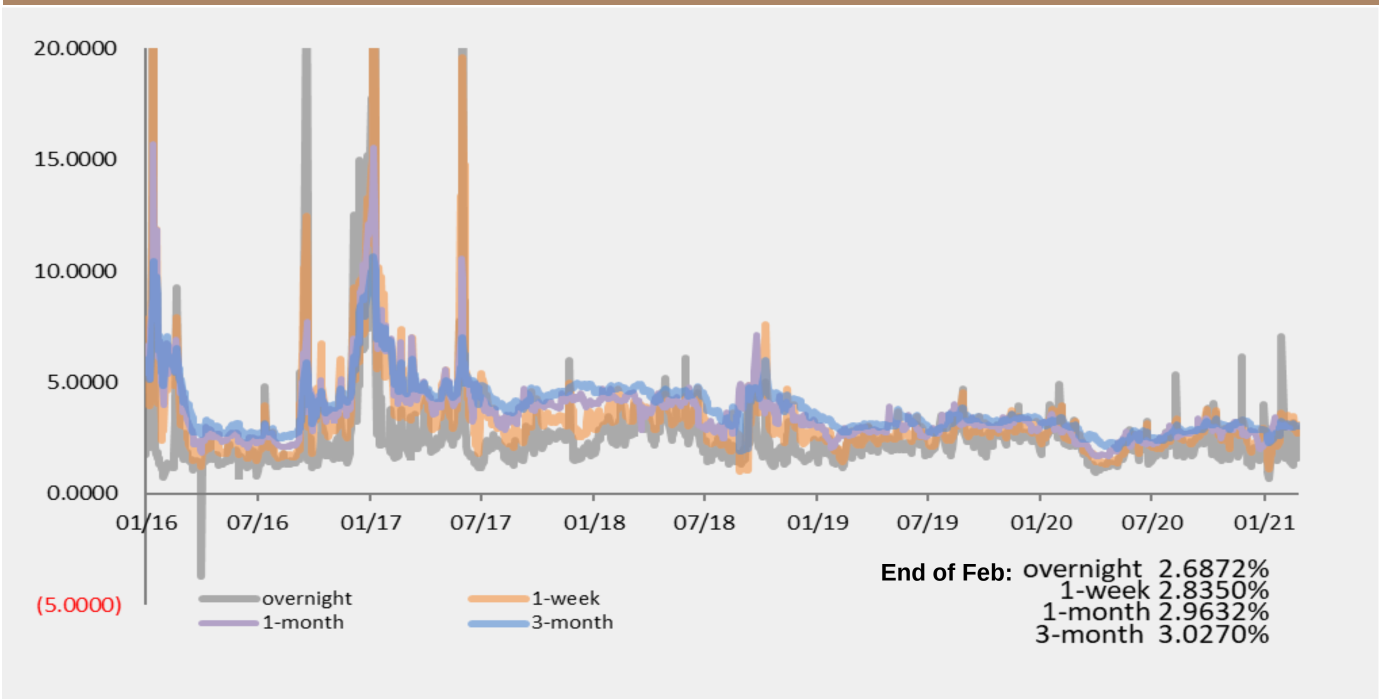
Source: HKMA

USD-CNH and USD-CNY Exchange Rates



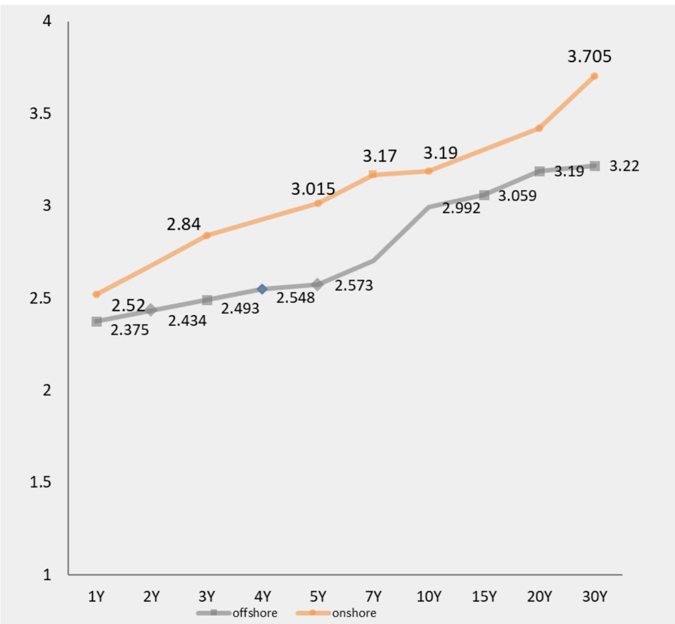
Source: Bloomberg

CNH HIBOR Fixing (%)



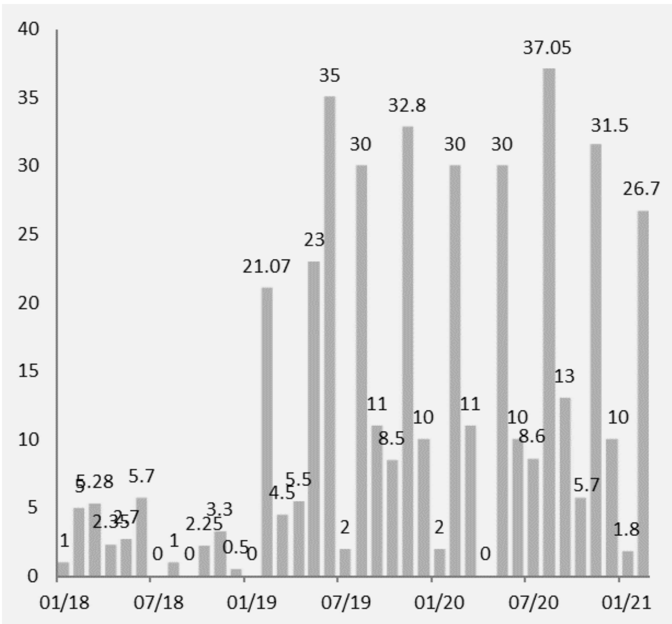
Source: Bloomberg

CNH & CNY China Sovereign Curve (%, 26 February 2021)



Source: Bloomberg

Hong Kong Offshore RMB Bond Issuance (RMB bn)

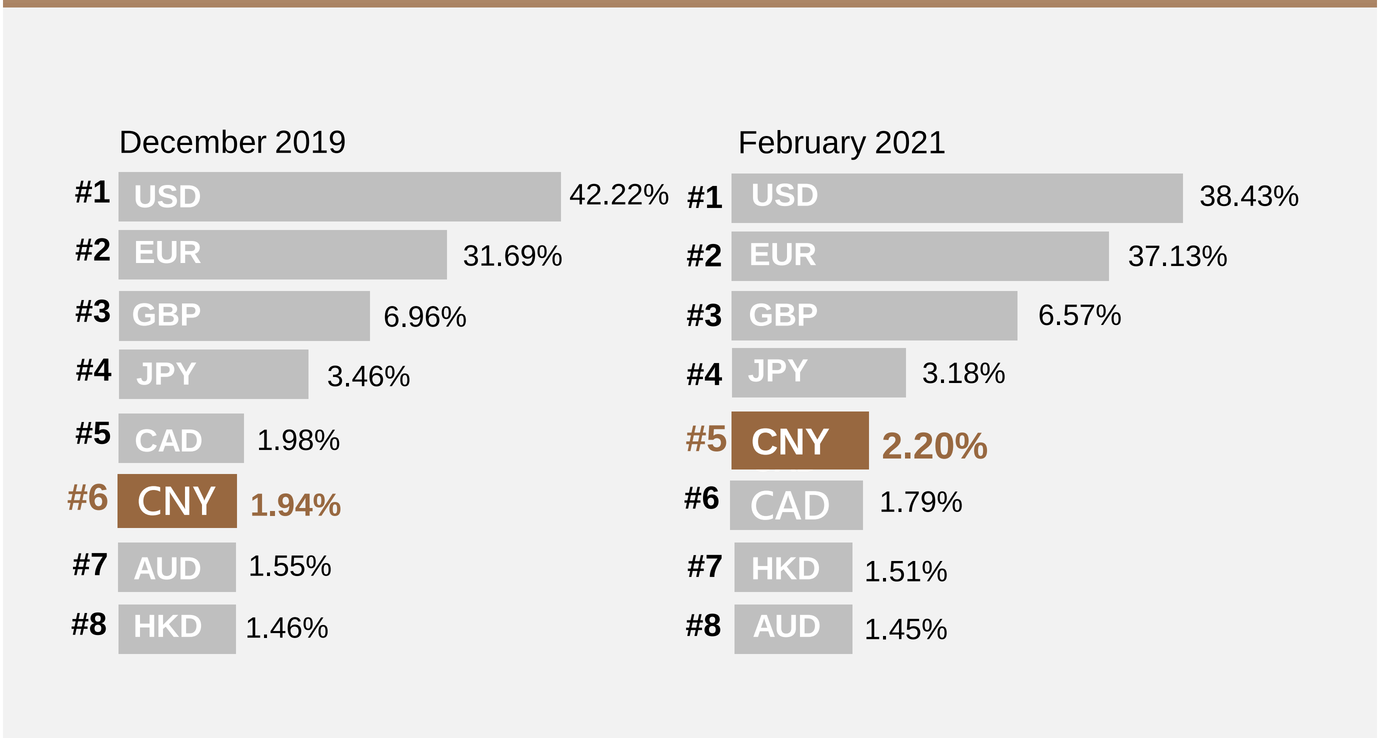


Source: BOCHK Global Market estimate

RMB Clearing Transaction Value (RMB tn)

Source: HKICL

SWIFT World payments currency ranking & market share



Source: SWIFT

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