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Editors:

Hualin Zhang

Tel: +852 2826 6586

Email: zhanghualin@bochk.com

Nathan Yeung

Tel: +852 2826 6205

Email: nathanyeung@bochk.com

CNH experienced two-way fluctuation, RMB's share of global reserve hit a 5-year high

In March, CNH experienced a two-way fluctuation due to geopolitical tensions and US's entry to the rate hike cycle; Key offshore RMB business indicators stably grew; RMB deposits dropped in March while the total remittance of renminbi for cross-border trade settlement increased by 60% MoM; RMB retained its position as the fifth most active currency in global payments; Cross-border securities investment experienced short-term fluctuation; RMB's share in IMF COFER reached the highest since 2016Q4 at 2.79%.

I. CNH experienced a two-way fluctuation

In March, the CNH traded between 6.31 and 6.39, with a higher fluctuation compared to last month. With the continuous geopolitical tensions and the market expectation to US Fed's interest rate hike, the global financial market experienced greater volatility in March, making capital outflow from emerging markets continuously. After a two-day drop of more than 600 basis points from 14th to 15th March, the CNH rebounded 370 basis points on 16th March, the highest one-day gain since 19th October last year, reaching back to 6.38 and 6.37 level. As China's state council gave a positive expectation on China's market, boosting market confidence in RMB. The CNH stabilized at 6.38 level at the end of the month. On 31 March, the central parity rate of RMB against US dollar

published by CFETS was 6.3482, up 0.49% YTD; the CNY closed at 6.3400 that day, down 0.49% MoM and up 0.51% YTD. The CNH closed at 6.3547, down 0.64% MoM and up 0.31% YTD.

The expectation on US Federal Reserve's quantitative tightening, the first interest rate hike and continuing geopolitical tensions between Ukraine and Russia continued to be the main risks to the global financial markets, causing capital outflow from emerging market and most emerging market currencies (including RMB) is depreciated. The spread between US and China government bond narrowed and later inverted. The US Federal Reserve announced its decision of 25 basis points interest rate hike in FOMC meeting in March.

The US Fed also implied that they will shrink balance sheet “rapidly”. Considering that, USD is likely to rise while RMB might encounter relatively higher depreciation pressure. Besides that, 5 US listing Chinese stocks were included on the US delisting list, making investors turned cautious on China-US relationship. Yet, market was stabilized after China’s regulator showed willingness to cooperate with the US regulator in order to solve the disagreement.

Since 18th April, both CNH and CNY experienced short-term depreciation pressure, reaching 1 year low. CNH drop more than 2800 basis points, from 6.37 to 6.657, as affected by the China Covid situation, stronger USD, global financial market volatility, etc. On 25th April, PBOC announced it would cut the Required Reserve Ratio (RRR) by 1 percentage point to 8%, effective on 15th May. PBOC raised the RRR twice last year with 2 percentage point rise each time. With the current volatility in RMB, it is believed that the RRR cut can provide more liquidity to the RMB FX market and boost market confidence. In a short-term, the RMB market will be affected by investors’ expectation and market sentiment. Yet, from the beginning from this year, the RMB demonstrated a better resilience compared to JPY and Euro. There are numerous uncertainties in the market, such as the Fed’s interest rate hike,

narrowing US-China government bond yield spread, Russia-Ukraine conflict, Covid situation and US-China relationship, the pressure on capital outflow still exist. It is likely that the RMB exchange rate will have adjustment in short to mid-term. However, from a long term perspective, considering the positive fundamental of China economy will not be affected. Therefore, it is unlikely that the RMB will depreciated continuously . Besides, as foreign investors’ allocation in China markets is relatively low, RMB assets still attractive to foreign investors.

Regarding offshore RMB liquidity, as of March 31, the overnight and 1-week CNH Hibor rates were 3.2695% and 2.5365% respectively; the 1-month CNH Hibor rate stood at 2.90633%; and the 3-month CNH HIBOR rate was 3.1285%.

II. Review of major offshore RMB business indicators

Offshore RMB business maintained stable with partial decrease in some indicators in March 2022. According to HKMA, as of the end of March 2021, Hong Kong's RMB deposits reached RMB 791.34 billion, down 12.7% MoM. US interest rate hike, market financing activities and lower attractiveness in RMB’s interest rate may be the reasons of the decrease.

However, RMB deposits rose 2.4% when compared to March 2021, showing the drop in recent months can be a one-off incident with no implication of continuous decline. RMB loans stood at RMB 177.99 billion, up 0.8% MoM. The total remittance of renminbi for cross-border trade settlement amounted to RMB 801.6 billion in March, up 60.1% MoM and RMB 2 trillions in the first quarter of 2022, up 17.8% YoY.

According to HKICL, RMB RTGS turnover was RMB 32.95 trillion in March 2022, up 18.4% MoM. In the first quarter of 2022, the total RMB RTGS turnover accumulated to RMB 101.51 trillion, up 11.3% YoY. According to SWIFT, the RMB has maintained its position as the fifth most active currency for global payments by value, with a share of 2.20%, slightly lower than last month at 2.23%, behind USD (41.07%), EUR (35.36%), GBP (6.47%), and JPY (2.80%).

According to the Currency Composition of Official Foreign Exchange Reserves (COFER) data released in March by the IMF, in the fourth quarter, the RMB accounted for 2.79% of the total allocated foreign exchange reserves, compared to 2.66% in the third quarter. It was the highest level since the fourth quarter in 2016. Meanwhile, 58.81% of all central bank currency reserves were still held in US dollars. It is believed that the RMB demonstrated strong resilience which increased investors' confidence in using RMB as a reserve, financing and settlement

currency.

According to Bloomberg, offshore RMB bond issuance amounted to RMB 39.437 billion in the first quarter of 2022, increased 10.31% YoY (RMB 35.75 billion). In March, PBOC successfully issued a total of RMB 50 billion worth of RMB bills in 6-months tenor in Hong Kong, with interest rate of 2.6%. The total amount of bids reached about RMB 22 billion, about 4.4 times larger than the issuance amount. It showed RMB assets remained appealing to foreign investors and they have confidence in China's economy.

III. Investing in China's Interbank Bond Market

With external uncertain factors, foreign investors reduced bond holdings in China markets. Foreign institutional investors reduced RMB 112.5 billion worth of bond holdings.

According to PBOC, as of the end of March 2022, foreign institutions held RMB 3.88 trillion worth of inter-bank bonds, accounted for 3.3% of the total (vs RMB 3.99 trillion in February). In terms of bond type, foreign institutions held RMB 2.43 trillion in government bonds (vs RMB 2.48 trillion in February), and RMB 1.01 trillion in policy bonds (vs RMB 1.05 trillion in February), respectively accounted for 62.7% and 26.1% of the total.

According to CFETS, foreign institutional investors invested RMB 573.9 billion in bonds and sold RMB 650.4 billion in March, with net selling of RMB 76.5 billion. Bond Spot transaction by Foreign institutional investors amounted to RMB 1.2 trillion, up 19% MoM. The average daily 10-year China-US government bond yield spread went to 144 basis points by the end of March due to rising US treasury yield, a significant decline since November 2021 (250 basis points).

Under the current uncertainty of global environment, foreign investment outflows were only a temporary fluctuation. Foreign institutions have been increasing their holdings in RMB bonds for 10 months. Although China market experienced capital outflow in March, there were 9 foreign institutions newly entered into China interbank bond markets, showing foreign investors' willingness in investing in China bond markets. By the end of March, a total of 1,034 foreign institutions entered into the markets, of which 514 of them entered through the direct investment channel and 748 entered through the Bond Connect while 228 entered through both channels. In the long term, foreign investors still interested in China RMB bond market. A temporary decline didn't reflect the long-term growing trend.

The latest report from Bond Connect showed that the Northbound trading was stable in March, up 9.9% MoM, with a turnover of RMB 647.8 billion and an average daily trading volume of RMB 28.2 billion. Chinese Government Bonds (CGBs) and Policy Financial Bonds (PFBs) were the most actively traded products, accounting for 51% and 33% of the monthly turnover respectively. The number of investors under Bond Connect continued to grow, with 88 added in the month. The total number of approved investors reached 3,453. Among the top 100 global asset managers, 78 have joined the Bond Connect.

With the continuous opening and improvement in China bond market, it is believed that it will attract more foreign investors to enter. First, China's economy demonstrated resilience, together with a stable currency and a lower fluctuation in foreign capital flow. Second, holding RMB assets can diversify foreign investors' portfolio. Third, considering China has a large and liquid bond market, yet, the proportion of foreign capital is lower than that of Japan, South Korea, Brazil and other emerging economies, there is still a lot of room for foreign investors to further allocate in RMB bonds.

State Council committee stresses economic, financial stability

The financial stability and development committee under China's State Council held a meeting on March 16, urging measures to keep the country's major economic indicators within an appropriate range and maintain stable operation of the capital market. Concrete actions must be taken to bolster the economy in the first quarter, the meeting said, adding that monetary policy should take the initiative to cope with the situation, while new loans should maintain an appropriate growth.

The meeting stressed that relevant authorities should earnestly shoulder their responsibilities, actively introduce market-friendly policies and prudently introduce policies that have a contractionary effect. Authorities should timely respond to issues that draw attention from the market. Any policy that has a significant impact on the capital market should be coordinated with the financial regulatory authorities in advance to maintain stable and consistent expectations, the meeting said. The financial institutions should bear in mind the overall situation and firmly support the development of the real economy, the meeting said. It added that long-term institutional investors are welcome to increase their shareholding.

HKEX Signs MOU with CEEEX to Explore Greater Bay Area, International Carbon Opportunities

Hong Kong Exchanges and Clearing Limited (HKEX) announced on March 24th that it has signed a Memorandum of Understanding (MOU) with the China Emissions Exchange (CEEEX) to explore cooperation in tackling climate change and promoting sustainability through carbon finance.

Under the MOU, HKEX and Guangzhou-based CEEEX will jointly explore the development of a voluntary carbon emission reduction programme in the Guangdong-Hong Kong-Macao Greater Bay Area, with the aim of supporting China's efforts to peak carbon emissions by 2030 and reach carbon neutrality by 2060. The two exchanges will also work together to share research and experience on carbon market financing and global carbon market standards, to help boost the internationalisation of China's carbon market.

China solicits opinions on draft financial stability law

China has unveiled a draft law on financial stability, which is open for public opinions starting from April 6th. The draft, jointly compiled by the People's Bank of China (PBOC) and other relevant authorities, outlined a cross-agency mechanism for maintaining financial stability. It orders establishment of a fund for ensuring financial stability, calls for cooperation among different financial regulators and local authorities, and sets out punishments for financial institutions, regulators and individuals failing to perform their duties in terms of preventing financial risks.

The draft aims to establish and improve an efficient, authoritative and well-coordinated working mechanism for financial stability, further strengthen the financial safety net and firmly forestall systemic risks. It is necessary to set up such a mechanism to safeguard the bottom line of preventing major financial risks, especially given "the complex economic and financial situation at home and abroad", the PBoC said in a statement when releasing the draft.

China to pilot digital yuan in more cities, e-CNY now a payment option on WeChat Pay in all pilot areas

China's central bank announced on April 2 that its digital yuan pilot program will be expanded to more domestic cities following its successful operation over the past years. The e-CNY will be accessible in Tianjin and Chongqing municipalities, Guangzhou in South China's Guangdong province, Fuzhou and Xiamen in East China's Fujian province, and six cities in East China's Zhejiang province hosting the 2022 Asian Games. Most recently, Beijing and Zhangjiakou were included into the program after tests in the 2022 Olympic and Paralympic Winter Games. A number of application modes have taken shape in wholesale and retail, catering, tourism and payment of administrative fees, which cover both online and offline scenarios and can be replicated and promoted, according to a PBOC meeting on March 31.

Few days later, WeChat announced that users can open digital yuan wallets by registering through Tencent-backed WeBank, so they can make payments and transfer money directly within WeChat using e-CNY, offering China's digital currency in trial as a payments option in all pilot areas.

The CSRC Solicits Public Comments on Revision to the Provisions on Strengthening Confidentiality and Archives Administration of Overseas Securities Offering and Listing by Domestic Companies

In order to support domestic companies to offer and list securities in overseas markets pursuant to laws and regulations, to strengthen the confidentiality and archives administration concerning such overseas securities offering and listing by domestic companies, and to enhance cross-border regulatory cooperation in this regard, China Securities Regulatory Commission (CSRC), Ministry of Finance of the People's Republic of China (MoF), National Administration of State Secrets Protection, and National Archives Administration of China, have jointly revised the Provisions on Strengthening Confidentiality and Archives Administration for Overseas Securities Offering and Listing (Announcement No.29 [2009] of the CSRC, hereinafter referred to as the "Provisions"). Now the revised Provisions is open for public consultations.

The revised Provisions made the following adjustments to accommodate the new circumstances and developments concerning overseas securities listing and offering: First, adding the Accounting Law of the People's Republic of China, the Law of the People's Republic of China on Certified Public Accountants and others as its superordinate laws and regulations; Second, expanding the scope to govern both direct and indirect overseas listing, as is consistent with the Draft Provisions of the State Council on the Administration of Overseas Securities Offering and Listing by Domestic Companies; Third, setting clear requirements on companies' duty of information security by introducing clearer guidance to domestic companies, relevant securities companies and securities service providers on confidentiality and archives administration concerning overseas securities offering and listing by domestic companies; Fourth, laying a solid institutional foundation for secure and efficient cross-border regulatory cooperation and improving relevant arrangements.



Thoughts on RMB became the fourth largest global payment currency in the world for the second time

Jian Ying, Principal Strategist BOCHK

According to Society for Worldwide Interbank Financial Telecommunication (SWIFT), the RMB was ranked as fourth in payment value in December and January, with the market share increasing from 2.7% in December to 3.2% in January, the highest since the start of RMB internationalization. This article will analyze the implication and reason of the RMB making the fourth place in payment. Whether the ranking will be changed in short-term and if RMB could maintain a long-term growth in global payment would also be analyzed in this article.

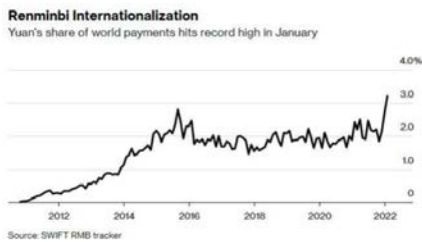
I. Characteristics of RMB's return to the fourth most active payment currency

The internationalization of the RMB was started in 2009. It has only been more than ten years, but the international currency function has continued to improve. First, it has become the main global payment currency, and then developed into major foreign exchange transactions, financing, investment and international reserve currencies. In fact, as early as August 2015,

RMB payment once surpassed the Japanese yen and rose to the fourth place among all currencies. After 6 years, RMB was once again surpassed Japanese Yen to become the fourth most active in payment and maintained its position for 2 months. There were a few different factors driving RMB to become the fourth rank in SWIFT.

First, the paces of rising were different. The RMB rapidly jumped to the fourth in the first time while it showed steady growth in the second time. In the first few years of RMB Internationalization, RMB business was growing rapidly which contributed to the rise in global payment. In August 2015, RMB's market share in payment was 2.79%, the first time surpassed Japanese Yen as the fourth rank. However, after the "8.11 Exchange Rate Reform", RMB experienced greater volatility, causing RMB in SWIFT payment to drop. After 2017, the global RMB payment rebounded for five consecutive years, but the increase in each year was smaller. In 2021, RMB payment value amounted to USD 95 trillion, up 38% YoY.

In December 2021, SWIFT RMB payment value amounted to USD 10.3 trillion, rising back to the fourth in SWIFT. In general, after a continuous steady growth in years, the second time of reaching to the fourth had a better fundamental than the first time.



Second, the market conditions were different. The RMB exchange rate was volatile in the first time while the RMB exchange rate was stable in the second time. In August 2015, when the RMB first got the fourth place in global payment, offshore RMB experienced great volatility in both foreign exchange rate and interest rate, caused by the expectation of RMB depreciation and foreign investors' short selling position in RMB. To develop a healthy offshore RMB market, China strengthened macro management of cross-border business and RMB exchange rate expectation management. RMB exchange rate and interest rate were therefore stabilized. The fluctuation range narrowed down to 2200 basis points and the fixing price of CNH overnight HIBOR stabilized to below 4%. Considering that, the first time of RMB payment increase was driven by the active trading on offshore RMB volatility; the second time was a normal market development.

Third, the growth drivers were different. The first time of growth was driven by trade settlement and the second times was driven by multiple factors. In the early stage of RMB internationalization, cross-border trade settlement was the main driver for RMB outflow. With various reasons, the onshore and offshore RMB exchange rate spread widened, with spot rate widened to over 1000 basis points, causing arbitrage activities in cross-border trade. The RMB payment was therefore increased rapidly, with RMB trade financing value exceeding EURO to be the second largest in the world. In 2021, SWIFT RMB trade financing reached the bottom and rebounded. Although it was only 20% of cross-border trade financing compared to 2014, there are rarely arbitrage activities and more of actual demand.

Fourth, the status of RMB internationalization were different. It was an early stage of RMB internationalization in the first time while RMB gained global recognition in the second time. The internationalization of the RMB is very short, which is hardly compare with the USD, the EURO and JPY. Also, the fundamental of RMB internationalization was different than other major currencies. In 2015, it was hard to secure its fourth position in SWIFT payment as the RMB was newly introduced to western market.

In October 2015, after the RMB inclusion to IMF SDR basket, foreign investors had increasingly entered into China onshore market and increased RMB bond and stock holdings which contribute to further use on RMB payment.

Fifth, the payment infrastructure conditions were different. The clearing bank was the main RMB clearing infrastructure in the first time while CIPS system was developing well in the second time. While major currencies could use offshore clearing channel in its internationalization progress, but RMB couldn't be cleared as the clearing channel was not yet established when the RMB was firstly introduced to foreign markets. 2014-2015 was the fastest period of offshore clearing banks establishment, with 16 offshore clearing banks newly launched in Europe, Asia, America, Australia and Africa, accounted for 70% of the current clearing banks. Afterwards, China speed up financial infrastructure development. CIPS system (Phrase one) and CIPS system (Phrase two) were established in October 2015 and March 2018 respectively for global coverage in clearing business. By the end of August 2021, there were 67 direct participating banks, 1144 indirect participating banks. Global RMB clearing network had been improving.

II. How should we view RMB returning

as the fourth most active payment currency?

The rise of RMB in global payment is meaningful to RMB internationalization. To begin with, we need to define the SWIFT messaging system and currency clearing. Clearing is one of the functions of clearing institutions (including commercial banks) for clients' fund transfer and payment. Major international currencies must complete clearing with the help of clearing institutions or commercial banks. CIPS system and overseas RMB clearing banks belong to cross-border and offshore RMB clearing systems, corresponding to the domestic CNAPS clearing system.

Messaging system is the information transmission in the clearing and settlement process. It informs the counterparty with clearing instructions in a standardised format. SWIFT is the most widely used, the largest and most impactful messaging format among international banks. SWIFT is adopted by 11,000 banks and financial institutions around the world. The clearing system and the messaging service are indispensable to complete the clearing and settlement of financial activities.

Although the SWIFT message services are widely used, SWIFT cannot cover all financial activities due to the existence of other messaging and clearing system such as currency clearing systems, foreign exchange trading systems, bond settlement systems, central clearing systems, and custody systems. Therefore, if it needs to fully evaluate various international currency functions, other clearing and trading system should be analysed at the same time.

On the other hand, as some major international currencies' domestic clearing system also use SWIFT, some clearing information may be exaggerated and double counted. Specifically, the US CHIPS and Fedwire, the Japanese BOJ Net all uses their own messaging format. And European's TARGET2 could use SWIFT and other messaging format. Therefore, the information of USD and JPY in SWIFT are more accurate while the EURO is less accurate as it includes both international and domestic clearing data. When RMB payment ranked as fourth place for 2 consecutive months, the payment value in December 2021 was increased 57% from August 2015, yet, the proportion of all currency payment in the world declined slightly (2.79% vs 2.7%). However, it didn't mean the RMB payment function had not improved much. Instead, it meant the RMB payment in SWIFT decreased due to the enhancement of CIPS processing capacity. In 2021, the average

daily processing volume of CIPS increased to RMB 321.3 billion, accounted for 13% of SWIFT. Therefore, considering the additional data from CIPS, the gap between RMB and JPY in international payment had been narrowing in recent years.

Besides, the decline of JPY in payment also contributed to the recent rise in RMB SWIFT payment. There are many factors that affect the changes in currency payments, RMB payment may be affected by other factors in the future.

III. Rooms for RMB international payment to increase in the future

Currency has the functions of settlement, payment, and valuation and is widely used for international trade and investment. The use for international trade and investment could also reflect the internationalization status of that currency. In 2021, SWIFT global payment value accounted for USD 4,270 trillion, of which USD 1,684 trillion was paid in USD, accounted for 39% of all global payment value. USD was the leading payment currency for global trade and investment. Although RMB SWIFT payment has made significant growth in recent years, RMB was still lagging behind other major currencies, such as USD and EURO. Therefore,, there is still a room for RMB improvement in the future.

1. Unbalanced regional development.

Hong Kong is a global offshore RMB business hub and an offshore RMB clearing centre. There are some major offshore RMB market includes East Asia, Southeast Asia, Europe, the United States, Canada and Australia. In the past 5 years (2016-2021), the RMB business in Europe has developed rapidly, with the amount of SWIFT RMB payment increased by 83%, higher than the global growth rate of 65.8%. Meanwhile, the amount of RMB payment in the US and Canada, and Australia increased by 56% in average ; In East Asia (including Japan, South Korea, Taiwan and Macau) and Southeast Asia, the growth rates were 32.4% and 28.9% respectively. Considering the closely business relationship between East and Southeast Asia and mainland China, RMB settlement should have more room for improvement.

2. Unbalanced currency function. SWIFT compiled four types of data including global RMB payments, foreign exchange transactions, bond transactions and trade finance. Changes in payment data actually reflect foreign exchange transactions, bond transactions, trade finance and other financial activities. Taking the US dollar as an example, in 2021, the value of USD foreign exchange and bond transactions were 71% and 54% of the payment amount,

respectively. Compared with RMB payment, the transaction amount of RMB foreign exchange and bonds in 2021 were equivalent to 95% and 6%, respectively. It indicated that RMB foreign exchange transactions were quite active. However, the transaction amount of RMB bonds was only equivalent to 6% of the payment amount, showing the RMB bond trading was still far behind USD bond trading.

3. Insufficient offshore market depth.

Compared with the offshore USD market, the offshore RMB market is at an early stage. According to the Bank for International Settlements (BIS), the average daily RMB foreign exchange transaction value in April 2019 was US\$284.2 billion, equivalent to only 4.9% compared with USD's transaction. The RMB international bond market includes domestic Panda Bonds and overseas Dim Sum Bonds. In 2021, foreign institutions issued RMB 106.5 billion of Panda Bonds in China, while the issuance amount in Hong Kong's RMB Dim Sum Bonds was RMB 169.6 billion (most of which are offshore RMB central bank bills and government bonds). Meanwhile, the offshore USD bond issuance was USD 1.5 trillion. Obviously, the RMB bond market is still in developing progress.

4. Insufficient risk management tool. Hong Kong is the centre for offshore RMB product innovation. In recent years, Hong Kong has been enriching RMB products and strengthened liquidity management. Hong Kong also acts as the “One Belt and One Road” investment and risk management centre. Recently, Hong Kong, Singapore, Taiwan, Chicago and other exchange centre have launched standardized RMB Futures and Options, which will help expand the RMB risk management function. However, compared with US, there needs lot of improvement.

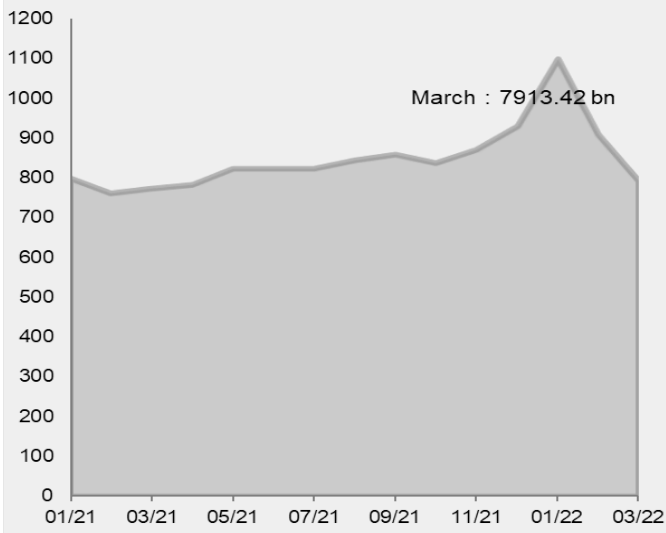
5. Further development in market interconnection between China and Hong Kong. The interconnection arrangement between China and offshore markets, especially with Hong Kong, will be essential for investors to participate in both onshore and offshore markets. It is very important for RMB internationalization. Financial market interconnection builds cross-border transactions and capital channels between onshore and offshore markets, enabling

investors to conduct cross-border investments in their own familiar operating methods. However, there is still a lot of room for further expansion in interconnection in insurance markets, commodity markets and ETFs markets between the two places.

To conclude, it is a significant milestone for RMB internationalization payment with its fourth rank for 2 consecutive months. With the continuous progress of RMB internationalization, RMB international payment functions will steadily improve. However, changes in payment value in particular months are a normal market practice. Most importantly, Hong Kong needs to leverage the advantage of international financial centre to seize the strategic opportunity of RMB internationalization in product innovation, offshore market development, and RMB risk management. It will not only help China to expand the global offshore RMB markets, but also create more business opportunities in future.

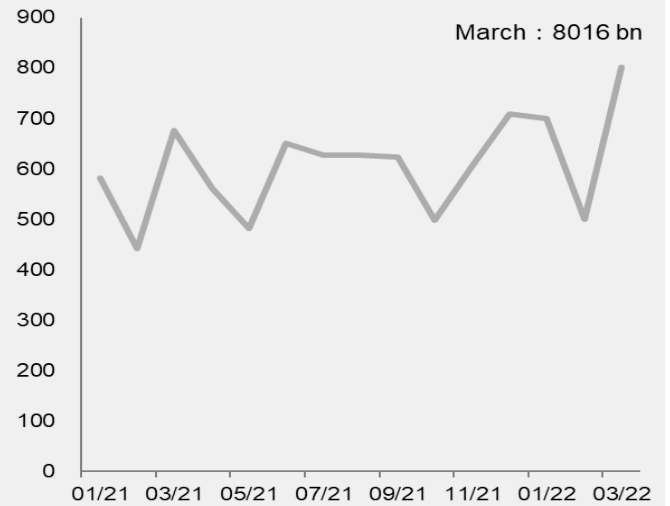
Market Indicators

Hong Kong RMB Deposits (RMB bn)



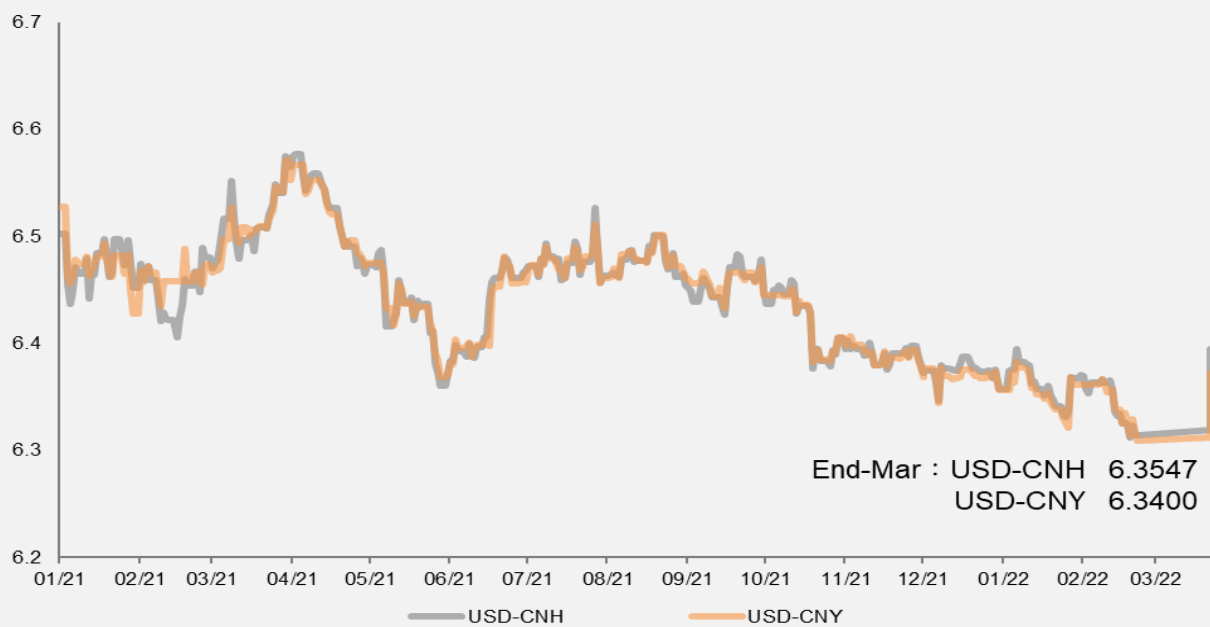
Source: HKMA

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

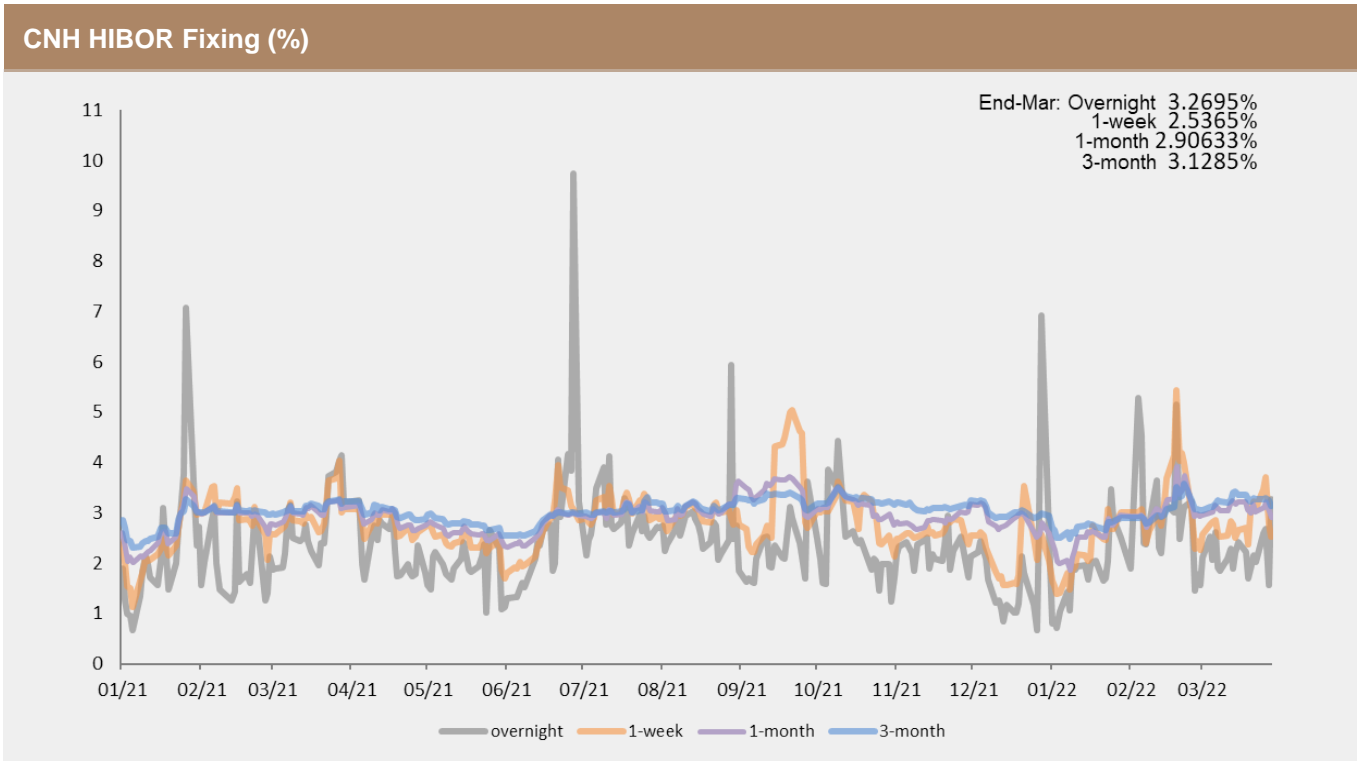


Source: HKMA

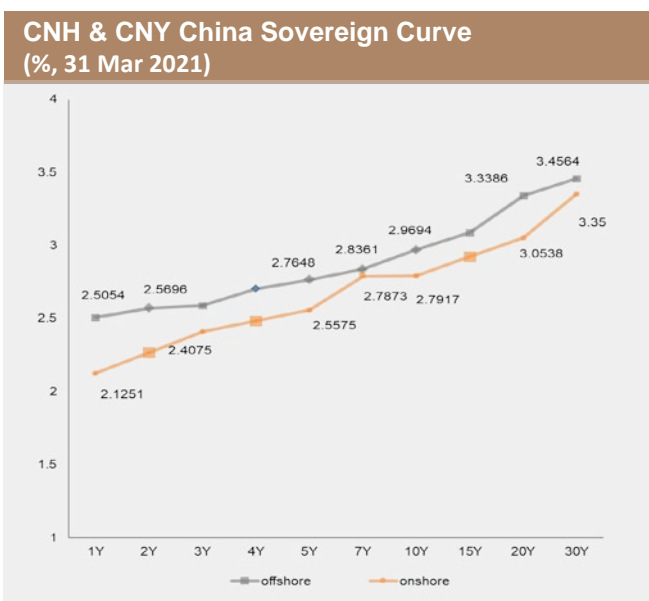
USD-CNH and USD-CNY Exchange Rates



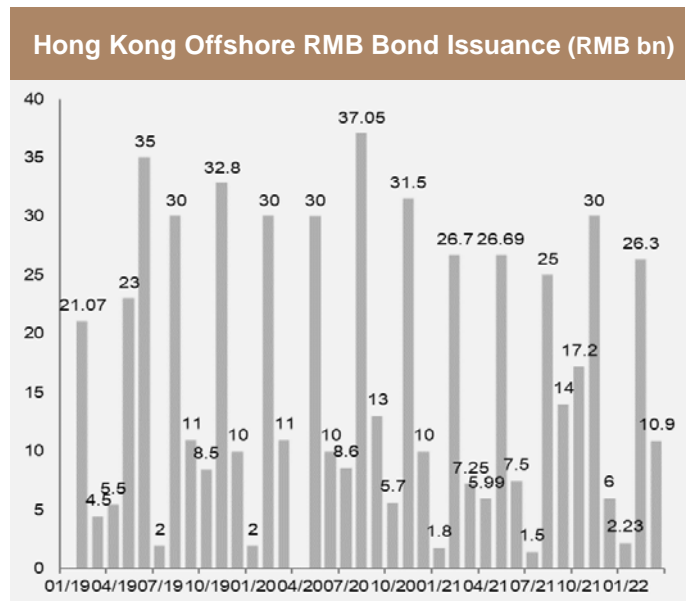
Source: Bloomberg



Source: Bloomberg



Source: Bloomberg



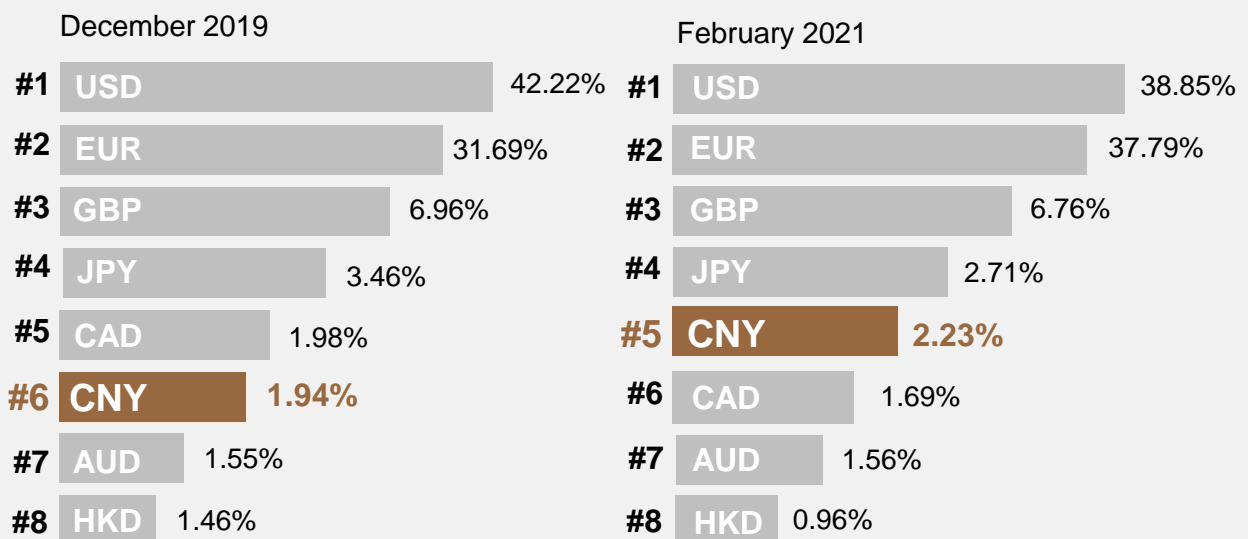
Source: BOCHK Global Market estimate

RMB Clearing Transaction Value (RMB tn)



Source: HKICL

SWIFT World payments currency ranking & market share



Source: SWIFT



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