| Global Research | 8 August 2016

Offshore Renminbi – Looking on the bright side

- **Another weak RGI reading in June further illustrates the challenging CNH environment over the past year**
- **But FX reform efforts are finally starting to pay off; we see more CNY stability as the G20 meeting nears**
- **Internationalisation is picking up in another form: rising foreign holdings of onshore Renminbi assets**

Click for Infographic

A year of change for the Renminbi

Kelvin Lau +852 3983 8565
Kelvin.KH.Lau@sc.com
Senior Economist, HK
Standard Chartered Bank (HK) Limited

Eddie Cheung +852 3983 8566
Eddie.Cheung@sc.com
Asia FX Strategist
Standard Chartered Bank (HK) Limited

Becky Liu +852 3983 8563
Becky.Liu@sc.com
Head, China Macro Strategy
Standard Chartered Bank (HK) Limited

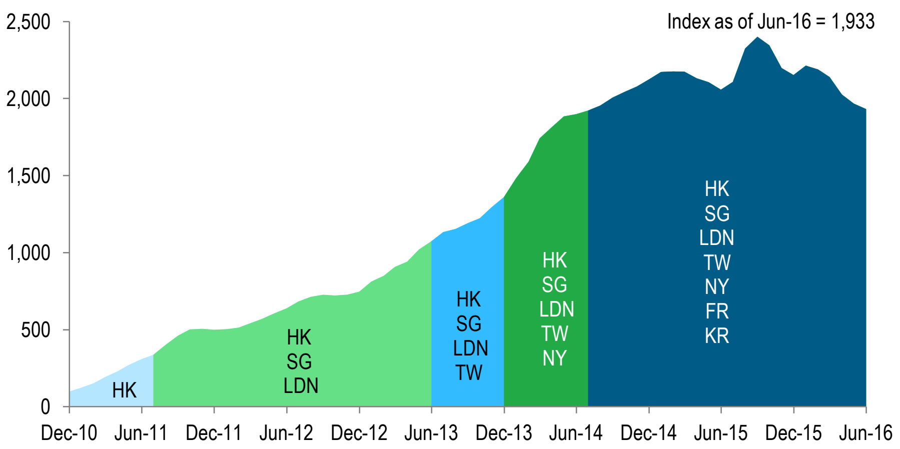
Chidu Narayanan +65 6596 7004
Chidambarathanu.Narayanan@sc.com
Economist, Asia
Standard Chartered Bank, Singapore Branch

August 2016 marks the first anniversary of the Chinese yuan (CNY) fixing reform. The CNY has fallen around 6.5% against the USD over the year, the worst-performing Asian currency. Our tracker shows that the offshore CNY (CNH) market shrank almost 20% between September 2015 and June 2016. The *Standard Chartered Renminbi Globalisation Index* (RGI), our proprietary measure of CNH activity across key offshore centres, fell another 1.8% m/m to 1,933 in June from 1,968 in May (Figure 1). This is the eighth drop in nine months, albeit at an easing pace of late. The rebound in cross-border payments in May failed to sustain in June. The collective fall in CNH deposits at our key RGI centres also resumed in June; they now stand at H2-2013 levels. Dim Sum issuance remained lacklustre.

It's not all bad news, however. Both USD-CNY and USD-CNH weathered the Brexit fallout, with USD-CNY stabilising below 6.70 and the CNY-CNH basis staying narrow. The People's Bank of China (PBoC) has improved its communication with the market, making its policy intentions transparent; the market has also gained a better understanding of the new daily CNY fixing mechanism, which references a basket.

Capital outflow pressure remains, but foreign inflows to China's onshore bond market rose to the second-highest on record in June, at CNY 47.68bn. Increasing foreign access to onshore markets also drives Renminbi internationalisation. In all, the hard-won credibility built by the PBoC following early episodes of high CNY volatility in late 2015 and early 2016 appears to be paying off. We see more CNY stability ahead of the G20 meeting in Hangzhou in early September.

Figure 1: RGI was down another 1.8% in June



Note: The RGI (Bloomberg: SCGRRGI <Index>) is a comprehensive index that tracks CNH internationalisation across markets and geographies; our interactive data visualisation tool enables exploration of the evolution of the subcomponents: *https://www.sc.com/BeyondBorders/infographics/rgi-tracker;*
Source: Standard Chartered Research

RGI breakdown offers more disappointment

The biggest disappointment behind June's RGI drop is the m/m decline in cross-border Renminbi payments after the mini-rebound in May (Figure 2). This partly reflects still-weak genuine demand for Renminbi trade settlement and other remittance channels. Falling CNH deposits remain a persistent drag.

CNY stability is in the works

6.70 appears to be the line in the sand for USD-CNY for now; we see more stability ahead of the G20 meeting

With the G20 meeting looming in early September, authorities appear to be leaning towards more CNY stability near-term. After bottoming at 94.21 on 11 July, the China Foreign Exchange Trade System (CFETS) CNY basket climbed back above 95 on the higher USD. The climb higher in the basket coincides with onshore USD-CNY approaching the psychological 6.70 level. The authorities appear to have resisted allowing the USD-CNY fixing to move above 6.70 closer to end-July as the USD gained strength.

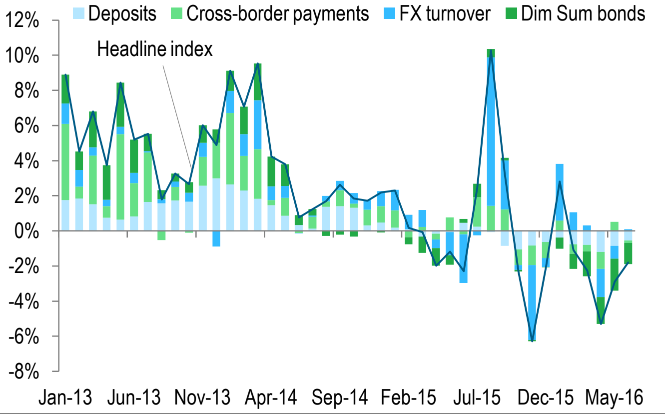
The price action in spot and around the CNY fixing suggests intolerance for further CNY weakness above 6.70 near-term, in our view. We see two reasons: First, authorities likely want to prevent capital outflows from breaching this psychological level. Our estimate of China's non-FDI capital outflows showed an increased in June to USD 43bn from USD 35bn in May. Second, the authorities may favour greater stability and less upside volatility in the USD-CNY cross towards 6.70 ahead of the G20 meetings in September and the official inclusion of the CNY in the IMF's Special Drawing Rights (SDR) basket on 1 October.

The much narrower basis also demonstrates greater stability in price action between the CNY and CNH. The basis was close to 200 pips in July, but is now below 100 pips. USD-CNY risk reversals have also fallen to their lowest levels in 2016. If anything, markets appear to be heeding the PBoC's actions. The hard-won credibility built by the PBoC following the CNY volatility in early 2016 appears to be paying off.

Near-term, we still believe the CNY basket has room to fall if USD-CNY remains comfortably below 6.70 and the USD weakens. Markets remain unconcerned as long as USD-CNY stays below 6.70. We expect 6.70 to be a cap for USD-CNY for now, barring a much larger USD spike. We maintain our USD-CNY forecast of 6.67 at end-2016.

Figure 2: RGI is still contracting

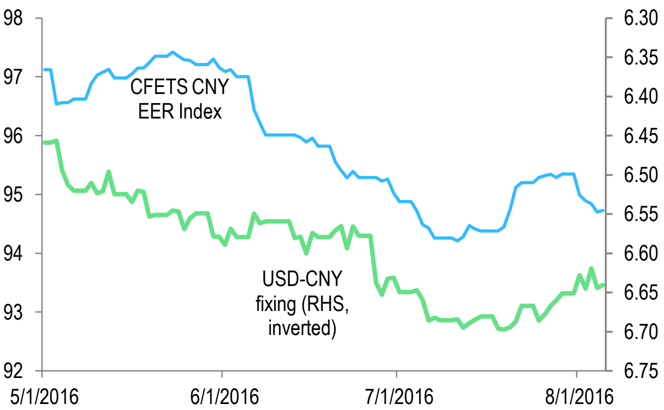
Contributions of RGI components to % m/m change, ppt



Source: Standard Chartered Research

Figure 3: Short-term downside limit tested in July

USD-CNY daily fixing, and CFETS CNY EER Index



Source: Bloomberg, Standard Chartered Research

Primary market weakened in July on lower redemptions; secondary-market price reactions remain firm

Momentum in Dim Sum bonds is holding up well

Sentiment in the Dim Sum bond market remained constructive in July, although total returns were a touch lower than in the previous few months. Total returns of Dim Sum bonds were 0.61%, down slightly from 0.75-0.75% in the previous months, and average bond prices edged higher by 0.27%, also a touch lower than 0.41-0.45% in May-June, according to the iBoxx Offshore Renminbi bond index (Figure 4).

The primary market weakened in July, owing to a slower redemption schedule. Gross issuance was CNY 26bn, down from CNY 57bn in June. We expect primary issuance to remain lacklustre in the foreseeable future, but think the decline in the Dim Sum bond market size will pause in H2.

We maintain a constructive view on the Dim Sum bond market and continue to prefer duration. Supply of long-dated bonds is likely to be very limited until the next offshore China Government Bond (CNH CGB) auction, likely in November. Demand is likely to stay solid, with Dim Sum bonds yielding higher than onshore peers and global developed-market bond yields.

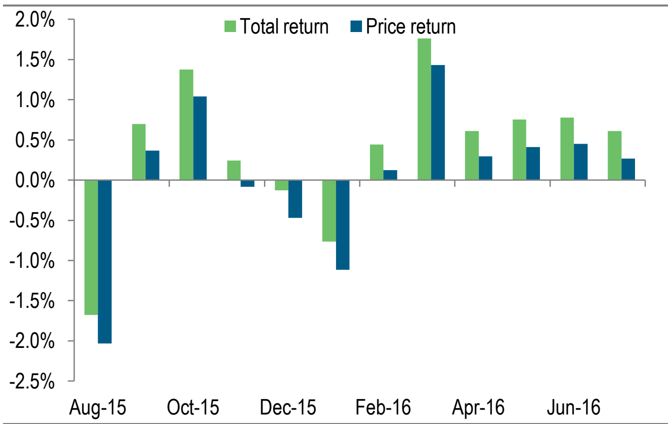
Foreign investors bought 14% of net CGB issuance in H1, and have become the fourth-biggest investors

Foreign investors become key buyers of onshore CGBs

Foreign inflows to China's onshore bond market were the second-highest on record in June, despite weak FX performance. Foreign holdings of China onshore bonds increased CNY 47.68bn in June, second only to CNY 47.86bn in February 2014 (Figure 5). Inflows included CNY 23bn of CGBs, CNY 7bn of Policy Financial Bonds (PFBs), CNY 11bn of other interbank bonds, and CNY 7bn of exchange-traded bonds.

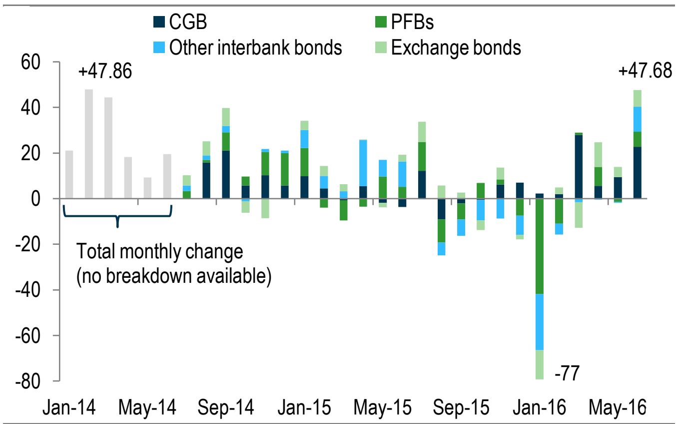
Foreign investors became the fourth-biggest buyers of onshore CGBs, absorbing 14% of total net CGB issuance in H1 – behind only commercial banks (48%), funds (29%) and exchanges (18%). Foreign ownership of CGBs rose to a new high of 2.8% as of end-H1 from 2.3% at end-2015; but foreign ownership of the overall market fell to a new low of 1.3% (from 1.5% at end-2015). We expect cumulative foreign inflows to total c.CNY 3-6tn by 2020, and foreign ownership to rise to c.4-7% by then. (See *On the Ground, 5 August 2016, 'China – Foreign inflows to bonds near record high'*).

Figure 4: Total and price returns of Dim Sum bonds
iBoxx offshore RMB bond index returns (%)



Source: iBoxx, Bloomberg, Standard Chartered Research

Figure 5: Monthly change in foreign holdings of China onshore bonds *(CNY bn)*



Source: PBoC, Wind, Standard Chartered Research

Disclosures appendix

Analyst Certification Disclosure: The research analyst or analysts responsible for the content of this research report certify that: (1) the views expressed and attributed to the research analyst or analysts in the research report accurately reflect their personal opinion(s) about the subject securities and issuers and/or other subject matter as appropriate; and, (2) no part of his or her compensation was, is or will be directly or indirectly related to the specific recommendations or views contained in this research report. On a general basis, the efficacy of recommendations is a factor in the performance appraisals of analysts.

Global Disclaimer: Standard Chartered Bank and/or its affiliates ("SCB") makes no representation or warranty of any kind, express, implied or statutory regarding this document or any information contained or referred to in the document (including market data or statistical information). The information in this document, current at the date of publication, is provided for information and discussion purposes only. It does not constitute any offer, recommendation or solicitation to any person to enter into any transaction or adopt any hedging, trading or investment strategy, nor does it constitute any prediction of likely future movements in rates or prices, or represent that any such future movements will not exceed those shown in any illustration. The stated price of the securities mentioned herein, if any, is as of the date indicated and is not any representation that any transaction can be effected at this price. SCB does not represent or warrant that this information is accurate or complete. While reasonable care has been taken in preparing this document and data obtained from sources believed to be reliable, no responsibility or liability is accepted for errors of fact or for any opinion expressed herein. This document does not purport to contain all the information an investor may require and the contents of this document may not be suitable for all investors as it has not been prepared with regard to the specific investment objectives or financial situation of any particular person. Any investments discussed may not be suitable for all investors. Users of this document should seek professional advice regarding the appropriateness of investing in any securities, financial instruments or investment strategies referred to in this document and should understand that statements regarding future prospects may not be realised. Opinions, forecasts, assumptions, estimates, derived valuations, projections and price target(s), if any, contained in this document are as of the date indicated and are subject to change at any time without prior notice. Our recommendations are under constant review. The value and income of any of the securities or financial instruments mentioned in this document can fall as well as rise and an investor may get back less than invested. Future returns are not guaranteed, and a loss of original capital may be incurred. Foreign-currency denominated securities and financial instruments are subject to fluctuation in exchange rates that could have a positive or adverse effect on the value, price or income of such securities and financial instruments. Past performance is not indicative of comparable future results and no representation or warranty is made regarding future performance. While we endeavour to update on a reasonable basis the information and opinions contained herein, we are under no obligation to do so and there may be regulatory, compliance or other reasons that prevent us from doing so. Accordingly, information may be available to us which is not reflected in this document, and we may have acted upon or used the information prior to or immediately following its publication. SCB is acting on a principal-to-principal basis and not acting as your advisor, agent or in any fiduciary capacity to you. SCB is not a legal, regulatory, business, investment, financial and accounting and/or tax adviser, and is not purporting to provide any such advice. Independent legal, regulatory, business, investment, financial and accounting and/or tax advice should be sought for any such queries in respect of any investment. SCB and/or its affiliates may have a position in any of the securities, instruments or currencies mentioned in this document. SCB and/or its affiliates or its respective officers, directors, employee benefit programmes or employees, including persons involved in the preparation or issuance of this document may at any time, to the extent permitted by applicable law and/or regulation, be long or short any securities or financial instruments referred to in this document and on the SCB Research website or have a material interest in any such securities or related investments, or may be the only market maker in relation to such investments, or provide, or have provided advice, investment banking or other services, to issuers of such investments and may have received compensation for these services. SCB has in place policies and procedures and physical information walls between its Research Department and differing public and private business functions to help ensure confidential information, including 'inside' information is not disclosed unless in line with its policies and procedures and the rules of its regulators. Data, opinions and other information appearing herein may have been obtained from public sources. SCB expressly disclaims responsibility and makes no representation or warranty as to the accuracy or completeness of such information obtained from public sources. SCB also makes no representation or warranty as to the accuracy nor accepts any responsibility for any information or data contained in any third party's website. You are advised to make your own independent judgment (with the advice of your professional advisers as necessary) with respect to any matter contained herein and not rely on this document as the basis for making any trading, hedging or investment decision. SCB accepts no liability and will not be liable for any loss or damage arising directly or indirectly (including special, incidental, consequential, punitive or exemplary damages) from the use of this document, howsoever arising, and including any loss, damage or expense arising from, but not limited to, any defect, error, imperfection, fault, mistake or inaccuracy with this document, its contents or associated services, or due to any unavailability of the document or any part thereof or any contents or associated services. This document is for the use of intended recipients only and, in any jurisdiction in which distribution to private/retail customers would require registration or licensing of the distributor which the distributor does not currently have, this document is intended solely for distribution to professional and institutional investors. This communication is subject to the terms and conditions of the SCB Research Disclosure Website available at *https://research.sc.com/Portal/Public/TermsConditions*. The disclaimers set out at the above web link applies to this communication and you are advised to read such terms and conditions / disclaimers before continuing. Additional information, including analyst certification and full research disclosures with respect to any securities referred to herein, will be available upon request by directing such enquiries to *scgr@sc.com* or clicking on the relevant SCB research report web link(s) referenced herein.

Country-Specific Disclosures – This document is not for distribution to any person or to any jurisdiction in which its distribution would be prohibited. If you are receiving this document in any of the countries listed below, please note the following:

United Kingdom and European Economic Area: SCB is authorised in the United Kingdom by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. This communication is not directed at Retail Clients in the European Economic Area as defined by Directive 2004/39/EC. Nothing in this document constitutes a personal recommendation or investment advice as defined by Directive 2004/39/EC. **Australia:** The Australian Financial Services Licence for Standard Chartered Bank is Licence No: 246833 with the following Australian Registered Business Number (ARBN: 097571778). Australian investors should note that this communication was prepared for "wholesale clients" only and is not directed at persons who are "retail clients" as those terms are defined in sections 761G and 761GA of the Corporations Act 2001 (Cth). **Bangladesh:** This research has not been produced in Bangladesh. The report has been prepared by the research analyst(s) in an autonomous and independent way, including in relation to SCB. THE SECURITIES MENTIONED IN THIS REPORT HAVE NOT BEEN AND WILL NOT BE REGISTERED IN BANGLADESH AND MAY NOT BE OFFERED OR SOLD IN BANGLADESH WITHOUT PRIOR APPROVAL OF THE REGULATORY AUTHORITIES IN BANGLADESH. Any subsequent action(s) of the Recipient of these research reports in this area should be subject to compliance with all relevant law & regulations of Bangladesh; specially the prevailing foreign exchange control regulations. **Botswana:** This document is being distributed in Botswana by, and is attributable to, Standard Chartered Bank Botswana Limited which is a financial institution licensed under the Section 6 of the Banking Act CAP 46.04 and is listed in the Botswana Stock Exchange. **Brazil:** SCB disclosures pursuant to the Securities Exchange Commission of Brazil ("CVM") Instruction 483/10: This research has not been produced in Brazil. The report has been prepared by the research analyst(s) in an autonomous and independent way, including in relation to SCB. THE SECURITIES MENTIONED IN THIS REPORT HAVE NOT BEEN AND WILL NOT BE REGISTERED PURSUANT TO THE REQUIREMENTS OF THE SECURITIES AND EXCHANGE COMMISSION OF BRAZIL AND MAY NOT BE OFFERED OR SOLD IN BRAZIL EXCEPT PURSUANT TO AN APPLICABLE EXEMPTION FROM THE REGISTRATION REQUIREMENTS AND IN COMPLIANCE WITH THE SECURITIES LAWS OF BRAZIL. **China:** This document is being distributed in China by, and is attributable to, Standard Chartered Bank (China) Limited which is mainly regulated by China Banking Regulatory Commission (CBRC), State Administration of Foreign Exchange (SAFE), and People's Bank of China (PBoC). **Germany:** In Germany, this document is being distributed by Standard Chartered Bank Germany Branch which is also regulated by the Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin). **Hong Kong:** This document (except any part advising on or facilitating any decision on futures contracts trading) is being distributed in Hong Kong by, and is attributable to, Standard Chartered Bank (Hong Kong) Limited 渣打銀行（香港）有限公司 which is regulated by the Hong Kong Monetary Authority. Insofar as this document advises on or facilitates any decision on futures contracts trading,

Document approved by
Tony Phoo
Senior Economist, NEA

Document is released at
06:52 GMT 08 August 2016