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RMB international payment share hit historical high, International status steadily improved

In January, offshore RMB had a strong performance, with key indicators continuing to grow. RMB deposits hit a 6.5 year high to RMB 900 billion at the end of 2021; RMB loans fell from the high in the second half of the year. RMB global payment ranked fourth for the second consecutive month and set a record high at 2.79% since 2015. In the bond market, foreign institutional investors bought a net 141.3 billion; Trading volume of Northbound Bond Connect were growing steadily, with a daily average of over RMB 41.1 billion.

I. Offshore RMB performed strongly

The strong performance of the offshore RMB persisted in January, trading in a narrow range of 6.33 to 6.37 during the month, significantly stronger over the last month. The yuan hovered around 6.38 at the start of the month, and gradually strengthened to 6.33 then pulled back to 6.36 by the end of the month. The Dollar index rose during the month, hitting a 97 high at the end of the month. The rise on Dollar index was mainly due to the US Fed saying their asset purchase scheme will end by the end of March and they will start rising rate and trim its balance sheet soon after rate hike. On 28 January, the central parity rate of RMB

against US dollar published by CFETS was 6.3746, an increase of about 0.08% from the beginning of the year; The CNY closed at 6.3613 that day, up 0.08% from the beginning of the year. The CNH closed at 6.3707, down 0.21% MoM but up 1.42% since the beginning of the year.

The RMB strengthened in January, mainly due to seasonal FX demand and favorable economic data. The trade surplus reached USD 94.463 billion, and the net inflow of Stock Connect reached a record high. In addition, seasonal factors were also key factors affecting the further strengthening of RMB as companies generally need to pay wages and bonuses before the Chinese New Year, so, the demand of RMB was high.

In addition, seasonal factors were also key factors affecting the further strengthening of RMB as companies generally need to pay wages and bonuses before the Chinese New Year, so, the demand of RMB was high. Moreover, with the hawkish US Fed and a falling stock market, RMB was still appreciating, showing that international investors were optimistic about the Chinese Market. Also, the stabilized FX flow and trading in China made RMB assets more attractive and stabilized RMB in response to US Fed's rate hike. In short-term, RMB might be affected by geopolitical conflict and US Fed's rate hike. Looking ahead, considering the global pandemic still imposed uncertainty to the world, China's "zero" policy can protect the real economy.

Regarding offshore RMB liquidity, as of January 31, the overnight and 1-week CNH Hibor rates were 2.511% and 3.012% respectively; the 1-month CNH Hibor rate stood at 2.9535%; and the 3-month CNH HIBOR rate was 2.89067%.

II. Review of major offshore RMB business indicators

Offshore RMB business indicators remained growing. According to HKMA, as of the end of December 2021, Hong Kong's RMB deposits reached RMB 926.8 billion, up 6.7%

MoM and 28.4% YoY, reaching a 6.5 year high. In 2021, monthly average of RMB deposit was RMB 825.4 billion, up 23.5% compared to 2020. Hong Kong's RMB loans was RMB 163.58 billion, down 13% MoM and up 7.6% YoY. The total remittance of renminbi for cross-border trade settlement amounted to RMB498.7 billion in October, up 20.4% YoY. The annual total remittance of renminbi for cross-border trade settlement amounted to RMB 7,083.6 billion in 2021, up 12% compared to 2020. According to HKICL, RMB RTGS turnover was RMB 40.11 trillion in January 2022, up 32.3% YoY. According to Bloomberg, offshore RMB bond issuance amounted to RMB 2.237 billion at the end of January 2022, up 24.3% MoM.

According to SWIFT report in January 2021, the RMB has retained its position as the fourth most active currency for global payments by value, with a share of 3.2%, behind USD (39.92%), EUR (36.56%), and GBP (6.3%). Overall, RMB payments value increased by 10.85% compared to December 2021. Whilst in general all payments currencies decreased by 6.48%. A number of factors affected the increase of RMB in global payment, including better Covid prevention, economic fundamental, increase in global import and export, stabilised RMB, RMB internationalisation.

III. Investing in China's Interbank Bond Market

According to the latest interbank bond market data released by the CFETS data, foreign institutional investors bought 783.2 billion yuan of bonds and sold 641.9 billion yuan of bonds, giving a net purchase of 141.3 billion yuan in January 2022, up 36.5% MoM. Among them, 644.4 billion yuan of bonds was traded through settlement agency mode, with net purchase of 136.1 billion yuan, doubling from the previous month; 780.7 billion yuan of bonds was traded through Bond Connect mode, with a net purchase of 5.2 billion yuan.

By end of Jan 2022, based on the calculation of legal entities, 508 and 734 foreign institutional investors entered the market through the settlement agent model and the Bond Connect respectively, up 1 and 7 in the month. From the perspective of investor structure, overseas commercial banks and overseas securities companies are relatively active. Foreign institutions still prefer investing in policy bonds, government bonds, interbank certificates of deposit (NCD) and other bonds with relatively good liquidity. The trading volume of these three types of bonds accounted for 27%, 59% and 12% respectively, making 98% in total. From the perspective of investor structure, overseas

commercial banks, overseas securities companies and overseas product transactions are relatively active. Foreign institutions still prefer policy-based financial bonds, national bonds, interbank certificates of deposit (NCD) and other bonds with good liquidity. The trading volume of these three types of bonds accounted for 27%, 59% and 12%, accounting for 98% in total. The outstanding maturity of bonds actively traded by foreign institutional investors is mainly in less than one year, 1-3 years, 3-5 years and 7-10 years, with its trading volume accounting for 39%, 13%, 15% and 26% respectively.

Up to date, more than 50 institutions participated in Southbound Bond Connect trading. In November, onshore investors traded foreign corporate bonds, government bonds and others in CNH, USD and HKD.

Trading under Bond Connect remained active in Jan 2022. Average daily turnover under Northbound Bond Connect reached 41.1 billion yuan, up 58% MoM, and monthly trading volume accumulated to 7809.7 billion yuan, up 30.5% MoM. With 79 new joiners in the month, Northbound Bond Connect expanded its coverage to 36 jurisdictions across the globe with 3312 foreign institutional investors, including 78 of the top 100 global asset management companies.

According to the latest data from the PBOC Shanghai Headquarter, the outstanding bonds held by overseas institutional investors reached 4.07 trillion yuan as of the end of Jan 2022, accounting for 3.5% of the total. The proportion of foreign capital in China's bond market is still lower than that of developed economies such as Japan and South Korea, showing great potential for foreign funds to increase allocation of RMB assets in the future.



SAFE and PBoC Issue New Rules Concerning the Overseas Loan Business of Banking Financial Institutions

On January 29, the PBoC and the SAFE jointly issued the Notice on Matters related to Overseas Loan Business of Banking Sector (hereinafter referred to as the Notice). The main contents of the Notice include: 1. To establish a policy framework for banks' overseas loans integrating domestic and foreign currencies, bring banks' offshore RMB and foreign exchange loans into unified management, expand the scope of banks' overseas RMB loan business, and facilitate the use of RMB in banks' overseas loan business. 2. To bring cross-border capital flows related to banks' overseas loans into the macro-prudential policy framework. 3. To clarify the requirements for banks to handle overseas loans and relevant use of cross-border funds, to effectively prevent risks. The Notice will take effect from March 1, 2022.

China Issues Opinions to ease market access in Shenzhen

On January 26, the National Development and Reform Commission (NDRC) and the Ministry of Commerce jointly issued *Opinions on some Special Measures to ease market access in Shenzhen to Build a Pilot Demonstration Zone for Socialism with Chinese Characteristics*. The main contents of the Opinions can be summarized as "6+24". "6" refers to sectors including the application of advanced technologies, financial investment, medicine and health, education and culture, transportation etc., where market access is ready to be eased and market participants have a strong willingness to enter. "24" refers to 24 specific measures. In the financial sector, four measures specify that Shenzhen will step up financial support capacity in underpinning agricultural supply chains, promote mutual market access of insurance business between Shenzhen, Hong Kong and Macao, improve the convenience of cross-border trade settlements, and enhance the market environment for infrastructure REITs.

Interbank Bond Market and Exchange-traded Bond Market Jointly Issue Supporting Measures for Connectivity

On January 20, the Shanghai Stock Exchange (SSE), the Shenzhen Stock Exchange (SZSE), National Interbank Funding Center (NIFC), China Securities Depository and Clearing Co., Ltd. (CSDC), and Interbank Market Clearing House Co., Ltd. (Shanghai Clearing House) jointly issued the Interim Measures for the Connectivity Business between the Interbank Bond Market and the Exchange-traded Bond Market (hereinafter referred to as the "interim measures").

According to the Interim Measures, the Connectivity has been designed to realize order routing and nominal holding through front-end and back-end infrastructure connections on the basis of respecting the existing listing and floating modes, existing account systems and transaction settlement rules of the two markets, with the connectivity including the "Interbank-bound Connect" and the "Exchange-bound Connect". Therefore, institutional investors in the exchange-traded bond market and the participants in the interbank bond market will be entitled to "one-click access" without the need to open accounts on both sides or change their routine, thus facilitating the participation in the subscription and trading of cash bonds in the other side's market.

PBoC Solicits Opinions on Supporting Cross-border RMB Settlement in New Forms of Foreign Trade

On January 7, the PBoC published a draft notice on supporting cross-border RMB settlement in new forms of foreign trade (hereinafter referred to as the Draft Notice) to solicit public comments. The draft notice mainly includes three aspects: First, the scope of payment institutions' business will be expanded from trade in goods and service to current accounts. Second, it clarified the business and filing requirements for banks, payment institutions and other relevant business entities. Third, it makes clear the requirements for authenticity verification of the business and data submission etc., in order to make banks and payment institutions fulfil their due diligence responsibilities in carrying out the above business, prevent and control potential risks.



Features and Prospects of Hong Kong as a Leading Offshore RMB Hub

Dr. E Zhihuan ,Chief Economist, Bank of China (Hong Kong)

The offshore RMB market in Hong Kong is an early promoter and full-cycle participant of RMB internationalization. For a long time, through cross-border trade and investment transactions, the offshore RMB market has functioned as a new investment channel for foreign investors and an enhancement to the diversification of RMB business modes, which could be considered building up the advantages of first-mover by the volume of transactions. In 2022, Hong Kong will promote the further development of an offshore RMB hub and enhance the depth and breadth of the RMB market, thereby continuously enriching the currency basket of Hong Kong as an international financial center and adding more unique competitive advantages to it.

1. Steadily Increasing RMB Exchange Rate Has Bolstered the Development of the Offshore Market

In 2021, the exchange rate of RMB against USD showed a rising trend amid two-way fluctuations. From the beginning of 2021 to early September, this exchange rate fluctuated in both directions, while the rate of USD to RMB hit its highest point this year, which refers to RMB's depreciation to 6.577. Since then, from September to the end of 2021, the RMB exchange rate had performed a trend of volatile appreciation and recorded its lowest point within the year at 6.3458 against USD.

The dominant factor for the recent strengthening of the RMB exchange rate is that the balance of payments of China remains in good condition, and the surplus on the balance of trade in goods and services has brought a large demands for foreign exchange settlement. In the third quarter of 2021, China's trade surplus was 476.2 billion yuan, a year-on-year increase of 30.7%; the capital and financial account recorded a deficit of 311.9 billion yuan, accounting for a year-on-year increase of 63.3%. In the first 11 months of 2021, the trade surplus in goods and services reached 2.7571 trillion yuan, accounting for a year-on-year increase of 18.1%.

In general, the marketization of the RMB exchange rate has been further improved, and the exchange rate flexibility has gradually increased. The RMB exchange rate has remained stable against the items in the currency basket, while it shows two-way expectations and two-way fluctuations against the USD. It can be said that while maintaining the flexibility of the exchange rate, the RMB has improved the resilience of fluctuations and improved the confidence of the global market in RMB assets.

In line with the steady and rising trend of the RMB exchange rate, the offshore RMB market in Hong Kong has developed steadily and is characterized by the fact that the size of the RMB capital pool remains the world's leading, and the RMB product system is increasingly diversified.

According to the data released by the Hong Kong Monetary Authority, the balance of RMB deposits in Hong Kong at the end of November 2021 reached 868.7 billion yuan, an increase of 4% on a month-on-month basis and a 20.4% increase from the end of 2020, hitting a recorded high since October 2015. In 2021, the RMB capital pool in Hong Kong had exceeded 800 billion yuan for seven consecutive months. The balance of RMB loans was 188.2 billion yuan, an increase of 2.2% on a month-on-month basis and a 23.8% increase from the end of 2020,

which reached its historically high in the past four years. In the first 11 months of 2021, the cross-border trade settlement for RMB in Hong Kong amounted to 6,375 billion yuan, an increase of 10.1% over the same period last year. The size of the capital pool is an important indicator of market depth, and it is also the key to maintaining Hong Kong as the world's largest offshore RMB hub.

2. Clearing System is the Cornerstone for Hong Kong being an Offshore RMB Hub

The payment and clearing system in Hong Kong brings benefits from the number of transactions they have been dealing with. Specifically, about 75% of the global offshore RMB payment is settled through Hong Kong, which strengthens Hong Kong's position in offshore RMB payment and clearing. The volume of RMB clearing transactions in Hong Kong rank first among the overseas clearing centers. According to data from Hong Kong Interbank Clearing Limited (HKICL), in December 2021, the volume of RMB Real Time Gross Settlement (RTGS) in Hong Kong was 37.18 trillion yuan, recording a year-on-year increase of 27.8 %. The total volume of RMB Real Time Gross Settlement (RTGS) in 2021 was 357.7 trillion yuan, accounting for a year-on-year increase of 26.6%.

The cross-border use of the RMB for trades in goods has a direct impact on the global payment currency ranking, and it is also a determining foundation for the development of the offshore RMB market. Data released by the Society for Worldwide Interbank Financial Telecommunication (SWIFT) shows that RMB has regained its popularity for cross-border payment among the other currencies. In November 2014, based on the statistics of the global payments by value, the proportion of the RMB used in international payments had reached an all-time high of 2.45% in the ranking. In December 2015, the RMB accounts for 2.31% in the global payments market, but it had dropped to 1.67% at the end of 2016 and climbed back to 1.88% in December 2020. Then, RMB's market share in global payments increased from 2.14% in November to 2.7% in December 2021. In terms of the total value, the RMB raised to the fourth place in global payments in December 2021, which accounts for an increase of 34.6% on a month-to-month basis comparison to November and thus surpassed the Japanese yen for the first time in the last five years. It is noticeable that the overall value of global payments in all currencies increased by only 6.44% during the same period. In December 2021, the top three active currencies for global payments

were USD for 40.51%, Euro for 36.65%, and British pound for 5.89%.

The cross-border RMB trade settlement is a decisive factor that determines the realization and enhancement of RMB's function as an international currency and builds the foundation for other RMB businesses. The increase in the size of the RMB capital pool in Hong Kong would persistently support the activities of trade and financial transactions, and diversify and expand the RMB products, including stocks, bonds, funds, insurance, and derivative products, in the offshore market in Hong Kong.

The issuance of the bonds denominated in RMB, or the "dim sum bonds", is closely related to the stock of capital pools in the offshore RMB market, which directly affects the willingness of investors to trade bonds for financial purposes in the offshore RMB market. According to statistics released by Bloomberg, as of the end of December 2021, the issuance of offshore RMB bonds in the primary market was 169.6 billion yuan, including 120 billion central bank bills and 14 billion treasury bills. This figure is 10% lower than the 188.9 billion yuan in 2020, which accounts for 155 billion central bank bills and 5 billion treasury bills.

At present, the value of products traded in RMB in Hong Kong is still lower than that in other international currencies, which means that products denominated in RMB have more room for development. According to sample statistics conducted by the Bank for International Settlements (BIS) every three years, the average daily volume of RMB foreign exchange trading in Hong Kong was USD 107.6 billion in 2019, an increase of 39.6% from the survey three years ago. This figure accounts for 30 percent of RMB foreign exchange trading globally, compared with USD 56.7 billion in London and USD 41.5 billion in Singapore.

3. Interconnection of Financial Markets Provides New Impetus to Offshore RMB Hub

In recent years, the Mainland has accelerated the opening up of the onshore financial market, and the home market has driven the RMB. The cross-border use of RMB in the trade sector has been fully unrestricted, which empowers the market to adjust to the equilibrium in response to the changes in the RMB exchange rate and capital flows. Specifically, Stock Connect and Bond Connect, the landmark mutual market access program linking the Hong Kong and Mainland China equity and bond markets, have pioneered greater accessibility and investor choice, resulting in record trading volumes of 86.5 billion yuan in 2014 and 2 trillion yuan in 2021.

On September 24, 2021, the "Southbound Bond Connect" was officially launched, providing an institutional basis for the two-way opening of the Mainland bond market and Hong Kong's capital market, and also providing domestic investors with cross-border investment convenience. This move has been considered to support Hong Kong as an important channel for foreign investors to access the capital market in the Mainland, and also makes Hong Kong the preferred destination for mainland investors to invest in overseas assets.

The "Northbound Bond Connect" has been growing steadily and continuously since it was put into operation, and it has gradually become an inevitable channel for foreign investors to flow into the Chinese bond market. According to data from the China Central Clearing Corporation, as of the end of December 2021, the RMB bonds held by foreign investors reached 3.6834 trillion yuan in terms of par value, and the cumulative increase in RMB bonds was 798.5 billion yuan. According to data from the Shanghai Headquarters of the Central Bank of China, as of the end of December 2021, the total amount of bonds held by foreign institutions in the interbank market reached 4 trillion yuan, accounting for about 3.5% of the par value of the total interbank bond market.

On October 19, 2021, the "Outline Development Plan for Guangdong-Hong Kong-Macao Greater Bay Area" suggests the consolidation of the high-level interconnection of the financial markets in the region, and the formation of free flow of resources and the factors of production. The Guangdong-Hong Kong-Macao Greater Bay Area (GBA) has become the first experimental site for the Cross-boundary Wealth Management Connect Scheme (Cross-boundary WMC), which consists of the Southbound Scheme and the Northbound Scheme that offer full coverage of state-owned banks, joint-stock banks, and foreign-funded banks. The operation of the Cross-boundary WMC is completely market-driven, that is to say, under the framework of macro policies and closed-loop management of funds, it provides convenience for the residents in the Mainland GBA cities investing in wealth management products distributed by banks in Hong Kong and Macau. Such a cross-border channel has brought more investment opportunities for the investors in the GBA, which not only deepens the interconnection of the financial markets in the three places but also promotes the integration and development of regional economies. The Cross-boundary WMC has boosted the two-way capital flow, improved the service quality of asset management in Hong Kong, and drove Hong

Kong to develop its wealth management services with a business characteristic of RMB.

The interconnection of the financial markets between Hong Kong and the Mainland has boosted the RMB's share in the world currency reserves. In March 2017, the International Monetary Fund (IMF) released the Currency Composition of Official Foreign Exchange Reserves (COFER), separately identifying holdings in RMB for the first time in its statistics for the fourth quarter of 2016. Later on, in the third quarter of 2017, the claimed foreign exchange reserves in RMB were USD 107.9 billion, accounting for 1.12% of the overall allocated foreign exchange reserves. In 2021, the amount of RMB as foreign exchange reserves has risen from USD 314.2 billion in the second quarter of 2021 to USD 319 billion in the third quarter, recording 11 consecutive quarters of growth. That growth also reflects the changes in the proportion of RMB in the total foreign exchange reserves, which rose from 2.61% in the second quarter to 2.66% in the third quarter of 2021, ranking as the world's fifth-largest reserve currency and recording the highest ever, since the IMF added RMB to its Special Drawing Rights basket in 2016.

4. Enhancement of the Market Depth and Breadth of Hong Kong as an Offshore RMB Hub

The National 14th Five-Year Plan also sets out a very important and attractive development theme for Hong Kong that to prudently advance the internationalization of RMB through market-driven policies and enterprises' independent choices, and promote a new mutually beneficial and cooperative relationship with the free use of RMB. In 2021, the People's Bank of China together with 5 other Chinese regulators issued new rules covering the promotion of the cross-border RMB settlement process, optimizing the management of cross-border RMB investment and financing, and facilitating personal current accounts, sending a clear signal to the market to accelerate the internationalization of RMB with salient practical and policy significance. In the future, the RMB will vigorously enhance the investment reserve function in addition to maintaining the trade payment function. As foreign investors continue to increase their holdings of RMB assets, Hong Kong will have more business opportunities in RMB settlement, investment management, foreign exchange transactions, and risk management.

As the world's leading international financial center, Hong Kong has long been widely recognized by global investors for the depth, breadth, and internationalization of its

financial market, as well as the degree to which its legal rules are in line with international standards. These outstanding advantages have made Hong Kong an optimal gateway for foreign investors to access the financial market in the Mainland.

In 2022, Hong Kong should actively take the following measures to further promote the construction of offshore RMB hub:

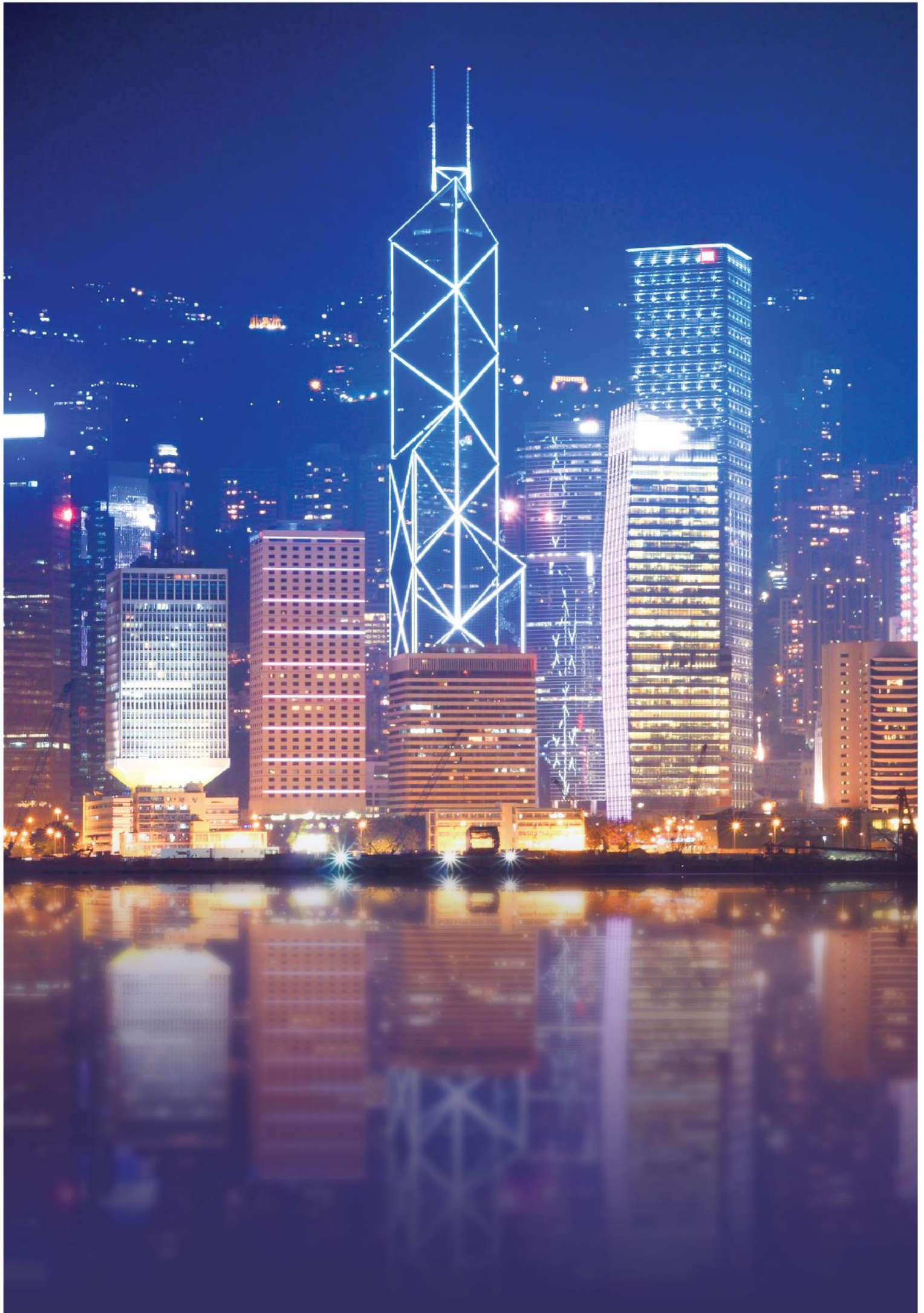
First of all, Hong Kong should promote and attract the demands for offshore RMB business in reference to the progress of the opening-up of the financial market in the Mainland. In recent years, the holdings of RMB bonds and stocks by foreign central banks, institutional investors, and individuals have continued to grow significantly, which resulted in bringing more foreign investors and bolstering greater integration of the Mainland's financial market with the international standards. The People's Bank of China and other regulatory agencies have adopted a series of reform measures, including unifying the management of Qualified Foreign Institutional Investor (QFII) and RMB Qualified Foreign Institutional Investor (RQFII) and canceling their quotas, simplifying market entry procedures for foreign institutions, introducing the market interconnection and multi-level custody model, and opening the Wealth Management Connect and Southbound Bond Connect.

The purpose of these new policies and practices was to improve the degree of free convertibility of capital in the Mainland's financial market and to catalyze the transformation of the market to adopt a modern financial system with international standards. The offshore RMB market in Hong Kong should take the initiative to serve as a trailblazer who offers an experimental platform for the RMB business, and such an arrangement also can be a buffer for the further opening of the Mainland's capital market. As the Mainland accelerates the opening of its onshore financial market, Hong Kong can walk at the same pace with the progress of RMB internationalization and capital account opening and play a more important role as an intermediary in cross-border capital activities.

Secondly, Hong Kong should make good use of its existing advantages to further enhance the depth and breadth of the offshore RMB market. Based on serving the needs of the local market, Hong Kong should play its role as a capital pool facing the global market, and extend RMB business to Southeast Asia. By focusing on key regions, key areas, and key enterprises, Hong Kong should cultivate market demand, guide global RMB capital flows, and assist foreign investors in flexibly

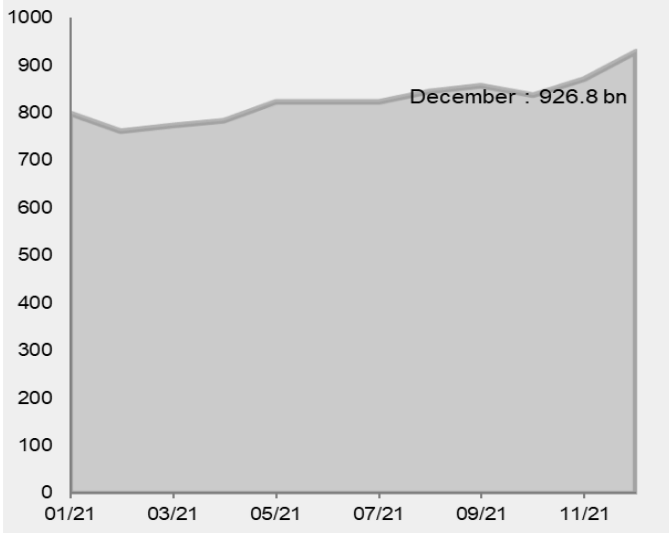
holding RMB assets. These practices are considered meeting market demands, strengthening the interconnection for the offshore market with the onshore market, and promoting the internationalization of the RMB.

It is equally important that the offshore RMB market in Hong Kong should continue to expand the scale of existing RMB-denominated products and further promote RMB product innovation. These changes will help meet the diversified needs of investors and assist Hong Kong to embrace the transformation of having a scaled offshore RMB capital pool to the comprehensive advantages in offshore RMB business.



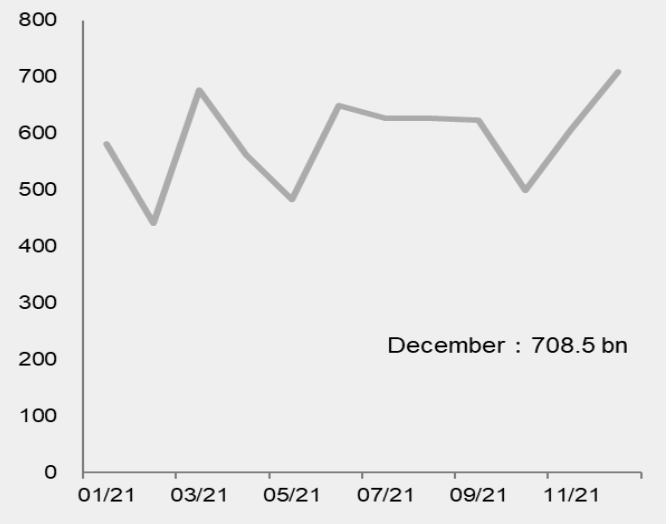
Market Indicators

Hong Kong RMB Deposits (RMB bn)



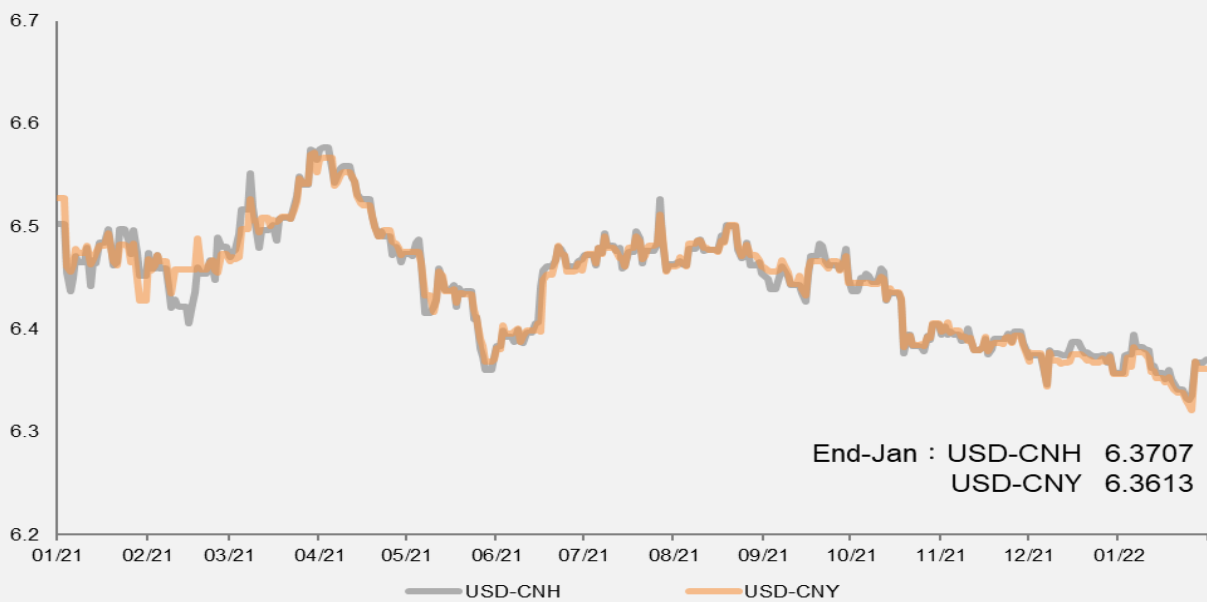
Source: HKMA

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

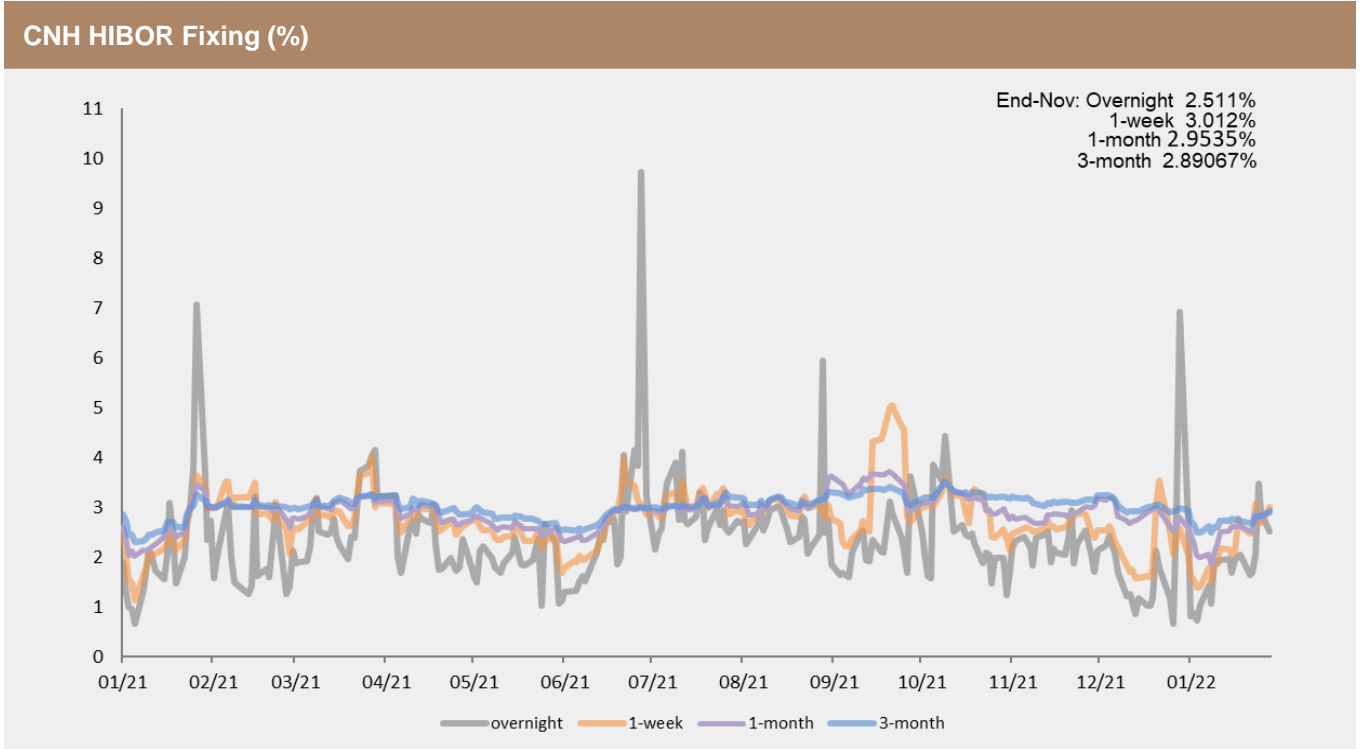


Source: HKMA

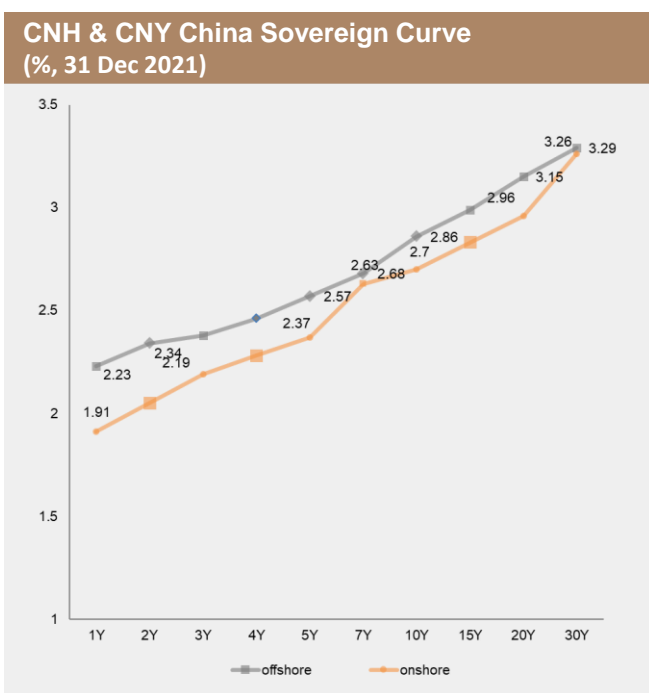
USD-CNH and USD-CNY Exchange Rates



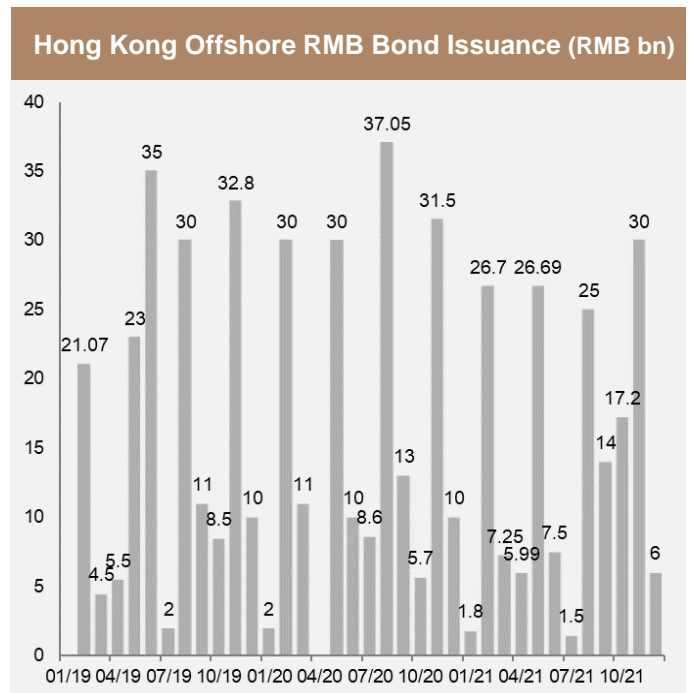
Source: Bloomberg



Source: Bloomberg

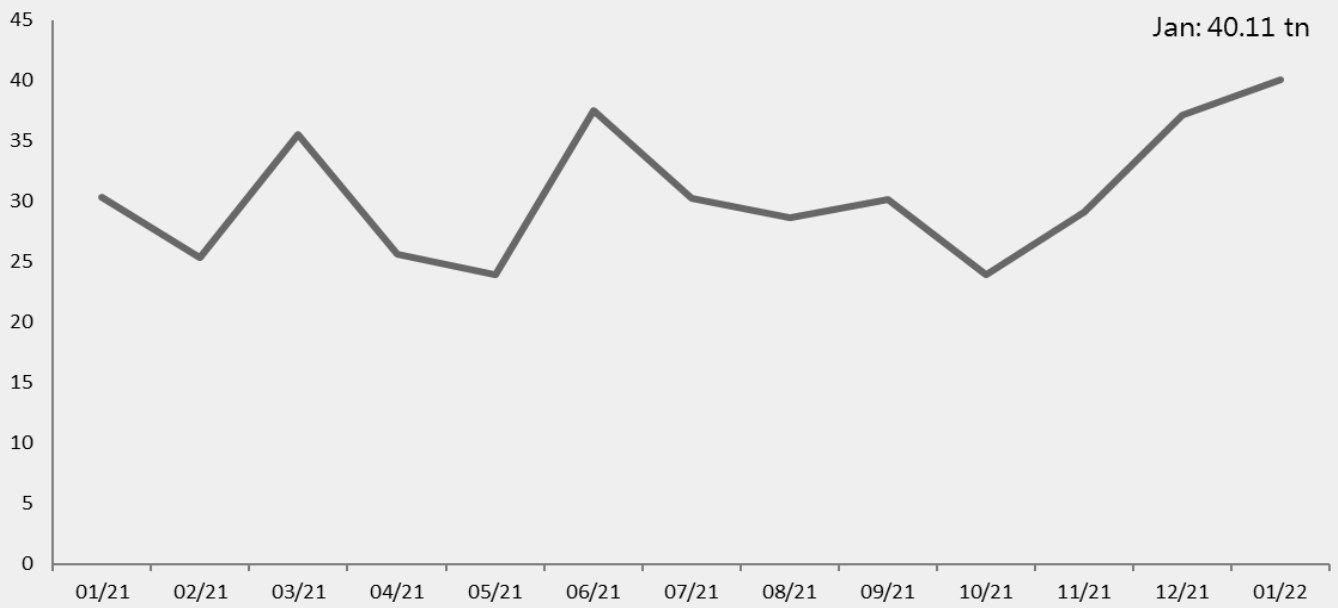


Source: Bloomberg



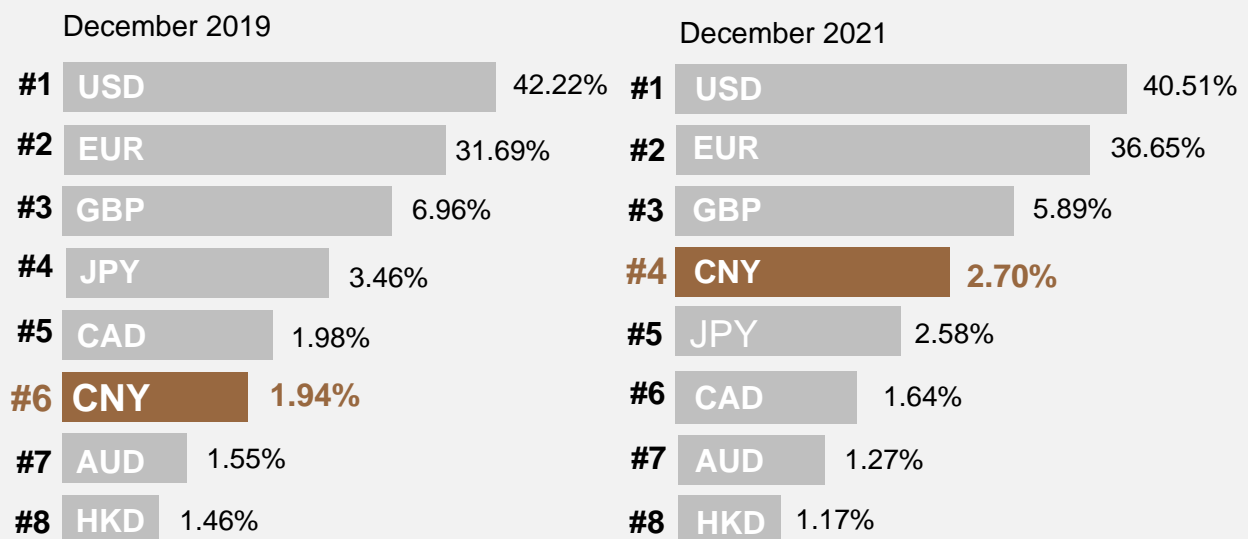
Source: BOCHK Global Market estimate

RMB Clearing Transaction Value (RMB tn)



Source: HKICL

SWIFT World payments currency ranking & market share



Source: SWIFT



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