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2022 Half-Year Offshore RMB Market Review and Outlook

In the first half of 2022, the complicated international environment weakened global economic growth. The pandemic spread in China has affected the economic operation. With such environment, the RMB exchange rate strengthened first and then weakened, with two-way fluctuations widened. Yet, the RMB demonstrated a stable performance compared with other currencies. The offshore RMB business continued to develop steadily, the international use of RMB continued to rise. The proportion of global foreign exchange reserves rose to a new high of 2.88%.

1. The RMB exchange rate showed resilience

At the start of the year, as Russia-Ukraine crisis intensified, the RMB demonstrated safe-haven characteristics. It appreciated to 6.3 level in early March, the highest since May 2018. Afterwards, the US Federal Reserve raised interest rates for the first time and signaled a faster pace of interest rate hike. On April 11, for the first time since 2010, the US-China 10-year government bonds yield spread inverted. Since then, due to the rising dollar index, soaring US bond yields, increasing geopolitical risks, domestic pandemic and other factors, the RMB exchange rate has been adjusted, falling below 6.8. On April 25, the PBOC announced a 1% cut in the reserve requirement ratio for financial institutions, sending a signal of "stability" in the foreign exchange market. In May, the offshore

USDCNH traded between 6.62 and 6.82. On May 20, the People's Bank of China cut the 5-year LPR by a larger-than-expected 15 basis points, causing a rally in Chinese assets such as A-shares, Hong Kong stocks and USDCNH. In June, the offshore RMB trading range narrowed to between 6.65 and 6.79. The US Federal Reserve raised interest rates by 0.75% on June 15, the largest increase in 28 years. The target range of federal funds rate went to between 1.5% to 1.75%. The dollar index continued to rally this month, rising as high as 105. The offshore RMB exchange rate briefly fell to 6.78 due to the strong dollar, and then quickly adjusted back to 6.70, showing RMB's flexibility and resilience. On June 30, the central parity rate of RMB against US dollar published by CFETS was 6.7114, down 0.76% MoM; the CNY closed at 6.6993, down 0.41% MoM; The CNH closed at 6.6941 down 0.23% MoM

Regarding offshore RMB liquidity, as of June 30, the overnight and 1-week CNH Hibor rates were 1.5792% and 2.1718% respectively; the 1-month CNH Hibor rate stood at 2.414%; and the 3-month CNH HIBOR rate was 2.8473%.

2. Major offshore RMB indicators showed stable development

In the first half of 2022, despite the market fluctuations, the offshore RMB market maintained a healthy and stable development, with positive RMB business indicators. According to HKMA, RMB deposit reached a new record high to 1 trillion in January. As of the end of May 2021, Hong Kong's RMB deposits increased to RMB 850.45 billion, up 1% MoM. The average monthly deposit in the first five months reached nearly RMB 900 billion, up 14 % YoY.

RMB investment and financing business rebounded. The RMB-denominated loans in Hong Kong stood at RMB181.62 bn in May, up 1.8% MoM. Since the beginning of the year, the average monthly loan has remained at RMB176.0bn, up 10.5% YoY. According to Bloomberg, in the first half of 2022, offshore RMB bond issuance in primary market amounted to RMB 81.33 billion, up 7.1% YoY (RMB75.94 bn). Central bills issuance continued to support the Dim Sum bond market, totalling RMB6 0bn in 6 issuances.

Hong Kong continued to serve as an offshore RMB clearing hub. Total clearing processed by HK RTGS reached RMB 191.9 trillion in the first half of 2022, up 7.6% YoY, accounting for more than 70% of the global total offshore RMB clearing value. Cross-border RMB trade settlement in the first five months of this year totalled RMB 3.52 trillion, up 28.4 % YoY. In addition, according to SWIFT, the global payment currency ranking of RMB remained the fifth most active as global payment currency in June where it rose from 2.15% in May to 2.17%.

RMB assets remained attractive. In the first half of 2022, the cumulative trading volume of bond Connect reached RMB 3.8 trillion, up 21% YoY and accounting for 58.5% of the total turnover of the previous year. Treasury bonds and policy financial bonds were the most active, accounting for 43% and 41% respectively. The number of Bond Connect accounts continued to rise, and successfully assisted Baring Asset Management Limited and BNP Paribas Asset Management France to enter the market. By far, 80 of the world's top 100 Asset Management companies have completed filing and entering the market. As of the end of June, there were 1,043 foreign institutions in the market, according to the CFETS. Among them, 518 entered the market through direct investment channels, 757 through Bond Connect channels, and 232 through both channels.

By the end of June, foreign institutions held RMB 3.57 trillion worth of bonds in the interbank market, accounting for about 2.9% of the total custody. In terms of bond types, government bonds remained the most popular, accounting for 63.4% (RMB 2.32 trillion). Followed by policy financial bonds, accounting for 23.6% (RMB 0.86 trillion).

3. RMB's global reserve function continued to strengthen

In the second quarter of 2022, international financial markets continued to experience volatility due to the US Fed's interest rate hike and Russia-Ukraine crisis. While the offshore RMB exchange rate fluctuated, especially when the dollar strengthened, there was no significant selloff in the RMB markets and the RMB has not weakened against most currencies. It reflected the long-term positive fundamentals of the Chinese economy. Recently, the RMB has maintained two-way fluctuation and relatively stable. This shows that the RMB market sentiment is generally healthy and has become more market-oriented, which will also help stabilize foreign investment. After previous short-term volatility, the RMB exchange rate against a basket of currencies has corrected to some extent. In the short term, the US dollar index, the repair of China economic fundamentals and the pandemic situation remain the three key factors affecting the RMB exchange rate.

According to the latest official COFER data released by the International Monetary Fund, the RMB's foreign exchange reserves fell slightly to USD 336.39 billion in the first quarter of this year, down 0.2% from the previous quarter. The share of RMB in global foreign exchange reserves was 2.88%, up from 2.79% in the previous quarter, a consecutive growth of 9 quarters since 2020. The share also reached a new record high. Global holdings of RMB reserves fell in the first quarter, mainly because foreign investors reduced their holdings of RMB bonds. However, during the same period, global foreign exchange reserves fell by USD 370.8 billion, or 3.1% MoM. Among them, the reserve assets of the top three currencies, USD, EUR, and JPY fell by USD 392 billion. Therefore, the share of RMB reserve assets has increased rather than decreased, further consolidating the status as the fifth largest reserve currency. The strengthening of RMB as an international currency demonstrates China's relatively strong economic and financial resilience under the current high inflation, slowing economic recovery and intensifying financial turmoil.

Looking forward 2H2022, with the supportive policies to corporates gradually comes into effect, the resumption of work and production, China's economy will stabilize and recover; Foreign trade will remain resilient and the RMB basis for further depreciation will be significantly weakened.

Two-way fluctuation characteristic will be maintained. On May 11, the IMF completed its 5-yearly review of Special Drawing Rights (SDR) and increased the RMB weighting from 10.92% to 12.28%, up 1.36%. The increase in RMB weighting of SDR basket reflects the increasing international recognition of RMB. In the long run, considering that the fundamentals of China economy remain unchanged and foreign investment in RMB assets is still under-allocated, RMB assets are still attractive to foreign investors.



RMB Internationalization Updates

SAFE launched high-level cross-border trade and investment opening-up trials

SAFE launched trials in Shanghai, Guangdong, Hainan, and Zhejiang etc. to further open up cross-border trade and investment.

China cut reserve requirement ratio for foreign currency deposits

PBOC cut the RRR for foreign currency deposits by one percentage point from the current 9% to 8%, starting from May 15, 2022.

PBOC Issues New Bond Lending Rules for Interbank Market

The rules support market participants to conduct the regulated central bond lending.

China to pilot digital yuan in more cities

PBOC expanded digital yuan pilot program to Tianjin, Chongqing, Guangzhou, Fuzhou and Xiamen, and six cities in Zhejiang province.

2022

JAN

4

29

FEB

1

MAR

24

APR

2

6

25

PBOC & SAFE issued the "Notice on Overseas Loan Business of Banking Financial Institutions"

The Notice encourages onshore banks to extend loans to overseas corporates either directly or by via financing with offshore banks.

HKEX and China Emissions Exchange Guangzhou signed MOU

HKEX and CEEX will jointly explore cooperation in tackling climate change and promoting sustainability through carbon finance.

China solicited opinions on draft financial stability law

The draft clarified the responsibilities of the mechanism for coordinating national financial stability and development, and also proposed to set up a guarantee fund for financial stability.

CSRC Solicits Public Opinions on Rules Regarding Overseas Listings

The Opinions further regulate overseas securities offering and listing activities by domestic companies in direct or indirect form.

PBOC, CSRC and SAFE issued joint announcement on Further Facilitating Foreign Institutional Investors' Investment in China's Bond Market

They will coordinate to promote opening-up of the interbank and exchange bond markets, and unify cross-border capital management.

PBC announces largest cut in 5-year LPR

PBOC lowered the 5-year loan prime rate (LPR) by 15 basis points to 4.45 percent, its biggest cut in the mortgages-referenced benchmark for longer-term lending.

BIS announces Renminbi Liquidity Arrangement

The Renminbi Liquidity Arrangement (RMBLA) will provide liquidity through a reserve pooling scheme to participating central banks from the Asia-Pacific region.

PBOC, HKMA & SFC to launch Swap Connect

The official launch of Swap Connect will take place after six months. At the initial stage, Northbound Trading will commence first.

Launch of ETF Inclusion in Stock Connect

Among the first batch of 87 eligible ETSs, 83 are for northbound trading and 4 for southbound trading.

Ministry of Commerce, PBOC and SAFE issued the "Notice on Supporting Foreign Economic and Trade Enterprises in Improving Foreign Exchange Risk Management Capabilities"

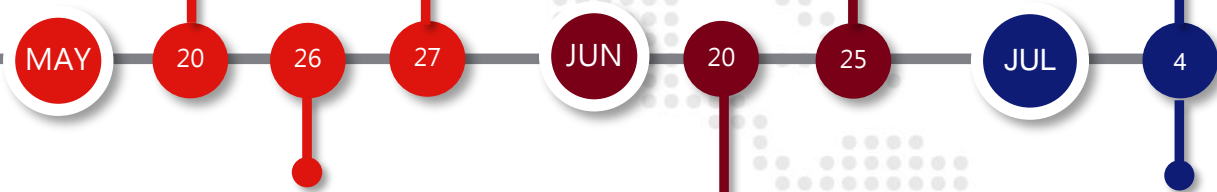
The Notice requested financial institutions to further facilitate cross-border RMB settlement for enterprises to avoid exchange rate risks.

Enhanced Currency Swap Agreement between PBOC and HKMA

The Currency Swap Agreement has become a long-standing arrangement with no need for renewal, with its size expanding from RMB500 billion to RMB800 billion.

PBOC issued the "Notice on Supporting Cross-border RMB Settlement of New Forms of Foreign Trade"

PBOC issued the Notice on improving policies related to cross-border RMB business in new forms of foreign trade such as cross-border e-commerce.



Celebrating the 25th anniversary of Hong Kong's return to the motherland — New features and policy developments of Hong Kong as a global offshore RMB business hub

Ying Jian, Principal Strategist

In the meeting celebrating the 25th anniversary of Hong Kong's return to the motherland and also the inaugural ceremony of the sixth-term government of the Hong Kong Special Administrative Region (HKSAR), President Xi Jinping delivered an address. He said, the central government fully supports Hong Kong in its effort to maintain its distinctive status and edges, to improve its presence as an international financial, shipping and trading center. Since the handover, the central government has highly trusted Hong Kong's financial industry, and launched many financial market opening-up pilot programs in Hong Kong, in an effort to build Hong Kong as a global offshore RMB business hub. On the occasion of the 25th anniversary of the handover, new policies and measures were successively introduced to further consolidate Hong Kong's distinctive status and edges.

I. New features of Hong Kong developing as a global offshore RMB business hub

1 、 To promote the steady and balanced development of Hong Kong offshore RMB market step by step

In December 2003, the People's Bank of China (PBoC) appointed the first offshore renminbi clearing bank in Hong Kong and launched four personal renminbi services, even before the mainland China officially introduced the internationalisation of the renminbi, marked by the launch of cross-border renminbi trade settlement in July 2009. After the introduction of the cross-border RMB trade settlement policies, the scope of RMB business in Hong Kong has been expanded from individuals to enterprises.

In August 2011, the central government announced a series of measures to promote the development of Hong Kong offshore RMB center, such as allowing foreign direct investment in RMB (RFDI), launching Renminbi Qualified Foreign Institutional Investor (RQFII) program, and promoting three types of overseas institutions to invest in the domestic bond market etc. The scope of RMB business in Hong Kong was expanding at that time, but with very limited RMB products, the overall market was relatively fragmented and not balanced.

In recent years, RMB business in Hong Kong has continued to rebound. A notable feature is that all kinds of business have maintained a certain growth rate, the capital account and current account keep abreast, and investment and financing business, asset management and financial product trading become more active. Dim sum bonds issued 292.3 billion yuan in the first half of this year, more than in all of last year, according to Bloomberg data. According to the Hong Kong Monetary Authority, the value of dim sum bonds traded in the first half of this year was 1.16 trillion yuan, 1.68 times that of the whole of last year. The data showed that outstanding yuan-denominated loans in Hong Kong reached 178.4 billion yuan at the end of April, up 13.4% year on year. According to the Hong Kong TMA, the average daily trading volume of RMB against the US dollar in Hong Kong last October was US \$123.8 billion, up 10.9 percent year on

year, making the volume of RMB foreign exchange trading in Hong Kong 4.1 times that of the UK, which ranked second.

2 · To build an ecosystem for the international use of RMB and promote a virtuous cycle driven by innovation

As an international financial center, Hong Kong operates under internationally aligned regulatory regimes, but it also provides regulatory flexibility for financial institutions to conduct business. In 2010, the Hong Kong Monetary Authority (HKMA) issued a "circular" on renminbi business, which made it clear that with regard to the RMB funds that have flowed into Hong Kong, authorized institutions participating in RMB businesses (Participating AIs) can develop RMB businesses based on the regulatory requirements and market conditions in Hong Kong. In other words, Participating AIs can conduct RMB businesses in accordance with the prevailing banking practices applicable to the businesses conducted in other foreign currencies, creating favorable conditions for renminbi product innovation. In the same year, Bank of China (Hong Kong) was the first to retain its offshore renminbi exposure, provide RMB position-squaring service to the peers in the offshore market. This move ushered in a new era of offshore renminbi trading and liquidity management, marked by the Spot USD/CNH Fixing and the CNH HIBOR Fixing first appearing in Hong Kong.

Hong Kong adopted the yuan earlier than other overseas regions, attracting a steady inflow of yuan to form an offshore renminbi pool. At the end of May this year, RMB deposits in Hong Kong reached 850.4 billion yuan, up 3.6 percent year-on-year, accounting for 60 percent of the total offshore RMB deposits. With abundant RMB funds, a full range of RMB products and robust RMB trading activities, Hong Kong has developed into an offshore renminbi asset management center, driving the growth of RMB fund management, insurance and derivative business, and gradually forming RMB business ecosystem in Hong Kong. The overseas use of the renminbi was expanding, instead of limiting only to cross-border use. According to a survey by the Securities and Futures Commission (SFC), there were 577 RMB investment products approved in Hong Kong in 2021, with assets under management of RMB204 billion yuan and onshore investment ETFs reaching USD8.325 billion. According to the statistics of the Hong Kong Stock Exchange, there were 2,356,000 contracts of renminbi futures and options traded in 2021 with an open position of 24,000 contracts at the end of the year. According to the statistics of the Hong Kong Insurance Authority, the premiums of the newly issued RMB insurance policies reached 5.86 billion yuan in 2021.

3 · To lay solid foundation for the implementation of RMB

internationalization to ensure its steady and sustained development

Over the past decades, Hong Kong has attached great importance to its financial infrastructure in building itself as an international financial centre, in an effort to ensure the efficient and safe operation of its financial system. It has also enabled the renminbi to access the world's most advanced payment and clearing network once it entered the offshore market. PBoC appointed Bank of China (Hong Kong) as the clearing bank for RMB business in Hong Kong, and engaged BOCHK to set up an renminbi real-time gross settlement (RTGS) system, connecting the mainland modern payment system on one end, and Hong Kong and the global mainstream payment and trading systems on the other end, including Hong Kong multi-currency RTGS system, the clearing and custodian system for debt instruments/the Central Moneymarkets Unit (CMU), securities settlement system, and other overseas debt and forex trading systems, building a network for RMB flows in the offshore market.

In 2015, CIPS was officially launched, and Hong Kong RMB RTGD System soon joined this national cross-border RMB payment system, playing an important role in the development of CIPS. Nowadays, the vast majority of renminbi clearing business in Hong Kong has been switched to CIPS.

According to Hong Kong Interbank Clearing Limited (HKICL), the cumulative clearing volume of RMB RTGS system reached 192 trillion yuan in the first half of 2022, up 7.6 percent year on year, with the average daily clearing volume exceeding 1.5 trillion yuan. According to SWIFT statistics, Hong Kong RMB payment value accounted for 72.3% of the world's total in 2021, making Hong Kong as the global RMB clearing hub.

4 · To channel and promote smooth two-way investment between onshore and offshore financial markets

The internationalization of the renminbi and the opening of capital account in the mainland China has been carried out simultaneously and mutually benefit each other, which is a major feature of the opening of China's financial market. Given China's steady economic growth, global investors have been interested in investing renminbi assets for years. The mainland introduced QFII and RQFII schemes in the early stage to meet the demand of foreign investors. However, with the expansion of the demand for renminbi assets, especially after the inclusion of RMB into the SDR currency basket by IMF in 2016, the mainland innovatively introduced the mutual market access program. Hong Kong has been in the leading position of offshore market in both channels. It has not only occupy a large

amount of the QFII and RQFII quotas, but also assists the mainland in promoting the policy innovation, such as Shanghai-Hong Kong Stock Connect (2014), Shenzhen-Hong Kong Stock Connect (2016), Bond Connect "Northbound" (2017), Bond Connect "Southbound" (2021) and the Greater Bay Area Wealth Management Connect (2021), as well as mutual recognition of funds (2015) and Shanghai-Hong Kong Gold Connect (2015), so as to attract foreign capital to invest in renminbi assets either in Hong Kong or through Hong Kong to the mainland market.

Mutual market access programs has proved to be a success. In 2021, the southbound trading volume under Shanghai/Shenzhen-Hong Kong Stock Connect reached 9.34 trillion yuan, up 70% year on year, accounting for 22.7% of Hong Kong stock market. The north trading volume was 27.6 trillion yuan, up 31 percent year on year, accounting for 10.7% of the combined Shanghai and Shenzhen stock markets. In 2021, the northbound transaction volume of the Bond Connect reached 6.46 trillion yuan, up 34.2% year on year, making it a major channel for foreign investors to increase their holdings of RMB bonds. By the end of 2021, the outstanding amount of renminbi bonds under custody in domestic interbank bond market by foreign institutions reached 4 trillion yuan, accounting for 3% of the total.

5 · To constantly enhance the core competitiveness of Hong Kong's offshore RMB business hub

Hong Kong has conducted offshore RMB business for nearly 20 years, but offshore renminbi market is still in the initial stage of development and has some shortcomings. In recent years, financial institutions in Hong Kong focused on tapping new business opportunities and diversifying their own services in response to market changes and customer needs. For example, Hong Kong offshore yuan liquidity management is relatively weak, with CNH interbank rate volatility greater compared to that of domestic market. Short-term funding through CNH swaps has also certain limitations. Seizing the opportunity of PBoC's regular issuance of renminbi bills in Hong Kong, BOCHK launched offshore PBoC Bills Repo business and market-making mechanism in 2021, providing a new liquidity management tool. In the first half of 2022, the transaction volume doubled that of 2021 (full year), with daily volume exceeding 10 billion yuan in some trading days, helping ease the tight liquidity conditions of offshore RMB.

In recent years, the PBoC has conducted in-depth research on the digital yuan (E-CNY) to meet payment demands in the digital

economy, and explored cross-border E-CNY usage scenarios. Financial institutions in Hong Kong have not only participated in testing the cross-border and offshore use of E-CNY, but also contributed to blockchain trade finance studies and mBridge project through bilateral and multilateral monetary cooperation.

In addition, Hong Kong's Green Business in renminbi has also achieved some breakthroughs, adding renminbi into green bonds, loans, deposits, equity investments and green insurance, helping build Hong Kong into a green finance center.

6 · To serve as the investment, financing and risk management center under the Belt and Road Initiative and the RCEP

The central government strongly supports Hong Kong to develop into a business center for investment, financing and risk management under the Belt and Road initiative. Leveraging its unique edges as the global offshore RMB business hub, Hong Kong has continuously expanded its coverage of offshore RMB services to other overseas regions and supported the development of other offshore RMB markets.

Nowadays, China pushes forward the implementation of the Belt and Road initiative by strengthening economic and trade cooperation with the neighboring countries, such as setting up free trade zones and establishing Comprehensive Strategic Partnership between China and the ASEAN countries. While RCEP entered into force this year, Hong Kong is actively applying to join the trade agreement, tapping more opportunities for offshore RMB business development.

ASEAN countries are the next focus of Hong Kong's offshore RMB business development. Hong Kong enjoys close economic and trade relations with ASEAN countries, and they are each other's major trading partner and source of investment, generating large amount of two-way capital flows. There is strong demand for cross-border financing, investment and forex services between the two places. Some financial institutions in Hong Kong set up branches and subsidiaries in ASEAN countries and coordinate the overall business in the region, taking RMB business as a main focus of business expansion. The analysis of SWIFT statistics shows that the amount of RMB received and paid between Hong Kong and ASEAN countries exceeds that among

ASEAN countries. ASEAN countries carry out RMB denominated trade financing, bond investment and other businesses with Hong Kong, indicating that ASEAN takes Hong Kong as its main counterparty in conducting offshore RMB business.

II. Mainland China's New policies and measures to support RMB business development in Hong Kong

With the 25th anniversary of Hong Kong's return to China, the development of Hong Kong's offshore RMB business hub has been improving. The global market continues to have stronger confidence in the RMB. The driving force of RMB internationalization is also becoming stronger, presenting a new development way driven by both market and policy. This year, to promote the development of RMB business in Hong Kong and RMB internationalization, Mainland regulators sort out all kinds of RMB-related policies put forward in different period, and analyzed the current market changes and demand, so as to further improve the internationalization policy system, focusing on key points that are conducive to promoting the development of the RMB business in Hong Kong. To sum up, it mainly focuses on the following aspects:

1. To improve offshore RMB liquidity management

On July 4, PBoC and the HKMA signed a long-standing currency swap agreement, expanding the scale of currency swap from the original RMB 500 billion to RMB 800 billion. It is an important measure taken by the central government to support Hong Kong as an offshore RMB business hub.

Hong Kong and the mainland signed a currency swap agreement as early as 2009, with an initial swap volume of RMB 200 billion, making it one of the first offshore regions to carry out currency swap agreement with the mainland. Over the past decade, the two sides have repeatedly renewed their agreements and expanded their amount, making Hong Kong the world's largest pool of RMB swap funds available outside China. The introduction of a long-standing currency swap agreement that does not need to be renewed regularly is an important innovation and improvement. Comparing to previous arrangement, as the long-standing currency swap agreement doesn't require regular renewal and re-signed, the implementation process is relatively simpler, and thus is highly replicable.

Carrying out RMB/HKD swap is significance to the healthy and stable development of Hong Kong offshore RMB market. RMB is

the legal tender issued by the PBoC. After RMB becomes an international currency, the People's Bank of China naturally takes the responsibility of global last lend of resort for RMB. As the offshore RMB pool in Hong Kong is limited, bilateral currency swap is a key liquidity safeguard for market players, apart from the liquidity management facilities of the HKMA and the clearing bank. The signing and expansion of the long-standing swap agreements can boost confidence in the RMB market. According to the PBoC's Report on the RMB internationalization, currency swaps between central banks and overseas monetary authorities have been used frequently, with outstanding RMB swaps reaching RMB 61.5 billion last year. As an increasing number of connectivity projects are introduced in Hong Kong, currency swaps may be considered to ease RMB funding pressure.

2. To enrich financial markets connectivity

Regulators in Mainland China and Hong Kong recently announced two connectivity projects. First, PBoC, Hong Kong SFC, and HKMA co-launched "Swap Connect". Second, China Securities Regulatory Commission, the Hong Kong SFC co-launched "ETF Connect". Both connectivity schemes further improved connectivity mechanism, enriching financial product offerings to onshore and offshore investors.

"Swap Connect" allows onshore and offshore investors to participate in the trading of derivatives market through the connectivity scheme between Hong Kong and the mainland infrastructure. The "northbound trading" will be opened initially, and the product offering will be limited to interest rate swap products first. It is expected to be officially launched in six months. Northbound trading of Swap Connect is jointly promoted by three infrastructure institutions, including the China Foreign Exchange Trade System (CFETS), which provides OTC derivatives trading services, the Mainland OTC derivatives clearing company-Shanghai Clearing House, and the Hong Kong OTC Derivatives clearing Company-Hong Kong OTC Clearing Company will provide centralized clearing service as central counterparties (CCP). Foreign investors do not need to change their trading habits, and access the CFETS trading system through the overseas third-party electronic trading platform. After finishing derivatives trade with domestic quotation institutions, CFETS will immediately transmit transaction information to the two clearing companies to complete the settlement.

The significance of "Swap Connect" is not only to provide new connectivity products, but also to provide risk hedging tools for overseas investors, reducing interest rate risk on bond value, boosting overseas

investors' long-term holding of bonds. It also has a strong support role for Hong Kong as an offshore RMB asset management hub.

The "ETF Connect" is an important complement to the Shanghai-Hong Kong Stock Connect and Shenzhen-Hong Kong Stock Connect, enriching product offering for onshore and offshore investors to invest in the stock markets of the two places. The CSRC and the Hong Kong SFC reached consensus on the inclusion of ETFs in the stock connect as early as 2016. The CSRC agreed in principle to officially launched ETF Connect and carry out market consultation on it at the end of June. The arrangements took the Shanghai-Hong Kong Stock Connect and Shenzhen-Hong Kong Stock Connect as reference, and included ETF trading, registration and settlement arrangements, investor suitability, and cross-border regulatory cooperation, allowing investors to trade approved ETFs of the two places.

3. To integrate bond market open-up measures

The Mainland continued to open its bond market, and improved Bond Connect and global connectivity (i.e., direct investment in the onshore interbank market), thus attracting more foreign investors to allocate RMB assets in Hong Kong.

In May, the CSRC and State Administration of Foreign Exchange jointly issued "about further facilitate foreign institutional investors to invest in China's bond market related matters," integrating a number of bond market open-up policies and measures, to form the integrated and systematic arrangement.

First, it establishes a multi-tiered custody system, allowing overseas investors to directly or through overseas custody banks to entrust bond custody to the onshore banks. Together with the current settlement agent system, the multi-tiered custody system provides an alternative option for foreign investors;

Second, the market entry procedures will be simplified. Foreign investors will be allowed to enter the market as legal persons instead of filing products individually. For registered products, it provides non-transaction transfer services;

Third, foreign investors who are allowed to enter the inter-bank market can invest in the bond market directly or through connectivity.

In addition, bond market operators have proactively optimized the investment environment for overseas institutions and enhance investment infrastructure. On July 4, CFETS cooperated with Bond Connect to

connect the bond issuing and distribution system with a one-stop electronic platform for bond primary deals in the offshore market (ePrime). Foreign investors can participate in online distribution without having to repeatedly sign distribution agreements offline after each issuance. It also promotes the linkage of the primary market and secondary markets. Bond Connect also reduced overseas service fees on its electronic trading platform.

4. To support the real economy in conducting cross-border business

Facilitation of trade and investment settlement has been one of the main focuses of RMB internationalization. In 2021, 6 Ministries including PBoC issued the "Notice on Further Optimizing Cross-border RMB Policy and Supporting Stable Foreign Trade and Foreign Investment (No. 330)", which enhance the effectiveness of cross-border RMB business in supporting the real economy. This year, to optimize the policy framework, PBoC and SAFE co-issued "Notice on Overseas Lending by Banking Institutions (No. 27)", encouraging domestic Banks to make loans to offshore corporates directly, or through foreign Banks to offer loans to offshore corporates. Relevant policies have been incorporated into the macro-prudential management policy framework.

Cross-border financing has expanded from one-way inflows to two-way financing, improving the international financing function of RMB. These measures will directly benefit RMB investment and financing businesses in Hong Kong.

Moreover, in June, PBoC published a circular that improve policies for cross-border RMB settlement in e-commerce and other foreign trade. It improves RMB business-related policy in cross-border business such as e-commerce. SAFE launched pilot program in some onshore cities to conduct high level open-up for cross-border trade and investment, covering capital account and current account projects. It is believed that it will promote the development of RMB internationalization.

3. RMB business opportunities in Hong Kong and main directions of improving policies and measures

Looking forward to the development of Hong Kong as a global offshore RMB hub, the prospects of RMB business are very bright. In the global financial market, after the start of Russia-Ukraine conflict at the beginning of the year, Europe and the United States implemented financial sanctions and weaponized payment currency, threatening the stability of the international monetary

system. Besides, the US Fed entered into rate hike cycle and started to reduce balance sheet where it alarmed emerging market countries, which rely heavily on dollar payments. Therefore, emerging market countries started to conduct research on local currency settlement with major trading partners. In addition to active promotion of bilateral local currency settlement framework agreements between ASEAN countries and neighboring countries, Russia has adopted local currency settlement measures, and recently the Central Bank of India has officially announced the RUB settlement for international trade. Also, RCEP will continue to expand the economic and trade cooperation between China and its member states and create a broader scope for the international use of the RMB.

At the policy level, the mainland has incorporated RMB internationalization into its national development strategy, showing its determination to promote the international use of RMB. The "14th Five-Year Plan" clearly states: "to promote RMB internationalization steadily and cautiously, maintain market-oriented and corporate's independent choice, and create a new mutually beneficial cooperative relationship based on the free use of RMB", which creates a blueprint for the development of RMB internationalization

In 2019, the central government published the Outline for the Guangdong-Hong Kong-Macao Greater Bay Area. Subsequently, 4 Ministries, including PBoC, issued recommendations on financial support for the development of the Greater Bay Area. It states specific direction of the development of a global offshore RMB business hub in Hong Kong and promoting the use of cross-border RMB in the Greater Bay Area. Under these guidelines, the Mainland is expected to announce more policy measures when policy implementation comes to effect:

First, increase cross-border capital flows and enhance Hong Kong's ability in managing offshore RMB liquidity. The mainland is expected to promote the RMB flow into Hong Kong through multiple channels and expand offshore RMB fund pool. For example, exploring ways for banks in the Greater Bay Area to conduct cross-border RMB lending and account financing in accordance with relevant regulations, lowering threshold for cross-border RMB cash pooling, promoting integrated local and foreign currency cash pooling policies, and moderately increasing the quota of cross-border RMB cash pooling. Management of offshore RMB liquidity should be improved. With continuous issuance of RMB central bills by PBoC and the increase of RMB Treasury bond issuance by the Ministry of Finance, it will promote the development of RMB bond repurchase business for better liquidity management.

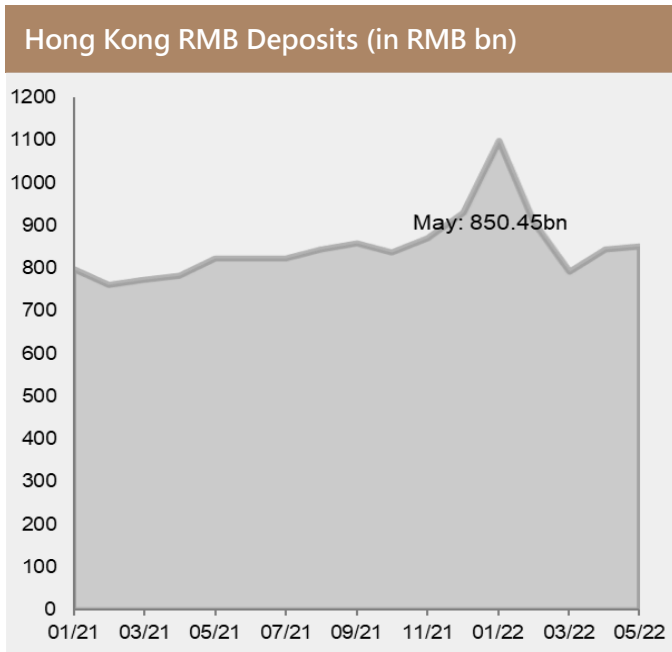
Second, RMB-denominated products should be further developed to increase the attractiveness of Hong Kong's offshore RMB assets. It is expected that the Mainland will continue support Hong Kong financial institutions in RMB business innovation, developing more offshore financing products, risk hedging products, and foreign exchange products. It is also expected that they will promote RMB-denominated stocks and wealth management products, approve more onshore institutions to issue dim sum bonds, encourage commodity settlement in RMB. The "Belt and Road" and RCEP RMB investment, financing and risk management platform will be built to meet different RMB needs.

Third, innovative and special RMB business should be developed to expand the depth of the offshore RMB market in Hong Kong. In supporting Hong Kong in building a green financial center, cross-border use of RMB should be enhanced by encouraging local governments, financial institutions and corporates to issue RMB green bonds and green loans. Cross-border use of digital RMB should be explored by utilizing Hong Kong's financial system. It is expected in research on dual-currency e-wallet with digital RMB and digital Hong Kong dollar built-in, explore the interconnection between digital RMB and Hong Kong FPS, and jointly study mBridge platform for cross-border network of digital currencies.

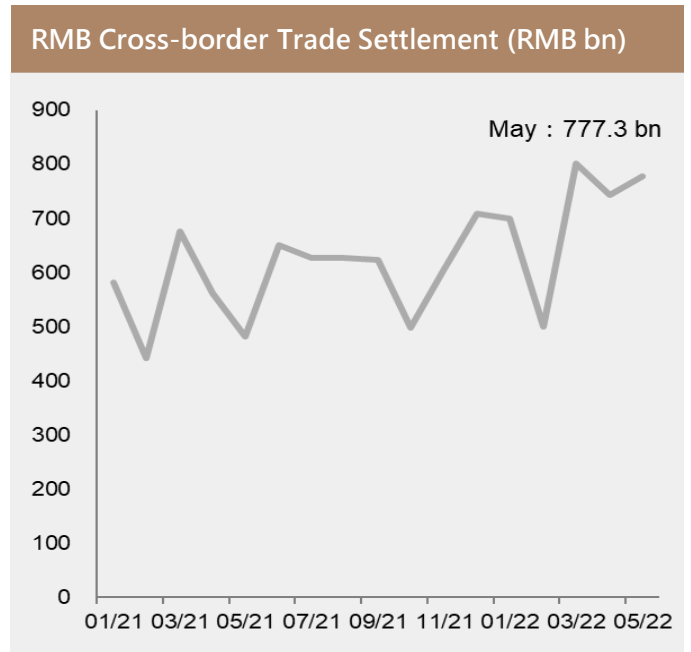
Fourth, financial market connectivity should be improved to facilitate cross-border RMB flows in the Greater Bay Area. We should continue improve the Stock Connect, Bond Connect, and Wealth Management Connect mechanisms. It is expected in lowering the entry threshold for domestic residents to participate in the stock Connect and wealth Management Connect, and adding RMB-denominated stocks to the southbound transactions of the Hong Kong Stock Connect. More products and insurance products should be included in Wealth Management Connect to meet investors' risk and return expectations. Increase the number of mainland institutional investors participating in the Southbound bond Connect and expand number of approved bonds; Establish Greater Bay Area insurance after-sales service centers in Qianhai, Nansha and Hengqin, and pilot cross-border RMB settlement for insurance renewal claims, to promote insurance connectivity.

To conclude, Hong Kong's global offshore RMB business hub has entered an important strategic period. President Xi Jinping encouraged Hong Kong to leverage its advantage to seize national development opportunity, connecting national strategy of 14th Five-Year Plan, Guangdong-Hong Kong-Macao Greater Bay Area, and the Belt and Road Initiative to strengthen growth drivers. PBoC clearly stated that it will continue support the development of Hong Kong's international financial center where Hong Kong will play an important role in the RMB internationalization. The new HKSAR government also mentioned its dedication in internationalizing RMB and strengthening Hong Kong's position as an offshore RMB business hub. With support from the central government and the efforts of the HKSAR government and society, we will continue to push Hong Kong to a higher level as a global offshore RMB business hub.

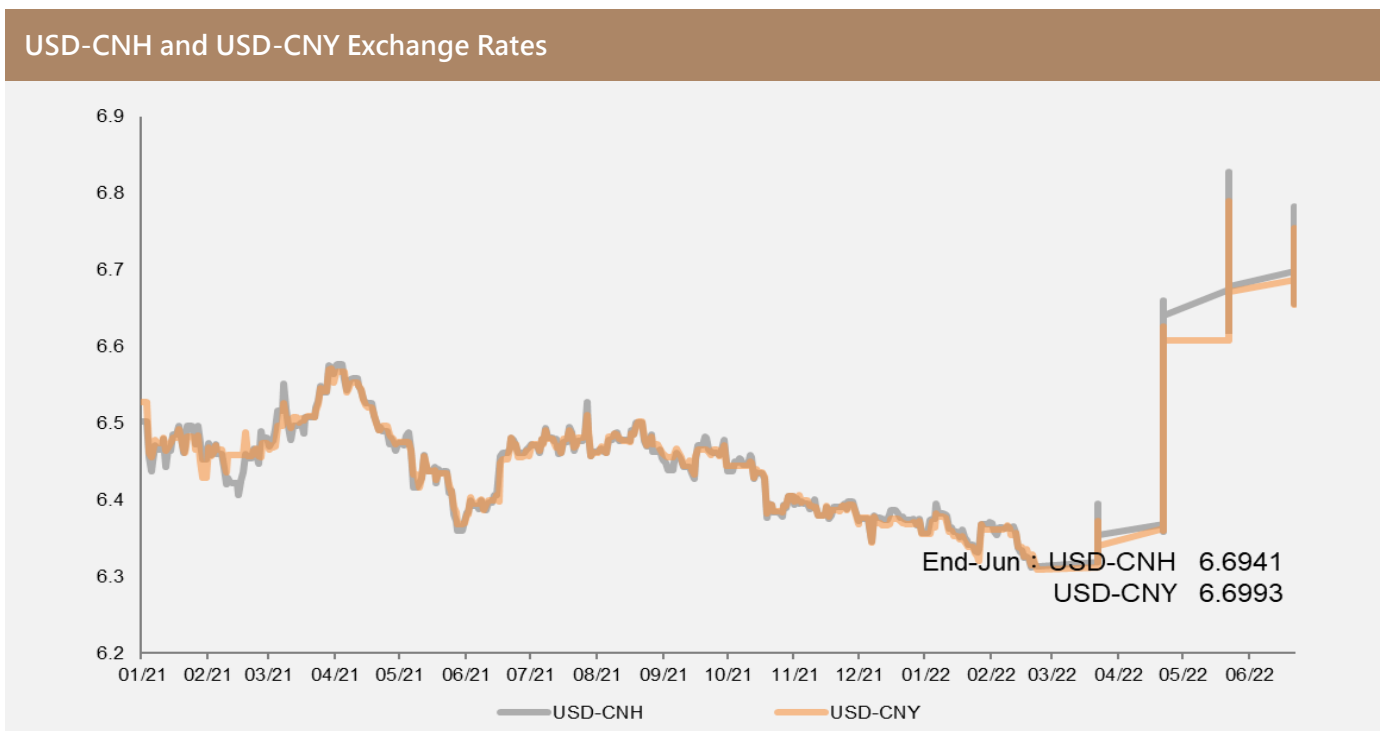
Market Trends



Source: HKMA

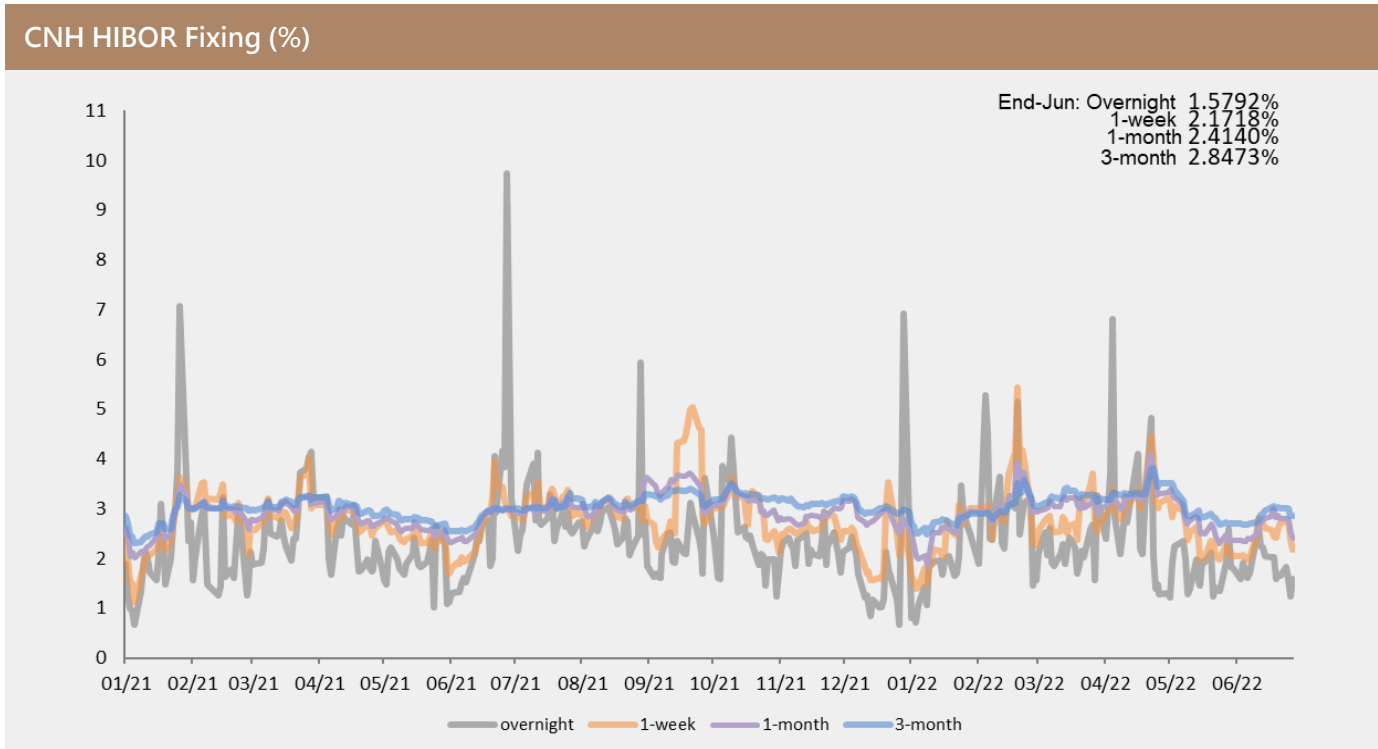


Source: HKMA



Source: Bloomberg

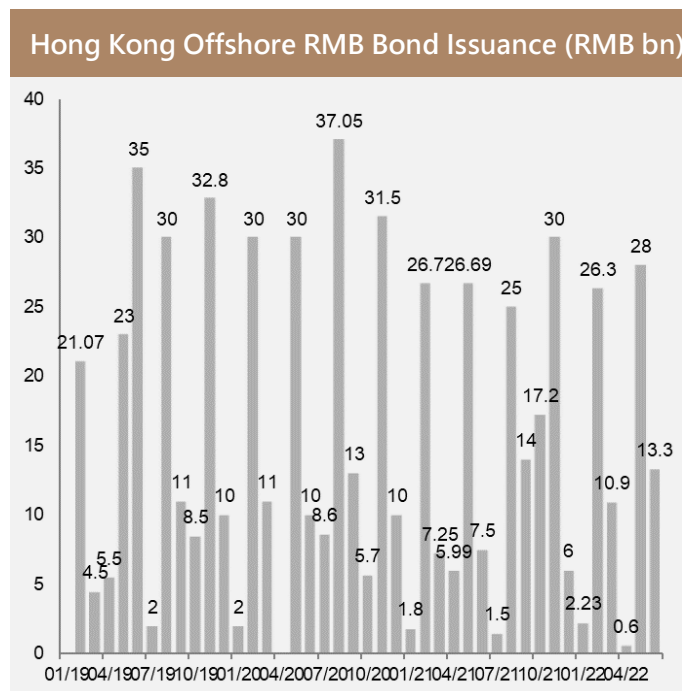




Source: Bloomberg

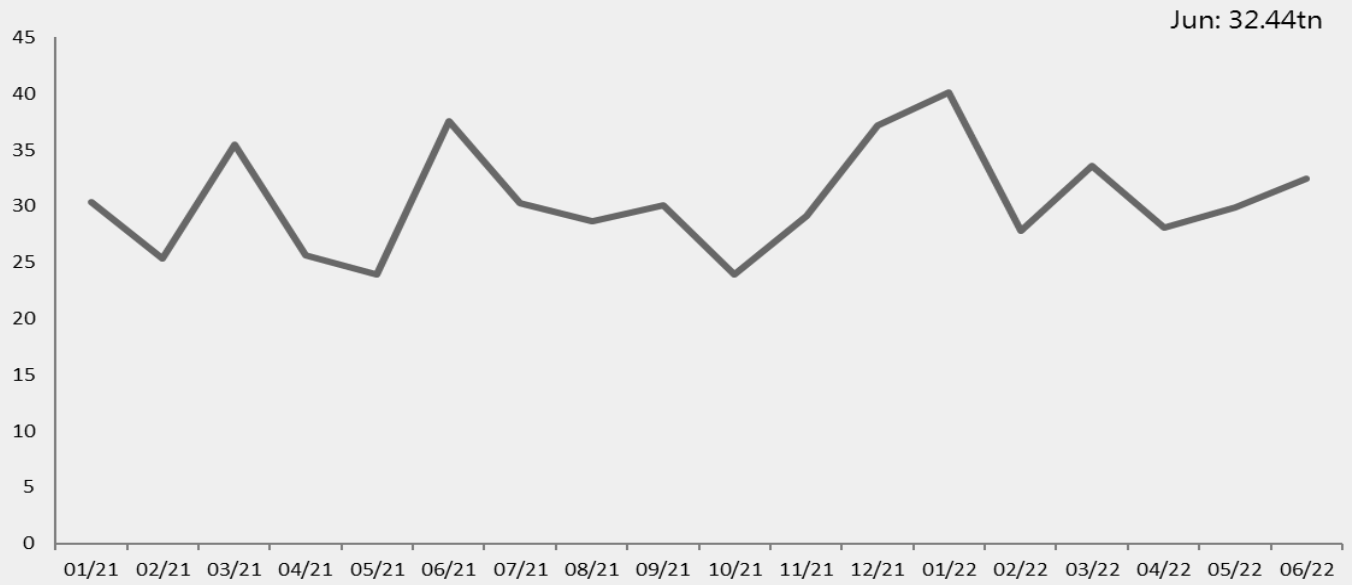


Source: Bloomberg



Source: BOCHK Global Market estimate

RMB Clearing Transaction Value (RMB tn)



Source: HKICL

SWIFT World payments currency ranking & market share

December 2019		Jun 2022	
#1	USD 42.22%	#1	USD 41.16%
#2	EUR 31.69%	#2	EUR 35.55%
#3	GBP 6.96%	#3	GBP 5.96%
#4	JPY 3.46%	#4	JPY 3.01%
#5	CAD 1.98%	#5	CNY 2.17%
#6	CNY 1.94%	#6	CAD 1.86%
#7	AUD 1.55%	#7	AUD 1.40%
#8	HKD 1.46%	#8	HKD 1.27%

Source: SWIFT

Market Data

	Hong Kong RMB Deposits (RMB bn) (Year-end / Month-end)	RMB Cross-border Trade Settlement (RMB bn) (Yearly / Monthly)	RMB Clearing Transaction Value (RMB tn) (Yearly / Monthly)	Overnight CNH HIBOR Fixing (%) (Year-end / Month-end)	1-week CNH HIBOR Fixing (%) (Year-end / Month-end)	3-month CNH HIBOR Fixing (%) (Year-end / Month-end)
2015	851.1	6833.1	221.22	1.763	5.026	5.459
2016	546.7	4542.0	201.57	12.813	11.817	9.131
2017	559.1	3926.4	212.63	1.729	3.000	4.803
2018	615.0	4208.9	233.98	1.726	2.795	3.582
2019	632.2	5376.3	265.81	1.929	2.400	3.260
2020	721.7	6324.1	282.47	4.031	2.958	2.882
2021	926.8	7083.5	357.70	6.926	2.5675	2.98617
2022.1	1095.9	699.4	40.11	2.511	3.012	2.89067
2022.2	906.7	500.7	27.83	3.2265	3.0185	3.2518
2022.3	791.3	801.6	33.57	3.2695	2.5365	3.1285
2022.4	841.9	742.5	28.09	1.26983	3.124	3.516
2022.5	850.4	777.3	29.87	2.5903	2.0753	2.6903
2022.6	/	/	34.44	1.5792	2.1718	2.8473

Source: HKMA, Bloomberg, HKICL, BOCHK

	USD-CNH Exchange Rates (Year-end / Month-end)	USD-CNY Exchange Rates (Year-end / Month-end)	HK Offshore RMB Bond Issuance (RMB bn) (Yearly / Monthly)	10Y CNH China Sovereign Bond Yield (%) (Year-end / Month-end)
2015	6.570	6.495	84.1	3.372
2016	6.981	6.952	42.2	3.637
2017	6.515	6.507	24.9	4.140
2018	6.870	6.879	29.1	3.602
2019	6.963	6.963	183.4	3.189
2020	6.503	6.527	188.9	2.947
2021	6.3571	6.3561	169.6	2.9264
2022.1	6.3707	6.3613	2.2	2.8554
2022.2	6.314	6.3092	26.3	2.9137
2022.3	6.3547	6.34	10.9	2.9716
2022.4	6.6404	6.6085	0.6	3.1923
2022.5	6.6787	6.6718	28	3.085
2022.6	6.6941	6.6993	13.3	3.1746



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