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Contents

Part 1 Market Review

Part 2 Policy Watch

Part 3 Special Topics

Part 4 Market Trends & Data

1

5

6

10

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RMB fluctuated in narrow range, Bond Connect launched ePrime Northbound Primary Service

The CNH traded in narrow and stable range in July compared with the previous month. The Key business indicators of offshore RMB were slightly fluctuated. RMB SWIFT global payment ranked fifth. Bond Connect launched cross-border bond subscription business. Net sold amount of foreign holding in RMB bond has declined, meaning china economy's good long-term fundamentals have not changed, and the prospect of RMB assets is still optimistic.

I. The CNH volatility narrowed with a stable trading in July

In July, the CNH exchange rate continued to depreciate in a narrow range, maintaining two-way fluctuations between 6.69 and 6.76. CNH traded at 6.69 to 6.71 at the beginning of the month, after the Federal Reserve sharply raised interest rates again by 0.75%, the US dollar strengthened to 108, offshore RMB fell to 6.76 in the middle of the month. CNH traded in a narrow range of 6.74 to 6.76 at the end of the month. The market trading sentiment was stable. On July 28, the SAFE held a meeting on foreign exchange management for the second half of 2022, which emphasized that it would maintain the stable operation and improve the micro supervision of the foreign exchange market. It was also pointed out that they will strengthen monitoring and response to risks in cross-border capital flows to safeguard national economic and financial security. This reflects China's determination to maintain the stability of the foreign exchange market, sending a positive signal to the

market. On July 29, the central parity rate of RMB against US dollar published by CFETS was 6.7437, down 0.48% MoM; the CNY closed at 6.7445, down 0.67% MoM; The CNH closed at 6.7498 down 0.83% MoM.

On July 12, the EUR fell below parity against the USD, trading at 0.9999 for the first time in nearly 20 years. The euro's parity increased risk aversion and rattled overseas financial markets, pushing the dollar index higher. The EU is an important trading partner for China, and a stagflation in the euro zone would raise the challenge of stabilizing China's economic growth through trade. It increased pressure on the RMB, yet, it has rebounded quickly. The euro briefly rose to an intra-week high near 1.0274 after the ECB raised rates for the first time in 11 years on July 21, raising its benchmark rate by 50 basis points, becoming the latest major central bank to enter into rate hike cycle. Sentiment fluctuated when the U.S. Labour Department released its consumer price Index (CPI) on July 13, rising 9.1% in June from a year earlier to a 40-year high.

The Fed raised its target range for the federal funds rate by 0.75% on July 28, from 1.5% to 1.75%, to 2.25% to 2.5%, as it seeks to control inflation without causing a recession. For the RMB, this year, influenced by multiple factors such as the Federal Reserve's interest rate hike and geopolitical conflicts, the USD play an important role in the international foreign exchange market as most of the currencies weakened against the US dollar. In this context, although the exchange rate of RMB against the US dollar has depreciated, compared with other major international currencies, the value of RMB is relatively stable. The dollar index is up more than 11% this year, while the euro, pound and yen are down between 10% and 17% against the dollar and the RMB is down 5.8% against the USD. With the increasing risks of recession in the United States and Europe, the RMB exchange rate has come under some pressure, but it will remain stable at a reasonable and balanced level.

Regarding offshore RMB liquidity, as of July 29, the overnight and 1-week CNH Hibor rates were 1.2445% and 1.1749% respectively; the 1-month CNH Hibor rate stood at 1.3306%; and the 3-month CNH HIBOR rate was 2.2000%.

II. Review of major offshore RMB business indicators

Offshore RMB business was slightly fluctuated in June 2022. According to HKMA, as of the end of June 2021, Hong Kong's

RMB deposits amounted to RMB 815.03 billion, down 4.2% MoM. HK RMB loans stood at RMB 174.97 billion, down 3.7% MoM. The total remittance of renminbi for cross-border trade settlement amounted to RMB 4.36 trillion in the first 6 months of 2022, up 28.4% YoY.

According to HKICL, RMB RTGS turnover was RMB 28.74 trillion in July 2022, accumulated 220.6 trillion in the first 7 months, up 5.74% 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%, higher than last month at 2.17%, behind USD (41.19%), EUR (35.49%), GBP (6.45%), and JPY (2.82%). According to Bloomberg, offshore RMB bond issuance in primary market amounted to RMB 373.14 billion in the 7 months of 2022, up 181% YoY.

III. Investing in China's Interbank Bond Market

In July, with the worse-than-expected US CPI in June, the Fed tightening expectations strengthened, and the impact of the domestic pandemic, the net outflow pressure of cross-border funds under securities investment increased.

In that month, the turnover under the mainland Stock Connect (northbound) turned into a net selling of RMB 21.1 billion after three consecutive months of net buying;

net buying volume under the Hong Kong Stock Connect (southbound) fell to \$1.8 billion from \$45.7 billion in the previous month which turned the net inflow of RMB 27.3 billion to net outflow of 22.8 billion.

According to CFETS, foreign institutional investors bought a net 6.6 billion yuan of yuan-denominated bonds in July. After four consecutive months of net selling, foreign bond buying data turned from outflow to inflow. With the continuous recovery of China's economy, narrowing US-China yield spread, and the overall stability of the RMB exchange rate, the situation of foreign investment in RMB bonds has shown marginal improvement.

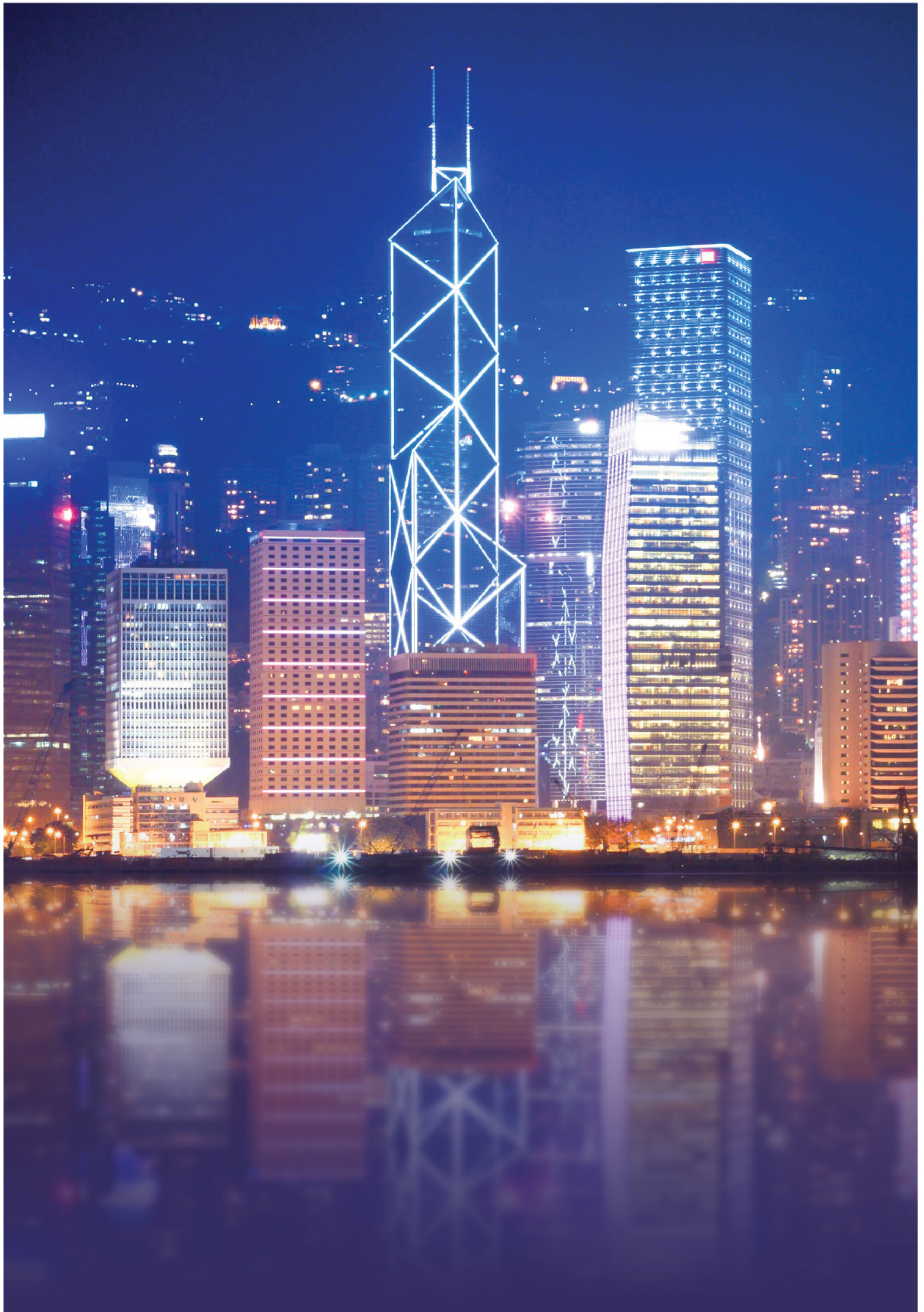
According to PBOC, by the end of July 2022, foreign institutions held RMB 3.51 trillion worth of inter-bank bonds, accounted for 2.9% of the total (vs RMB 3.57 trillion in June). In terms of the change in holdings, the amount of bonds held by overseas institutions in the interbank market decreased by 60 billion yuan in July, which was 30 billion yuan less than that in the previous month, showing a slower decline. In terms of bond type, foreign institutions held RMB 2.32 trillion in government bonds (vs RMB 2.32 trillion in June), and RMB 0.84 trillion in policy bonds (vs RMB 0.86 trillion in June), respectively accounted for 66.2% and 23.9% of the total.

Meanwhile, 8 more foreign institutions entered the interbank bond market in July, bringing the total number of foreign institutions to 1,051 by the end of July.

Among them, 520 entered the market through the direct investment channel, 764 through the bond connect and 233 through the above two channels simultaneously.

The latest report from Bond Connect showed a active market participation in July, with monthly trading volume reached RMB 691.4 billion. Average daily turnover stood at RMB 32.9 billion. Chinese Government Bonds (CGBs) and Policy Financial Bonds (PFBs) were the most actively traded products, each accounting for 41% of the monthly turnover. In that month, foreign institutions under the Bond Connect reduced their holdings of RMB bonds by 54.6 billion yuan, compared with 109.4 billion yuan in May and 93.3 billion yuan in June. The reduction of RMB bonds held by foreign institutions under the Bond Connect has narrowed, which may be related to the decline of US Treasury yields and the narrowing of US-China yield spread during the month.

On July 4, Bond Connect and CFETS jointly launched the Northbound primary service for China Interbank Bond Market (CIBM). The service allows offshore investors to participate in the Northbound subscription of CIBM new issuances. By the end of July, the service has attracted 43 pioneer offshore investors. Among them, 25 offshore investors received allocations from 47 deals, bringing the transaction volume to RMB 1.37 billion in China government bonds, policy financial bonds, green financial bonds, and super short-term commercial papers etc.



HKMA enhances the Renminbi liquidity Facility

HKMA introduced the following enhancement to the RMB Liquidity Facility with effect from 27 July 2022: 1. Increasing each of the intraday and overnight funds to RMB20 billion from the previous RMB10 billion. 2. Extending the operating hours of the overnight repo from the previous 6:00 p.m. to the RMB Real Time Gross Settlement (RMB RTGS) system close at 5:00 a.m. the next day. 3. Lowering of rates applicable to the overnight repo to the average of the most recent three TMA overnight CNH HIBOR fixings (inclusive of the fixing on the same day) plus 25 basis points, subject to a minimum at 0.25%. The previous rates, which will no longer be applicable, involved a spread of 50 basis point and were subject to a minimum of 0.50%.

China to expand cash-pooling program to integrate currency management

China will expand cash-pooling services for multinational companies to integrate domestic and foreign currency management on a larger scale, the People's Bank of China and the State Administration of Foreign Exchange said on July 22. Shanghai, Guangdong, Shanxi and some other regions will be added to this pilot program to facilitate the use and management of cross-border capital.

New policies introduced into the program include increasing pilot areas and companies, allowing multinationals to handle centralized receipts and payments of domestic and foreign currencies in China for their overseas subsidiaries, and further streamlining yuan-denominated cross-border receipts and payments for multinationals.

The pilot cash-pooling program originated in the Chinese capital Beijing and the southern economic powerhouse Shenzhen in March 2021. Cross-border capital managed by the program has amounted to nearly \$50 billion since then.

The History of International bond Market and its implication to the development of offshore Renminbi bond

Ying Jian, Principal Strategist

The issuance and transaction of international bonds of an international currency is an important element of its international currency function. It is also an important indicator of its currency internationalization. EUR international bond has a strong role regionally, accounting for more than 60% of the total issuance in Eurozone. Meanwhile, USD international bond is the world's main financing tool, offshore issuance accounts for nearly 90%. Similarly, the JPY accounts for 86% of issuance outside Japan, even though issuance has shrunk.

The formation and current situation of USD and JPY international bonds

The experience of Europe and the United States show that the international bond of a currency should be the extension and development of domestic bond market, with the rise of the international acceptance and usage. The international bond development usually comes after the development of domestic bond. In this internationalization process, market factors and policy factors will play a role in influencing the development of domestic and offshore international bond.

1. International bond denominated in US dollars

Yankee Bonds - Yankee Bonds comply with the securities laws of the United States, are registered in the US, with the same accounting and disclosure standards as American issuers. New York is the issuance center. From 1946 to 1963, Yankee bonds issued a total of 14 billion dollars.

Eurodollar bonds - The Eurodollar bond market has developed rapidly as a result of changes in US policy. The introduction of the Interest Equalization Tax in 1963 by the Kennedy Administration, along with the Voluntary Foreign Credit Restriction Program and Regulation Q, raising the financing cost for foreign institutions in the United States. Yankee bond issuance was therefore plummeted.

Dollar bond - In 1974, the U.S. abolished the Interest Equalization Tax, then gave up the Voluntary Foreign Credit Restriction Program which stimulated the Yankee bond market again. Foreign issuers, especially some sovereign institutions, returned to the U.S. bond market. London continues to be the mainstream dollar funding center outside the US.

In recent years, the United States has promoted domestic international bond issuance, reformed the registration process and withholding tax, and introduced a "safe island" issuance program without registration -- Rule 144A /S. Rule 144A issuance mainly attracts foreign issuers to issue dollar bonds in the United States through private placements (private offerings), while Clause S allows eligible U.S. institutions to invest in offshore dollar bonds.

2. International bond denominated in Japanese yen

Samurai Bonds - The Japanese government strictly regulates the issuance of JPY bonds by foreign issuers in Japan. Samurai bonds are issued sporadically, mainly by sovereign or international institutions.

Euroyen Bonds - In 1977, European issuers issued JPY bonds for the first time, launching the Euroyen bond market. In 1985 Euroyen bond issuance exceeded samurai bonds and occupied a large proportion of the European bond market.

Other International Bonds - The first Shogun bond denominated in a foreign currency appeared in Japan in 1985. Combining the characteristics of Euroyen and samurai bonds, Japan allowed the issuance of daimyo bonds, which could be

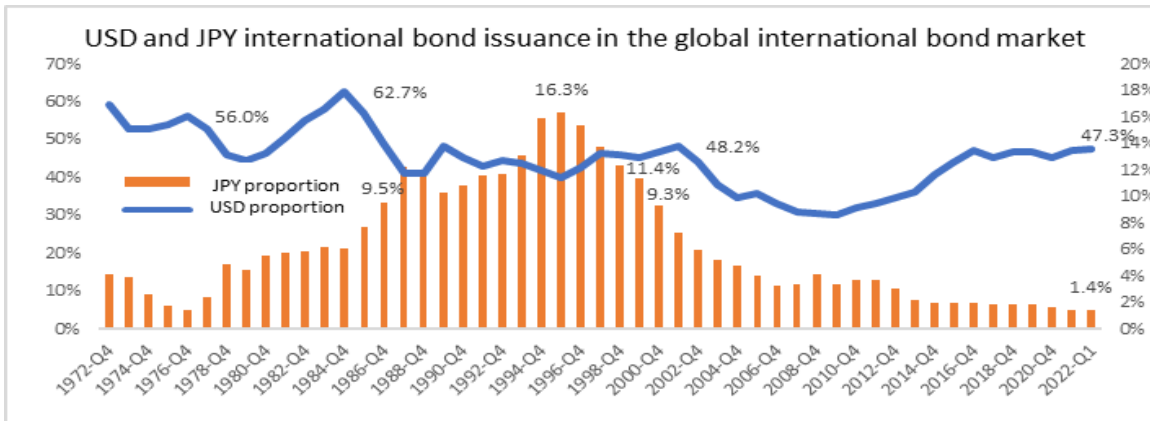
sold both in Japan and internationally.

3. Current situation of international bond issuance

In the first quarter of 2022, \$13.1 trillion of international bond outstanding was issued in US dollars, accounting for 47.3% of global bond outstanding, surpassing EUR international bond at \$10.6 trillion (38.3%).

In the international dollar bond market, the domestic market represented by the Yankee bond is smaller than the Eurodollar bond-dominated offshore market. It is estimated that the offshore dollar international bonds issued outside the U.S. is \$11.6 trillion, 7.7 times the amount of dollar international bonds issued inside the U.S.

JPY international bond issuance was once outperforming, in the 90's, it has become the world's second largest international bond issue currency. In this century, with burst of Japan's economic bubble, the JPY international bonds also fell to the bottom. In the fourth quarter of 2021, the outstanding of JPY international bonds issuance was \$376.2 billion, accounting for only 1.4% of the global international bond market. Similar to USD bond, offshore JPY international bond issuance is 6 times the domestic market.



2. The history of international bonds denominated in US dollars and Japanese Yen and its implication to the development of offshore yuan bond

Europe and the United States are the major international currencies which have a long history of bond development. The government has also played an important role in promoting the development of international bond. It has adjusted its policies to guide market development and accumulated considerable experience.

1. Explore different functions of domestic and foreign international bond as an important strategy to promote currency internationalization;
2. Actively encourage international and sovereign institutions to issue bonds to improve the grade of the bond market;
3. Optimize the domestic international bond issuance mechanism to provide more convenience for overseas issuers;

4. Improve cross-border bond investment channels and promote integrated pricing of domestic and offshore international bonds;

5. Participate in the bond repurchase business to enhance the depth and breadth of the international bond market;

6. Constantly improve the financial infrastructure for bond issuance, and promote the integration of domestic and offshore international bond.

In addition, the United States and Japan have two important lessons in developing their international bond. First, maintaining stable macroeconomic growth is the fundamental for promoting the development of international bond. Second, keeping the stable opening-up policy can avoid fluctuations in the international bond market.

Comparing the development of RMB international bond market, in 2005, the International Finance Corporation and the Asian Development Bank issued panda bonds for the first time, and in 2007,

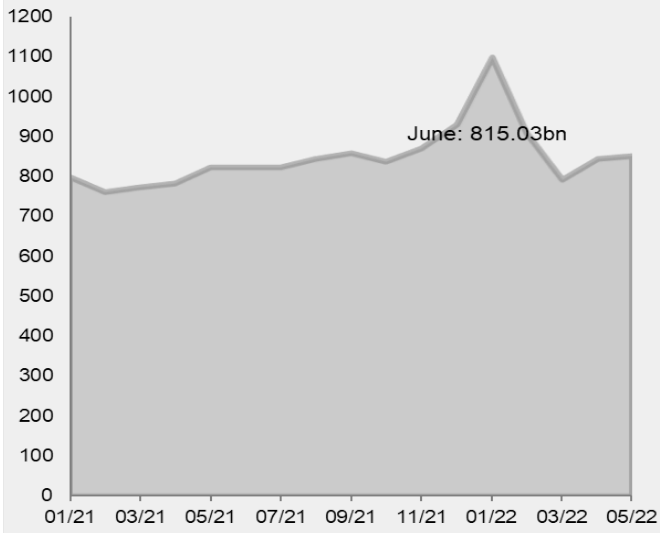
the China Development Bank issued RMB dim sum bonds in Hong Kong for the first time, forming a situation of joint development and mutual promotion between domestic and overseas international bonds. In 2021, the issuance of panda bonds and dim sum bonds was RMB 85.7 billion and 169.6 billion respectively. Currently, the internationalization of RMB is advancing steadily and cautiously. The opening of the mainland capital account, especially the bond market, has been significantly accelerated. After the official inclusion of RMB into SDR, the global holdings of RMB assets continue to increase, which has created favorable conditions for accelerating the construction of the RMB international bond market.

The above-mentioned analysis of the development of USD and JPY international bonds has numbers of implication to promoting the issuance of RMB international bonds with a clearer direction and more targeted measures to ensure the steady and long-term development of this important RMB internationalization business:

1. Construct top-level planning to promote the development of the onshore and offshore markets. Research on policies and measures to promote panda bond and dim sum bond, and clear policy guidance to issuers and investors to participate in the development of onshore and offshore bond markets.
2. Consider the introduction of safety island bond issuance in the onshore market. On the basis of maintaining the consistency of domestic bond issuance rules between domestic and overseas institutions, another way to connect onshore and offshore international bond markets should be established;
3. Adapt the common practice of bond issuance in the offshore market. Appropriately lowering the entry threshold for overseas institutions to issue panda bonds and provide more facilitation should be considered.
4. Actively take measures to speed up the construction of dim sum bond market and cultivate an offshore international bond issuing center in Hong Kong. Develop Hong Kong dim sum bond market to attract international organizations, foreign governments, multinational corporations and international banks to participate, and form a complete offshore RMB yield curve;
5. Promote the construction of offshore RMB repo market and support offshore RMB products. By increasing the central bill and the government bond issuance to enrich the repurchase collateral, and continue to expand the scale of repurchase transactions.

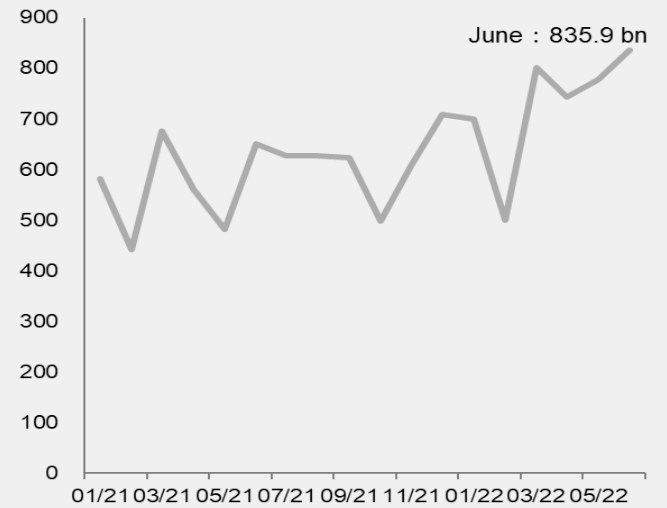
Market Indicators

Hong Kong RMB Deposits (RMB bn)



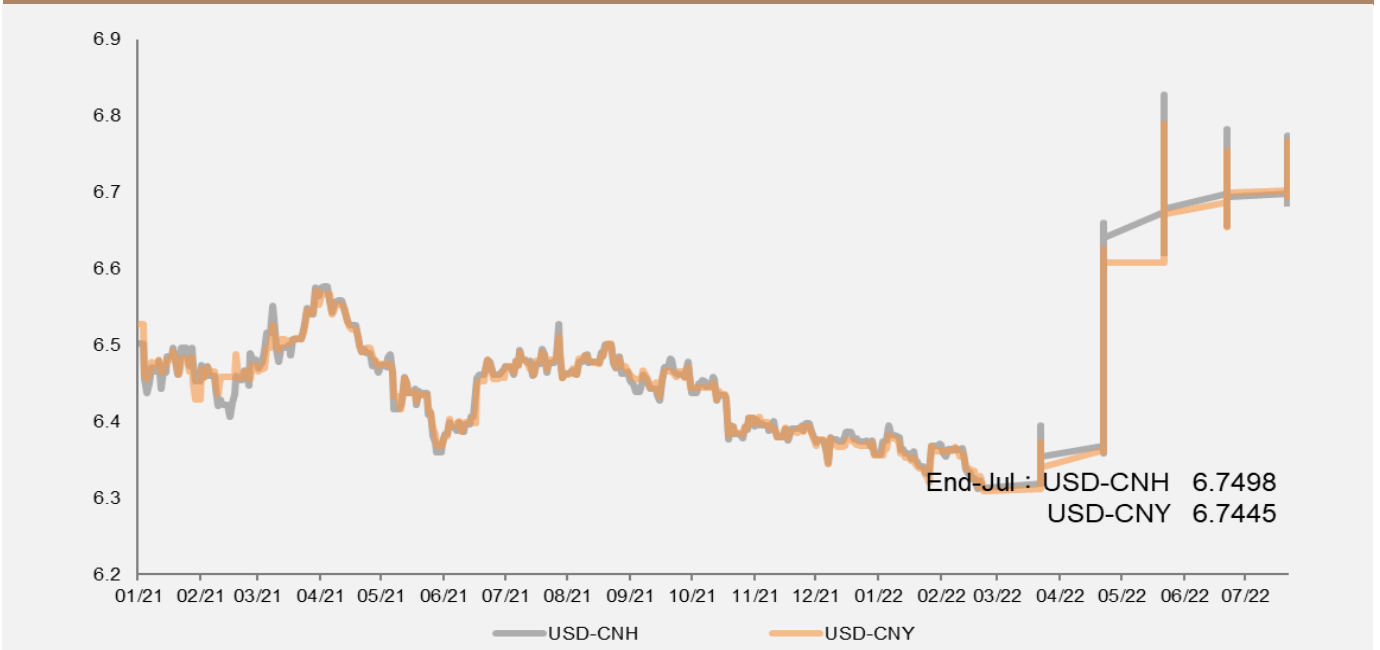
Source: HKMA

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

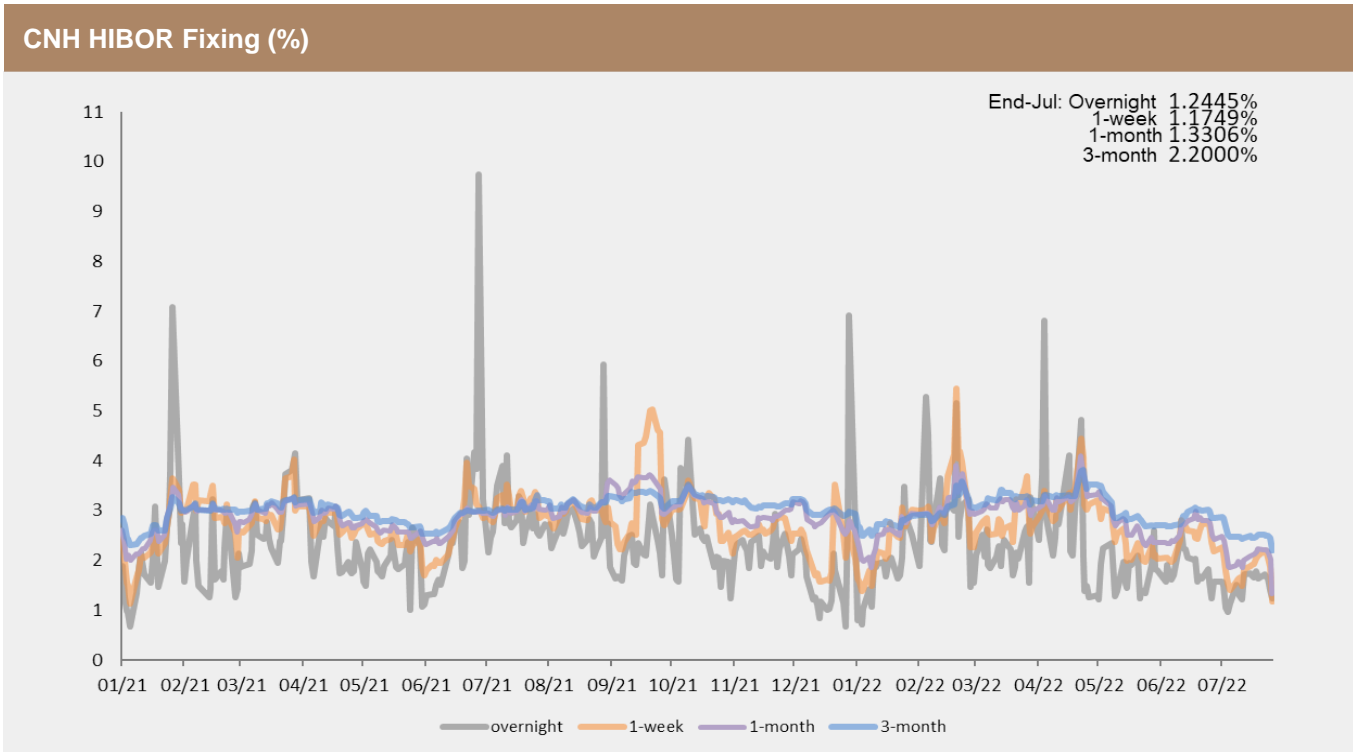


Source: HKMA

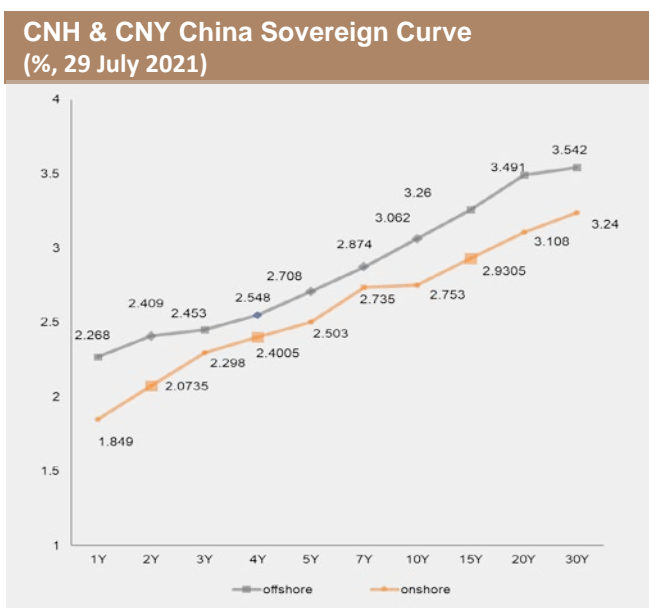
USD-CNH and USD-CNY Exchange Rates



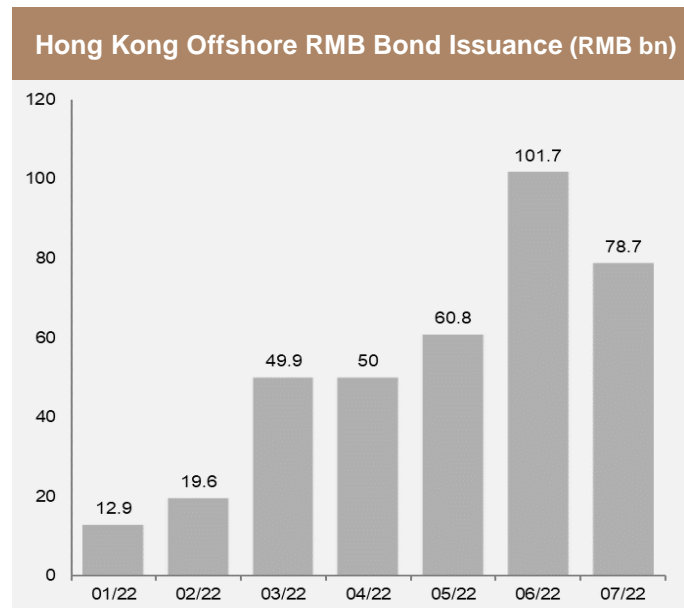
Source: Bloomberg



Source: Bloomberg

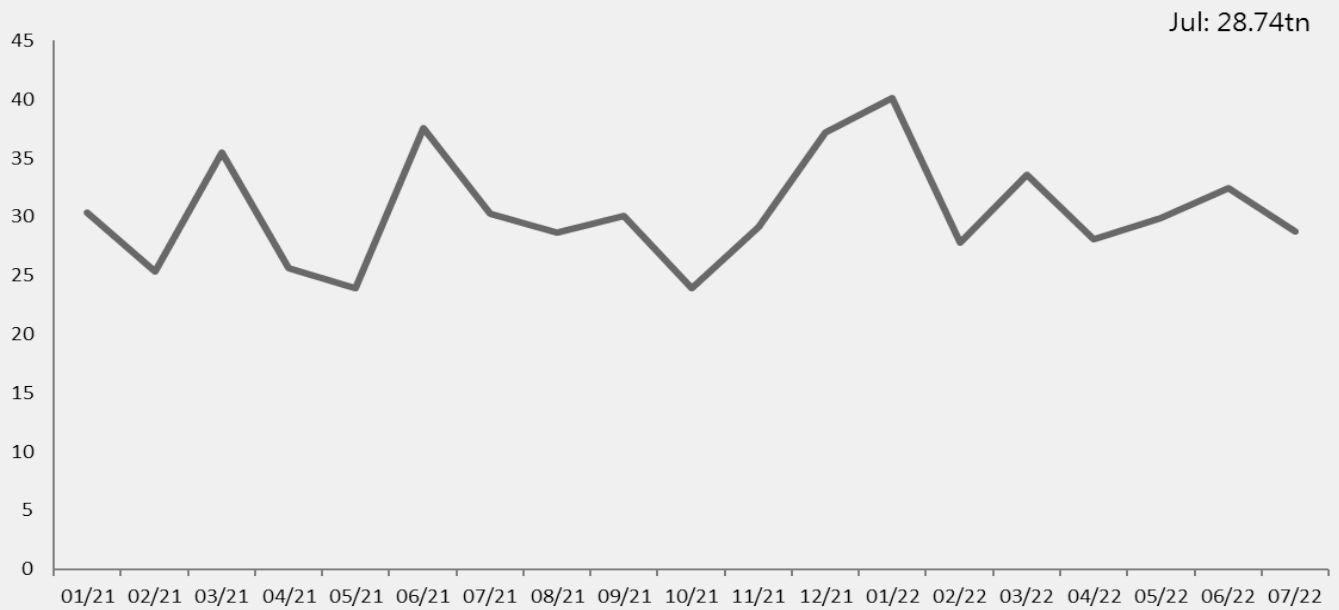


Source: Bloomberg



Source: BOCHK Global Market estimate

RMB Clearing Transaction Value (RMB tn)



Source: HKICL

SWIFT World payments currency ranking & market share

December 2019		July 2021	
#1	USD 42.22%	#1	USD 41.19%
#2	EUR 31.69%	#2	EUR 35.49%
#3	GBP 6.96%	#3	GBP 6.45%
#4	JPY 3.46%	#4	JPY 2.82%
#5	CAD 1.98%	#5	CNY 2.20%
#6	CNY 1.94%	#6	CAD 1.68%
#7	AUD 1.55%	#7	AUD 1.38%
#8	HKD 1.46%	#8	HKD 1.30%

Source: SWIFT



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