

RMB Internationalization and RMB Offshore Markets Development

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January 7, 2016

Agenda

1. Progress of RMB Internationalization

2. Development of RMB Offshore Markets

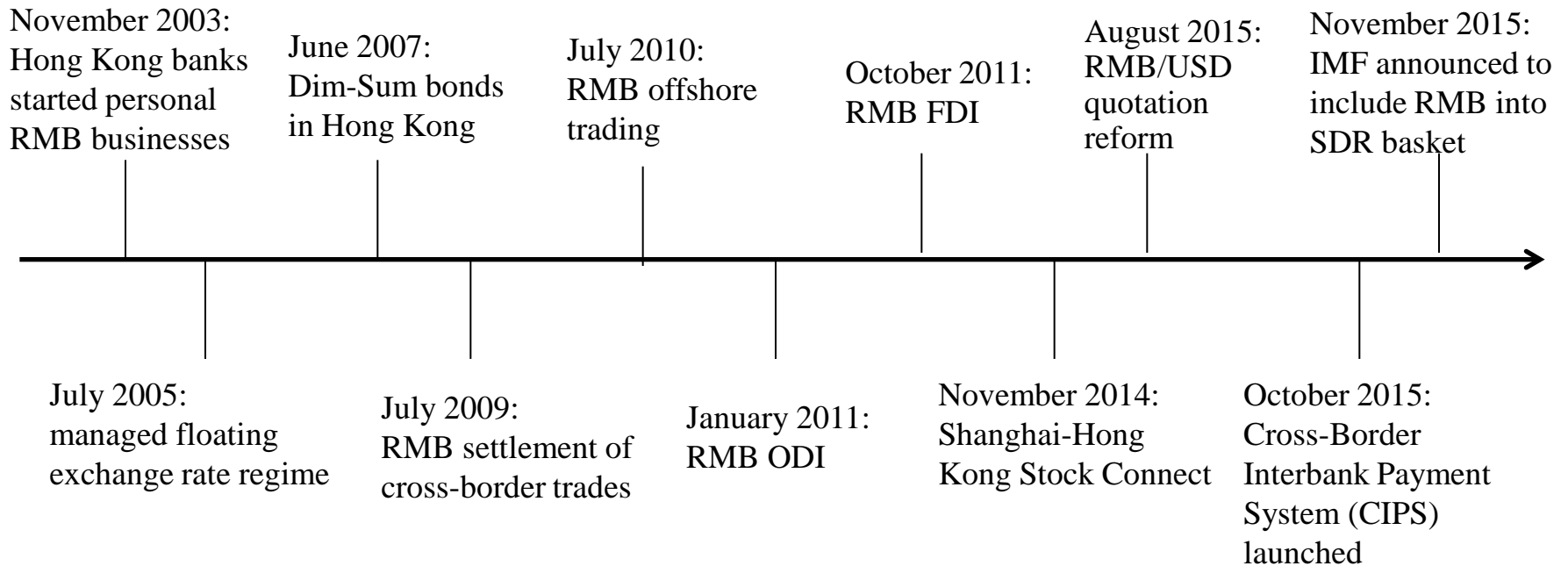
3. Institutional Reforms to Promote RMB Internationalization

4. Potentials and Prospects

5. Conclusions

Progress of RMB Internationalization

1) Key Milestones

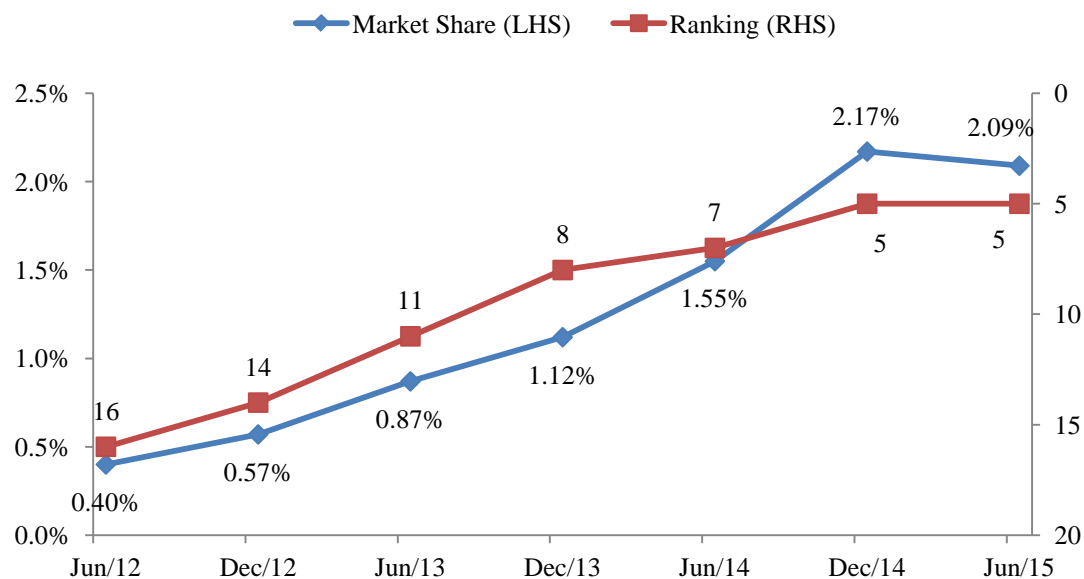


Progress of RMB Internationalization

2) International Use of RMB: Growing Scale and Scope

- IMF: RMB's presence in international trade and settlement has been growing from a very low base. China has made substantial progress in cross-border use of its currency compared to other countries.
- In Q2 2015, RMB ranks 2nd in the world in trade finance, 5th in payment 6th in foreign exchange trading and international interbank loans.

RMB as a payment currency



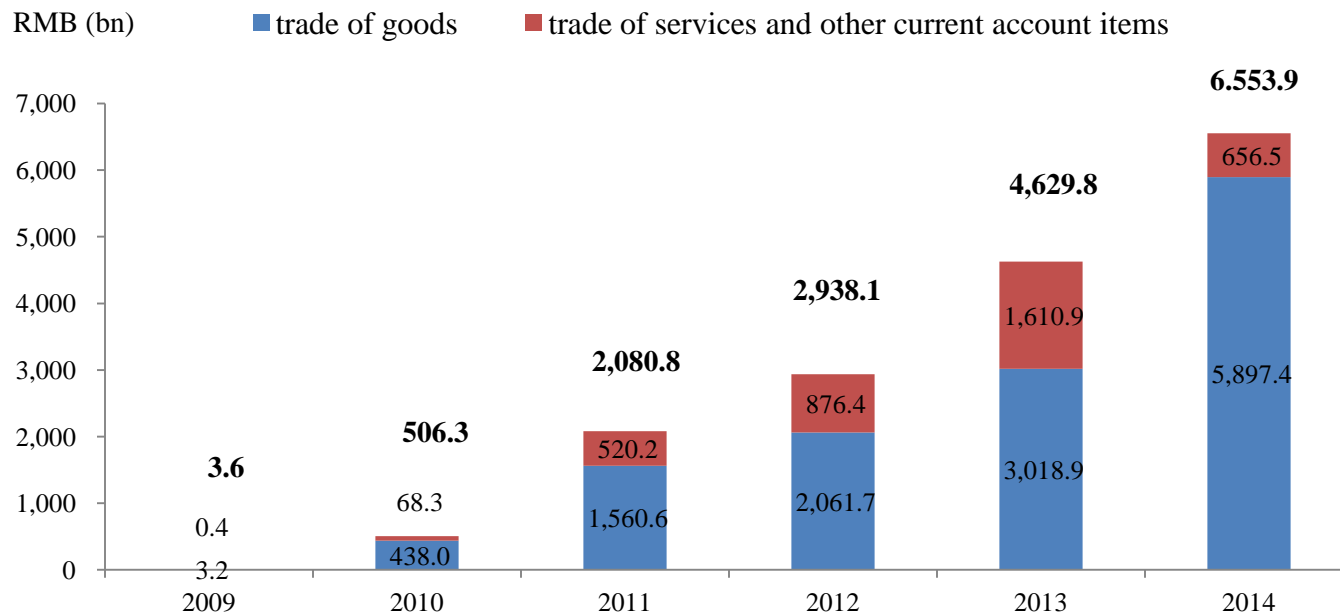
Source: IMF, SWIFT

Progress of RMB Internationalization

2) International Use of RMB: Growing Scale and Scope

- In 2014, current account items settled in RMB reached 6.6 trillion yuan, a 42% growth YoY. Outward direct investments (ODI) settled in RMB reached 187 billion yuan, surging by 118% YoY. Foreign direct investments (FDI) settled in RMB reached 862 billion yuan, a growth of 92% YoY.

Current Account Items Settled in RMB



Source: Report on RMB Internationalization 2015, People's Bank of China

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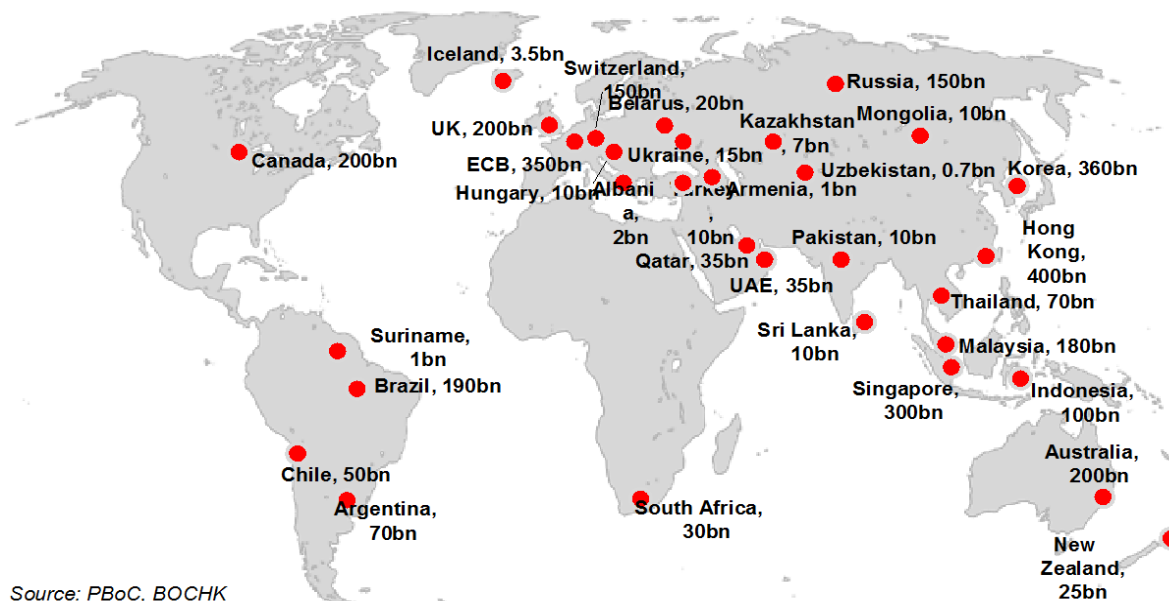
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Development of RMB Offshore Markets

1) RMB Offshore Markets

- Offshore RMB deposits increased rapidly in the last five years. At the end of September 2015, global offshore RMB deposits amounted to RMB2.7 trillion.
- So far over 30 central banks around the world have signed bilateral currency swap agreements with China. Total swap contract value reached RMB 3 trillion yuan.
- RMB assets held by foreign central banks amounted to 667 billion yuan by April 2015.

Bilateral Currency Swap Agreements



Source: PBoC, BOCHK

Development of RMB Offshore Markets

2) Leading Offshore Centers

- Among offshore centers, Hong Kong, Taiwan and Singapore dominated the offshore RMB deposit business due to their large local Chinese populations. Korea grew very quickly due to its close trade connection with China.
- London, unlike Hong Kong, Taiwan and Singapore, has received smaller RMB deposits. However, London has long been focused on foreign exchange trading. Its average daily RMB trading volumes reached US\$61.5 billion in 2014. London accounted for over 40% of all Foreign Exchange trading in RMB, which equals the share of such trades taking place in Hong Kong.

Offshore RMB Deposits (2014)

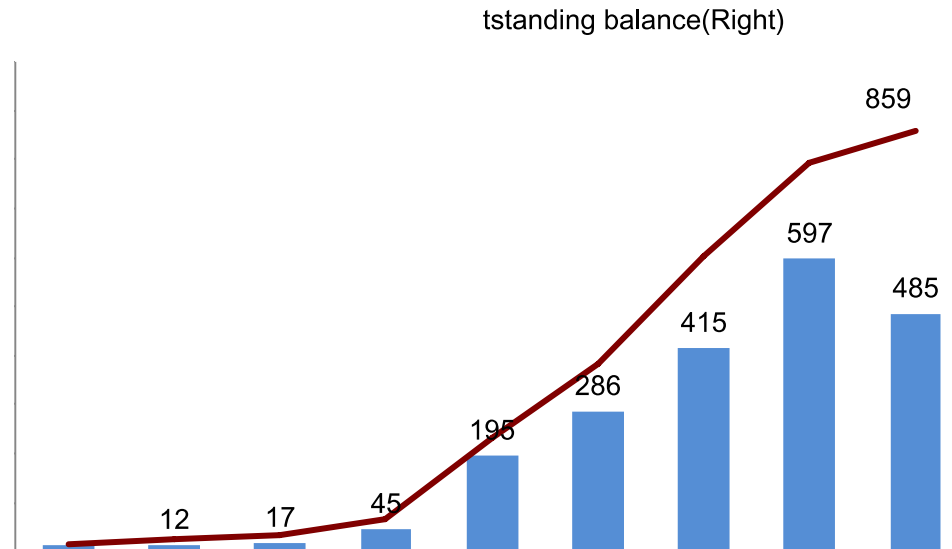
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Development of RMB Offshore Markets

3) RMB Offshore Bond Markets

- Outstanding offshore RMB bonds reached to 859 billion yuan by November 2015.
- The leading RMB bond centers are Hong Kong, Singapore, Luxembourg and Taiwan.
- Offshore RMB bond issuance of 2015 were relatively low compared to that of 2014. It might be because of the huge equity and FX market volatility in China and the depreciation of RMB against the dollar.

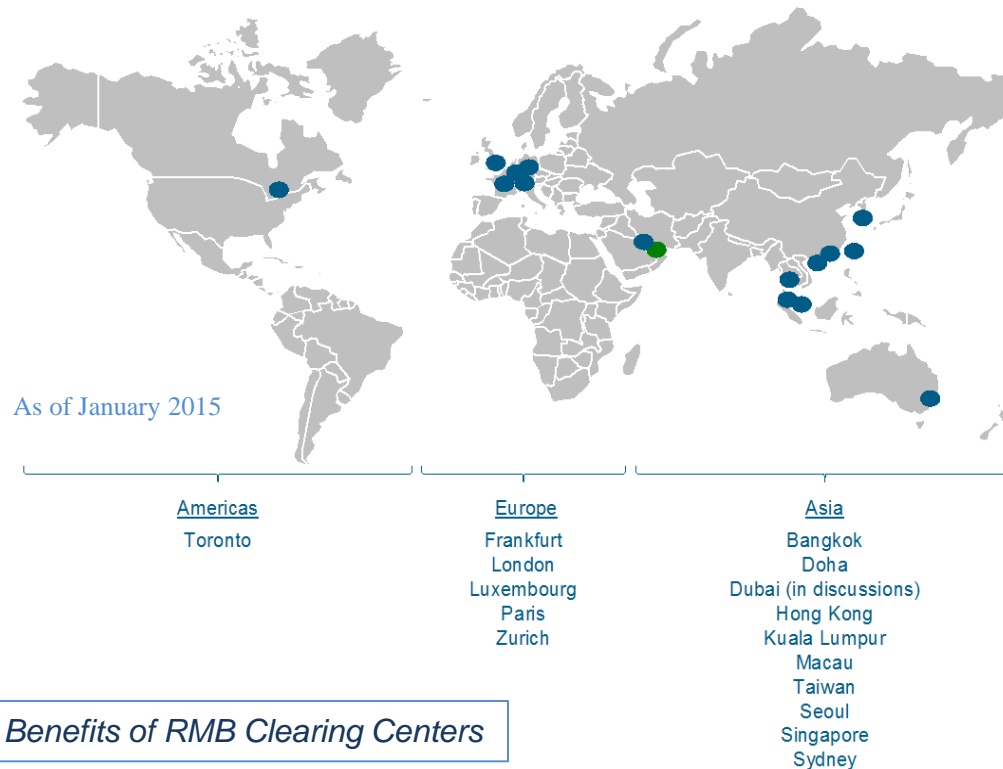
RMB Offshore Bond Markets



Source : Thomson Reuters, CMS

Development of RMB Offshore Markets

4) Offshore RMB Clearing Centers approved by PBOC



Benefits of RMB Clearing Centers

- Direct access to onshore RMB liquidity
- Access to RMB clearing services in the same time zone
- Greater operational efficiency for companies and banks seeking to use RMB denominated services
- Capture regional RMB flows by leveraging trade linkages with China

Source: PBOC, CMS, SWIFT

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Institutional Reforms for RMB Internationalization

Trade Currency

- ✧ China is the world largest trade country
- ✧ 25% of China's trade settled in RMB
- ✧ Full liberalized current account
- ✧ World's 5th most used payment currency

Investment Currency

- ✧ Access to China's Interbank Bond Market
- ✧ RQFII quota amounted to RMB 970 billion
- ✧ Shanghai – Hong Kong Stock Connect
- ✧ Mutual Recognition of Funds

Reserve Currency

- ✧ RMB has been included in the IMF SDR basket
- ✧ Over 60 central banks hold total 667 billion RMB as Foreign reserve (April 2015)
- ✧ Over 30 central banks have signed Bilateral Swap Agreement with POBC

Institutional Reforms

- 1. Capital Account Opening**
- 2. Interest rate Liberalization**
- 3. Foreign Exchange Rate Regime Reform**

Institutional Reforms for RMB Internationalization

1) Capital Account Opening:

China has made significant progress in opening up its capital account since its current account fully opened in 1996, major milestones include:

- ✓ Liberalized securities investment in the early 2000s, starting with institutional investment. QFII and QDII quotas increased quickly.
- ✓ Made the RMB more usable in international trade settlements since 2009.
- ✓ Launched the RQFII program in 2011 to allow offshore RMB to flow into China's domestic capital markets.
- ✓ Introduced the new Stock Connect programs. The Shanghai-Hong Kong Stock Connect program launched in 2014, and the Shenzhen-Hong Kong Stock Connect program is likely to become operational this year.

Institutional Reforms for RMB Internationalization

2) Interest Rate Liberalization:

China has reached the full liberalization of interest rates. It has generally followed a sequenced approach:

- ✓ liberalizing money-market and bond-market rates before bank rates,
- ✓ liberalizing lending rates before deposit rates, and
- ✓ liberalizing long-term and wholesale rates before short-term and retail rates.

In October, 2015, China had removed the ceiling on its benchmark deposit rates, marking the full liberalization of the interest rate.

Institutional Reforms for RMB Internationalization

3) RMB Exchange Rate Regime Reform:

China's "managed floating exchange rate regime" was launched in 2005, and has speeded up exchange rate reform recently:

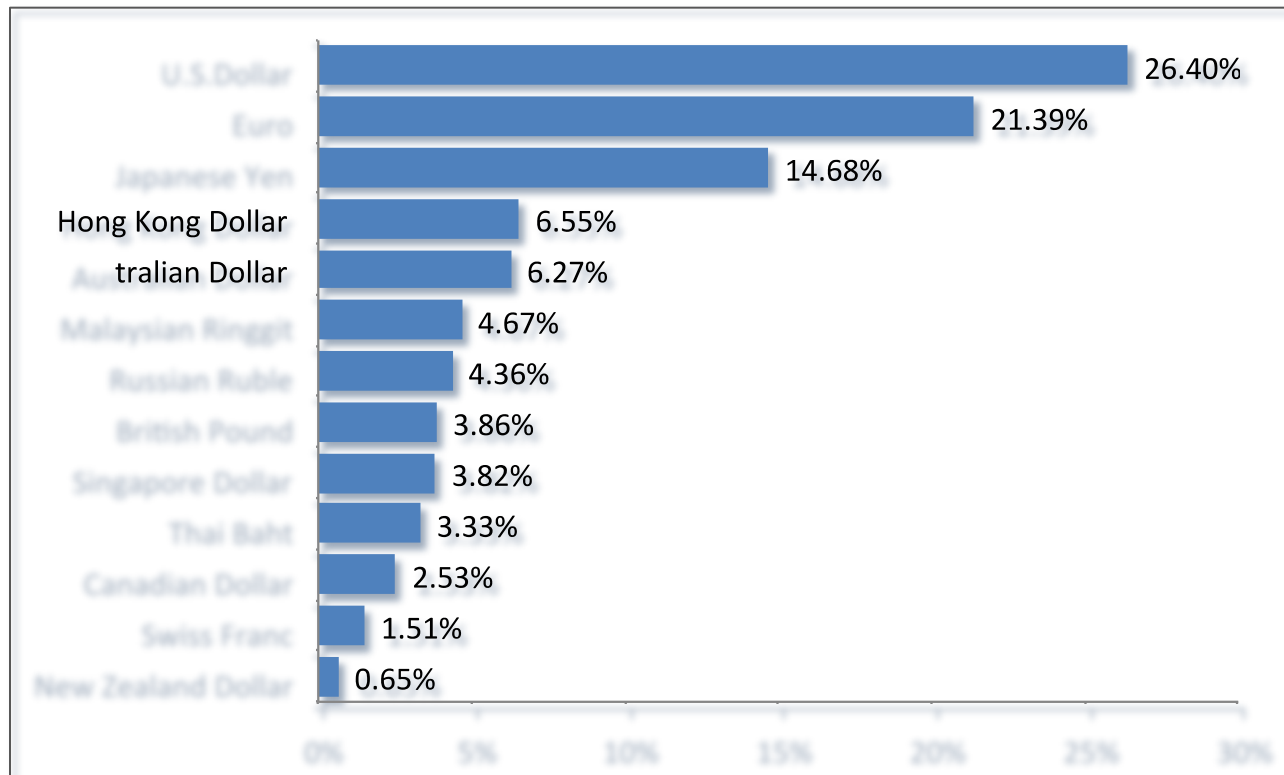
- ✓ widening the trading bands against the dollar from 0.5% in 2007 to 3% in 2015
- ✓ Removing the bid/ask spread control for RMB/USD exchange rate quotation in July 2014, and
- ✓ Improving the quotation mechanism of RMB/USD in August 2015

Institutional Reforms for RMB Internationalization

3) RMB Exchange Rate Regime Reform:

- China Foreign Exchange Trade System (CFETS) just introduced a new exchange rate index, which shows that the RMB intends to be valued against a basket of 13 trade-weighted currencies.

The CFETS RMB Index

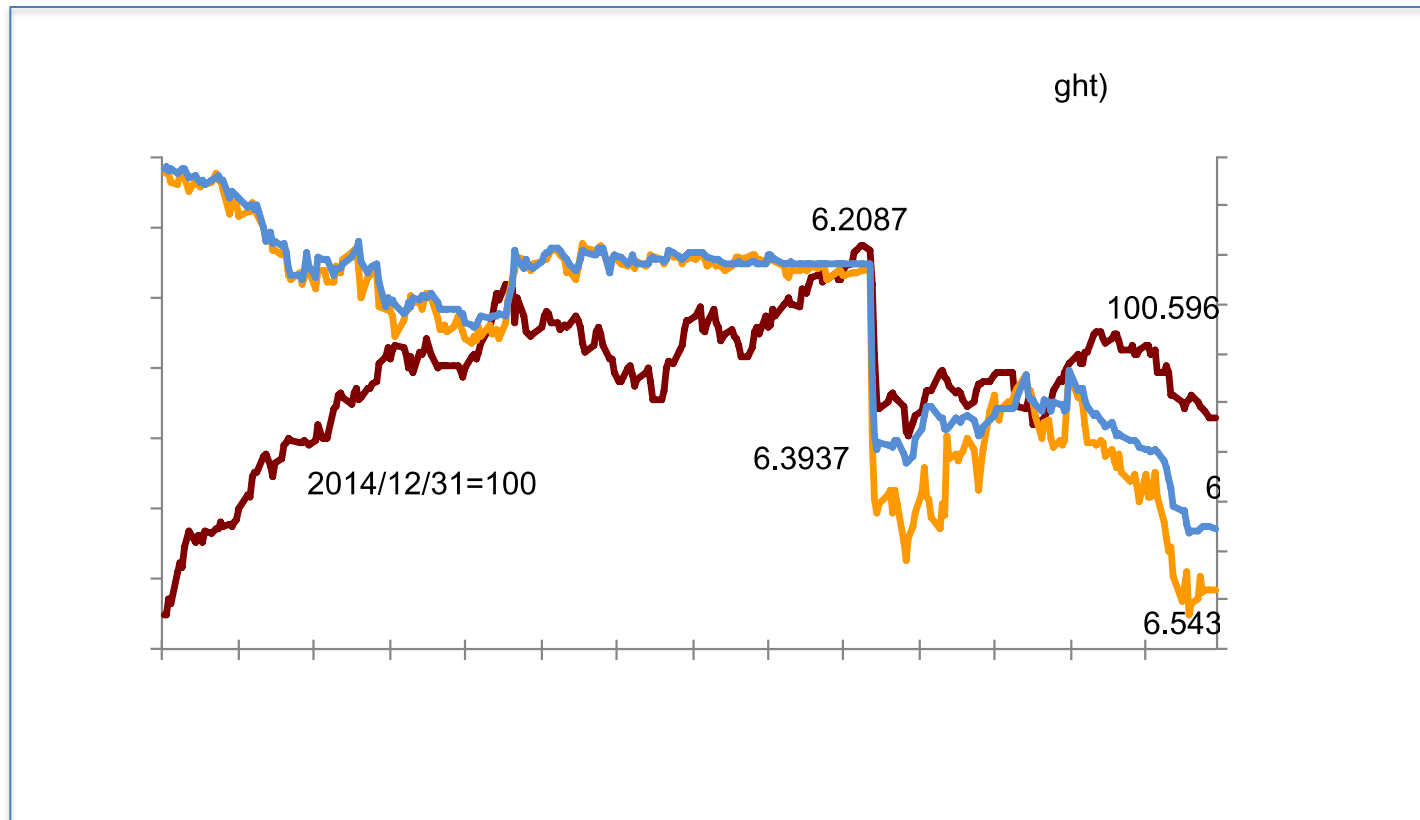


Source : PBOC, CMS

Institutional Reforms for RMB Internationalization

3) RMB Exchange Rate Regime Reform:

Switching RMB Targeting to a Basket of Currencies?



Source : Bloomberg, Thomson Reuters, CMS

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Potentials and Prospects

1) Settlement, payment and investment denominated in RMB: great potential

Trade Settlement

- In 2014, China's total imports and exports reached 26 trillion yuan.
- Current account items settled in RMB were 6.6 trillion yuan, only 25% of the total current account trading volume.

ODI

- In 2014, China's ODI reached USD116 billion.
- 186 billion yuan of China's ODI was settled in RMB, 26% of total ODI.

RMB Deposits

- RMB deposits in major RMB offshore markets amounted to 2.7 trillion yuan by Q3 2015.
- Offshore RMB deposits were only 2% of onshore RMB deposits.

Potentials and Prospects

2) The impact of SDR inclusion: a growing demand for RMB

- ✓ The RMB's weight in the SDR basket of 10.92% will put it ahead of the Japanese yen (8.33%) and the British pound (8.09%), yet behind the US dollar (41.73%) and the euro (30.93%).
- ✓ The immediate affect of IMF SDR inclusion will be limited. The SDR inclusion will trigger a portfolio rebalancing by the IMF in the next several years. This could affect investment decisions of other official and private investors, and boost the short to medium term demand for RMB. I expect in the next two years:
 - 1) The IMF will hold RMB 200 billion yuan (10.92% of its \$280 billion SDR) ;
 - 2) Assume RMB will take 2% of global non-China FX reserves (\$8 trillion) – the current level of the Canadian dollar. This translates to 1.04 trillion yuan. This means an additional 400 billion yuan on top of its current holdings.
 - 3) Private-sector demands are hardest to estimate but most important. If 0.5% of global asset under management (\$20 trillion) will be allocated in RMB in the next two years, this amounts to around 650 billion RMB.
 - 4) Altogether, SDR inclusion would likely generate 1.25 trillion RMB offshore demand in the next two years.
- ✓ While RMB inflows are largely to the onshore bond/FX market, the offshore RMB market will benefit as offshore RMB business opportunity grows.

Potentials and Prospects

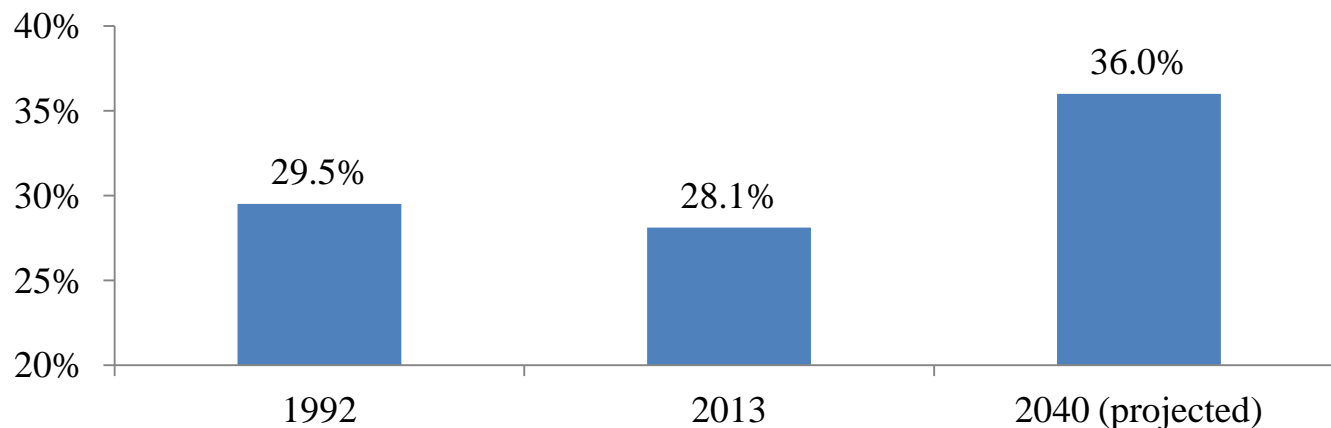
3) Shanghai-Hong Kong Stock Connect & Shenzhen-Hong Kong Stock Connect

- Shenzhen-Hong Kong Stock Connect, after the successful launch of Shanghai-Hong Kong Stock Connect in 2014, becomes the next main initiative for China to open its capital market
- Its aim is to connect Mainland China's capital market with Hong Kong, and hence facilitate China's integration with international financial markets
- It will increase the pool of RMB liquidity in Hong Kong by providing more investment products.

Potentials and Prospects

4) “One Belt One Road” and “Go Global” Strategy

Investment/GDP ratio to Rise in “One Belt One Road” Regions



- By 2040, USD 46 trillion additional funds will be needed, 40% of which (about USD18.5 trillion) will come from international capital market financing.
- RMB offshore markets - Hong Kong, in particular, will play an important role in financing the investment.

Potentials and Prospects

5) Overseas investments by China's individual investors

- In the past, there has been a USD 50,000 annual limit on individual purchases of foreign exchange
- The new QDII2 (Qualified Domestic Individual Investors 2) program, which is expected to launch this year, will allow qualified individual Chinese investors – defined as those who hold over one million RMB portfolio assets, access to foreign stocks, bonds and real estates, without the 50,000 USD ceiling.

Potentials and Prospects

6) Entry of Foreign central banks into China's interbank bond market

Foreign central banks, international financial organizations and sovereign wealth management funds are allowed to invest in China's interbank market

- Application process has been simplified, replacing an approval process with registration
- Removal of the quota system
- Investment scope has been broadened from cash bond to repos, bond borrowing and lending, bond forwards, interest rate swaps, and forward rate agreements etc.

This contributes to RMB's transformation from a settlement currency to an investment currency, and eventually to a reserve currency.

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Conclusions

1. China has made significant progress in RMB internationalization within a short period of time and from a very low base, evidenced by the gradual expansion, in terms of scale and scope, of the international use of its currency.
2. RMB offshore markets have been developing naturally along with the cross-border use of RMB.
3. Institutional reforms, such as capital account opening, interest rate liberalization and exchange rate regime reform, have effectively promoted RMB internationalization.
4. The IMF SDR inclusion will boost global demand for RMB, benefiting offshore RMB centers, and
5. RMB internationalization and offshore markets are full of potentials and prospects for the future.

Thank you!

Q&A