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The offshore RMB market maintains robust performance

RMB exchange rate remained in a narrow two-way fluctuation pattern in March. Major offshore RMB business indicators decreased due to seasonal factors. In terms of bond market, FTSE Russell confirmed China Government Bonds to join WGBI index in October, which will be phased in over 36 months and expected given China a 5.25% weighting. The inclusion of China Government Bonds will further encourage capital inflow to China bond market and support RMB exchange rates. Bond Connect activities remained robust, with daily trading volume amounted to RMB 24.8 billion. PBOC issued RMB 5 billion of central bank bills in Hong Kong, and the issuance was well-received by investors in the offshore markets. RMB share of global currency reserves reached a record high, increasing for 8 consecutive quarters.

I. RMB exchange rate remained in narrow two-way fluctuation in March

CNH remained in narrow two-way fluctuation around 6.5 in March. DXY index rose sharply in the beginning of the month, which caused CNH to drop below 6.5, a new low since 2021, mainly due to third wave of virus outbreak in Europe. CNH then rose a few consecutive trading days to 6.47. In late March. US weekly jobless claims reached one-year low, consumer confidence index hit one-year high, and new stimulus package caused DXY index to reach 92.9, a four-months high, and caused CNH to weaken to 6.55. As of March 31, the RMB's central parity rate against the USD closed at 6.5713, down 1.5% MoM, down 1.9% compared to beginning of the year. CNY closed at 6.5539, down 1.2% MoM, down 1.4% compared to beginning of the year. CNH closed at 6.5681,

down 1.3% MoM, down 1.7% compared to beginning of the year.

Under the circumstances of US economic recovery coming after China's economic recovery, RMB's recent strong trend may weaken if US treasury yields continue to rise and the rebound of DXY index continue. It is worth noting that although CNH depreciated 0.4% against USD YTD, CNH remain strong when comparing with other countries (appreciated 4% or above against JPY and CHF), as the China economy recovers from Covid-19 quicker than other countries. In the medium term, demand on RMB settlements from trades would increase when the world economies gradually recover, also FTSE Russell confirms China Government Bonds to join WGBI index in October, which would provide certain level of support to the RMB exchange rates, we expect RMB exchange

rates to remain in two-way fluctuation, with possible increase in volatility.

Regarding the CNHHIBOR, as of March 31, the O/N, 1-week and 3-month CNH HIBOR rates were 4.1503%, 3.0011% and 3.1757% respectively.

II. Major offshore RMB business indicators decreased due to seasonal factors

Major offshore RMB business indicators decreased due to seasonal factors. According to HKMA, as of the end of February 2021, Hong Kong's RMB deposits reached RMB 761 billion, above RMB 700 billion for 4 consecutive months, but a decrease of 4.6% compared to beginning of the year. Hong Kong's RMB loans balance was RMB 159 billion, remaining flat compared to beginning of the year. According to PBOC, RMB cross-border trade settlement was RMB 441.1 billion in February, down by 24.1% compared to beginning of the year. According to HKICL, RTGS turnover was RMB 35.5 trillion in March 2021, up by 40% compared to last month, up by 17.1% compared to beginning of the year. As of March 2021, dim sum bond issuance amounted to RMB 35.75 billion.

According to a SWIFT report in February 2021, the RMB was the fifth most active currency for domestic and international payments by value, with a share of 2.2%,

behind USD (38.43%), EUR (37.13%), GBP (6.57%) and JPY (3.18%). Due to Chinese holidays, RMB payments value decreased by 13% compared to the previous month, while in general all payment currencies decreased by 4.2%.

III. FTSE Russell confirms China Government Bonds to join WGBI index in October. Bond Connect activities remained robust

US treasury yield rose in March, some foreign investors changed to US bonds, slowing down foreign investors' increasing holdings in China Government bonds. According to China Bond data, as of March 2021, foreign holdings in Chinese Government bonds reached RMB 2.04 trillion, decreasing around RMB 16.51 billion within the month. The US-China interest rates spread may continue to narrow, causing fluctuation in capital inflow. On March 29, FTSE Russell gave final approval for inclusion of China Government Bonds in its flagship bond index (WGBI) from Oct, 2021, which will be phased in over 36 months and expected given China's 5.25% weighting. WGBI covers bonds from over 20 countries, where Japan (over 17%) constitutes the highest shares among Asian countries, and UK's constitutes 5.48%. The inclusion of China Government Bonds will further encourage capital inflow to China bond market and support RMB exchange rates.

Bond Connect trading remained active in March, and trading tickets totalled 6723, while trading volume and average daily turnover reached RMB 570.3 billion and RMB 24.8 billion respectively. Chinese government bonds and policy financial bonds are investors' major focus, accounting for 42% and 38% of monthly trading volume respectively. In the same month, the scheme welcomed 27 new investors, and expanded its coverage to 34 jurisdictions across the globe with 2,450 global institutional investors, including 76 of the top 100 global asset management companies.

IV. RMB share of global currency reserves reached the highest since 2016

According to the latest statistics released by the International Monetary Fund (IMF), by the end of the fourth quarter, reserves held in RMB increased to USD 267.52 billion, or 2.25% of allocated reserves, increasing 8 consecutive quarters and reached record highs.

As of today, USD is still the largest reserve currency, with its share of global currency reserves falling 3 consecutive quarters to 59.02% of allocated reserves, due to USD depreciation. However, it remains uncertain whether RMB share of global currency reserves will continue to rise. In 1Q 2021, US treasury yield remained high, the DXY index rebounded and the RMB exchange rates weakened as a result, which may indicate a rebound in USD share of global reserves and a fall in RMB's share.

China pilots cash-pooling service integrating local, foreign currency management

On March 12, the People's Bank of China (PBOC) and the State Administration of Foreign Exchange (SAFE) announced the launch of a pilot cash-pooling service for multinational companies that integrates domestic and foreign currency management in Shenzhen and Beijing to further facilitate the use of cross-border capital. The cash-pooling service will unify domestic and foreign currency management policies and allow multinationals to purchase foreign exchange at will within a certain limit, noting that the purchased funds can be deposited in the domestic primary account for external payment. The pilot program will also implement two-way macro-prudential management to improve the autonomy and capital efficiency of cross-border financing on the basis of steady and prudent operation, further facilitate the transfer and use of funds, and enhance operational and post-operational oversight.

PBOC issues RMB5 billion central bank bills in Hong Kong

On March 25, PBOC issued RMB5 billion six-month central bank bills in Hong Kong, with interest rates standing at 2.6%, 10 basis points less than last time. The issuance was well-received by investors in the offshore markets, with the total bid amount reaching about RMB25 billion, five times the amount in circulation.

ISDA and CCDC: Use of RMB Bonds as Margin for Derivatives Transactions

On March 25, the China Central Depository & Clearing Co., Ltd. and ISDA published a whitepaper —Use of RMB-denominated Chinese Government Bonds as Margin for Derivatives Transactions, that analyses the feasibility, challenges, prospects and suggestions relating to use of RMB bonds as initial margin.

Measures unveiled to relax Hainan market access

China rolled out 22 measures on April 8 aimed at further relaxing market access in the Hainan Free Trade Port, to facilitate the free flow of key production factors and cultivate industries with comparative advantages internationally, according to a document jointly released by the National Development and Reform Commission and the Ministry of Commerce. New measures include supporting online sales of prescription drugs, helping the island develop an online games sector, exploring the delegation of the approval of online games to Hainan, supporting Hainan in building charging stations for new energy vehicles and pressing ahead with autonomous driving technologies and boosting the innovative development of homegrown high-end medical equipment.

China interbank market launched CDS index

On April 8, the China Foreign Exchange Trading System (CFETS) and the Shanghai Clearing House (SCH) jointly issued a notice, launching trading and clearing services for China's first credit default swap (CDS). This marks the further expansion of the credit derivatives products, improving risk management for institutions selling CDS in the market.



A Unique Practice Of Currency Internationalization — The Roadmap Of RMB Internationalization Under The ‘Dual Circulation’ Strategy

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Ding Meng, Economist

With the global economic recession led by Covid-19, economic powers are shifting to emerging markets. The containment measures have plunged international trade and investment into deep contraction, but the supply chain restarted at an accelerated pace. While the profit-driven nature of investment decisions dominated the global market layout, expansionary policy and hot money could create a potential “financial market turmoil”. From a macro perspective, protectionism can play out in the long term, but the trend of globalization will not come to the end.

In the face of the changing global economic and financial landscape, the 14th Five-Year Plan proposes to form a “dual circulation” development pattern in which domestic economic cycles play a leading role while international economic cycle remains its extension and supplement. With the further opening up of financial markets, it is of great theoretical and practical significance to explore a new development path of RMB internationalization.

I. A brief history of international currencies development and

summary of the unique path of RMB internationalization

Looking back at history, the process of GBP and USD internationalization was mainly accompanied by the growth of domestic economic and political power, which was formed spontaneously through the market. The characteristics of JPY internationalization was driven by foreign trades and policies, and the development was promoted through regional currency cooperation.

The internationalization of RMB has followed a unique development path that is different from USD, EUR and JPY. More embodied in the internationalization of credit currency, the internationalization of RMB is the result of policy and market driven. In the post-Covid era, China's economy and trade investment will continue to increase, and will continue to promote the use of RMB in international markets.

E Zhihuan (2015) proposed the three major factors that determine the prospects of RMB internationalization, including the size of the real economy, the extent of foreign trade, and

investment links; the depth and breadth of the financial market system can provide efficient and low-cost trading environment with sufficient liquidity for the use of RMB and international market confidence in RMB assets.

II. RMB internationalization is the result of policy and markets

Beginning from the RMB trade settlement pilot in 2009, relevant departments have successively loosened policy constraints on RMB business, introducing a series of measures to promote the development of the offshore bond market, promoted internal business needs, and basically formed an offshore RMB product and service system. In 2016, RMB joined the SDR, started a three steps process of internationalization from trade media, investment tools to reserve currencies, and started the development of international reserve currencies diversification. After that, the RMB internationalization policy gradually gave way to market development. Factors such as the exchange rates and capital flows gradually increased the impact of RMB internationalization, and RMB internationalization showed a market-led characteristic.

The cross-border use of RMB under trade in goods is the basis for RMB internationalization. According to SWIFT statistics, in November 2014, RMB accounted for a historical high of 2.45% in international payment currencies, surpassing the ranking of JPY. Global RMB payment accounted for 1.67% at the end of December 2016, falling from 2.31% in December 2015, and in February 2021, the proportion was 2.2%. At present, the policies regarding cross-border use of RMB in the trade sector is completely liberalized, and the market is adjusted according to changes in the RMB exchange rates and capital flows. Cross-border trade is still the substantive foundation for continuing promotion of RMB internationalization.

In March 2017, the International Monetary Fund (IMF) released the official foreign exchange reserve currency composition (COFER) report, which separately listed the holdings of RMB foreign exchange reserves for the first time. In the third quarter of that year, the scale of RMB foreign exchange reserves was USD 107.94 billion, accounting for 1.12% of the total allocated foreign exchange reserves. The proportion of RMB foreign exchange reserves rose to 2.13% in the third quarter of 2020.

III. The offshore market is an early promoter and full-cycle participant of RMB internationalization

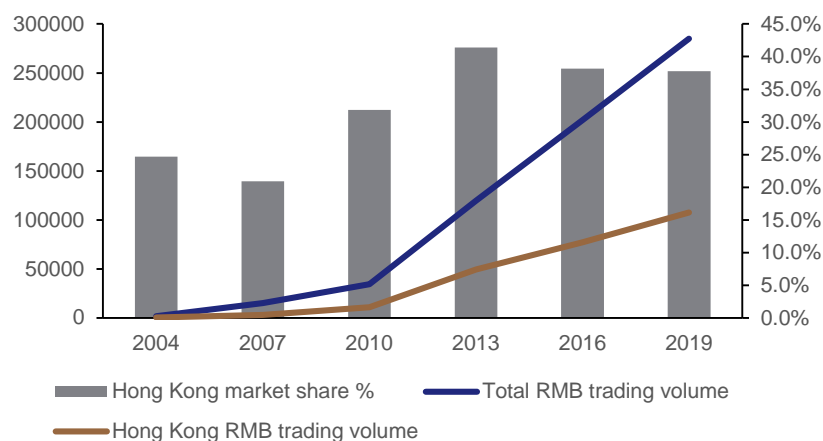
From the perspective of currency internationalization theory, the offshore market is uniquely important for promoting currency internationalization. The internationalization of USD has largely benefited from the depth and breadth of the London USD offshore market. After the introduction of the EUR, the London EUR offshore market has also developed rapidly, providing new impetus for the internationalization of the EUR. On the contrary, the JPY lacked support in the offshore market, which restricted its ability to develop internationally.

Offshore financial centers play an important role for foreign exchange transactions. According to the triennial foreign exchange survey report issued by the Bank for International Settlements in 2019 and the semi-annual foreign exchange market report issued by the Bank of England, London is still the world's largest foreign exchange trading center and the most important foreign exchange market for USD and other currency pairs. As of April 2019, London's foreign exchange transactions accounted for 43% of the total global foreign exchange transactions, nearly three times higher than the 16.5% in New York, the United States.

The offshore market is an early promoter and full-cycle participant in the internationalization of RMB. It has accumulated first-mover and scale advantages through cross-border transactions in trades and investments. Hong Kong has the first offshore RMB clearing system and a leading scale of RMB capital pool, with accelerating growth in RMB foreign exchanges market, and increasingly diversified RMB products scope. According to statistics from the Bank for International Settlements (BIS), the average daily turnover of RMB foreign exchange transactions in Hong Kong in 2019 was USD 107.6 billion, an increase of 39.6% from the survey three years ago, accounting for 37.8% of the global RMB foreign exchange transactions, exceeding London's USD 56.7 billion and Singapore's USD 41.5 billion.

The full convertibility of the capital account and the cultivation of foreign investors to freely participate in the domestic financial market are still crucial to the development of RMB internationalization. However, the control of financial risks cannot be ignored in the process. Therefore, considering the background that financial risks in the Hong Kong offshore market can be relatively isolated from the mainland market, it is a reasonable policy decision to further promote RMB internationalization by satisfying conditions under the capital account.

Figure 1: Global and Hong Kong RMB trading volume (USD mn)



Source: BIS, BOCHK Financial Research Institute

IV. RMB internationalization and the RMB exchange rates marketization complement each other

There are two levels of relationship between the RMB exchange rates and RMB internationalization. One is the relationship between the elasticity of the RMB exchange rates and the internationalization of the RMB, and the other is the impact of the exchange rates difference between the offshore and the onshore RMB markets on the internationalization of the RMB.

As RMB internationalization develops, elasticity of the RMB exchange rates have gradually increased, maintaining basic stability against a basket of currencies, showing two-way expectations and fluctuations against the USD, while the degree of marketization determined by the RMB exchange rates has further increased.

In the process of global financial turmoil triggered by the pandemic, the RMB exchange rates were more stable than other currencies, entering a rebound period after a short period of depreciation. The foreign exchange market gradually got rid of the psychological barriers of maintaining the RMB exchange rates or breaking a certain price level, and increased the resilience while maintaining the elasticity of exchange rates.

In the area of exchange rates pricing, as a regional international currency, the role of RMB in the reference basket of exchange rate pricing in ASEAN countries is increasing. The exchange rate is the result of market transactions and can best reflect market supply and demand. The role of RMB as the exchange rate pricing reference anchor is a comprehensive reflection of RMB's use as an international currency in the region in multiple areas such as payments, reserves and investments, etc.

By using a method similar to Jeffrey A. Frankel & Shang-Jin Wei (1994), which interpreted changes in ASEAN countries exchange rates compared to changes in JPY exchange rate, assuming RMB as the currency-pegged basket member by ASEAN countries currencies, we tested using the monthly average exchange rate data from January 2010 to June 2020. The result showed statistically significance in the RMB real exchange rate changes to the Brunei dollar, Indonesian rupiah, Lao kip, Malaysian ringgit, Singapore dollar, Thai baht, and Philippine peso. As the RCEP further deepens the degree of economic integration in the region, trade competition and cooperation between China and ASEAN countries will continue to increase. It is expected that ASEAN countries currencies will include RMB in the reference basket

measuring their currencies changes more frequently, and it will be easier to achieve breakthroughs RMB internationalization in the ASEAN region.

V. The roadmap of RMB internationalization under the context of currency competition and “dual circulation” strategy

While the world economy has entered into post-pandemic era, with major economies relying on expansionary policy to stimulate the economy and international trade and investment not yet back at normal state, China is facing an increasingly complex international environment. Therefore, we should explore a new roadmap of RMB internationalization, providing strong impetus to external circulation of Chinese economy.

Table 1: Summary of the regression analysis results of changes in ASEAN real exchange rates against changes in RMB real exchange rate and USD real exchange rate

	Constant term	RMB	USD	R-squared
BND	0.0008	0.3924	-0.0643	0.155
IDR	-0.0031	0.4312	0.3459	0.105
LAK	-0.0005	0.1089	0.8716	0.835
MYR	-0.0011	0.7561	-0.2969	0.143
SGD	0.0008	0.3983	-0.0606	0.161
THB	0.0008	0.4278	0.239	0.189
PHP	-0.0002	0.1964	0.5395	0.267
VND	-0.0021	0.0379	1.0213	0.669
KHR	0.0001	0.0767	0.9705	0.734
MMK	-0.0114	0.2851	0.2257	0.002

Note : Coefficients in red are with greater than 90% statistical significance greater than 90%.

Source: CEIC, BOCHK Financial Research Institute

1. Steadily expand international use of RMB, supporting external circulation of China's economy

From the perspective of “dual circulation” strategy, currency/monetary policy is the key link between external and internal circulation of an economy. On the one hand, through interest rate channel/transmission mechanism, monetary policy achieves prudent capital allocation and price discovery to provide financial support to the internal circulation of the real economy. On the other hand, through the exchange rate fluctuation, monetary policy mitigates the external effects to the economy to some extent, providing a relatively stable operating environment for the internal circulation, and connecting the internal and external circulation through trade and capital flow channels. More importantly, if a national currency functions as an international currency, it will help expand the external circulation of the country's economy, and strengthen its capacity of global financial governance. For China, it is of particular importance to promote international use of RMB and maintain its standing in the international monetary system, which would offer China many advantages, such as serving as key pillars of improving its international influence in global financial governance.

2. Enhance the functions of RMB as an international currency and increase the global acceptance of RMB financial assets.

Foreign central banks have been increasingly willing to hold RMB reserves in recent years. At present, more than 60 central banks and monetary authorities around the world have included the RMB in their foreign exchange reserves, developing the function of the RMB as an international reserve currency.

To enhance the functions of RMB as an international currency is an important part of long-term development of RMB internationalization. With increased holding of RMB assets by overseas investors, major RMB business indicators grew in terms of cross border RMB settlement, offshore RMB clearing, deposits and loans, as well as dim sum bond issuance. China should seize this opportunity to expand the use of the renminbi in the commodity pricing and trading, leveraging RMB denominated oil futures contracts to promote the development of the commodity industry and financial service in a coordinated way, which can well cushion external shocks of global commodity price fluctuation and improve the china's capacity to ensure energy security.

3. Gradually develop RMB as a new safe-haven currency and a new option for reserve assets.

With increased elasticity, the RMB exchange rate remained robust among the major currencies. In recent years, the RMB exchange rate has gone through ups and downs, forming a pattern of two-way fluctuations and maintaining a strong elasticity. Market supply and demand plays a decisive role in exchange rate formation, and market expectation of the RMB exchange rate is more rational and moderately different, with no unified one-way expectations of appreciation or depreciation, which will continue to strengthen market confidence of RMB financial assets.

In the global economic recession, the RMB exchange rate remained robust among the major currencies with increased elasticity and generally staying stable at a reasonable, balanced level. Therefore, in the post-epidemic era, we should gradually build the risk-hedging function of RMB as a strong support for the international use of RMB.

4. Establish local currency settlement system in key regions and deepen economic cooperation along Belt & Road routes

Under the impact of Sino-US trade frictions, China's foreign trade has entered into

reconstruction period. Southeast Asia markets, as the key area along Belt & Road routes, and the target market of Chinese going-out enterprises, are in desperate needs for diversified financial services in RMB and other regional currencies. The internationalization of the RMB in Southeast Asia provides timely help in this situation as "fuel in snowy weather", rather than "icing on the cake". In addition, the physical connection and cultural aspects of the "Belt & Road" will elevate the real demand and potential for economic development.

5. Strengthen the construction of RMB financial infrastructure, and contribute to the last mile of RMB connectivity

In the post-epidemic era, we should continue to optimize the operation of the CIPS and supporting facilities, in order to enhance the efficiency of cross-border fund transfer providing liquidity supports for RMB in foreign exchange and commodity future trading. It can be also considered to encourage foreign countries to establish local RMB clearing systems, and connect with CIPS. It's beneficial to attract more overseas investors participating RMB financing, investment and trading, provide strong support for the internationalization of the RMB.

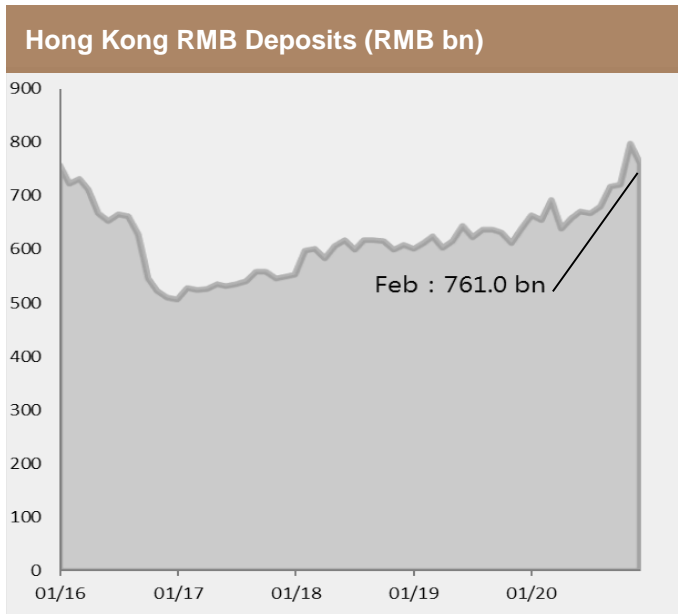
6. Give full play to the first-mover advantage of the offshore markets, and promote the use of RMB in key areas such as Belt & Road

It is suggested to promote extensive cooperation between onshore and offshore financial markets. On one hand, giving full play to the advantages of offshore markets such as superior financial infrastructure, to attract more foreign capital investment by providing international investors with comprehensive offshore RMB products such as funds, insurance and MCB deposits, and further develop the width and depth of offshore RMB markets. On the other hand, actively cooperate with offshore markets and support the opening-up and international interconnectivity of the onshore market. The use of RMB by multinational enterprises and overseas institutions has been improving in recent years. But the USD and EUR are still the main settlement currency in the global market, especially in southeast Asia. It is necessary to strengthen the cultivation of local RMB markets in ASEAN, and promote RMB as a key currency along Belt & Road, by carrying out various RMB educational and promotional activities through local RMB clearing banks, Chinese banks, enterprises and industry associations, with participation from local central banks and business clients, as well as PBOC if conditions permit.

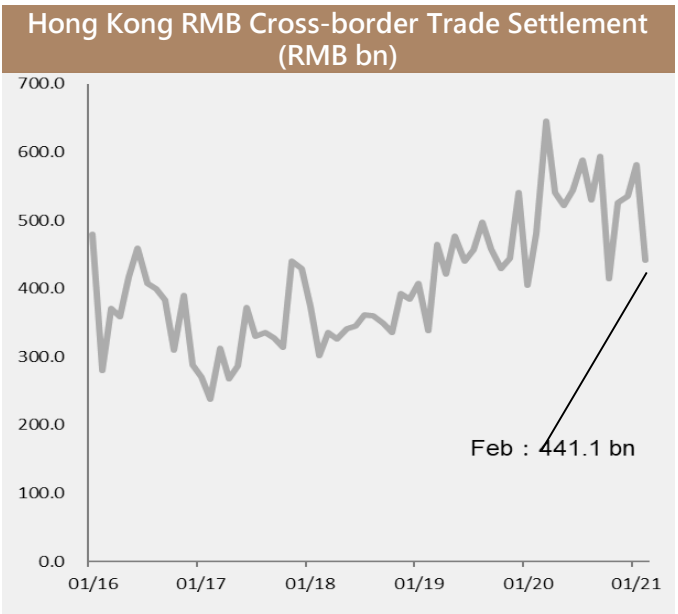
In summary, even though it's easier said than done, RMB internationalization has a long way to go. Under a "dual circulation" development pattern, we should expand the use of RMB in trade and investment with countries in ASEAN and "Belt & Road" area as breakthrough, enrich offshore RMB products utilizing the Hong Kong's role as the offshore RMB hub and global financial centre, strengthen interconnectivity cooperation between onshore and offshore capital markets within Great Bay Area, and further enhance the international role of the RMB to reflect China's emergence as a global economic power.



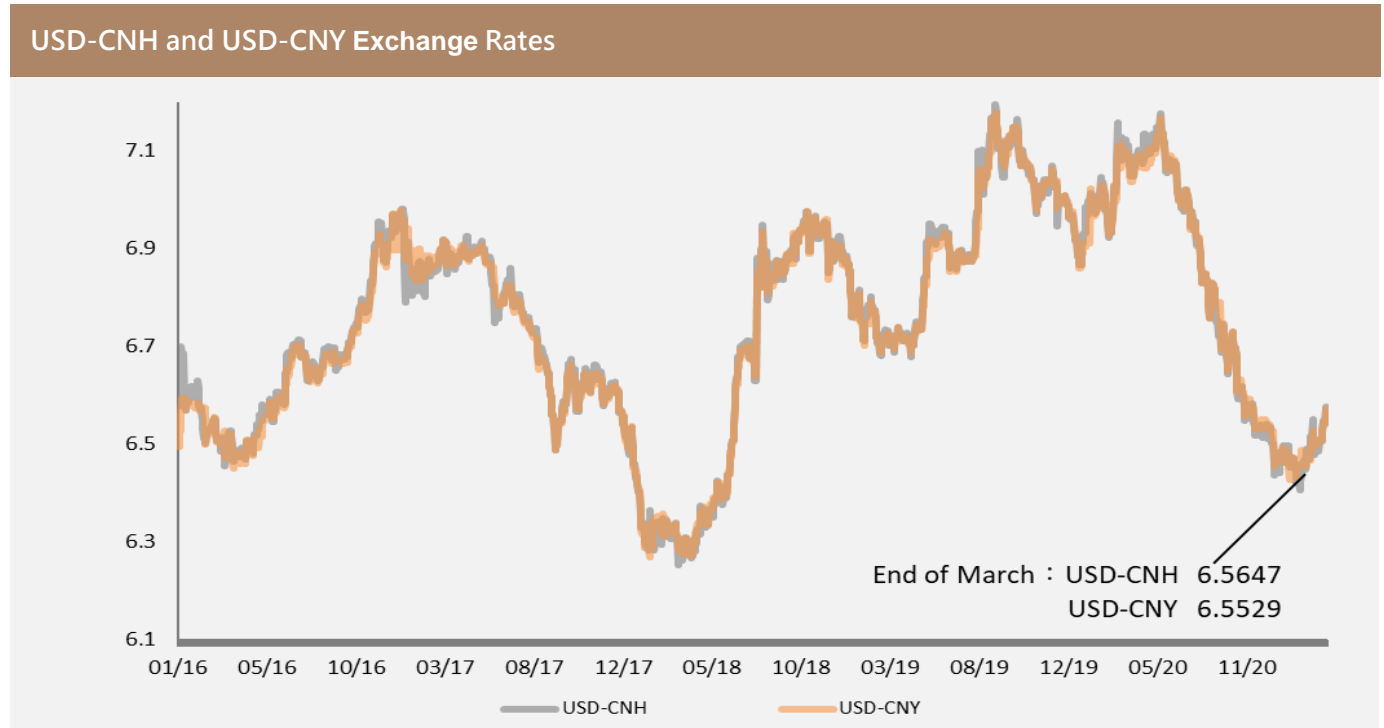
Market Indicators



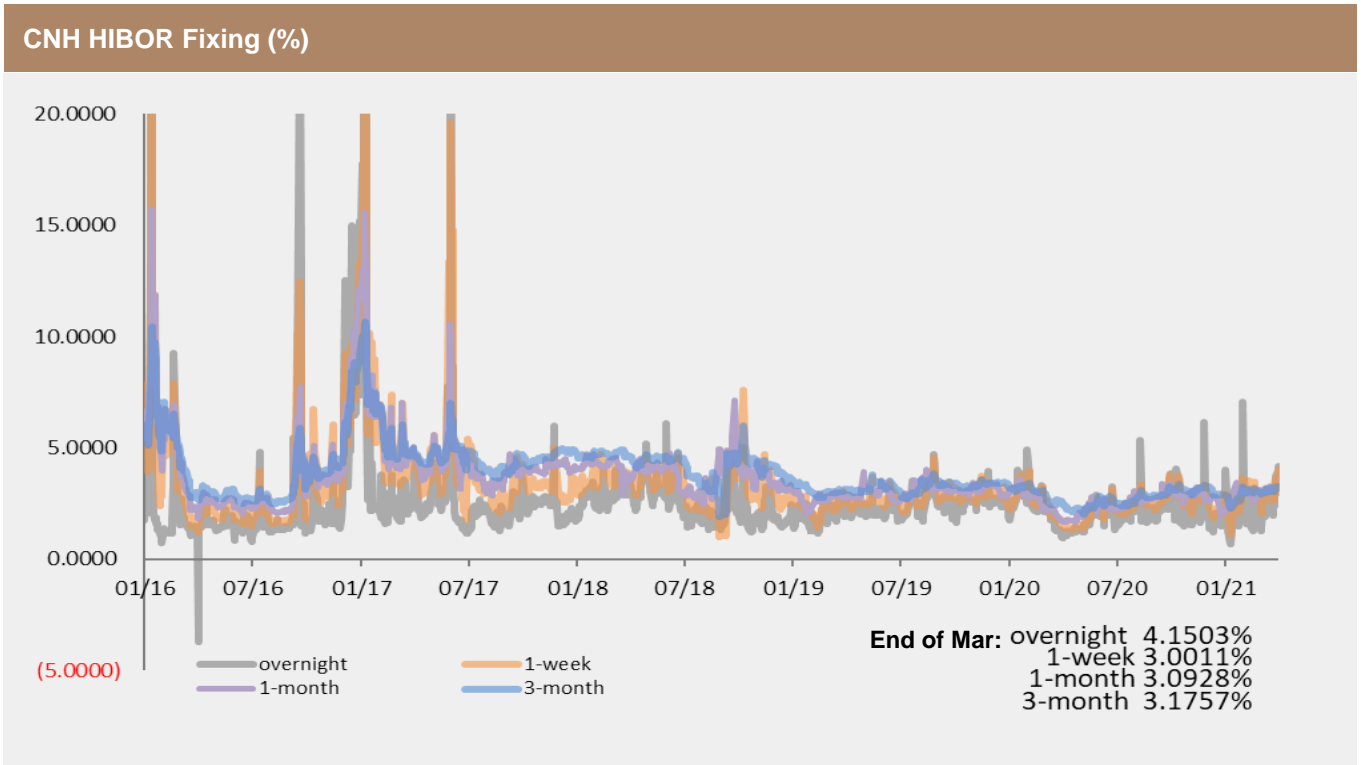
Source: HKMA



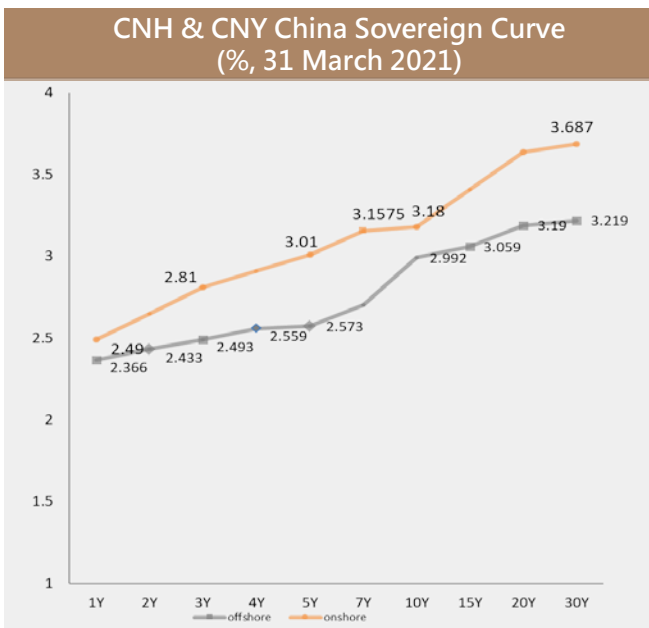
Source: HKMA



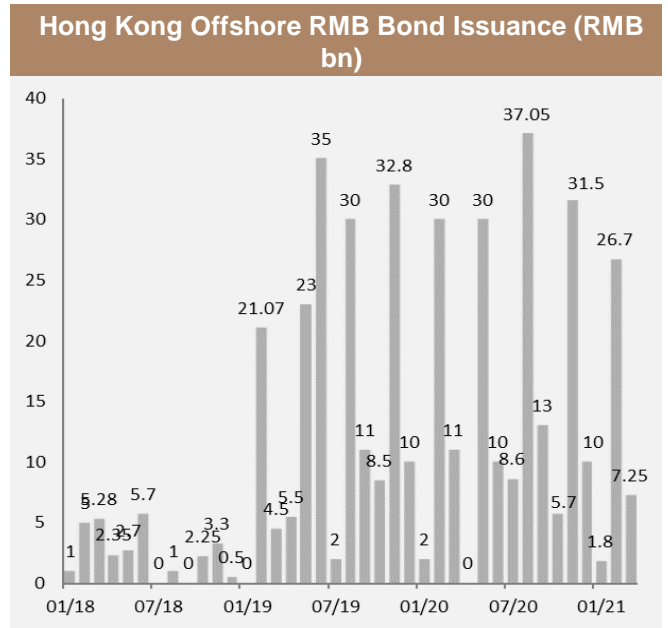
Source: Bloomberg



Source: Bloomberg

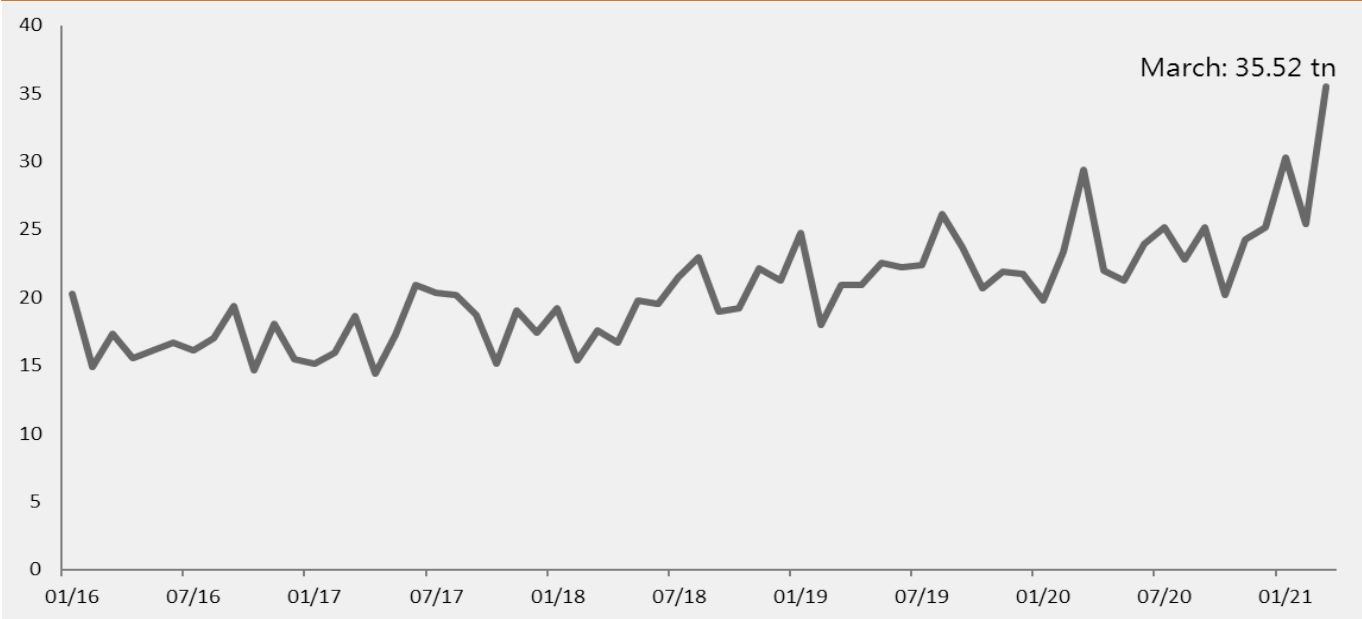


Source: Bloomberg



Source: BOCHK Global Market estimate

RMB Clearing Transaction Value (RMB tn)



Source: HKICL

SWIFT World payments currency ranking & market share

December 2019		February 2021	
#1	USD 42.22%	#1	USD 38.43%
#2	EUR 31.69%	#2	EUR 37.13%
#3	GBP 6.96%	#3	GBP 6.57%
#4	JPY 3.46%	#4	JPY 3.18%
#5	CAD 1.98%	#5	CNY 2.20%
#6	CNY 1.94%	#6	CAD 1.79%
#7	AUD 1.55%	#7	HKD 1.51%
#8	HKD 1.46%	#8	AUD 1.45%

Source: SWIFT



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