FINDINGS OF THE GLOBAL RENMINBI SURVEY

Progress amid uncertainty

2016 Renminbi Internationalization Report

BENCHMARK THE Asset RESEARCH

中国建设银行
China Construction Bank

Asset Benchmark Research

Asset Benchmark Research conducts in-depth, product-specific surveys on Asia's financial markets. Part of the group that publishes The Asset magazine, the research team specializes in accessing senior corporate decision-makers and institutional investors to provide accurate quantitative and qualitative data to assist in management decisions.

Co-published by Asset Publishing and Research Limited and China Construction Bank.

Asset Publishing and Research Limited
Suite 1203-05, 12th Floor
Chinachem Exchange Square
1 Hoi Wan Street, Quarry Bay
Hong Kong SAR, PR China
Tel: +852 2573 6078

China Construction Bank
No. 25 Finance St., Xicheng District
Beijing 100033
PR China
Tel: +86 10 95533

FINDINGS OF THE GLOBAL RENMINBI SURVEY

Progress amid uncertainty

2016 Renminbi Internationalization Report

BENCHMARK THE Asset RESEARCH

中国建设银行
China Construction Bank

Preface

Now in its second year, the 2016 Renminbi Internationalization Report, co-published by China Construction Bank (CCB) and Asset Benchmark Research, explores the development of the cross-border renminbi-denominated business. Although the overall internationalization of the currency sees some new challenges in 2016, the report finds that the number of companies holding offshore renminbi deposits has increased. Notably, small and medium-sized corporates have nearly caught up with large enterprises in the usage of the renminbi.

Learning from the internationalization of the US dollar, yen and other currencies, we see that the internationalization of a country's currency is a long process and is dependent on its convertibility and a mature economy. Other prerequisites include a sophisticated clearing system and robust financial markets. There is no fixed schedule for any currency to internationalize and it is impossible to do it overnight. Renminbi internationalization is a long-term strategy. Throughout this process, we need to remain steadfast, patient and keep confident.

The fundamental drivers of the renminbi's internationalization have not changed as the Chinese economy is still growing at a fast pace. China's trade and foreign direct investment are strong while the capital account is gradually being opened in both directions as well. Going forward, the government will be committed to the policies underpinning renminbi internationalization and deepening the renminbi exchange rate formation mechanism.

Internal statistics of CCB highlights the continued importance of the renminbi's cross-border use to the bank. Since 2009, cross-border renminbi flows arranged by CCB on behalf of its customers have accumulated to more than 13 trillion yuan, subject to an annual average growth rate of 200%. More than 21,000 corporate customers from 189 countries and regions have taken advantage of CCB's expertise in the renminbi.

In lockstep with the rapid internationalization of the renminbi, CCB has expanded its offshore renminbi clearing, settlement and financing services; while investing equally in product innovation in bond, fund, custody and trade offerings. In 2016, CCB's offshore renminbi clearing branches in Chile and Switzerland, as PBoC designated renminbi clearing banks in the two countries, successfully began to operate. The most active of the bank's offshore renminbi clearing branches– the London branch, as the designated UK renminbi clearing bank – cleared more than 13 trillion yuan, making it the largest overseas renminbi clearing centre outside of Asia.

The collaboration of the three overseas renminbi clearing branches in the UK, Switzerland and Chile has been key to the success of the bank's strategy to "provide access to world-wide renminbi clearing through a single branch". CCB has also been appointed as the market maker for renminbi business in Hong Kong, South Korea, and Taiwan among other regions.

In 2017 and 2018, CCB's team of renminbi specialists around the world expects more open policies on capital markets to give a special impetus to the internationalization of the renminbi. Grouped often as the One Belt, One Road strategy, more intensive trade relations across Asia, Europe and Africa promise to boost the global use of the currency even more. We look forward to examining its impact in next year's edition of the Renminbi Internationalization Report.

Mr. Huang Zhiling
Chief Economist
China Construction Bank

Contents

I. Executive summary

The international acceptance of China's currency, the renminbi, continues to grow. The global renminbi survey conducted by Asset Benchmark Research (ABR) on behalf of CCB finds both progress and pull-back in various aspects of the process. The annual survey aimed to gauge the level of acceptance of the renminbi in cross-border trading and financing activities among China-based and foreign corporations. Altogether, 210 companies participated in the survey conducted in August and September last year. 70 of the companies are based in China. We also gauged investor appetite for the renminbi by evaluating portfolio allocations of more than 300 institutional investors and conducting 13 in-depth interviews with investors on renminbi trends.

Although Chinese regulators continue to pursue policies whose long-term goal is to establish the renminbi as a global currency for the purpose of trade and investment, renminbi internationalization appeared to decelerate somewhat in 2016 after fast development over the last few years.

Major findings

SMEs catch up with larger companies in their offshore use of the renminbi

- The number of SMEs using renminbi for trade settlement has increased from 38% to 51%, while fewer large corporates say they settled trades in renminbi in 2016 than in 2015
- The number of SMEs booking foreign exchange (FX) transactions in renminbi outside China has increased from 14% to 49%, while that of larger corporates has declined
- SMEs' activity has more than doubled since 2015 in CNH instruments

The renminbi gains ground in offshore deposits

- 54% of respondents maintain deposits in renminbi outside China. A bigger share of North Asian companies hold them (65%), while American and European peers are least likely to (9%)
- The use of offshore renminbi deposits among China-based corporates has increased since 2015 (51% in 2016, up from 33% in 2015)

More overseas companies than China-based companies use renminbi for trade settlement during the past 6 months

- 52% of respondents have used the renminbi in international trade settlement, and a further 5% say they will likely do it in the next six months
- More overseas companies do it (53% versus 49% in China) and see a growing trend in the future. Comparison with 2015 shows a small overall decline among China-based respondents (49% down from 56% in 2015)
- 31% of China-based respondents will have more than 20% of international trade denominated in renminbi in the following two years

The pace of renminbi internationalization appears to have slowed down

- China-based respondents are evenly split between those who see it slowing down and those who see it accelerating, while more overseas respondents perceive a slowdown in the process of renminbi internationalization
- As an encouraging sign, the percentage for whom renminbi cross-border trade accounts for more than 60% of their total trade has increased from 2% to 7%. Still a very small percentage of cross-border trade is conducted in the renminbi (less than 1% for 43% of China-based respondents). 69% estimate it will remain below 5% in the next two years
- Respondents are cautiously optimistic about the effect of One Belt, One Road (OBOR) on renminbi internationalization

Cross-border cash pool structures have become more common, but further growth faces uncertainty

- More China-based respondents than a year earlier (35% versus 23%) have set up some form of cross-border renminbi cash pool structure. The usage of cross-border intercompany loans has significantly increased (15% versus 7%) as other means to pool have become more difficult to implement
- 58% of respondents have not felt any effect of the depreciation of renminbi on their treasury this year, while a third of respondents say they are directly affected by the currency's depreciation

Despite many companies' use of offshore renminbi for financing, it constitutes a small share of total funding

- 40% of respondents have renminbi-denominated offshore funding, but it constitutes less than 10% of the companies' total financing
- The number of China-based corporations using the offshore renminbi for a material portion of their funding (2% or more) is likely to grow from 16% to 39% in two years
- 36% of China-based companies held offshore renminbi loans in the previous six months, 32% of overseas companies did
- 31% of overseas companies consider issuing panda bonds
- Lower cost of funding and diversification of investor base are the main perceived benefits of panda bonds
- Very few respondents (7% overseas, none in China) have obtained offshore funding via Special Economic Free Trade Zones (FTZs)

FX risk management becomes a priority

- 37% of China-based and 58% of overseas corporates booked FX transactions in renminbi outside mainland China in the past six months
- 69% of China-based and 56% of foreign respondents have increased the level of active management of FX risk
- China-based corporates are more likely to use offshore CNH deliverable forwards and swaps as well as offshore CNH spot markets
- Overseas corporates prefer natural hedging of assets and liabilities

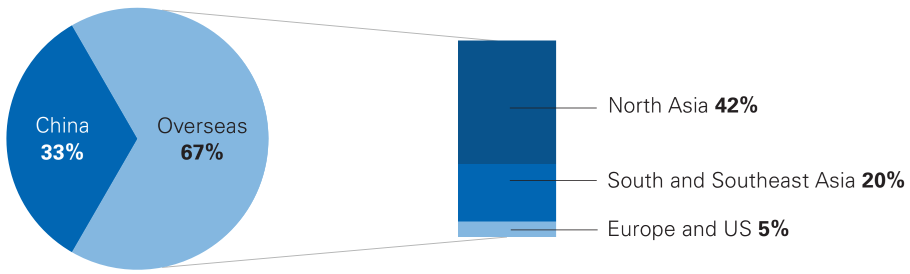
Institutional investors are eager to use new channels to access renminbi bonds but need regulatory clarity

- Hong Kong, Malaysia and Singapore-based institutional investors interviewed in the survey maintain a higher allocation to offshore renminbi bonds (30%) than to onshore renminbi bonds (19%) in 2016
- More than half of respondents are interested in accessing the China Interbank Bond Market (CIBM)
- Investors are evenly split between Qualified Foreign Institutional Investors (QFII), Renminbi Qualified Foreign Institutional Investors (RQFII) and CIBM Direct as their preferred channel to access China's onshore bond market
- Investors would be further encouraged to invest in China's onshore bond market if they had complete access to the country's onshore FX market and more clarity on regulations
- CNH bonds would be more attractive if there was better liquidity and more research available
- Given the inclusion of the renminbi in the Special Drawing Rights (SDR) basket of the International Monetary Fund (IMF) and in the foreign reserves of more and more central banks and monetary authorities, 25% of the institutional investor respondents say they would increase their allocation to CNY assets, but the percentage will be small (less than 10%) for the time being

II. About the survey

For the *2016 Global Renminbi Survey*, ABR contacted 210 CFOs, corporate treasurers and finance directors. A third of them are from China, 42% from North Asia, which for the purpose of this survey consists of Hong Kong, Japan, South Korea and Taiwan. A further 20% are from South and Southeast Asia, Australia and India, and 5% from Europe, the US and the rest of the world. For the purpose of this survey, corporates based in Hong Kong and Taiwan were grouped together with overseas companies.

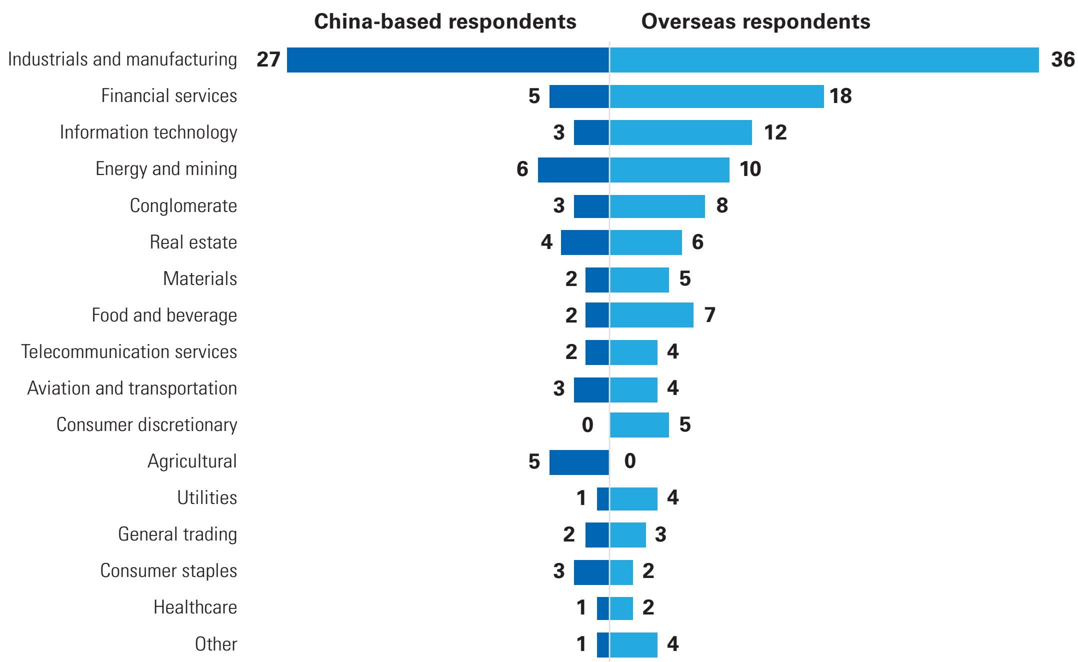
CHART 1: **Distribution of respondents by location**



The responses were obtained via an online questionnaire and telephone interviews conducted in August and September 2016.

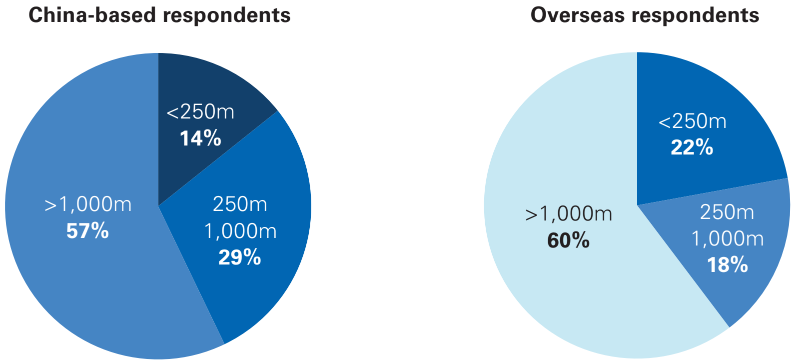
The industrials and manufacturing sector is most broadly represented among the survey participants, with 27 corporations in China and 36 abroad. Financial services (5 companies in China, 18 foreign), information technology (3 in China, 12 foreign) and energy and mining (6 in China, 10 foreign) together contribute more than a quarter of responses.

CHART 2: **Distribution of respondents by industry**



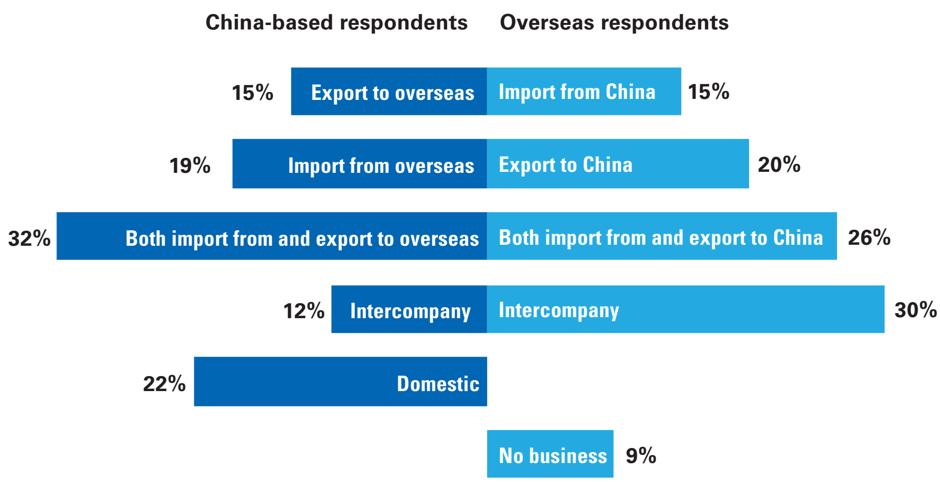
Overall, large corporations, with annual revenues of more than US$1 billion represent 59% of respondents, mid-cap corporations with revenues between US$250 million and US$1 billion constitute 21% and SMEs account for the remaining 20%.

CHART 3: **Distribution of respondents by annual turnover (US$ million)**



Among China-based corporates, 66% of the participants export or import from overseas, or do both. Among overseas respondents, 61% import from, and/or export to China, but an additional 30% of participating companies buy from, or sell to their subsidiaries in China.

CHART 4: **Respondents' engagement in cross-border activities**



("Domestic" companies mostly buy and sell within China. "No business" refers to companies that do not have a significant business or investment in the mainland, while "Intercompany" are corporates that buy from and/or sell to their China or overseas subsidiaries.)

III. Overview of major regulatory changes and update on renminbi internationalization

Internationalization of China's currency is a process that the country's government and regulators are pursuing at a gradual and measured pace. While the long-term goal is for the renminbi to serve as a global trade currency, global investment currency and a global reserve currency, the paths leading to achieving these objectives are dotted with challenges.

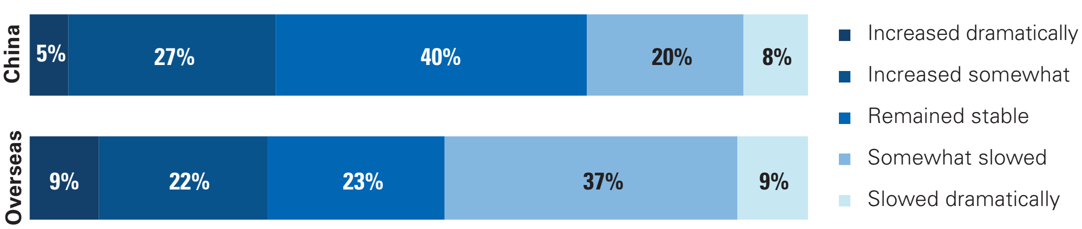
Using the renminbi for trade settlement brings benefits to China-based companies, allowing them to reduce their FX exposure and the cost of hedging. However, while China promotes the use of the renminbi for trade, individual companies' ability to adopt the renminbi more widely depends on their overseas partners' ability and willingness to accept it.

At the same time, many domestic companies still require education on the benefits of renminbi-denominated trade before they will consider discussing this with their overseas buyers and suppliers.

Overseas institutional investors are eager to invest in China, attracted by the country's robust growth and returns surpassing what they can earn in their domestic markets. As China has been gradually opening its markets to foreign investors, the use of the renminbi in investment is now largely liberalized for both equity and fixed income securities – in some cases no longer subject to quota ceilings.

The regulations are indeed evolving to make investing in China easier. In February 2016, China's State Administration of Foreign Exchange (SAFE) introduced changes to its long-standing QFII scheme easing restrictions on investing in China A-shares. In September, revisions were made to the RQFII scheme, effectively giving larger asset managers even greater scope to invest in mainland markets.

CHART 5: **View on the pace of renminbi internationalization**



In November, the expansion of the existing Stock Connect scheme was announced, adding Shenzhen-based listings to the Shanghai-Hong Kong scheme in place since 2014. Also in February, the People's Bank of China (PBoC) announced a new scheme opening the country's vast interbank bond market to virtually all types of institutional investors.

Although foreign investors continue to be attracted by the opportunities China's economy presents, the country has been experiencing currency outflows, stemming from domestic investors' desire to diversify their investments and hedge against currency depreciation.

It is in this multi-faceted environment of potential further depreciation of the renminbi and gradually growing acceptance of the currency outside China, that this report examines the effects the policies have had on Chinese corporates doing business abroad and foreign institutions doing business in China.

Corporate respondents were asked to share their views on the pace of renminbi internationalization. Roughly a third of both China-based and overseas respondents believe that the pace increased – driven by the inclusion in the IMF's SDR basket, the development of several other FTZs and new investment channels.

40% of China-based respondents found that the pace of renminbi internationalization remained stable in 2016 and 28% believe it slowed. A larger share of overseas companies (46%) say that the pace has slowed since previous years.

40%

OF CHINA-BASED RESPONDENTS SAY THE PACE OF RENMINBI INTERNATIONALIZATION REMAINED STABLE IN 2016

IV. Use of renminbi and One Belt, One Road

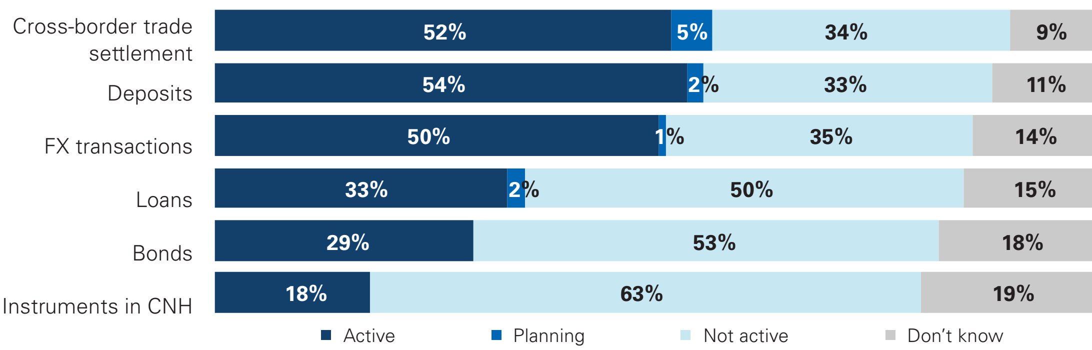
a. Cross-border activity

Most of the respondents use the renminbi for cross-border trade settlement, to maintain offshore renminbi deposits, and when conducting FX transactions in the currency outside China.

In the survey, participants were asked what aspects of offshore renminbi activity they were engaged in, how their usage of offshore renminbi had changed in the past six months (increased, decreased or hadn't changed) and what change they expected to see in the following six months.

Chart 6 examines the level to which the renminbi has made inroads in corporates' offshore deposits, cross-border trade settlement and other treasury activities as well as their plans for such activities going forward.

CHART 6: **Respondents' engagement in renminbi-denominated cross-border financial activities**



("Planning" refers to companies who indicated they were inactive in the past six months, but expected an increase of activity in the following six months)

The survey finds that North Asian companies most commonly maintain renminbi deposits outside China, while few European and American ones do so. On the other hand, European and American corporates have a greater degree of involvement in FX transactions in renminbi and financial instruments in CNH.

More China-based corporates raise money via renminbi-denominated offshore loans than via issuing CNH-denominated bonds. The latter are more commonly used by foreign companies.

Also, fewer China-based companies conduct FX transactions abroad compared to foreign corporates.

CHART 7: **Breakdown of engagement in renminbi-denominated cross-border activity by region**

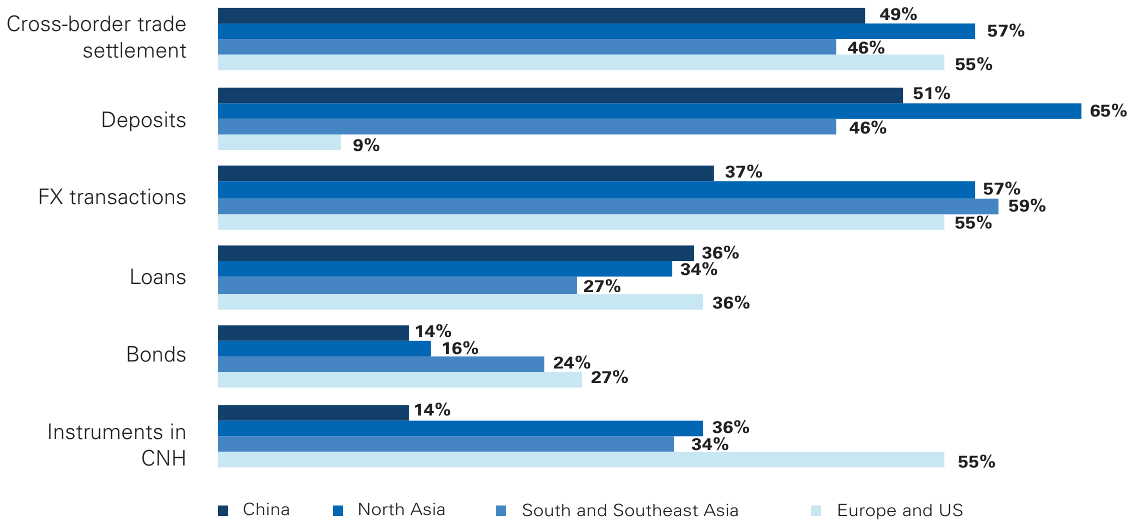
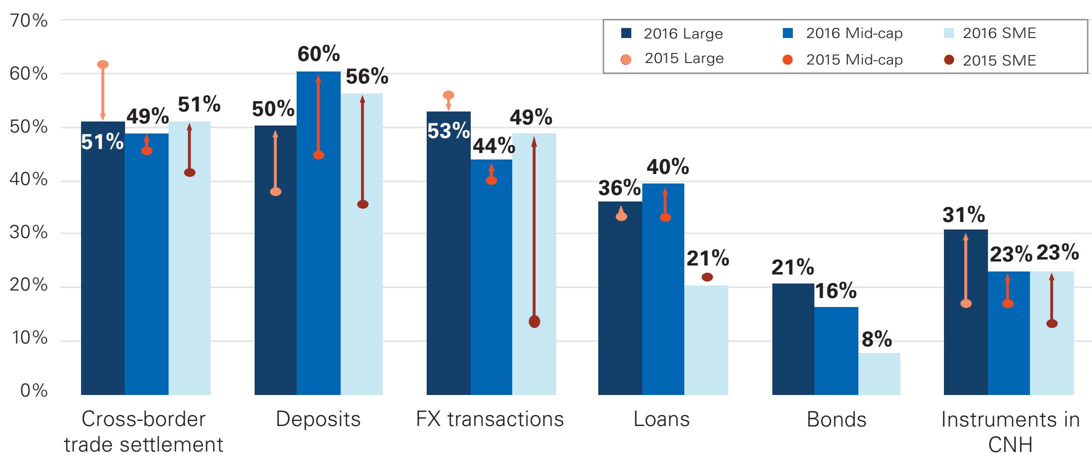


Chart 8 shows trends in the offshore renminbi activity of China-based corporations by comparing this year's survey results with the ones conducted in 2015. The survey finds an increase in involvement in offshore renminbi deposits across the board among large corporations, mid-caps and SMEs. An interesting picture emerges when the use of other channels was compared. The data show a clear increase in offshore renminbi activity for SMEs in cross-border trade settlement, FX transactions and CNH instruments. In contrast, fewer large corporations are active in cross-border trade settlement and FX transactions compared to 2015. This suggests that while SMEs were slower to start realizing the benefits of renminbi internationalization, larger companies that adopted these channels earlier now encounter obstacles that limit their further involvement.

The data also show that bonds attracted a considerable number of companies that used them as a financing method in the offshore renminbi market. However, no comparative data is available as "bonds" was not in the list of cross-border activities presented to respondents in the 2015 survey.

CHART 8: **Trends in offshore renminbi activity, China-based respondents**



The dots denote percentages of the offshore renminbi activities by company size in 2015
Note: "Bonds" was not given as an option in 2015

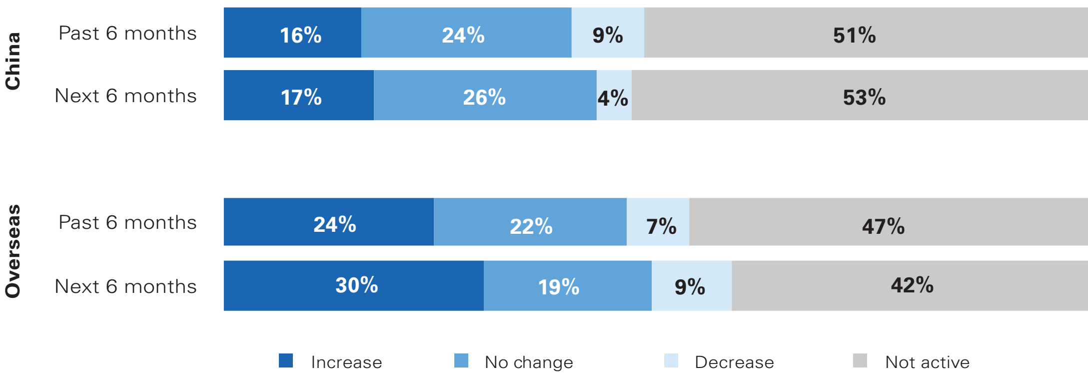
b. Cross-border trade settlement in renminbi

Comparison of results from this year's survey with the one conducted in 2015 indicates that there has been a small decline in the use of the renminbi in cross-border trade settlement among Chinese corporates.

While 56% of China-based respondents said a year ago that they used the renminbi in cross-border trade and a further 7% indicated they were planning to start doing so in the following six months, this year only 49% indicated activity in this area. 9% of the total say their activity has declined recently. This trend is expected to continue as only 47% say they would use renminbi in cross-border trade settlement in six months' time.

Among overseas respondents, 53% reported activities in the past six months and 58% indicate they would continue to use renminbi in cross-border trade settlement in six months' time. The number exceeds that of China-based respondents.

CHART 9: **Use of renminbi for cross-border trade settlement**

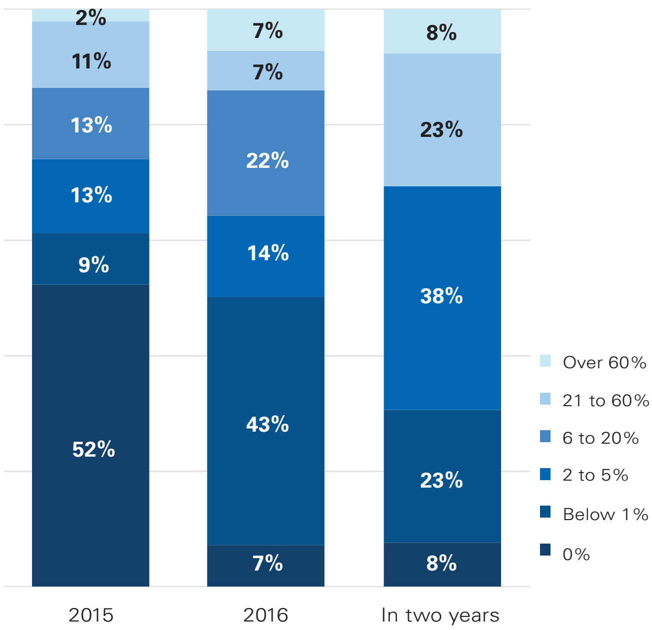


53%

OF OVERSEAS RESPONDENTS USED THE RENMINBI IN CROSS-BORDER TRADE IN THE PAST SIX MONTHS

Yet, those corporates that have begun and plan to continue using the renminbi to settle trade are keen to expand its usage. Notably, as seen in Chart 10, more than half of Chinese respondents in 2015 said that none of their overseas trade was denominated in the renminbi. This year only 7% of the respondents did. Furthermore, 31% of respondents predict renminbi would take up more than 20% of their international trade settlement in two years.

CHART 10: **Percentage of international trade denominated in renminbi, China-based respondents**



43% of China-based survey participants say that still only a very small amount of cross-border trade – less than 1% – is conducted in the currency. Many expect it to grow in the next two years, with the largest number of respondents estimating it to reach between 2 and 5%. Still, the share is expected to remain below 5% for almost 70% of respondents.

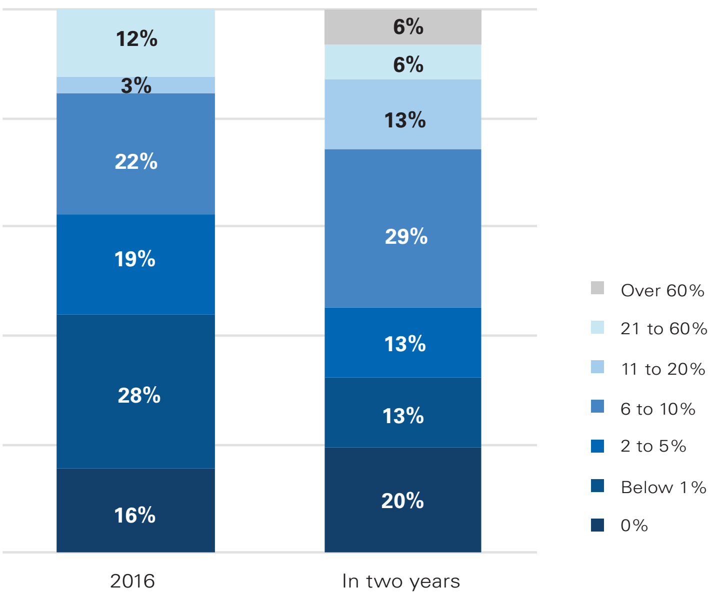
A few companies, however, have made serious inroads into adoption of the renminbi for international trade. The number of respondents whose majority (60% or more) of trade is denominated in renminbi has increased from 2% in 2015 to 7% in 2016. Similarly, overseas corporates expect the share of the trade they conduct in renminbi to increase, even though 75% of them say it is likely to remain below 10%.

While overall momentum in further adoption of the renminbi in cross-border trade settlement has temporarily slowed, the survey identifies a core of convinced corporates – both overseas and based in China – that no longer only experiment with the currency. Instead, they aspire to gradually increase the percentage of their total trade denominated in renminbi having witnessed the benefits of doing so first-hand. If their experience proves successful, other corporates will likely follow in their tracks.

43%

OF CHINA-BASED SURVEY PARTICIPANTS SAY THAT ONLY A VERY SMALL AMOUNT OF CROSS-BORDER TRADE IS CONDUCTED IN RENMINBI

CHART 11: **Percentage of international trade denominated in renminbi, overseas respondents**



c. Attitude towards adopting the renminbi for trade settlement

Respondents were asked about their attitudes towards adopting the renminbi for trade settlement to gauge how expectations regarding currency exchange rates and other factors play into their decision-making. China-based respondents said they were more proactive in requesting their counterparties to switch to renminbi in order to gain benefits from managing FX exposure outside China at better rates.

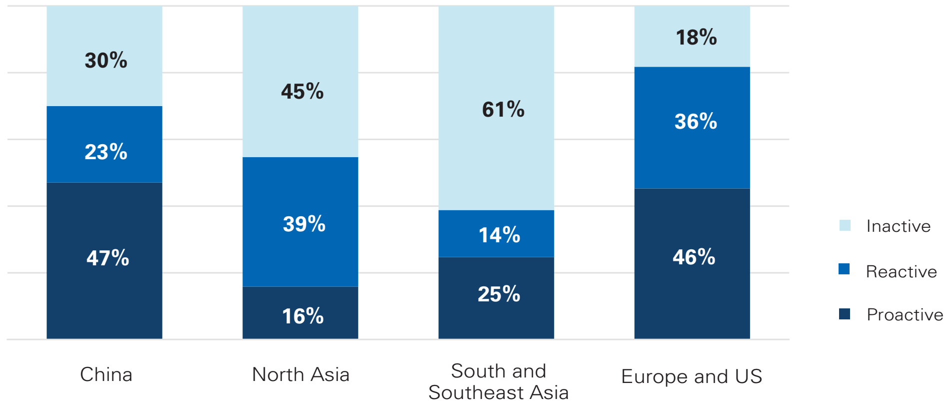
A China-based respondent says it wants to increase the usage of the renminbi, but it mainly depends on whether its overseas vendors can accept the currency or not. "It will be beneficial for us in terms of FX because we avoid big volatility on gain or loss caused by FX. Overall, so far our vendors can rarely accept renminbi in terms of settlement," the respondent says.

More overseas respondents say they tend to be reactive – switching only when pressed by mainland China counterparties. Yet, even those that show interest often experience hesitance by their Chinese suppliers and buyers.

One of the most widely cited obstacles to renminbi adoption in trade settlement in 2016 is summed up by a China-based respondent in the industrials and manufacturing sector: "The renminbi is not widely accepted in the cross-border business because [trade partners] expect that it will continue to depreciate."

Among overseas respondents, those in North Asia tend to be more reactive, while those in Europe and the US are more proactive. Despite the growing trade flows and tighter links forged through multiple free trade agreements, South and Southeast Asian respondents are least active in the domain – with 61% of them considering themselves neither pro- nor reactive, but simply inactive.

CHART 12: **Attitudes towards adopting renminbi for trade settlement**

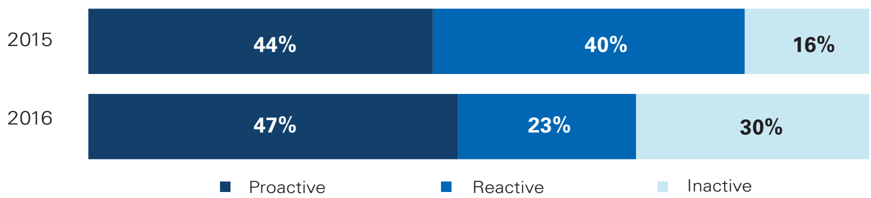


The attitudes towards adoption of trade settlement in renminbi confirm the slight decline seen earlier in the level of the activity. Among China-based corporates, twice as many as a year ago say they are inactive. The number of reactive respondents shrank from 40% to 23%, while the number of proactive ones remained approximately the same.

61%

OF SOUTH AND SOUTHEAST ASIAN RESPONDENTS ARE INACTIVE IN TERMS OF RENMINBI ADOPTION IN TRADE SETTLEMENT

CHART 13: **Attitudes towards adopting renminbi for trade settlement among China-based respondents**

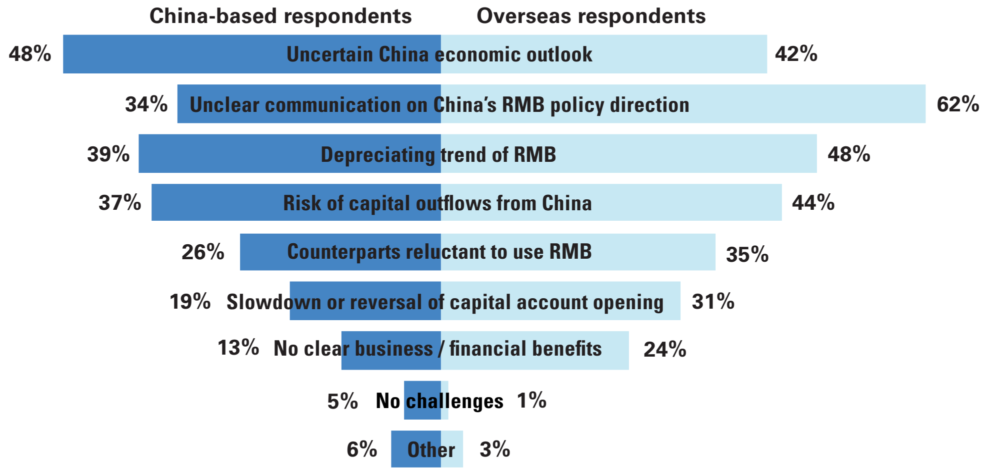


d. Challenges to further renminbi adoption

Respondents were asked what they saw as the biggest challenges to the international adoption of the renminbi for trade settlement. Overall, macroeconomic factors play the largest role, they say, whether it's general uncertainty about China's economic outlook, depreciation of the renminbi or risk of capital outflows from China.

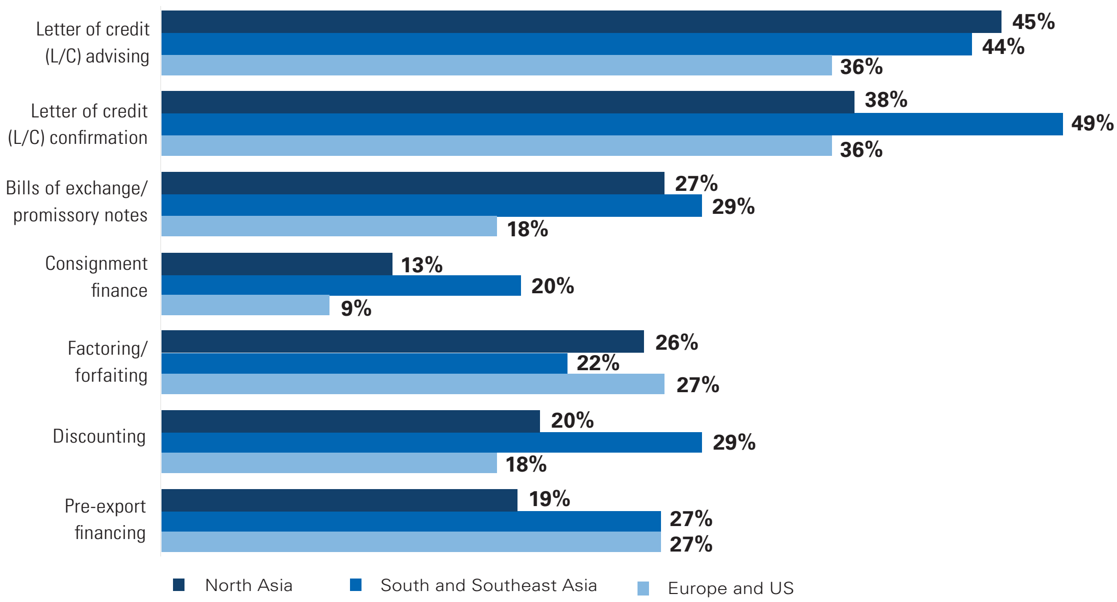
Stability, predictability and transparency of policies are needed to encourage broader usage of the renminbi for trade settlement, the respondents note. Some say the appreciation of the currency would provide a further incentive. Others also cite the ability to move funds freely in and out of China, while still others point out the need for economic stability and a generally more positive outlook.

CHART 14: **Challenges to international adoption of the renminbi**



The awareness of renminbi trade payment and finance products available outside China remains spotty. Only less than half of respondents are aware of the availability of the most standard trade finance instruments -- letters of credit denominated in renminbi in their market. Even fewer say they know of other products like consignment finance or factoring. It is apparent that banks need to increase their communication efforts about products available to corporate clients.

CHART 15: **Awareness of renminbi-denominated trade payment and finance products available in the respondents' market**



e. One Belt, One Road

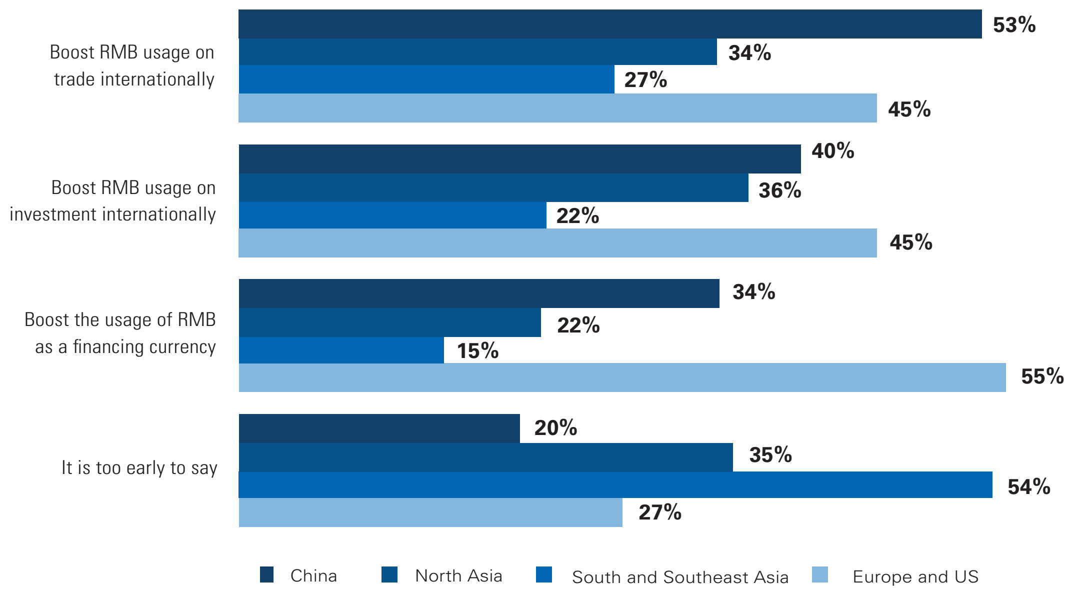
The One Belt, One Road (OBOR) initiative, unveiled in 2013, has stirred a mix of hopes and reservations about China's growing international influence. The long-term effect of the policy on the use of renminbi for trade and investment is still unclear, but a significant proportion of the respondents see it as a positive factor. 29% expect it to boost the usage of China's currency in international trade and 26% expect the same effect in international investment (respondents could choose more than one answer).

Respondents from China were most optimistic on the increased usage of the country's currency in international trade as a result of OBOR. South and Southeast Asia respondents, on the other hand, were most reluctant in their predictions, with more than half stating "it is too early to say" what, if any, effect the policy will have on the renminbi. North American and European respondents stand out for the widely held belief that the currency will benefit more with respect to financing.

Their expectation likely reflects an assumption that many of the infrastructure programmes proposed under OBOR will be financed by Chinese institutions, such as the Asian Infrastructure Investment Bank (AIIB).

A China-based respondent says he has yet to see the strategy translated into an implementation plan. "Definitely there will be massive investment from China in those countries involved in major infrastructure projects. That will definitely make a positive move on renminbi internationalization. But we still need to see how quickly that strategy gets to be implemented."

CHART 16: **Effects of the One Belt, One Road initiative on the internationalization of the renminbi**



Based on opinions by respondents in South and Southeast Asia, which is to play a critical role in the realization of OBOR, progress appears to be slow. 15% of respondents believe the use of the renminbi as a financing currency will be boosted as a result of the initiative.

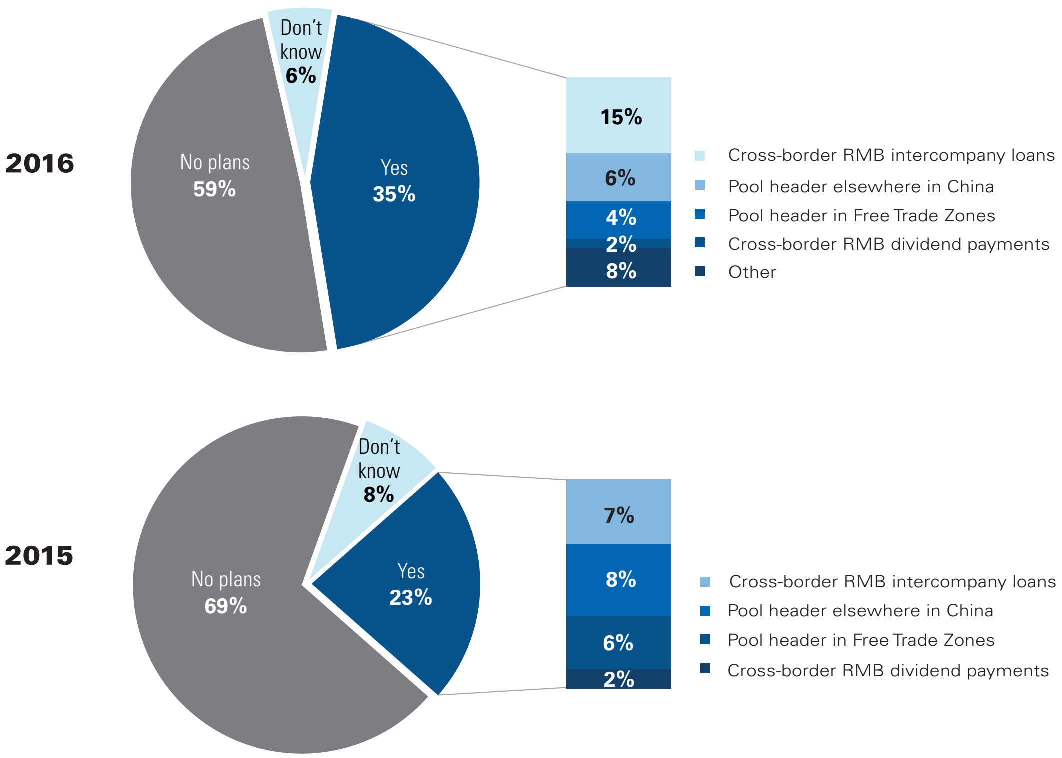
V. Cross-border treasury integration

Cross-border movement of funds in and out of China remains a source of frustration for corporate treasurers, particularly those with surplus cash operations in China.

In order to allow both multinational corporations and large Chinese enterprises to integrate their Chinese operations into their global treasury setup, China began introducing a series of reforms in its FTZs that dot the country. In many cases, the Shanghai FTZ took the lead in these, giving corporates with an entity in the zone a taste for fully automated sweeping of renminbi surplus. For those companies able to act on the reform, it made more costly and less flexible methods such as loans and dividends obsolete.

The devaluation of renminbi has apparently affected the use of cross-border cash pools. For most of 2016, companies that had already set up such structures no longer use it, while those seeking to implement one hesitated.

CHART 17: **Use of cross-border renminbi cash pool structures, China-based respondents**



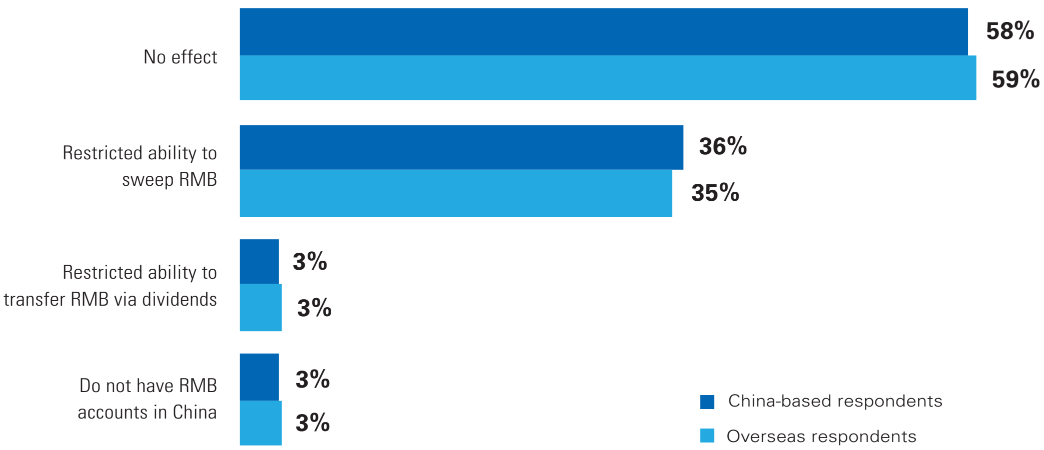
"We have already applied successfully for the cross-border renminbi cash pooling structure, but we haven't used it yet," says a China-based representative of a multinational corporation.

The usage of pool-headers within FTZs or outside the zones has not significantly changed since last year. 14% of respondents last year said they had set up a cross-border cash pool, either through one of the FTZs or through a nationwide reform scheme. This year, 10% say they have.

Growing much more quickly this year was the percentage of companies going back to (or adopting for the first time) intercompany loans as a conduit for cross-border liquidity management.

Nevertheless, most respondents, 58%, have not felt the effect of the devaluation of the renminbi this year on their treasury.

CHART 18: **Impact of the depreciation of renminbi on cross-border renminbi liquidity management practices**



10%

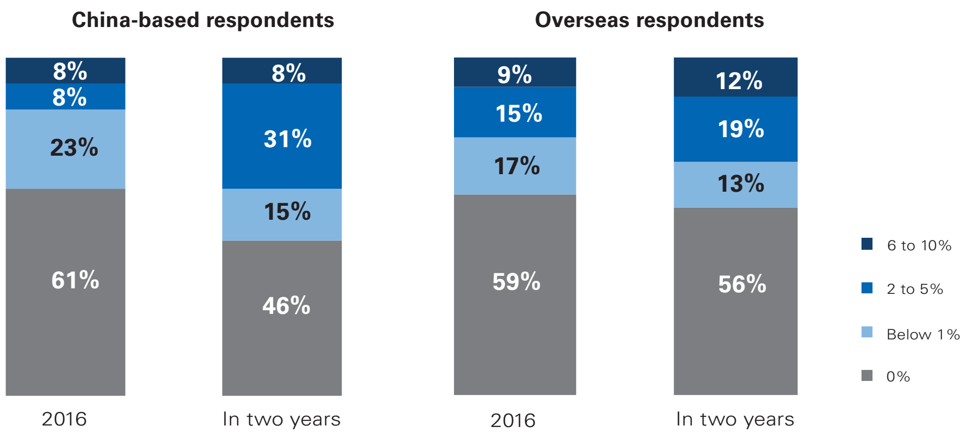
OF RESPONDENTS SAID THEY HAD SET UP A CROSS-BORDER CASH POOL THIS YEAR

VI. Financing

a. Renminbi funding outside mainland China

The offshore renminbi markets are no longer as attractive as they used to be for financing, while domestic alternatives gain appeal. Respondents were asked about their experience with offshore funding, which for the survey's purpose includes loans, receivables financing, bonds and other common financing instruments.

CHART 19: **Percentage of renminbi-denominated funding**



36%

OF THE RESPONDENTS IN CHINA INDICATE THEY HELD AT LEAST ONE FORM OF RENMINBI LIABILITY WITHIN THE PAST SIX MONTHS

The growth is most remarkable among China-based companies. While today 16% of them state that the renminbi accounts for a material share of their offshore funding, 39% say it will do so two years from now.

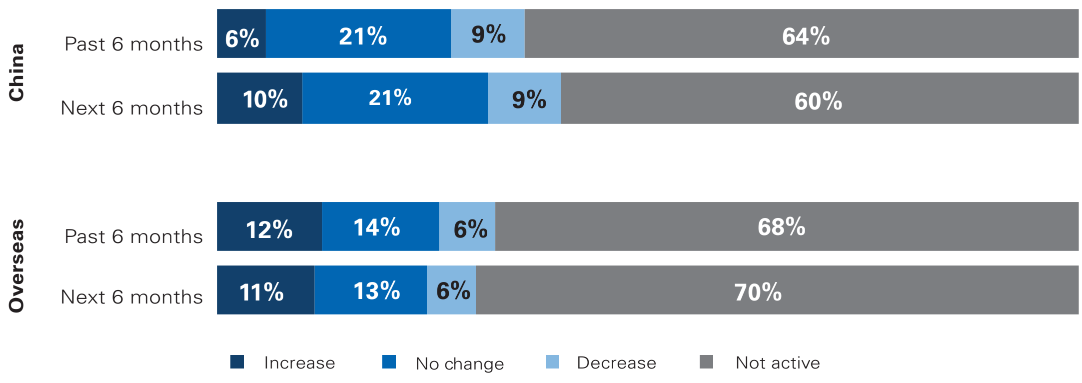
Renminbi-denominated funding constitutes a material share of total funding (2% or more) for only 24% of the overseas respondents. When asked about their estimated funding structure two years in the future, 31% indicate they would have 2% or more of it denominated in the renminbi.

b. Renminbi-denominated loans outside mainland China

The proportion of respondents who say their companies hold renminbi-denominated loans outside China was understandably higher among companies based in China than among those incorporated outside the country. 36% of the respondents in China indicate they held at least one form of renminbi liability within the past six months and a further 4% expect to hold them within the next six months.

This dynamic is not, however, reflected among corporates based overseas. Only 32% of respondents indicate they had loans in renminbi outside the country.

CHART 20: **Renminbi-denominated loans held outside China**

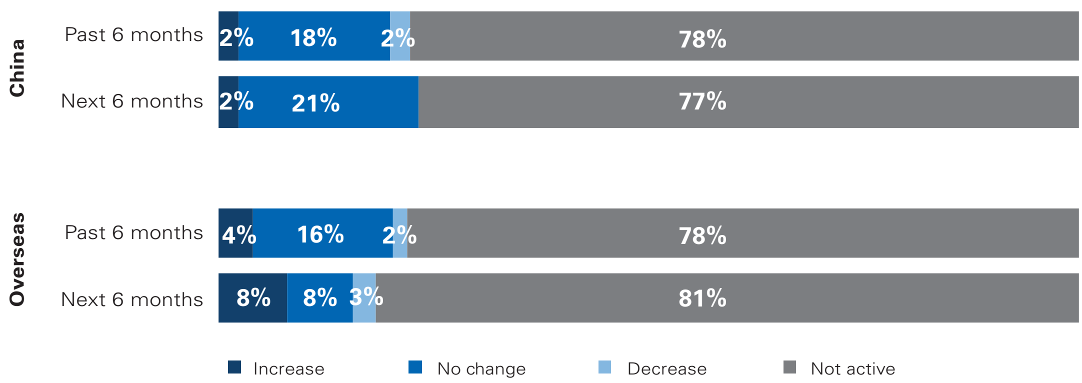


c. Renminbi-denominated bonds outside mainland China

The usage of renminbi bonds outside China is lower than that of loans. Only 22% of China-based survey participants say they had used them in the past six months and the six-month outlook did not indicate a significant change.

A similar share of corporates based overseas have issued renminbi bonds outside the country, but more of them indicate that they intend to increase this activity in the next six months.

CHART 21: **Renminbi-denominated bonds issued outside China**



31%

OF OVERSEAS RESPONDENTS WOULD CONSIDER ISSUING PANDA BONDS

d. Overseas corporates: Panda bonds

Panda bonds are renminbi-denominated bonds issued by foreign companies in onshore China. Issuance has more than doubled from 12 billion yuan in 2015 to 29 billion yuan in just the first seven months of 2016. Although still only a niche option for renminbi financing, the main advantage of issuing panda bonds, in the eyes of the respondents, is the lower cost of funding compared to other sources. Some point to the ability to extend their investor base, while others highlight benefiting from the Chinese government's efforts to promote the domestic corporate bond market.

Among survey respondents from overseas, 31% would consider issuing panda bonds, most with a caveat that they would do so only if they can obtain a lower cost of funding that way.

CHART 22: **Interest in using panda bonds, overseas corporates**

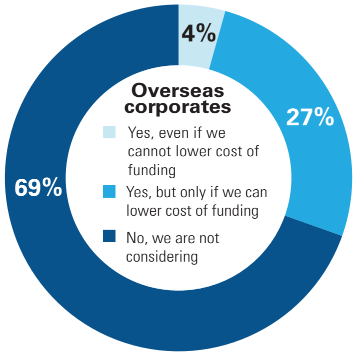
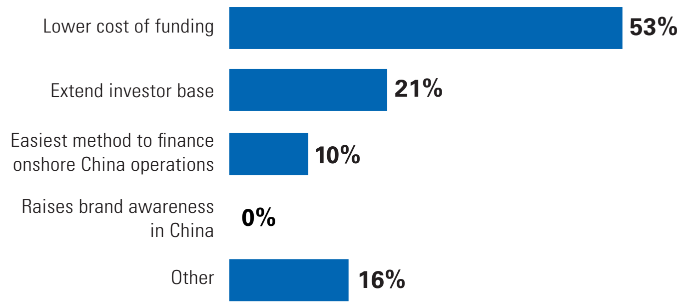


CHART 23: **Perceived benefits of panda bonds, according to respondents who have indicated interest in issuing them**



"With the PBoC rates going down and the Chinese government actively pushing the corporate bond market, conditions are favourable at the moment to put in place long-term debt at a reasonable price," notes one respondent.

The views of the survey participants were not, however, uniform. A China-based respondent says the cost is not justifiable when asked what factors discouraged him from issuing panda bonds, adding that the company saves more issuing bonds abroad. A respondent from Singapore cites the environment for panda issuance is "a bit restrictive" amid regulatory constraints.

7%

OF OVERSEAS CORPORATES RESPONDED POSITIVELY TO USING FTZS FOR FINANCING ACTIVITIES

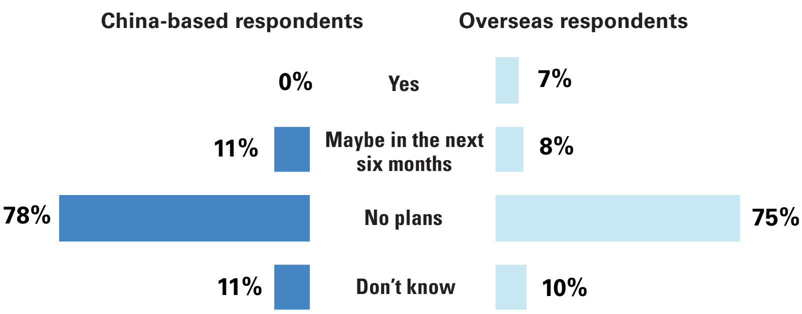
e. China corporates: Borrowing from offshore markets via FTZs

In 2013 China started setting up several FTZs that introduced a number of financial liberalizations, including cross-border cash pooling and access to offshore renminbi debt markets (such as Hong Kong). Survey participants were asked to what extent their Chinese entities used these jurisdictions to tap overseas renminbi markets for financing.

Only 7% of overseas corporates responded positively, another 8% say they will consider using entities in FTZs to access renminbi pools in overseas markets over the next six months. The remaining 85% either say they did not use FTZs for this purpose or did not know about their usage.

None of the China-based respondents affirmed that they currently use FTZs for borrowing offshore, with only 11% indicating an intention of using them in the future.

CHART 24: **Usage of Free Trade Zones for financing activities**

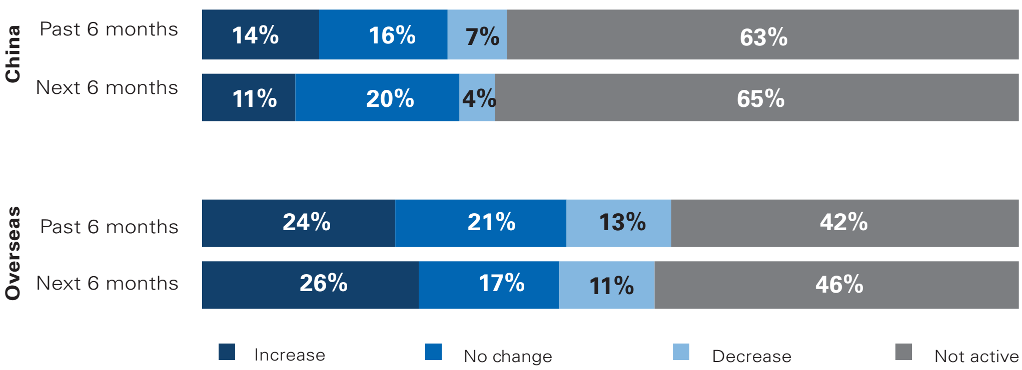


VII. Renminbi risk management

37% of China-based corporates say they actively book offshore FX transactions denominated in renminbi. A higher share of them expect the activity to increase in the next six months than to decrease.

Among overseas respondents, 58% booked renminbi FX transactions. As the number of FX transactions grows, managing the FX risk gains in importance, especially in light of greater volatility in the currency and amid expectations of further depreciation.

CHART 25: **FX transactions in renminbi booked outside mainland China**



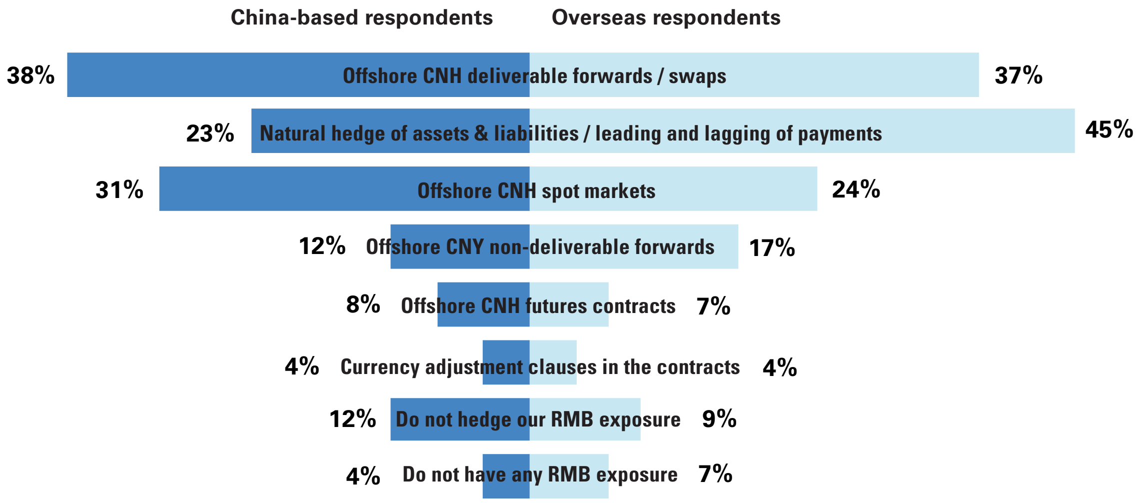
Conducting trade denominated in the renminbi makes ever more sense for Chinese companies, enabling them to pass on FX risks to overseas counterparties. Foreign companies, meanwhile, have many tools to hedge their exposure and many of them are keen to boost their renminbi capabilities.

In response to these challenges, 69% of China-based respondents and 56% of foreign respondents indicate that they have increased the level of active management of FX risk.

37%

OF CHINA-BASED CORPORATES SAY THEY ACTIVELY BOOK OFFSHORE FX TRANSACTIONS DENOMINATED IN RENMINBI

CHART 26: **Preferred ways to manage renminbi exposure**



12%

OF CHINA-BASED AND 9% OF OVERSEAS RESPONDENTS SAY THEY DID NOT HEDGE THEIR RENMINBI EXPOSURE

The preferred instruments for hedging renminbi currency risks are broadly similar between China-based and overseas respondents that access the offshore CNH market. CNH forwards and swaps, spot transactions and natural hedging via payments and receivables flows are the three most common methods for both types of respondents.

Overseas corporates are active to the same extent in the offshore CNH deliverable forwards and swaps, but their favourite tool is natural hedging of assets and liabilities and leading and lagging of payments.

12% of China-based and 9% of overseas respondents say they did not hedge their renminbi exposure.

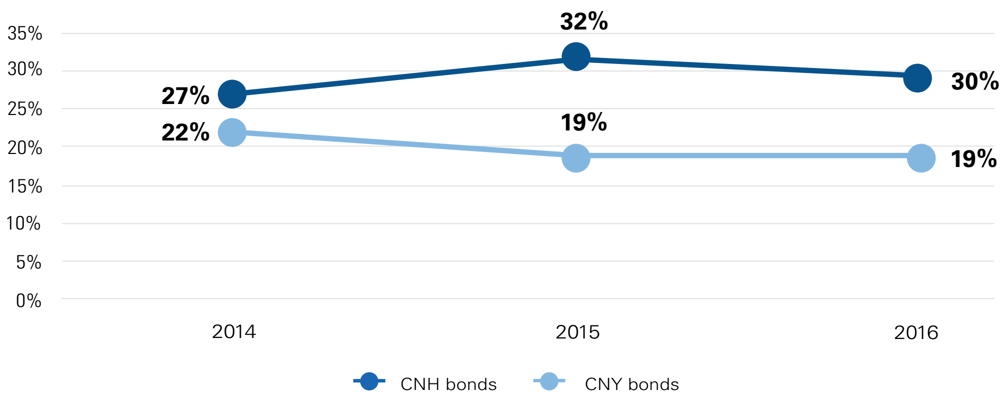
VIII. Institutional investors

In order to provide a more complete view of renminbi internationalization, ABR conducted in-depth interviews with 13 institutional investors based in Hong Kong, Malaysia and Singapore, asking them about their approach to investing in China, their exposure to the renminbi and their willingness to work with Chinese banks. ABR also drew information from the past three years of Asian Currency Bond Benchmark Review, the most recent of which was conducted during the first half of 2016 across 300 institutional investors managing local currency portfolios in Asia.

a. Trends in allocation to renminbi in investment portfolios

On average, institutional investors with Asian currency portfolios maintained a higher allocation to offshore CNH bonds in 2016 (30%) than to their onshore equivalents (19%). The CNH allocation declined slightly from the year before, while the average allocation to CNY remained steady.

CHART 27: **Allocation to renminbi in investment portfolios**



b. Preferred access channels

Announced in February 2016, direct access to the CIBM opened a new route for international investors to access onshore bonds. Previously open only to three types of institutions (foreign central bank-type institutions, renminbi clearing banks and overseas renminbi settlement banks) and investors using the QFII and RQFII platforms, virtually all types of institutional investors can now trade onshore bonds through a local custodian bank.

More than a half of the institutional investor respondents say they are aware of the new scheme and interested in using it. The other half either were not aware of it, or not interested in using it.

CHART 28: **Awareness of and interest in CIBM**

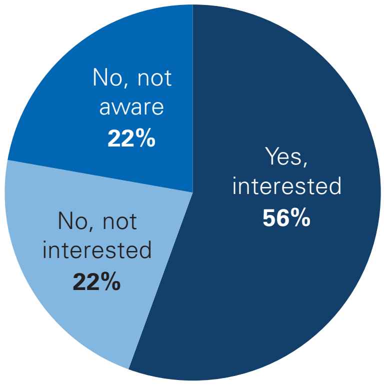
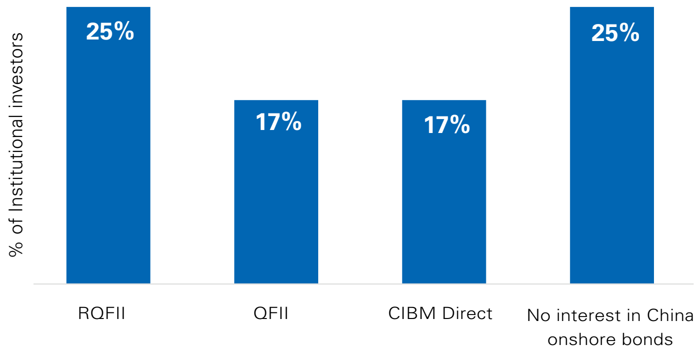


CHART 29: **Preferred channel of access to China's onshore bond market**



Institutional investors were asked about their preferred channel to access renminbi bonds. Considering the number of respondents, the answers presented in Chart 29 cannot be interpreted as indicating a statistically significant preference of one channel over another. Notably, the newcomer CIBM Direct holds its own compared to the well-established RQFII and QFII.

c. Increasing allocations to CNY onshore and CNH offshore assets

In order to pinpoint obstacles that discourage institutional investors from investing in CNY and CNH-denominated assets, respondents were asked what factors would encourage them to increase their exposure.

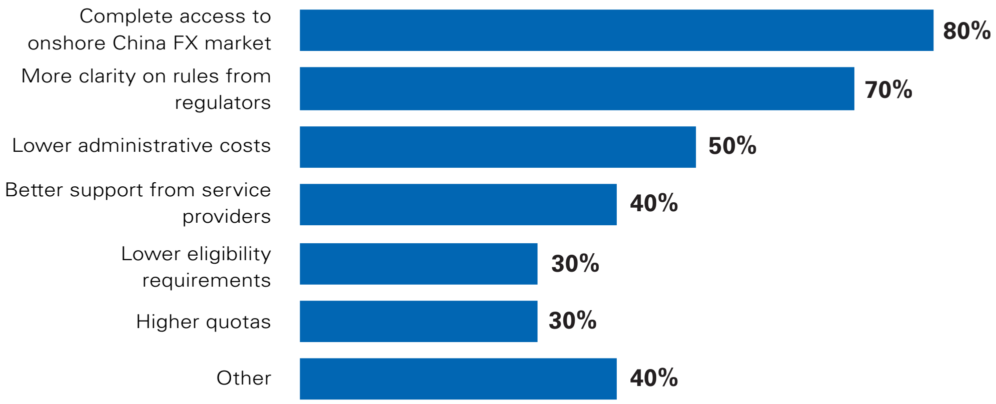
The most frequent answers were related to the freedom of access to the country's onshore FX market, as well as clarity from financial regulators about current and upcoming regulations.

"The trading and investment process of accessing onshore is still very administrative," comments one participant. "Price discovery is not as transparent as offshore especially on the credit front."

Still another stresses the importance of "levelling the playing field for offshore versus onshore, such as accepting English medium for CFETS and trading/settlement platforms."

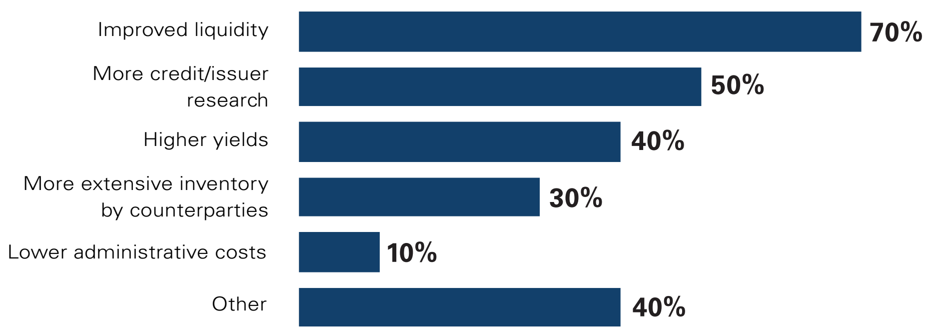
Other respondents spoke about lower administrative fees and the level of support from service providers, including clarity on taxation rules and documentation provided in English.

CHART 30: **Factors encouraging increase of investment in onshore China CNY denominated assets**



The offshore CNH market, being outside the scope of onshore financial regulators, faces a different set of challenges. Liquidity is named as the primary pain point, followed by a lack of credit and issuer research.

CHART 31: **Factors encouraging increase of investment in offshore China CNH denominated assets**



25%

OF INVESTORS SAY THEY WOULD INCREASE THEIR ALLOCATION TO CNY ASSETS AS A DIRECT RESULT OF THE SDR INCLUSION

d. Inclusion of the renminbi in IMF Special Drawing Rights

As of October 1 2016, the renminbi has been included in the basket of currencies constituting the IMF's SDR. Although the inclusion sparked speculation that this would increase the use of the currency in cross-border transactions, the respondents indicate that the effect is not noticeable at this stage.

25% of investors say they would increase their allocation to CNY assets as a direct result of the inclusion, and that the increase will be small (less than 10%).

IX. Working with Chinese banks

a. Readiness of corporates to engage overseas branches of Chinese banks for cash management

The overseas respondents showed no clear preference for local branches of global banks over those of major Chinese banks when asked what type of institutions they most associate with knowledge and capability in renminbi developments and products. Local branches of global and major Chinese banks each ranked as preferred for approximately 40% of respondents. Only 11% of the respondents preferred their domestic bank.

In order to retain and build their cross-border renminbi business, banks need to keep their clients informed about the latest renminbi developments. 60% of corporate respondents indicate that their banks have been doing a sufficient job, while a third say they have never been contacted regarding this.

60%

OF CORPORATE RESPONDENTS INDICATE THAT THEIR BANKS HAVE BEEN DOING A SUFFICIENT JOB TO KEEP CLIENTS INFORMED ABOUT LATEST RENMINBI DEVELOPMENTS

CHART 32: **Best banks for cross-border renminbi, overseas corporates**

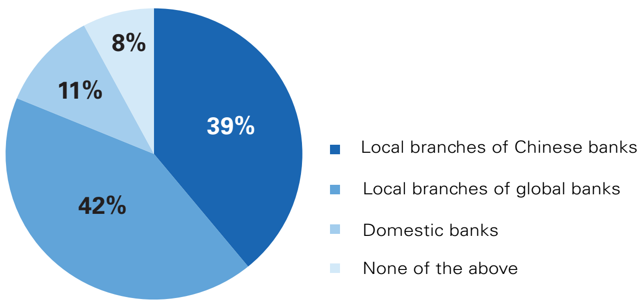


CHART 33: **Have you been contacted by your house bank with renminbi developments in the past 12 months?**

b. Readiness among foreign institutional investors to engage Chinese custodians

Similarly, the survey attempted to gauge institutional investors' willingness to work with onshore custodians in the course of their business. While 20% still clearly prefer to engage foreign custodian banks in China, as much as 80% are willing to use domestic custodians, giving rise to new business opportunities for Chinese banks.

CHART 34: **Readiness of foreign investors to engage Chinese custodians**

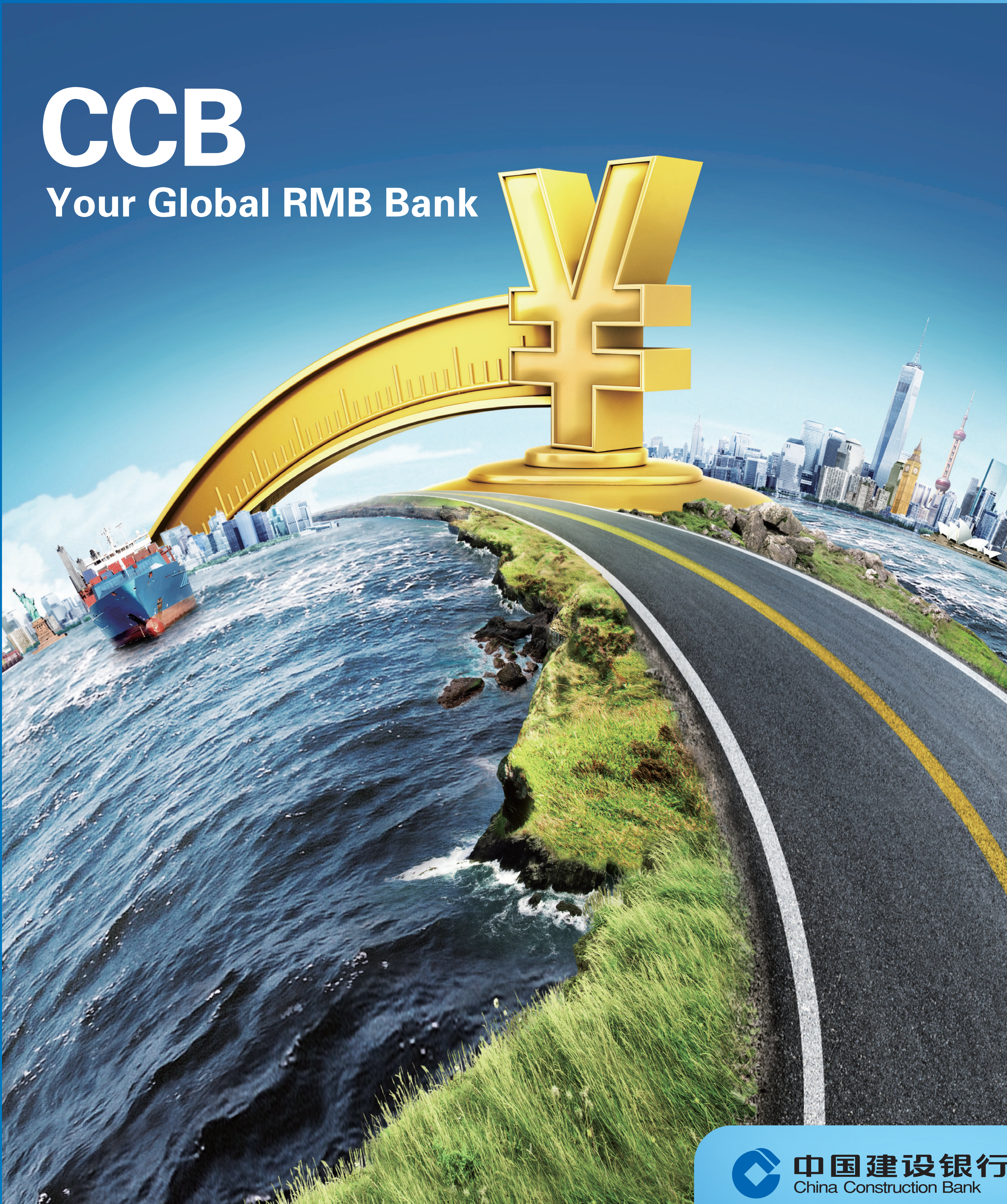
X. Conclusion

2016 was not a breakthrough year for the renminbi. Amid concerns over the domestic economy and general jitters in global markets, China's regulators elected to continue the liberalization of the currency on its very gradual course. The renminbi presented itself differently to those more keen to repatriate it out of China (such as cash-rich corporates) and those wanting to introduce new funds and invest in renminbi-denominated assets onshore (many institutional investors).

The pace of renminbi internationalization appears to have slowed down in 2016. Depreciation worries reduced the incentive to switch cross-border invoicing to renminbi. At the same time, SMEs went against the grain and increased their use of the renminbi for cross-border business much more quickly in 2016.

On the other hand, institutional investors found the process of currency liberalization to continue in strides. CIBM Direct, equity market links between Hong Kong and both onshore bourses as well as attractive yields compared to other SDR currencies are all good news to investors and the renminbi.

The host of reforms implemented over the past years mean all signs point to one direction: the renminbi's rise to become a global currency in trade and investment. All it takes now are bold regulators with a clear sense of direction and strong service from banks along the way for corporates and investors to go down that road.


CCB
Your Global RMB Bank