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# 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

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## A year of change for the Renminbi

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.

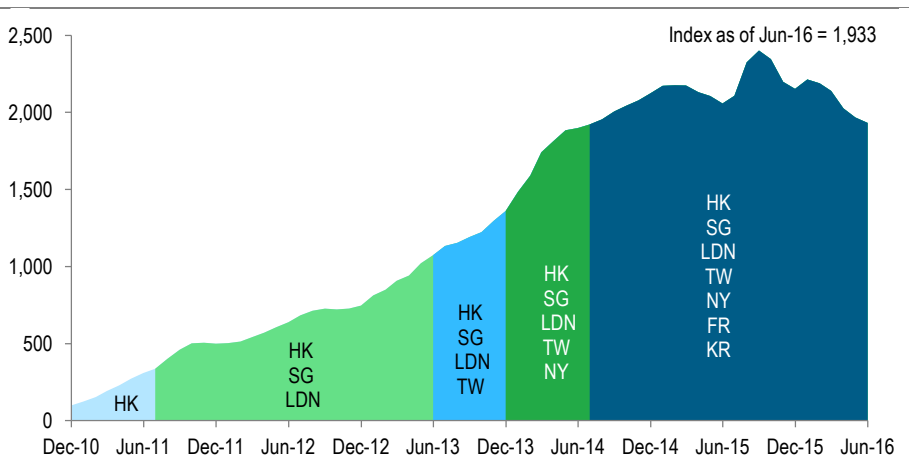
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Figure 1: RGI was down another 1.8% in June



Note: The RGI (Bloomberg: SCGRRI <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

Important disclosures can be found in the Disclosures Appendix

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### 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

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.

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

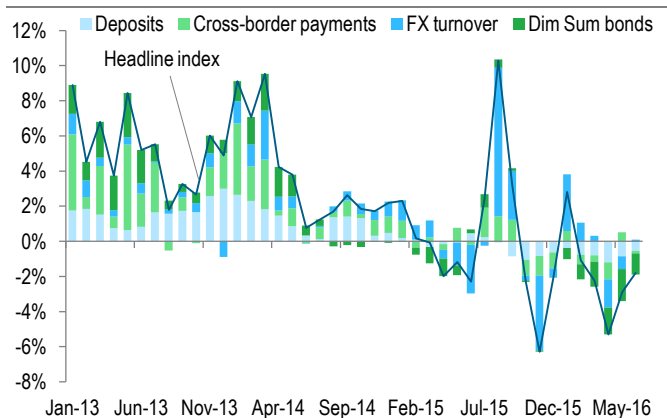
The price action in spot and around the CNY fixing suggests intolerance for further CNY weakness above 6.70 near-term, in our view. We see two reasons: First, authorities likely want to prevent capital outflows from breaching this psychological level. Our estimate of China's non-FDI capital outflows showed an increase 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**

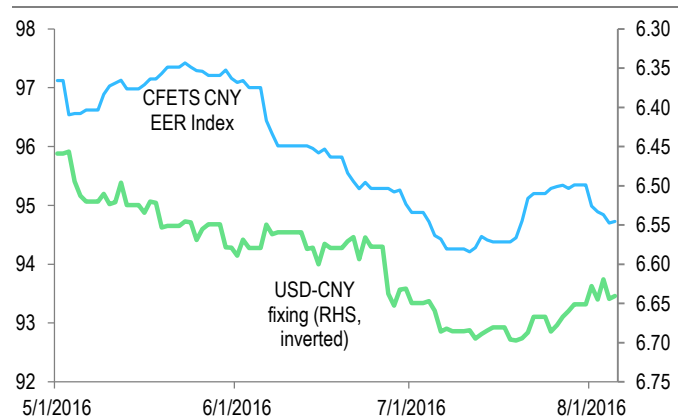
*Contributions of RGI components to % m/m change, ppt*



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.

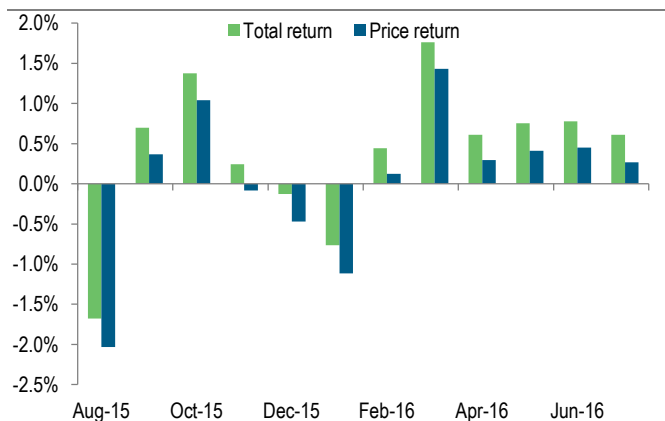
*Foreign investors bought 14% of net CGB issuance in H1, and have become the fourth-biggest investors*

### 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.

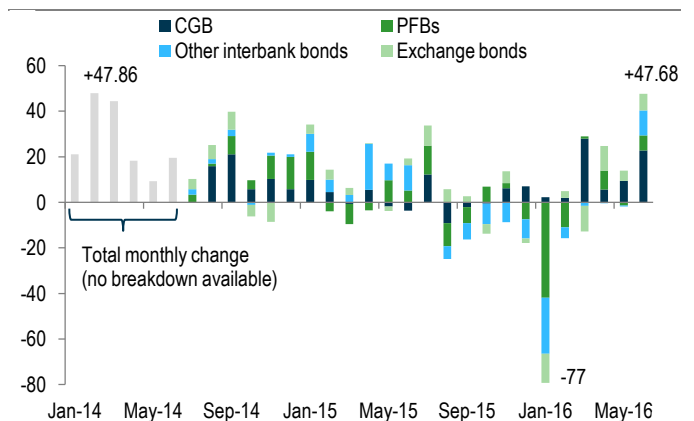
Foreign investors became the fourth-biggest buyers of onshore CGBs, absorbing 14% of total net CGB issuance in H1 – behind only commercial banks (48%), funds (29%) and exchanges (18%). Foreign ownership of CGBs rose to a new high of 2.8% as of end-H1 from 2.3% at end-2015; but foreign ownership of the 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



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