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中国建设银行 China Construction Bank

STABLE & RESILIENT

Renminbi Internationalisation Report 2020

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China Construction Bank Corporation (CCB) is a leading large-scale joint stock commercial bank in Mainland China. The bank ranked second in the "Top 1000 World Banks" in 2019 in terms of total tier-one capital according to the UK magazine The Banker. By the end of 2019, the bank has nearly 200 overseas commercial banking institutions at all levels, covering 30 countries and regions.

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All forward-looking assessments are made based on a combination of interviews with institutions, aggregation of third party assessments and our own assessments. We are not party to any insider information in any of the institutions we write about, and any information arising from special access that compromises our neutrality is specifically excluded, regardless of source.

Preface

In 2019, China Construction Bank (CCB) in partnership with The Asian Banker launched a survey on the internationalisation of the RMB, which covered 643 domestic and overseas enterprises and financial institutions. The survey found a sustained increase in the use of RMB-based cross-border products and services among companies and financial institutions globally, in which overseas companies have become increasingly proactive in using RMB for cross border trade purposes; the opening up of financial market facilitated continued RMB usage, with the CIBM (China Interbank Bond Market) Direct remained the most popular channel among overseas institutions for accessing China's onshore bond markets while use of Bond-Connect saw significant increase. The introduction of the national digital currency DC/EP shall further promote the internationalisation of the RMB. Although concerns over trade frictions and COVID-19 pandemic remain, the respondents surveyed were in general optimistic on the internationalisation of the RMB into 2020.

Since the beginning of 2020, the outbreak of the unexpected COVID-19 has caused immeasurable losses to the world economy. In the first quarter, China's GDP shrank by 6.8%, significantly impacting trade, consumption and supply in the short run. With the COVID-19 under control in China, and the scale of work and production resumption, various indicators like employment, investment and consumption are rebounding. Enterprises are stepping up digital transformation, improving their competitiveness by strengthening areas of weakness and adjusting structures, and seeking development in adversity. To ensure aggregate supply and demand stable, and help medium, small and micro-sized enterprises tide over the crisis, the government has put forward the "Six Stabilities" and "Six Safeguards" requirements, and adopted a proactive fiscal policy and prudent monetary policy. Meanwhile, the government continues deepening reform and opening up, stimulates innovation, and speeds up the replacement of old growth drivers with new ones. With gradual absorption of the short-term slow-down of economic growth, market confidence is being restored, stock and bond markets stabilized. In the long run, the fundamentals of China's economy featuring strong growth potential, resilience and overall healthiness remain unchanged.

At the same time, China continues to accelerate the opening up of its financial market, removing investment quota for QFII and RQFII, further facilitating overseas institutions investing through different channels, activating Shanghai-London Stock Connect and SSE-JPX ETF Connect, and relaxing limitations over foreign-funded institutions in conducting credit rating and financial business like bond underwriting in China. These measures are recognized extensively around the world for their strength, wide coverage and effectiveness. Over 60 countries and regions have included RMB into their official foreign exchange reserves; global bond indexes such as Bloomberg Barclays Global Aggregate Index and JP Morgan GBI-EM have announced inclusion of Chinese bonds. As of the end of 2019, 2,608 overseas institutional investors hold RMB bonds up to RMB2.88 trillion through various channels, foreign ownership of RMB stocks amounts to RMB1.44 trillion. There is no doubt that RMB assets have become an important part of global asset allocation.

As a Global Systematically Important Bank, China Construction Bank, while making best efforts in COVID-19 prevention and control, will continue to strengthen its "Three Capabilities", seek new business model and space based on "New Finance plus High-Tech", and support the development of real economy. As of the end of 2019, the Bank had established overseas institutions in 30 countries and regions, and has conducted cross-border RMB business for 30,000 customers from nearly 200 countries and regions. CCB, as the PBOC designated RMB clearing bank in the UK, Switzerland and Chile, sees sound operation and increasing market influence. As of the first quarter of 2020, RMB clearing bank in the UK maintained its position as the largest RMB clearing bank outside Asia, with the accumulated clearing amount exceeding RMB45 trillion.

Moving forward, the Bank will continue to fulfil its responsibilities as a promoter and market leader in the internationalisation of RMB, persist in financial opening up, and forge ahead with cross-border RMB business.

Ji Zhihong
Executive Vice President
China Construction Bank

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Executive Summary

In 2019, China Construction Bank in partnership with The Asian Banker launched the annual survey to assess the international usage of the renminbi (RMB). The survey was conducted among 643 executives from three groups of institutions, comprising companies and enterprises based in China (Chinese companies), companies and enterprises based outside of China (overseas companies), and financial institutions around the globe (FIs).

Use of RMB cross-border products and services continued to increase in 2019

The RMB Internationalisation survey has shown a consistent and sustained 2-year increase in the use of RMB based cross-border products and services adopted by both companies and financial institutions globally.

Among all RMB products and services, cross-border trade settlement witnessed the highest increase in use by companies in 2019, with more than half of surveyed respondents (65% overseas and 51% of Chinese companies, and 67% of FIs) indicating an increase in use of RMB cross-border trade settlement, and the growth is expected to continue in 2020.

Consistent with macro trends, RMB direct investment settlement also increased steadily in 2019, with 67% of FIs, 50% of overseas companies and 26% of Chinese companies having enhanced their engagements in cross-border direct RMB investments.

The use of offshore financing by overseas companies has continued to be popular in 2019, with 44% of them increasing offshore RMB financing (including loans, receivable financing and bonds), similar to 43% in 2018. For Offshore RMB deposits, the survey results showed a significant 40% of overseas companies increasing their RMB deposits outside mainland China in 2019.

Identifying new trends in RMB internationalisation in 2019

Overseas companies have become more proactive in using RMB for cross border trade purposes. When asked about the reasons for using RMB in trade settlement, 52% of overseas companies cited reduced foreign exchange risks and to obtain better rates from suppliers. Only 19% of overseas companies said that they 'use RMB only when counterparties require' in this year's survey, compared to 25% and 47% in the 2018 and 2017 survey respectively, signalling increased confidence.

China remains the top market for overseas companies with 39% of respondents choosing China as their key market compared with 27% in 2018. They also further diversified their geographical engagement among other countries for their use of RMB products.

A significant proportion of companies (57% of overseas companies and 44% of Chinese companies) do hedge their currency risk exposure, indicating a more matured foreign exchange market for RMB and increasing awareness of participants to manage currency volatility risk.

Offshore RMB (CNH) deliverable forwards/swaps emerged as an important tool for risk management for the respondents in 2019, while offshore CNH spot markets saw a significant increase of 50% in usage among financial institutions, compared with 23% last year.

Financial market liberalisation facilitated continued RMB usage

The China Interbank Bond Market remained the most popular channel (44%) among FIs for accessing China's onshore bond markets while use of Bond-Connects (33%) saw significant increase (by 12%) compared with last year.

78% of FIs indicated that they expect to increase their use of RMB in transactions in 2020 as a result of the various Stock Connect programmes. 52% of overseas companies and 51% of Chinese companies also expect the Stock Connects to increase their current use of RMB in transactions.

FIs were asked about the likely impact of the opening of financial markets for their institution and 29% expect these initiatives to boost the usage of RMB as a financing currency while 25% of respondents observed that these measures will enhance access by foreign financial institutions to China's financial sector.

Growing willingness to work with onshore Chinese service providers

Financial institutions' willingness to work with Chinese banks for custodial, counterparty and transactional services continued to grow in 2019. None of the respondents replied "No, prefer foreign service provider" down from 7% in 2018. Just 58% of respondents in 2018 replied that they would possibly work with Chinese institutions, while in 2019, the number increased to 78%.

Among overseas companies the preference for local branches of global banks grew to 50% versus local branches of Chinese banks (32%), compared to last year's survey where 41% of overseas companies had said that they prefer Chinese banks. Interestingly, among Chinese companies, the preference for Chinese banks grew to almost three quarters (73%) compared to 58% in 2018.

Positive perception for the national digital currency

FIs (67%) responded positively to the national digital currency DC/EP being issued by the People's Bank of China (PBOC) as did 57% of Chinese and 55% of overseas companies. Most corporates and financial institutions (84% of Chinese companies, 78% of FIs and 61% of overseas companies), view the introduction of a digital currency and its impact on RMB internationalisation favourably.

On using the digital currency, 52% of overseas companies and 44% of FIs are willing to use once all institutional frameworks governing the currency are in place, more proactive than Chinese companies (27%). 61% of Chinese companies and 56% of FIs took a more cautious approach adopting a wait and see stance before making any decision on whether to use.

There are still challenges to overcome

Impediments to RMB internationalisation remain but are short-term in nature and can be addressed through a prudent RMB policy and wider liberalisation efforts.

The ensuing trade tensions remained the most significant concern among the Chinese (74%) and overseas (62%) companies in the use of RMB for international transactions. Other potential challenges for respondents include currency volatility, with 67% of financial institutions rating it as a top challenge.

As for the impact of RMB volatility, there is a significant divergence among the respondents with 56% of FIs responding that it will not impact their usage of RMB, 62% of Chinese companies stated that it would not lead to a reduction in use, and 71% of overseas companies said that they would not increase their usage of RMB.

1. Emerging Opportunities for greater use of RMB in 2020

1.1. Opening-up of China's financial markets

The relevant Chinese authorities promulgated a host of regulations in 2019 towards opening its markets for overseas investors. Major breakthroughs include:

- China's State Administration of Foreign Exchange (SAFE) abolished investment quota restrictions for Qualified Foreign Institutional Investors (QFII) and Renminbi Qualified Foreign Institutional Investors (RQFII) to enhance financial reforms.
- Foreign institutions are now allowed to conduct credit ratings in China, they can assign ratings to all kinds of bonds in the interbank bond market and in the conventional bond market. They are also allowed to obtain class A master underwriting licenses in the interbank bond market. This will further facilitate overseas institutional investors to invest in the interbank bond market.
- Overseas financial institutions are encouraged/allowed to participate in the establishment and investment of: (1) financial subsidiaries of commercial banks; (2) pension management companies; (3) currency brokerage companies.
- Regulators have removed regulation mandating total shares held by domestic insurance companies not to be less than 75%. and relaxed the access conditions for foreign insurance companies and eliminated the 30-year operating period requirement.
- The time point of canceling the restrictions on foreign shares of securities companies, fund management companies, futures companies and life insurance companies in 2021 has been brought forward to 2020.

Greater interest in China's domestic equity market:

With the inclusion of 472 large-and mid-cap China A share companies in the MSCI Emerging Markets Index in 2019, China's weight in the index rose to about 34% (from about 28% in June 2017). Inclusion of China A shares in the index has helped increase foreign institutional investors' participation in China's domestic equity market. Non-Chinese holdings of China A shares has now risen to more than RMB 2.1 trillion ($304.4 billion) as of end 2019.

Stock Connect contributing to financial market integration:

With the launch of the London-Shanghai Stock Connect in June 2019, another milestone in China's financial opening up was realised. This initiative has been fundamental in expanding cross-border RMB investment and has seen Chinese companies beginning to list GDRs on the London Stock Exchange. Similarly, According to Hong Kong Exchanges and Clearing (HKEX) Stock Connect has seen northbound trading of eligible shares value [1] reach RMB 1,429 billion ($204 billion) and RMB 1,040 billion ($147 billion) for southbound by end of 2019, providing international institutional investors with market access and exposure to China A shares.

Shanghai copper benchmark:

In December 2019, it was announced that the Shanghai International Energy Exchange (INE) will launch an onshore domestic copper contract in China in the first half of 2020. The contract will be open both to domestic and to foreign participants using the overseas intermediary (OI) route into the market clearing the way for overseas market participants to trade copper denominated in RMB. China is the world's leading consumer of copper and this internationally traded copper contract will have a profound impact on the global copper market by expanding the current Shanghai Futures Exchange price into a regional benchmark.

[1] Source: HKEX. Share value calculated using closing price of 31 December 2019

Special Column 1: Use of RMB in neighbouring countries

The RMB and Asia

Through the accumulation of RMB deposits in key Asian financial centres with increasingly integrated financial market infrastructure, supply chains and free trade agreements, the use and demand for RMB in cross-border transactions will continue to gain momentum. This year's survey found that three of the top five offshore RMB markets are in Asia; Hong Kong, Singapore, and Japan.

As the largest offshore RMB market

Hong Kong continues to develop in terms of scale and depth. The CNH market has seen the formation of both exchange rate products such as Spots, Futures, Foreign Exchange (FX) Swaps as well as interest rate products like Dim sum bonds, RMB based IRS and Money Market instruments, providing for more comprehensive RMB products.

Bridge between Portuguese-speaking countries and China

Since February 2019, China has been accelerating its endeavour to promote Macao SAR as the offshore RMB clearing centre for eight Portuguese-speaking countries that have diplomatic relations with China. The series of initiatives includes issuance of Macao's first RMB denominated treasury bond by the Ministry of Finance, first offshore RMB bond by China's policy bank - Agricultural Development Bank of China (ADBC), and the first offshore RMB corporate bond. In May 2019, Portugal became the first Euro Zone country to issue an onshore RMB bond of RMB 2 billion through the CIBM. In December 2019, the PBOC and the Monetary Authority of Macao signed a swap agreement of RMB 30 billion ($4.3 billion) to further support cross-border trade and finance.

The Belt and Road Initiative (BRI)

The BRI continues to support broader efforts for RMB internationalisation. The latest data from China's General Administration of Customs showed that in 2019, cross border trade volume between China and BRI countries amounted to RMB 9.27 trillion (USD 1.32 trillion), a year-on-year growth of 10.8%, higher than the average growth of total cross border trade. The trade volume between China and BRI countries accounted for close to 30% of total trade, up 2% from 2018. From 2014 to 2019, total aggregate cross border trade volume for BRI countries exceeded RMB 44 trillion (USD 6.3 trillion) with an average annual growth rate of 6.1%. China has become the largest trade partner of 25 countries among BRI countries, and signed currency SWAP agreements with over 20 countries. By directly investing or purchasing equipment and services in RMB, BRI countries avoid foreign exchange risk, increase liquidity, improve efficiency and enhance overall financial stability in the region.

However, the BRI is principally financed by Chinese government funded development banks, commercial banks and investment funds driven primarily in US dollar. Chinese banks should look to expand their branch network and presence, while facilitating the greater use of cross-border RMB products. To reduce dependency on the US dollar and encourage further RMB internationalisation, China is well placed to collaborate with its partners to overcome this constraint through the relaxation of cross-border capital flow controls, quota management programs and currency exchange limits.

Trade facilitation arrangements increase RMB based cross-border transactions

In September 2019, PBOC launched a pilot programme to facilitate enhanced investment and trade regulatory arrangements in 18 free trade zones nationwide. This supports greater convenience in trade settlement and cross-border payments, assists import and export companies access trade finance and increases cash management efficiency. The trade facilitation arrangements have increased RMB usage in cross-border payments, investment and financing.

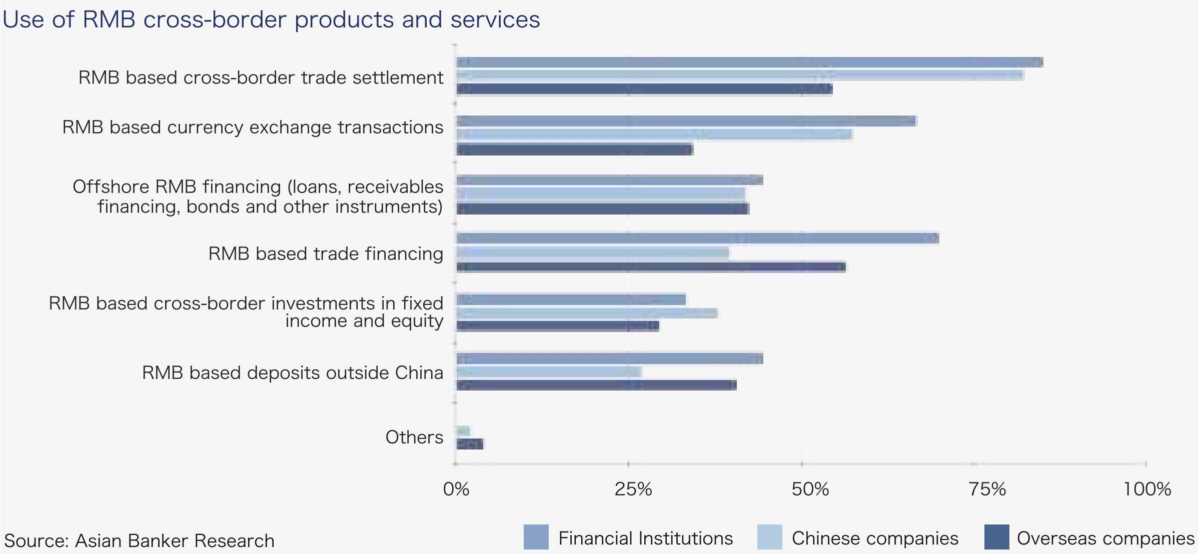
2. Use of RMB in cross-border payments and settlement

2.1. Use of RMB based cross-border products

The use of RMB based cross-border products and services continued to increase in 2019, consistent with the trends seen in the last year's survey. Among Chinese companies, cross-border trade settlement dominated, used by 82%, followed by RMB based currency exchange transactions (57%) and offshore RMB financing (42%). Similarly, 85% of FIs surveyed used RMB for cross-border trade settlement followed by 70% indicating the use of RMB for trade financing, with two-thirds (67%) engaged in RMB currency exchange transactions.

Please note that across the report, unless explicitly mentioned "Mainland China" is shortened to China in this report while the Greater China reference includes Hong Kong, Macao and Taiwan. "Offshore" and "overseas" refers to Hong Kong, Macao, Taiwan and rest of the world while "onshore" refers to Mainland China.

Figure 1: Cross-border trade settlement remains the most popular RMB cross-border product



Source: Asian Banker Research

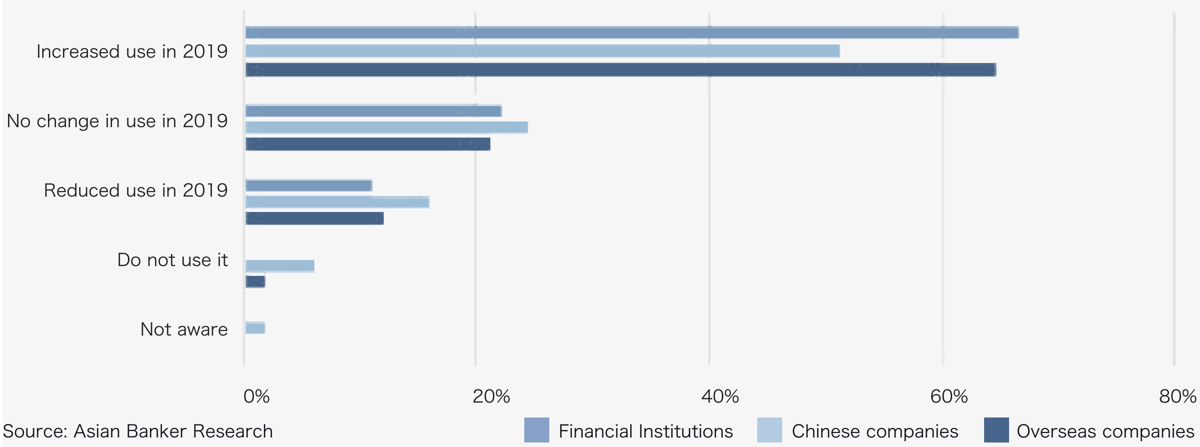
2.2. Use and status of RMB in cross-border trade

PBOC's data shows that trade settlement in RMB as a share of China's total trade grew to 19.15% in 2019 compared with 16.8% in 2018. In value terms, RMB trade settlement totalled RMB 6.04 trillion ($875.5 billion) in 2019, up from a total of RMB 5.11 trillion ($740.7 billion) in 2018.

The survey conducted by The Asian Banker shows that among all RMB products and services, cross-border trade settlement witnessed the highest increase in use by companies in 2019. Consistent with the trend seen in 2018, more than half the companies surveyed (65% overseas and 51% Chinese) and 67% of FIs increased trade settlement using RMB in 2019, while only 16% of Chinese and 12% of overseas companies and 11% of FIs reduced their usage. The growth is expected to continue in 2020 with 78% of FIs, 59% of Chinese companies and 51% of overseas companies planning to increase their cross-border trade settlement using RMB.

Figure 2: More than half of surveyed respondents indicated an increase in use of RMB cross-border trade settlement in 2019

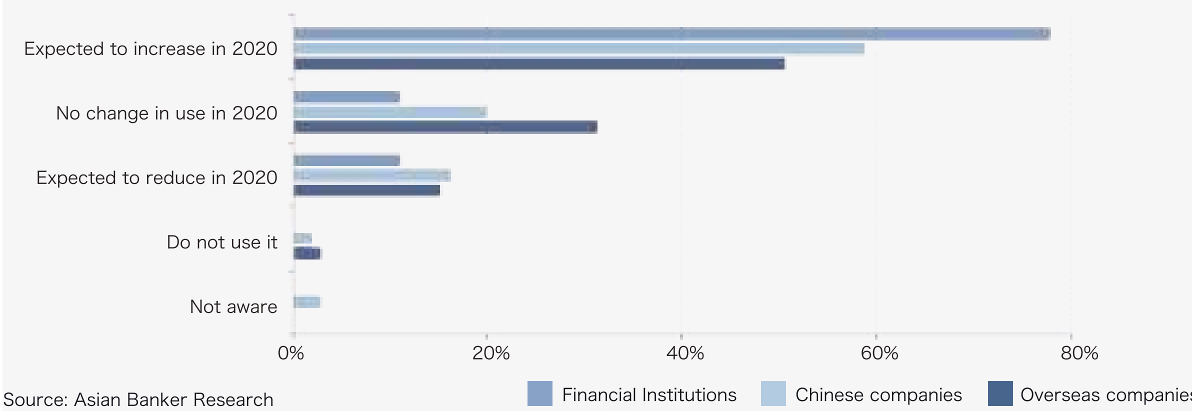
Change in use of RMB based cross-border trade settlement in 2019



Source: Asian Banker Research

Figure 3: Over 50% of respondents expect to increase their RMB-based cross-border trade settlement in 2020

Expected change in use of RMB based cross-border trade settlement in 2020

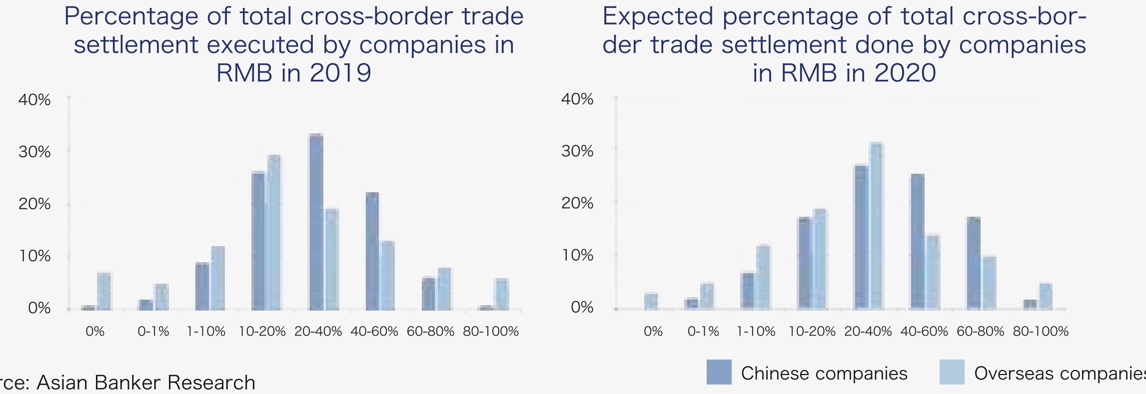


Source: Asian Banker Research

The companies were asked what percentage of their total trade settlement was conducted in RMB with most Chinese companies (33%) having conducted about 20-40% of their total trade in RMB, while most overseas companies (29%) conducted 10-20%. Overall, 76% of surveyed overseas companies conduct more than 10% of their cross-border trade settlement in RMB, 13% higher than 2018.

For 2020, 31% of overseas companies expect about 20-40% of their total trade to be executed in RMB, fractionally higher than their Chinese counterparts (27%).

Figure 4-5: 88% of Chinese companies have more than 10% of their cross-border trade conducted in RMB

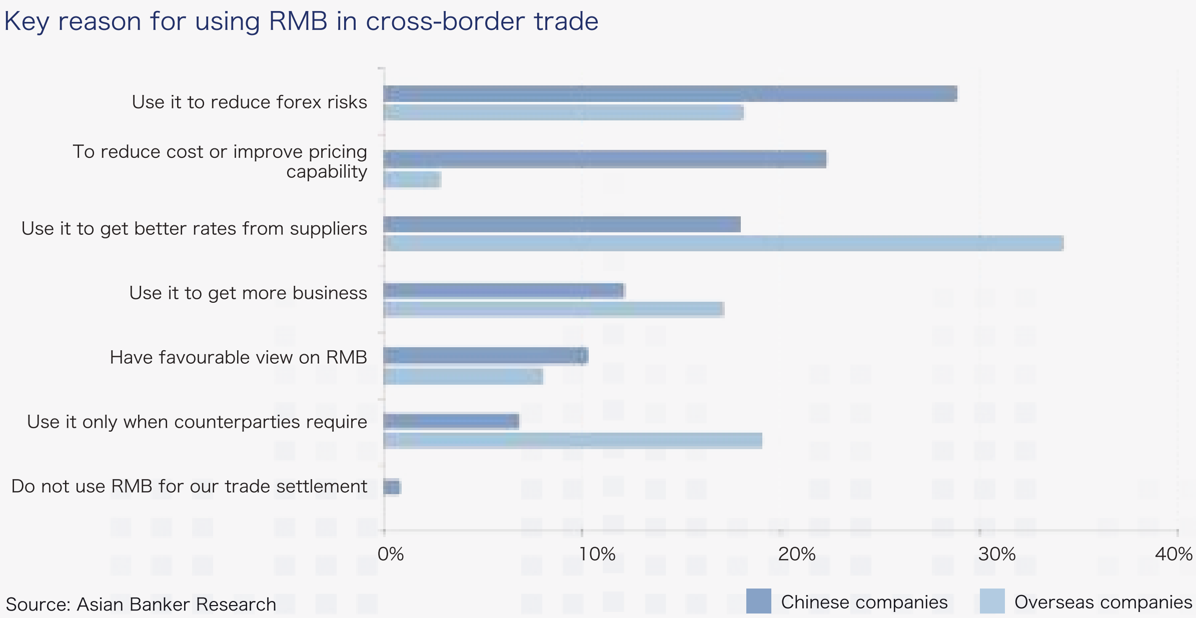


Source: Asian Banker Research

The factors for using RMB in trade settlement varied amongst companies. The most common reason for the use of RMB among Chinese respondents (29%) was to reduce their foreign exchange risks compared with 32% in 2018, while the highest number of overseas companies (34%) used RMB to get better rates from suppliers compared with 28% in 2018. Chinese companies are also using RMB to reduce costs, improve their pricing capability and improve rates from their suppliers.

Only 19% of overseas companies now say that they "use RMB only when counterparties require" in this year's survey compared to 25% and 47% in 2018 and 2017 survey, indicating that overseas companies continue to remain proactive in using RMB for cross border trade.

Figure 6: 34% of overseas companies use RMB to get better rates from suppliers while 29% of Chinese companies use it to reduce their forex risk



Source: Asian Banker Research

Special Column 2:
Developments in RMB cross-border payment systems

Developments in Cross-border Interbank Payment System (CIPS)

As of December 2019, the total number of CIPS Indirect Participants had reached 903, among which 697 participants are from Asia (including 392 Chinese mainland indirect participants), 109 are from Europe, 37 are from Africa, 26 are from North America, 18 are from Oceania and 16 are from South America, covering 94 countries and regions around the world.

As CIPS is developing and on-boarding an increasing number of participants, it seeks to identify the most preferred or efficient routes for fund transfers, which will greatly support cross-border RMB transactions including trade, direct investment, financing and remittance.

Change in use of RMB in SWIFT transactions

According to SWIFT data, the RMB has registered a growing market share in global payments, by value, which grew to 1.85% as at the end of April 2020, according to SWIFT's "RMB Tracker Monthly". It overtook the Canadian dollar as the fifth most used currency in the world, while quietly consolidating its position as an increasingly active currency worldwide for domestic and international payments by value.

2.3. Use and status of RMB in cross-border direct investments

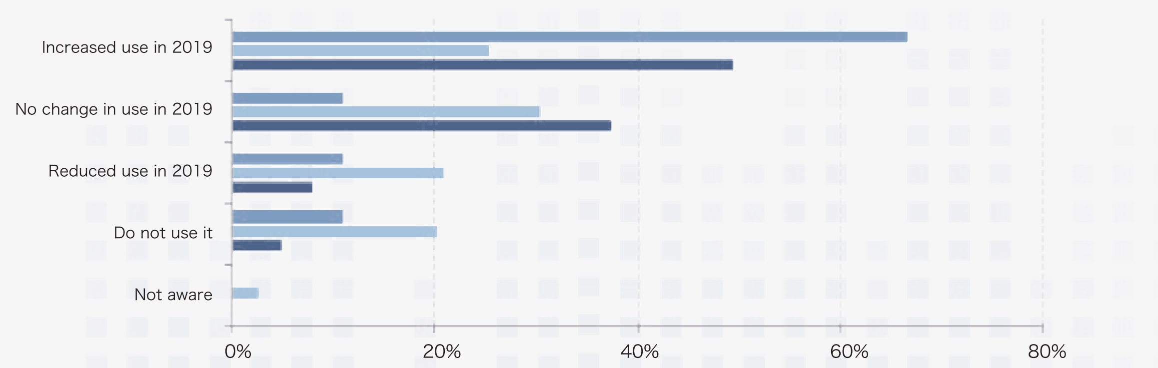
Macro-economic trends show that the total RMB direct investment settlement business has increased steadily from RMB2.66 trillion ($386.7 billion) in 2018 to RMB2.78 trillion ($402.9 billion) in 2019.

Relatively consistent with macro trends, the survey showed a marked growth in RMB cross-border investments. Among FIs, 67% said that they enhanced their engagements in use of cross-border direct RMB investments, while only 30% FIs did so in 2018. 11% reduced their use in 2019. On the other hand, those who replied “do not use” RMB in cross-border direct investments fell to 11% this year from 33% last year.

Among companies, 50% of overseas and 26% of Chinese respondents increased their use of RMB in cross-border direct investments, while 37% of overseas companies and 30% of Chinese companies maintained the status quo in 2019.

Figure 7: Increase in RMB cross-border investments use registered by financial institutions in 2019

Change in use of RMB based cross-border direct investments in 2019

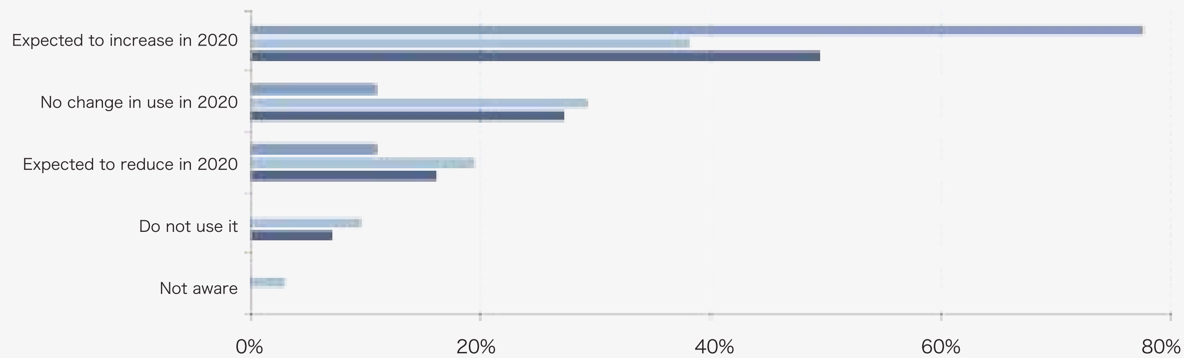


Source: Asian Banker Research

The trend is expected to continue in 2020 as 50% of overseas and 38% of Chinese companies as well as 78% of FIs expect to increase their cross-border investments in RMB in 2020.

Figure 8: The growth trend is expected to continue in 2020

Expected change in use of RMB based cross-border direct investments in 2020



Source: Asian Banker Research

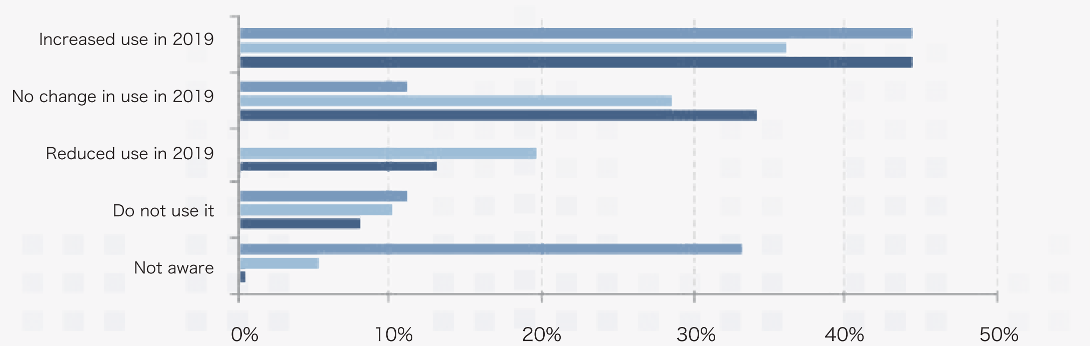
2.4. Holdings of RMB by overseas institutions

Onshore, the scale of total domestic RMB financial assets held by overseas entities maintained their momentum, increasing to RMB6.41 trillion as of end 2019 from RMB5 trillion in 2018, with stock (83%), bond ownership (32%) and deposits (14%) growing year-on-year.

The survey responses show that 44% of overseas and 36% of Chinese companies increased their RMB holdings outside China, while only 13% of overseas and 20% of Chinese companies reduced their holdings. Overall, one third of companies had no change in overseas RMB holdings. This trend is also indicative of growing RMB holdings in line with other products. Among FIs, 44% increased their RMB holdings while 11% commented that they did not engage in it.

Figure 9: More than one third of companies increased their RMB holdings outside China in 2019

Change in RMB based holdings outside China in 2019

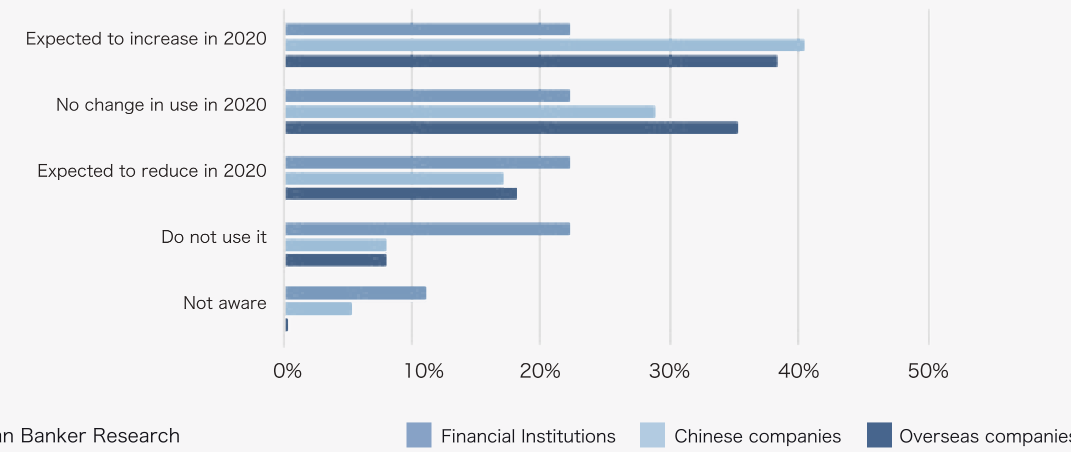


Source: Asian Banker Research

Going forward the trend is likely to accelerate as a greater number of Chinese companies (40%) and overseas companies (38%) indicated that they will increase their RMB holdings outside China in 2020. Among FIs, no trends emerged compared to 2019 with more than half either expecting to increase or retain the same level of RMB based holdings outside China.

Figure 10: 40% of Chinese companies expect to have greater RMB based holdings outside China in 2020

Expected change in RMB based holdings outside China in 2020



Source: Asian Banker Research

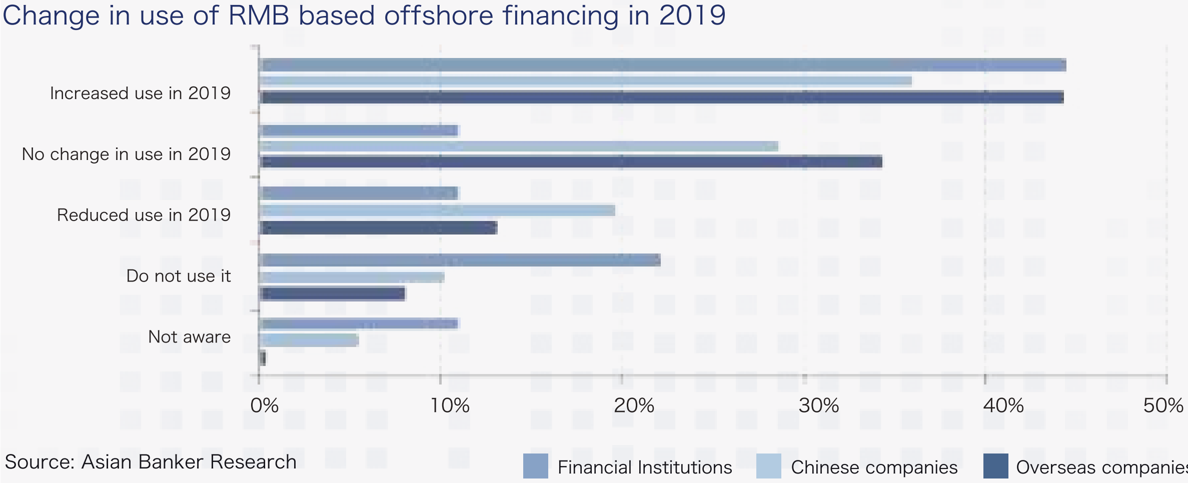
2.5. Developments in RMB financing in offshore markets

In 2019, 44% of overseas companies increased their offshore RMB financing (including loans, receivable financing and bonds), while 34% maintained the status quo, compared with 43% and 28% respectively in 2018. This reinforces the trend that greater use of offshore financing by overseas companies has stabilised in 2019.

36% of Chinese companies and 44% of FIs increased their offshore RMB financing, while 29% and 11% registered no change in use.

Figure 11: 44% of overseas companies increased their RMB offshore financing compared to 36% of Chinese companies

Change in use of RMB based offshore financing in 2019

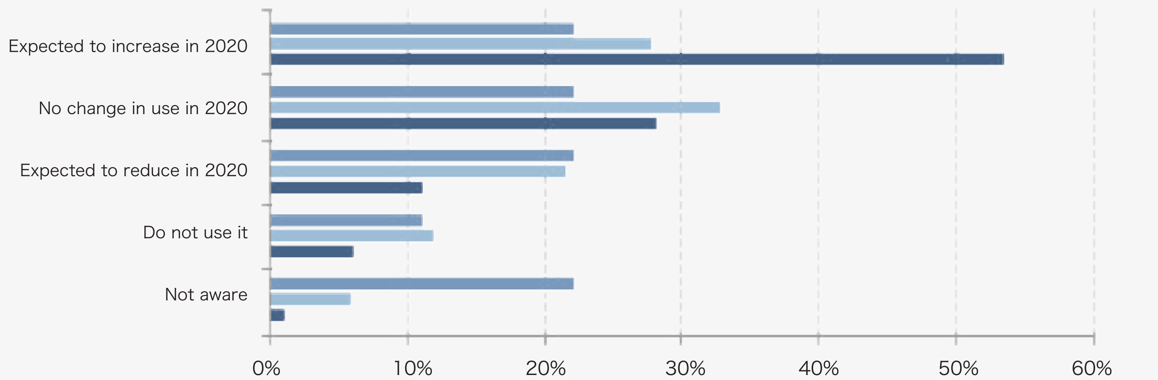


Source: Asian Banker Research

A similar trend is likely in 2020 with 54% of overseas companies and 22% of FIs expecting to increase their offshore RMB financing but the plurality of Chinese companies (33%) anticipate sticking to the status quo.

Figure 12: 54% of overseas companies expect to increase the use of offshore RMB financing in 2020

Expected change in RMB based offshore financing in 2020

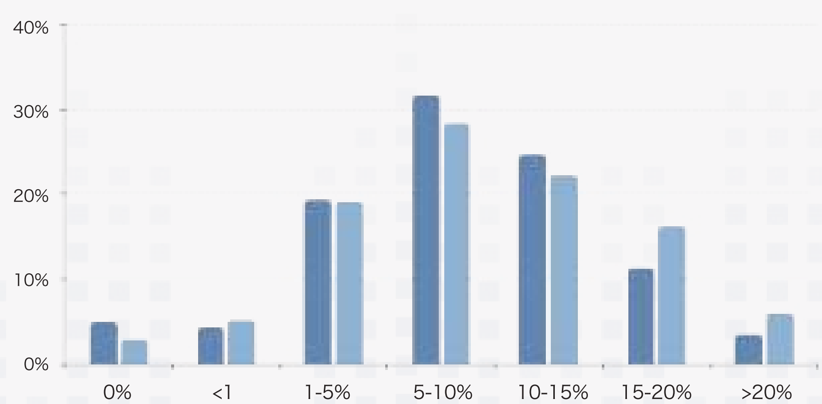


Source: Asian Banker Research

Based on the survey, the overall portion of RMB offshore bonds in total financing varied significantly among companies in 2019. Notably, the survey indicates a consistent increasing trend for overseas companies, 72% of them had over 5% of their financing conducted through RMB offshore bonds, 11% higher than 2018, while on the other hand, just 3% of overseas companies stated they had no access to RMB offshore bonds, compared with 11% last year.

Figure 13: More than 5% of total financing through RMB offshore bonds by 72% of overseas companies

Percentage of total financing done through RMB offshore bonds in companies

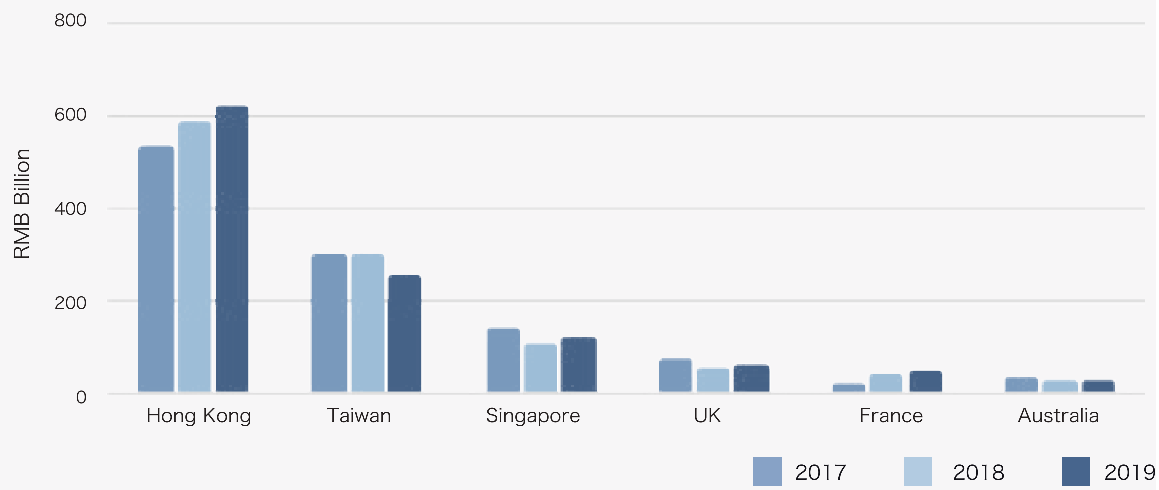


Source: Asian Banker Research

2.6. Use and change of RMB offshore deposits

Figure 14: Hong Kong has the largest balance of offshore RMB deposits

Offshore RMB deposits

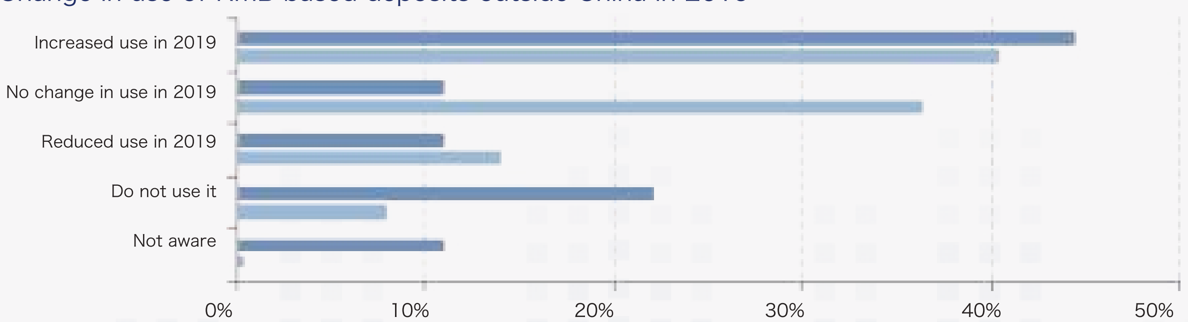


Source: Asian Banker Research, HKMA, CBC, MAS, BOE, RBA, BOF
Please Note: Data on RMB Deposits are annual averages each year. For 2019, averages are captured till December for Hong Kong and Taiwan, till September for Singapore, till June for UK, France, and Australia.

The survey results consistent with the trends seen last year show a significant 40% of overseas companies increased investments in RMB deposits outside mainland China in 2019. Interestingly, among FIs, 44% increased and only 11% decreased their RMB deposits outside mainland China, compared with 26% and 30% respectively in 2018.

Figure 15: 44% of FIs and 40% of overseas companies increased their RMB based deposits outside mainland China in 2019

Change in use of RMB based deposits outside China in 2019

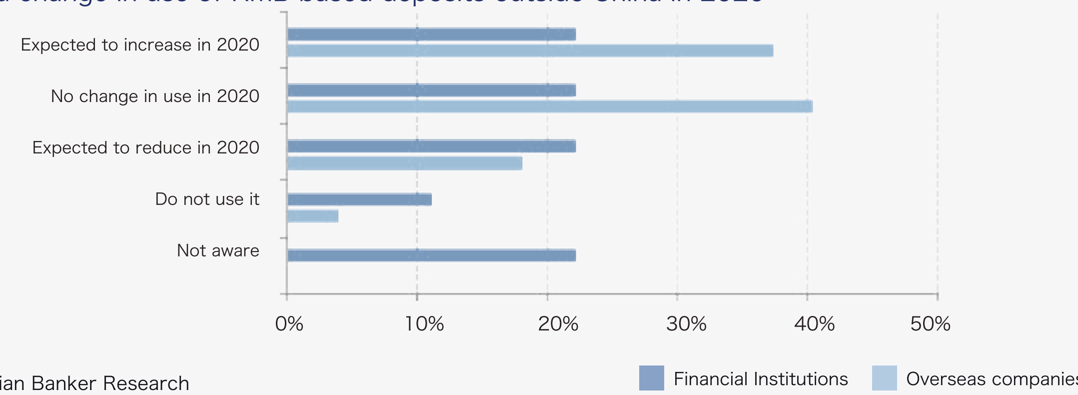


Source: Asian Banker Research

Respondents indicated their confidence for growing their RMB offshore deposits in 2020 as 37% of overseas companies and 22% of FIs plan to increase RMB deposits outside China while 40% of overseas companies and 22% of FIs expect to maintain the status quo.

Figure 16: 37% of overseas companies and 22% of FIs plan to increase deposits outside China in 2020

Expected change in use of RMB based deposits outside China in 2020



Source: Asian Banker Research

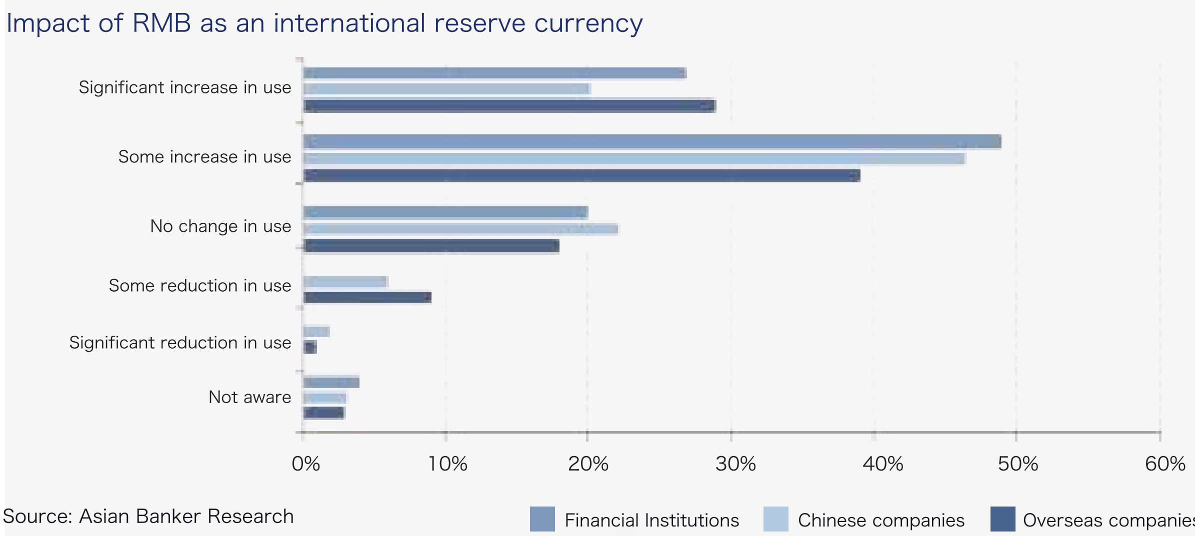
3. Key trends of RMB as international reserve asset

3.1. RMB's status as an international reserve asset

A central component of the RMB's standing as a global currency rests in its effective functioning as a reserve currency. At the end of 2019 RMB reserves held by countries that report to the International Monetary Fund's (IMF) Currency Composition of Official Foreign Exchange Reserves (COFER) system stood at RMB 1.52 trillion ($217.67 billion) in value, up from RMB 1.42 trillion ($203.08 billion) at the end of 2018, a year-on-year growth of 7%.

The RMB's status as a reserve asset has improved respondents' confidence in the currency. 69% of overseas companies, 67% of Chinese companies and 76% of financial institutions considered the position of the RMB as a reserve asset as the key reason for the increase in their use of the currency as compared to the year before, when 63%, 66%, and 51% respectively thought so.

Figure 17: 70% of respondents have increased the use of RMB due to its status as an international reserve asset



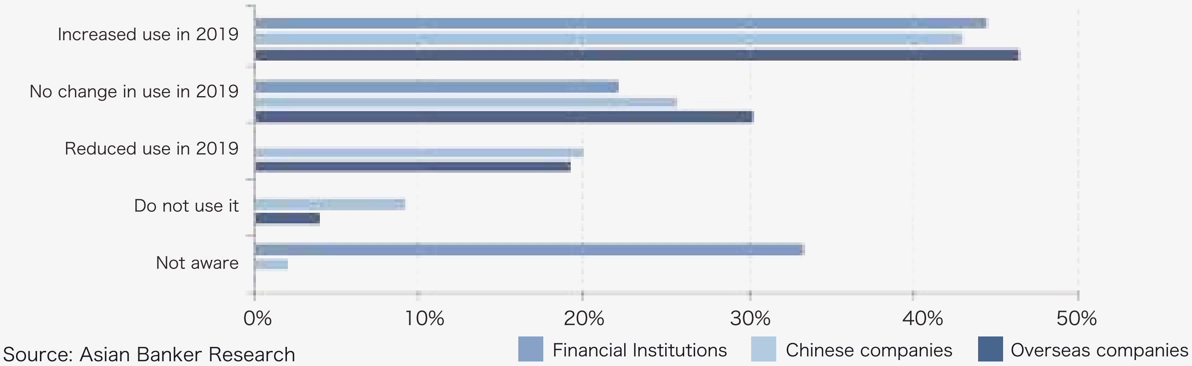
Source: Asian Banker Research

3.2. Developments in RMB currency exchange transactions

Consistent with macro trends, the survey shows that RMB based currency exchange transactions continued to grow among companies in 2019 with 43% of Chinese companies, 47% of overseas companies and 44% of FIs increasing their use, in line with last year's survey.

Figure 18: RMB currency exchange transactions registered strong growth among respondents in 2019

Change in RMB based currency transactions in 2019

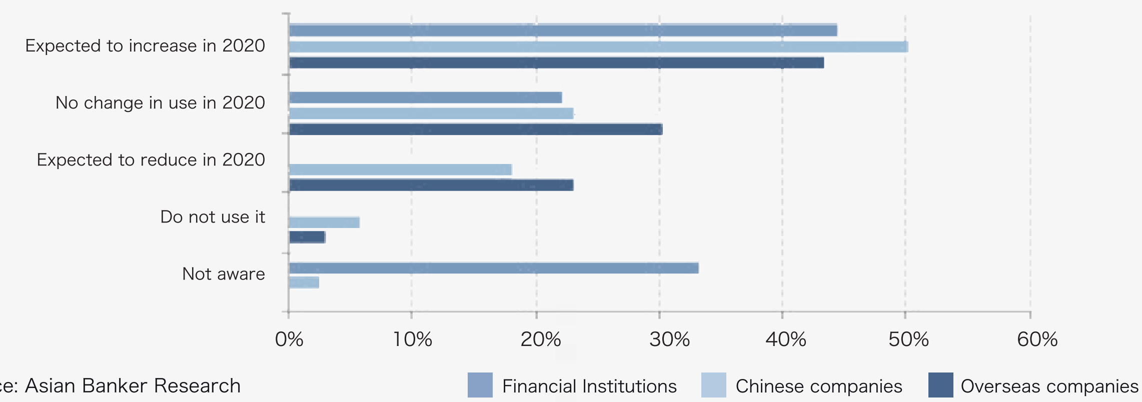


Source: Asian Banker Research

This trend is expected to continue in 2020 with 44% of FIs, 43% of overseas companies and 50% of Chinese companies indicating that they will increase RMB based currency exchange transactions this year, while only 23% of overseas and 18% of Chinese companies expect to reduce their use.

Figure 19: 46% of companies expect to grow their RMB currency exchange transactions in 2020

Expected change in RMB based currency transactions in 2020



Source: Asian Banker Research

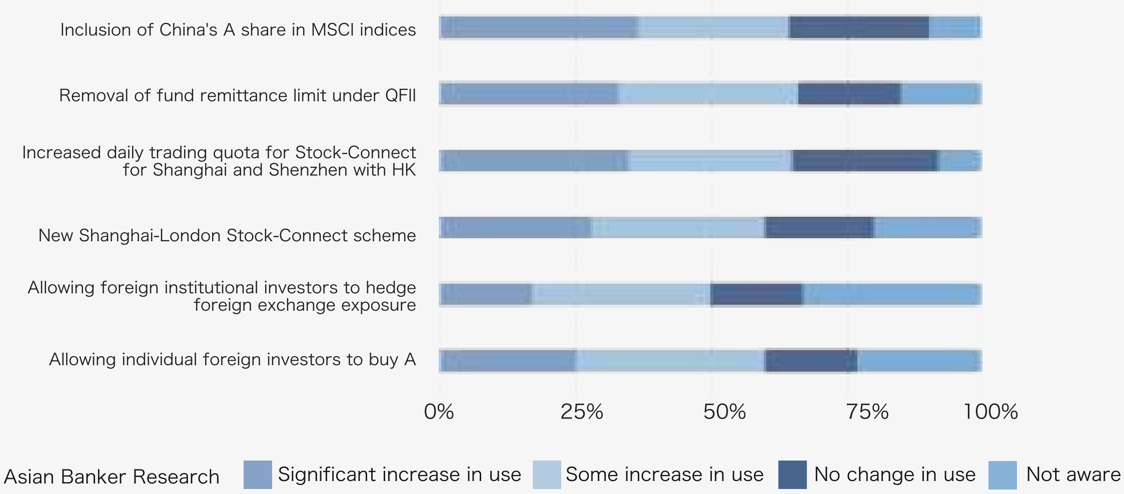
4. Key market integration initiatives supporting RMB internationalisation

4.1. RMB internationalisation with access to new channels

Financial institutions stated that the three main drivers to increase the use of RMB in transactions were the inclusion of China's A-share in MSCI indices (38%), increased daily trading quota for Stock-Connects (35%) and the removal of the fund remittance limit under the QFII scheme (33%).

Figure 20: Liberalisation of China's financial market boosted FI's RMB usage

Impact on use of RMB based products and services



Source: Asian Banker Research

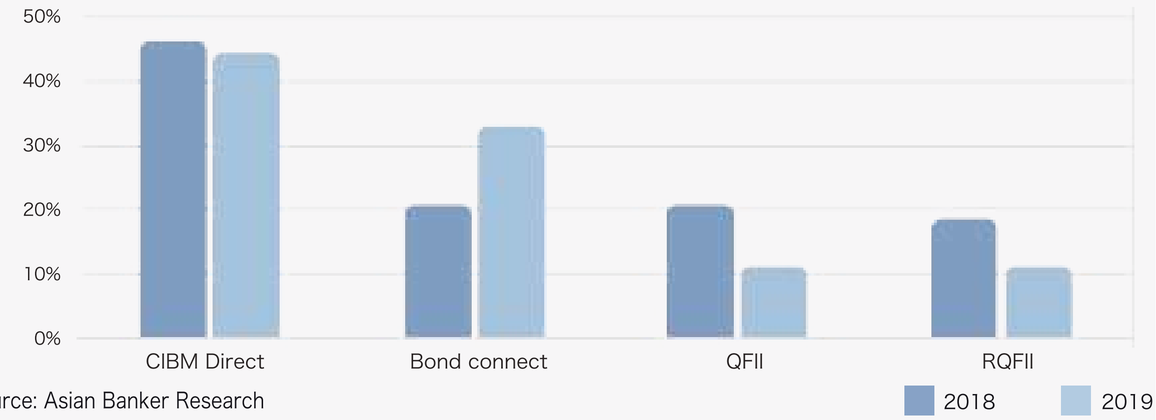
4.2. Accessing China's onshore bond market

The China Interbank Bond Market remained the most popular channel among FIs for accessing China's onshore bond markets with 44% of FIs using CIBM Direct, slightly lower than 47% last year. The popularity of the QFII/RQFII schemes decreased to 22% from 40% in 2018.

Notably, the use of Bond-Connects saw significant growth in 2019, increasing by 12 percentage points from 21% in 2018.

Figure 21: CIBM Direct emerged as the most commonly used channel by FIs

Channels used by FIs to access China's onshore bond market



Source: Asian Banker Research

Special Column 3:
Progress in RMB Capital Market: Bond and Private Equity

Impact of RMB Bond inclusion in Bloomberg Barclays Global Aggregate Bond Index

The inclusion of 356 RMB denominated Chinese government and policy bank bonds into the Bloomberg Barclays Global Aggregate Index in April 2019 accounting for 6.06% of the index's total market capitalisation is an important step in driving foreign capital inflows.

Since then, Chinese RMB denominated bonds have been included in two other global bond indices (JPMorgan Government Bond Index - Emerging Markets and Citi World Government Bond Index). This addition is likely to create a capital inflow of up to RMB 1.75 trillion (US$250 billion) - RMB 2.45 trillion (US$350 billion) for China in the short to medium term (three to five years).

The introduction of Chinese bonds into international indices allows China to showcase that its bond market infrastructure, supply of foreign exchange hedging tools and capital account convertibility match the requirements and needs of foreign institutional investors. A robust onshore bond market will help to finance growth among public and private companies, offering more choice for investors and support the broader push towards RMB internationalisation.

Development of RMB Private Equity

China's private equity market has been growing over the past decade with total transaction volume increasing from RMB 138 billion (US$19.7 billion) in 2013 to RMB 597 billion ($85.3 billion) in 2019 at a CAGR of 28%.

With the launch of the QDLP and the QDIE pilot program in 2013 for domestic investors investing in overseas private equity, a $2 billion quota for QDLP has been granted to qualified institutions including global asset management firms such as Man Group, Oak Tree, and Blackrock. Eleven qualified domestic institutions investing in over 14 overseas projects have utilised the $2.5 billion quota for QDIE.

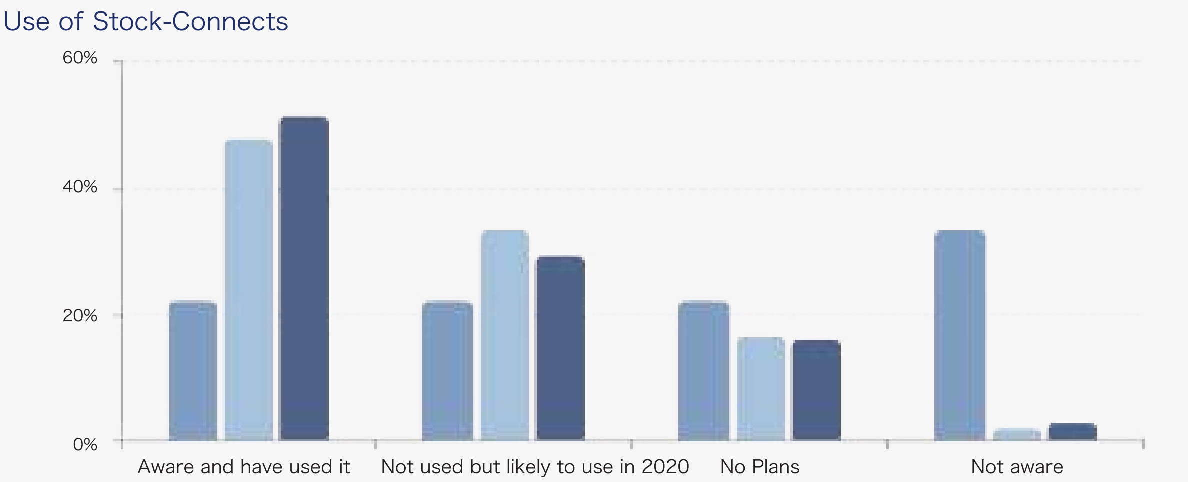
These programs have attracted overseas investment management firms to establish onshore entities to serve their domestic clients. JP Morgan, Allianz, Aberdeen, Manualife, AXA, BNP have registered wholly foreign owned enterprises (WFOE) in Shanghai in order to acquire a QDLP licence.

4.3. Impact of Stock Connect on RMB

The launch of the London-Shanghai Stock Connect in 2019, and Shanghai-Hong Kong and Shenzhen-Hong Kong Connect over the past few years has enabled global fund managers to better tap into China A-shares and further diversify their portfolio to capitalise on China's capital market growth. This is reflected in the outlook of financial institutions of which 78% indicated that they expect to increase their use of RMB in transactions in 2020 as a result of the"Stock Connects".

According to the survey, 52% of overseas companies increased their use of Stock-Connects in 2019, compared with 41% in 2018. Meanwhile, the proportion indicating"not aware"decreased from 18% in 2018 to just 3% in 2019. Although 46% of overseas companies have not used the Stock-Connect, 29% indicated they are likely to in 2020. Chinese companies and financial institutions showed relatively same response with last year, 81% and 44% stated they have used or plan to use Stock-Connect compared with 92% and 51% in 2018.

Figure 22: More than half of overseas companies used Stock-Connects in 2019

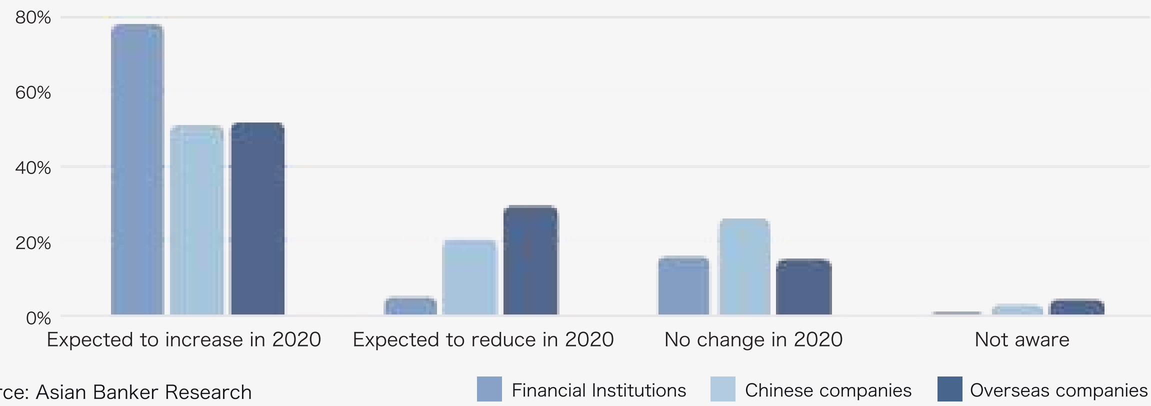


Source: Asian Banker Research

Most Chinese companies expect the various “Stock Connect” programmes to either increase (51%) or maintain (26%) their current use of RMB in transactions in 2020. A majority (52%) of overseas companies also expect their transactions in RMB to grow, although almost one third (29%) are signalling a reduction in use.

Figure 23: Over 50% of respondents expect "Stock Connect" programmes to increase their use of RMB in 2020

Expected change in use of RMB based transactions in 2020



Source: Asian Banker Research

5. Key developments in offshore RMB centres

5.1. Use and change of primary offshore RMB centres

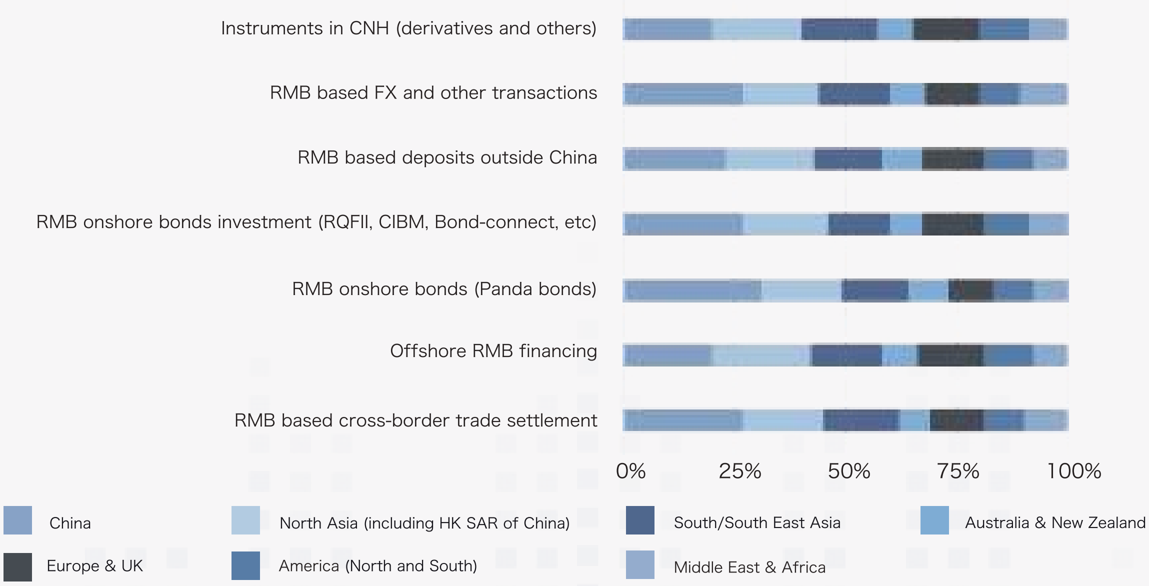
By December 2019, Hong Kong remained the largest offshore RMB clearing centre with a 75.43% share followed by a growing share for the UK at 6.36%. The UK is the most important trading centre for RMB globally, outside of mainland China, by volume and by value. An increased 43.57% of RMB FX transactions (excluding China) by value were conducted in the UK, with Hong Kong in second place with a 24.91% share according to Swift's RMB Tracker.

The survey results indicated that key markets for RMB based products varied by respondent groups. For overseas companies, North Asia (including Hong Kong), South and South East Asia emerged as their key markets for RMB based products outside of China. In general, 19% of overseas companies chose North Asia (including Hong Kong) as their key markets, while 18% of them chose South and South East Asia, compared to 11% and 12% respectively in 2018. China remains the top market with 39% of respondents choosing China as their key market compared with 27% in 2018, but they have a more geographically diversified engagement among other countries for their use of RMB products.

Chinese companies, on average, increasingly prefer North Asia (including Hong Kong) 19% compared to 10% in 2018. Although South and South East Asia remained the third key market for Chinese companies, the share decreased slightly from 18% in 2018 to 16% in 2019.

Figure 24: North Asia maintains its position as a key market for RMB based products for Chinese companies

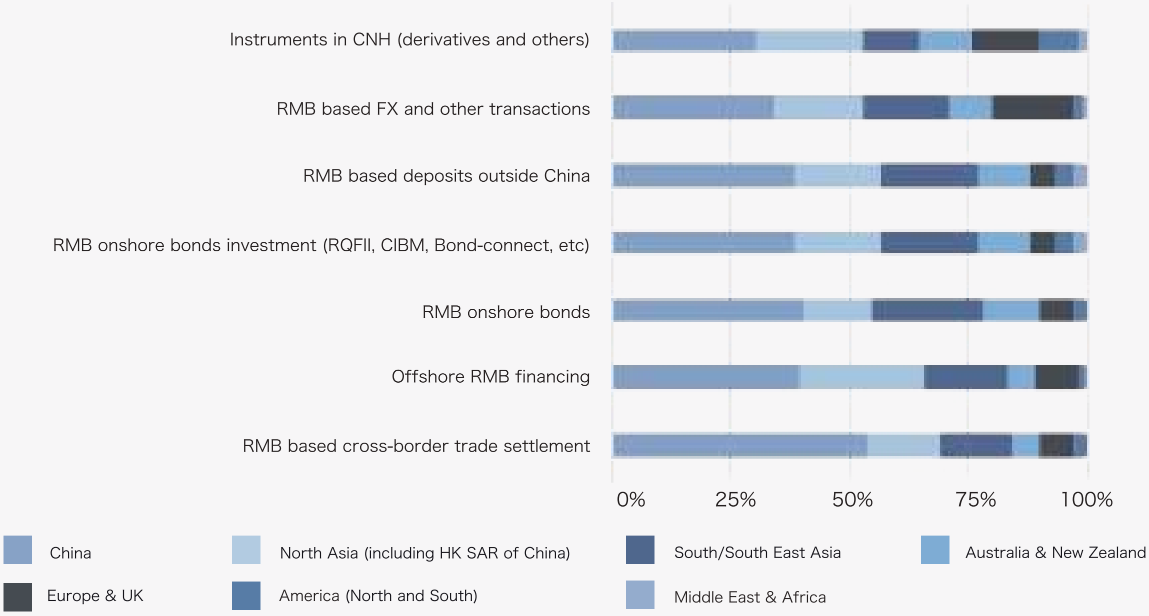
Key markets for RMB based products for Chinese companies in 2019



Source: Asian Banker Research

Figure 25: Ex-China, Asian markets are most important for overseas companies RMB based products

Key markets for RMB based products for overseas companies in 2019

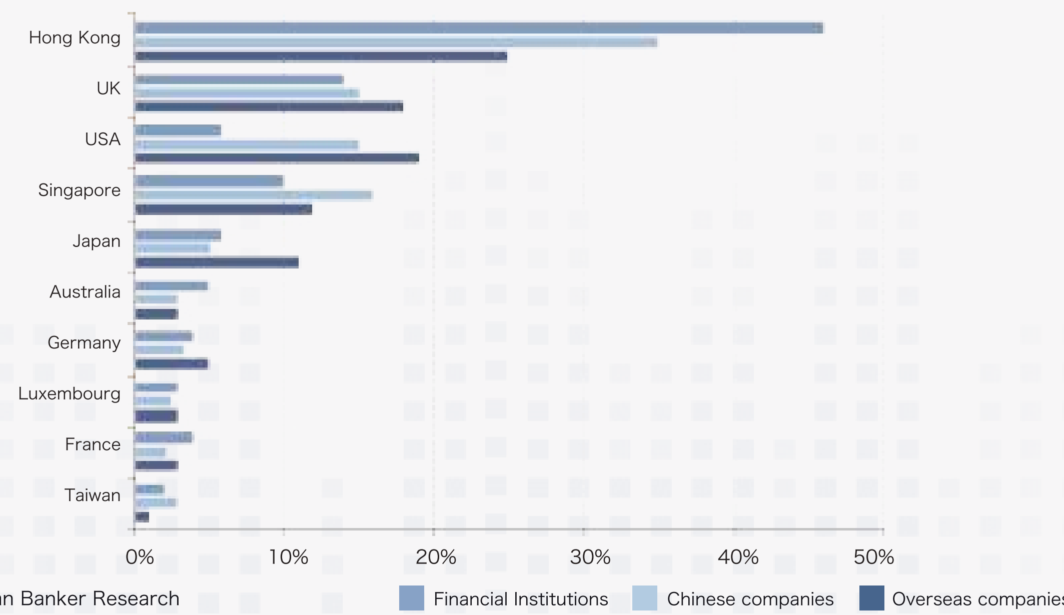


Source: Asian Banker Research

The respondents were asked to mark the main offshore RMB centre that they used for their transactions and Hong Kong was the most popular amongst 46% of FIs, 35% of Chinese and 25% of overseas companies, followed by the UK and US.

Figure 26: Hong Kong remains the main offshore RMB centre among respondents

Key RMB offshore centre used by respondents

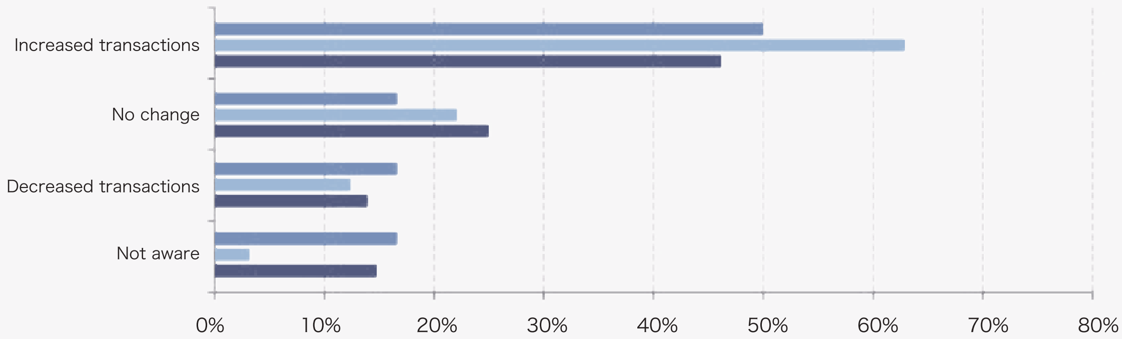


Source: Asian Banker Research

A majority of financial institutions (50%), Chinese (63%) and overseas (46%) companies increased their transactions at their main RMB offshore centre in 2019 and only 14% of overseas and 12% of Chinese companies decreased their transactions.

Figure 27: 63% of Chinese and 46% of overseas companies increased transactions at their main RMB hub in 2019

Change in transactions at key RMB centres in 2019



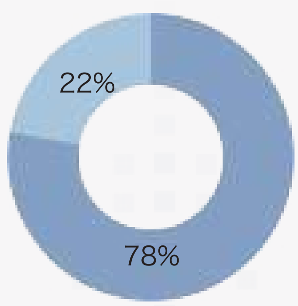
Source: Asian Banker Research

5.2. The positioning of Chinese financial institutions in key offshore RMB markets

Financial institutions' willingness to work with Chinese banks for custodial, counterparty and transactional services continued to grow in 2019. None of the respondents replied "No, prefer foreign service provider", down from 7% in 2018. Only 58% of respondents in 2018 indicated that they would possibly work with Chinese institutions, growing to 78% in 2019.

Figure 28: Most financial institutions showed a willingness to work with Chinese service providers

Willingness to work with onshore Chinese service providers for custodial, counterparty services

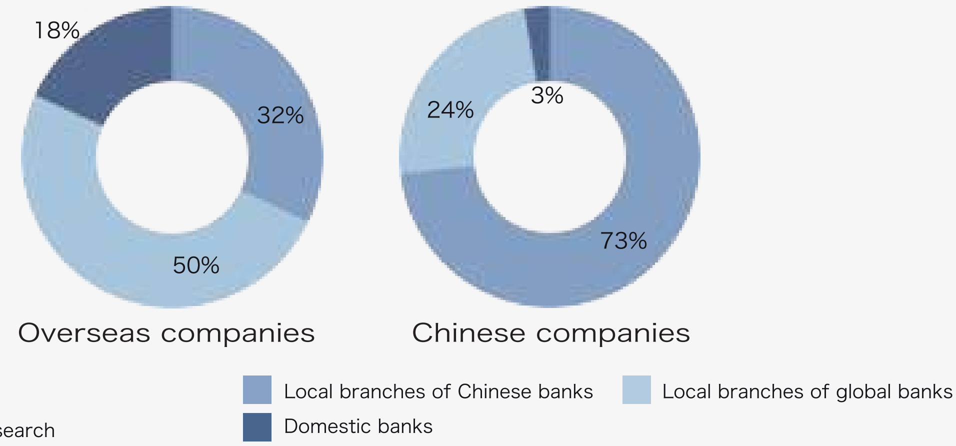


Source: Asian Banker Research

Among overseas companies the preference for local branches of global banks grew to (50%) versus local branches of Chinese banks (32%), compared to last year's survey where 41% of overseas companies had said that they prefer Chinese banks. Interestingly, among Chinese companies, the preference for Chinese banks grew to almost three quarters (73%) compared to 58% in 2018.

Figure 29: Half of overseas companies prefer local branches of global banks, 73% of Chinese companies prefer local branches of Chinese banks

Preference of banks among overseas and domestic companies for RMB products and services



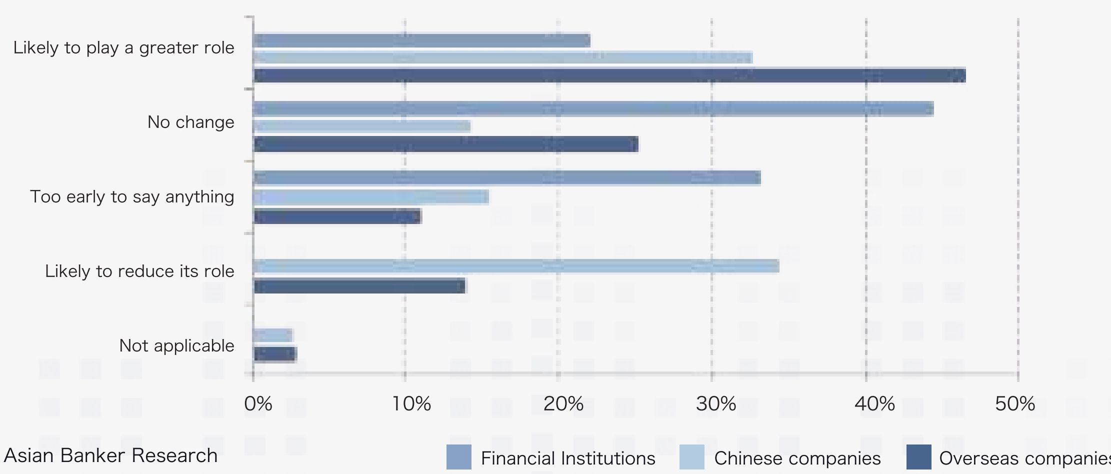
Source: Asian Banker Research

5.3. Brexit and its impact

The respondents were asked how they expected the role of London as an RMB offshore centre for their transactions to change post-Brexit and the responses were mixed amid the uncertainty. One third of Chinese companies expected that London is now likely to play a greater role with 47% of overseas companies reinforcing London's position in a post-Brexit era. Among FIs, 44% expect there to be no change in the role of London as offshore RMB centre, while over one-third of Chinese companies felt it is likely to be reduced post-Brexit.

Figure 30: No unanimity emerged over the role of London as an offshore RMB centre post-Brexit

Impact of Brexit on role of London as offshore RMB centre



Source: Asian Banker Research

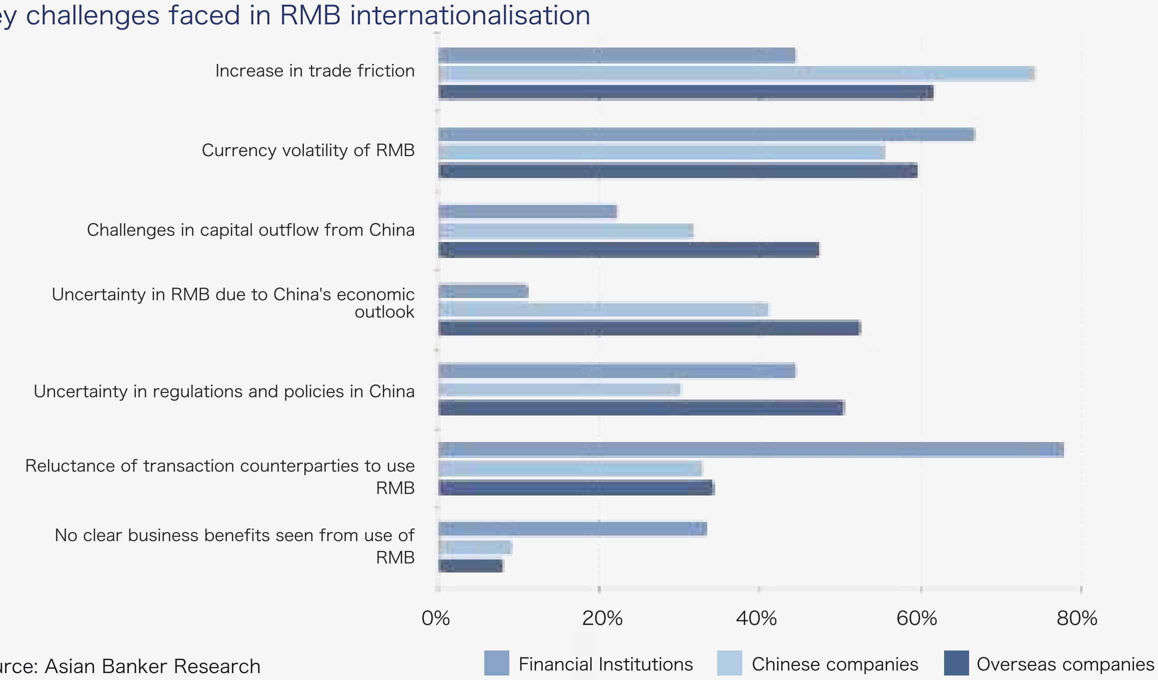
6. Challenges to RMB internationalisation

6.1. Key challenges

Macro-economic policies continue to play a significant role in RMB internationalisation. For the majority of Chinese (74%) and overseas (62%) companies, the ensuing trade tensions between China and the United States were considered among the top challenges in the use of RMB for international transactions. The impact of the signing of the Phase 1 trade agreement in January 2020 on existing trade frictions is yet unclear. Other potential challenges for respondents include currency volatility of the RMB, with 67% of financial institutions rating it as one of top challenges that will likely shape and impact RMB internationalisation efforts.

Figure 31: Increase in trade friction and currency volatility remain biggest concerns

Key challenges faced in RMB internationalisation

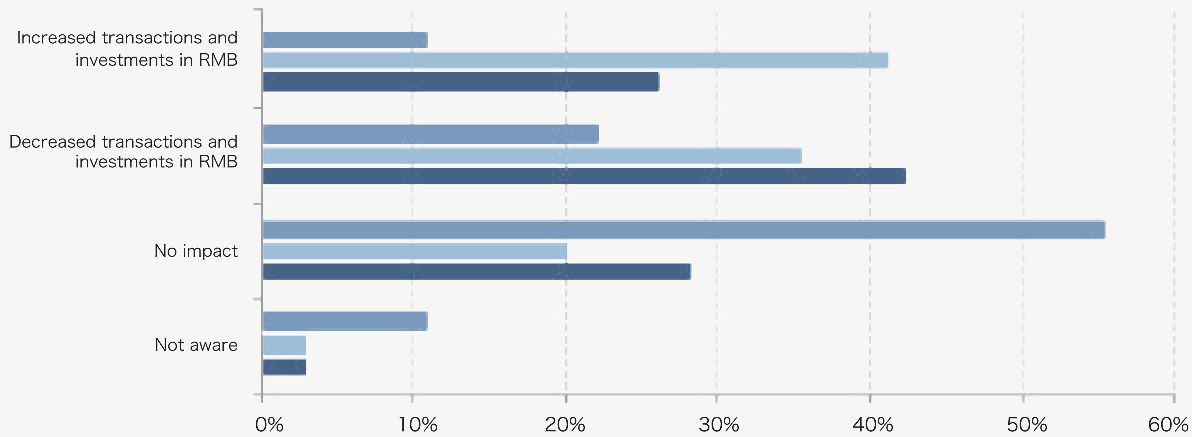


Source: Asian Banker Research

In terms of currency volatility, 42% of overseas companies said that it led to a reduction in RMB based transactions and investments, while a lower percentage (26%) reported an increase in use. On the other hand, 41% of Chinese companies stated that the increasing volatility had led to an increase in use and expected it will likely make Chinese exports more price competitive and support export-led growth of the Chinese economy. Among financial institutions, the largest share (56%) said that they did not witness a change in their usage of RMB.

Figure 32: Significant divergence between overseas and Chinese corporations over the impact of RMB volatility

Impact of currency volatility in 2019



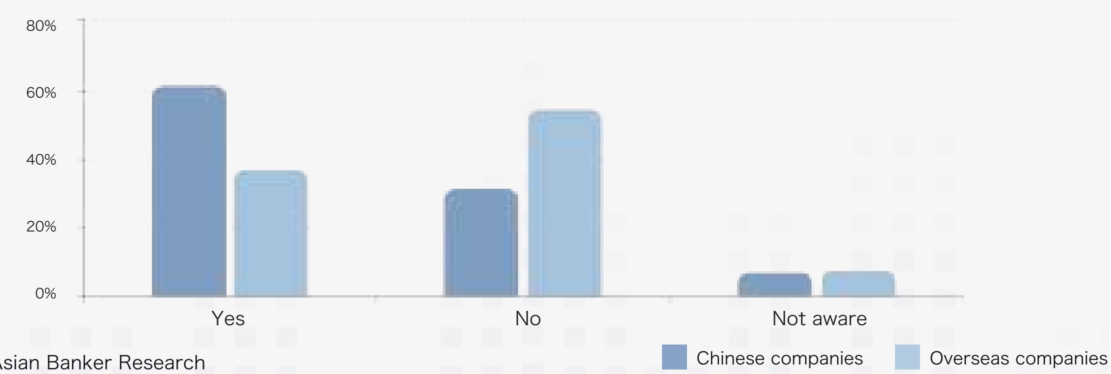
Source: Asian Banker Research

6.2. Impact of US-China trade friction on RMB internationalisation

With a departure from last year's survey, there was a significant deviation between overseas and Chinese corporations over how the trade conflict will likely impact their supply chains with respondents having undertaken divergent measures as a response to the ensuing trade tensions. 61% of Chinese companies commented that they have made supply chain changes following the increases in trade tariffs, while 57% of overseas companies have indicated that they have not.

Figure 33: Contrary response from Chinese and overseas companies towards supply chain adjustments in 2019

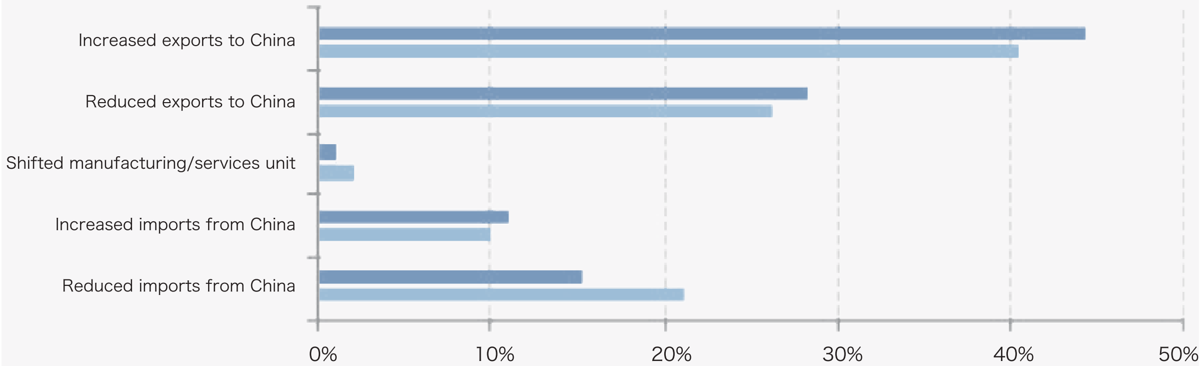
Supply chain adjustments in 2019 after tariffs increase



Source: Asian Banker Research

Among overseas companies, the largest proportion of companies (44%) increased exports to China, up from 33% in 2018, while 28% reduced exports to China in 2019, a significant decrease from 39% in 2018. Looking ahead, in 2020, 40% of companies plan to increase exports to China. A tiny fraction (1% and 2%) of companies shifted or expect to shift their manufacturing or service units, compared with 9% and 13% in 2018.

Figure 34: Supply changes made by overseas companies after tariff changes



Source: Asian Banker Research

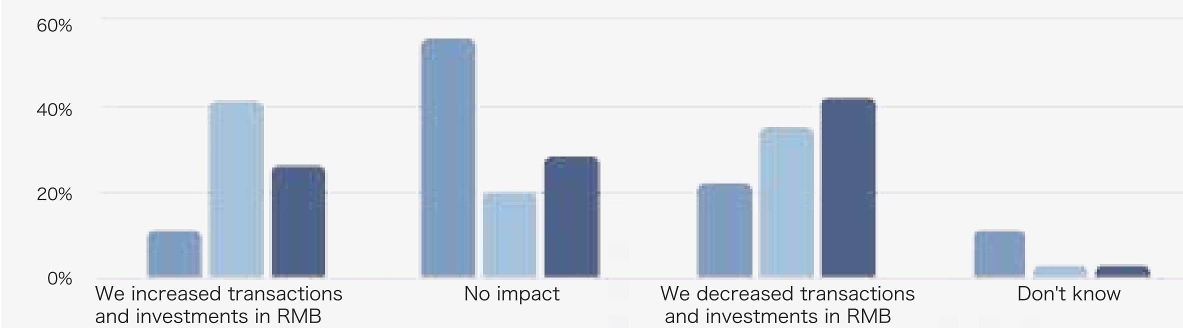
In 2019 Expected for 2020

6.3. Impact of currency volatility on RMB internationalisation

Responses diverged when asked about the impact of any future volatility on their transactions. 42% of Chinese companies said that it will have an impact and increase their transactions and investments in RMB, while 36% reported the opposite. 20% of Chinese companies and 56% of FIs do not expect future volatility to impact their RMB transactions. Among overseas companies, 43% said they will decrease RMB based transactions, 35% increase and 29% indicated no future impact.

Figure 35: Mixed approaches to any future RMB volatility

Expected impact of RMB currency fluctuation on cross-border business



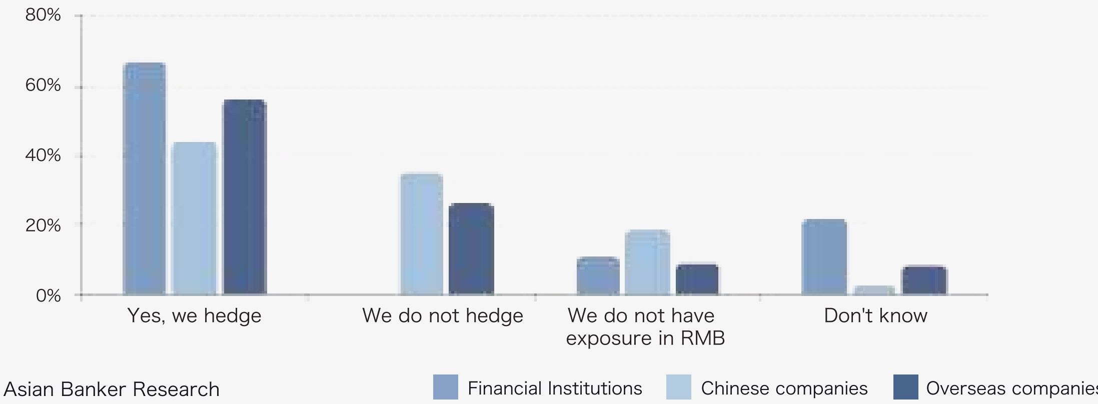
Source: Asian Banker Research

Financial Institutions Chinese companies Overseas companies

A significant 44% of Chinese companies and 57% of overseas companies do hedge their currency risk exposure compared with 43% and 48% respectively in 2018. The share of respondents who do not hedge decreased from 2018, indicating a more mature foreign exchange market for RMB and increasing awareness among participants to manage currency volatility risk. Financial institutions were equally guarded with 67% implementing risk mitigation techniques to manage any adverse currency movements on their balance sheets.

Figure 36: Most companies and financial institutions hedge their RMB exposure

Hedge RMB exposure



Source: Asian Banker Research

The preferred tools to hedge RMB exposure changed among respondent groups in 2019 compared with 2018.

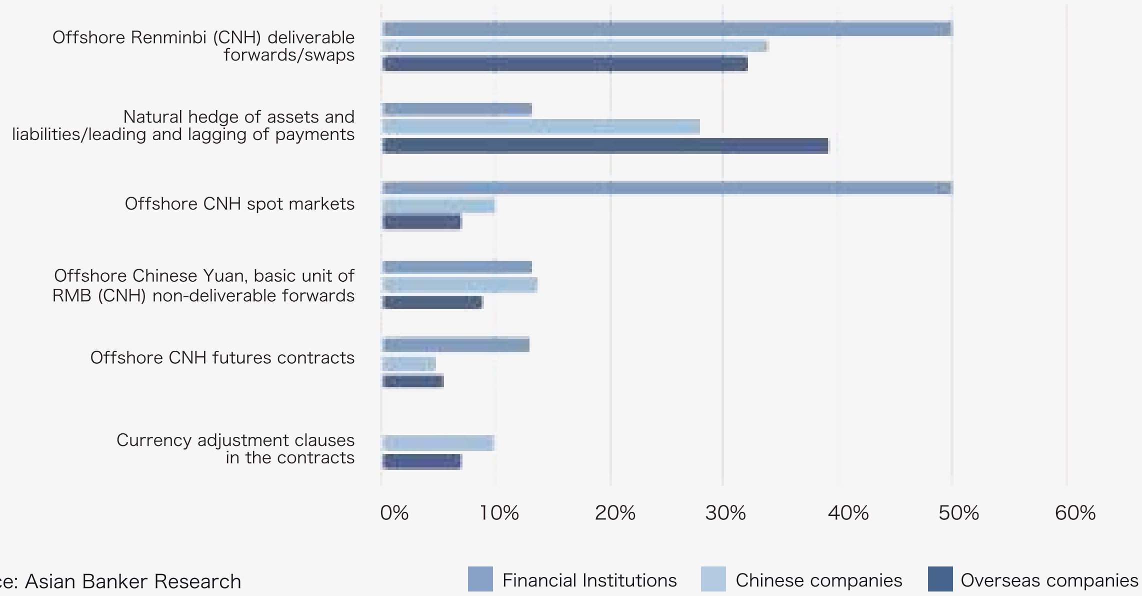
Among Chinese companies, the most preferred method has evolved from natural hedge of assets and liabilities (including leading and lagging of payments) (39% in 2018 vs 28% in 2019) to offshore RMB (CNH) deliverable forwards/swaps (33% in 2018 vs 34% in 2019). The usage of offshore RMB (CNH) non-deliverable forwards decreased significantly to 14% compared with 33% last year, while those using offshore RMB (CNH) spot markets increased to 10% compared to 7% in 2018.

For overseas companies, the most preferred method continues to be natural hedge of assets and liabilities (including leading and lagging of payments) with 39% of respondents choosing, slightly higher than 37% last year. Nevertheless, offshore RMB (CNH) deliverable forwards/swaps(9% in 2018 vs 32% in 2019) surpassed non-deliverable forward (27% in 2018 vs 9% in 2019) this year as an important tool for overseas companies to hedge RMB exposure. Overseas companies responded decreased use of offshore RMB (CNH) spot markets (7%) compared with 2018 (14%).

Among FIs, offshore RMB (CNH) deliverable forwards/swaps (50%) and use of offshore CNH spot markets (50%) emerged as the favoured methods for hedging compared to only 8% and 23% respectively in 2018. Consistent with companies, the use of offshore RMB (CNH) non-deliverable forwards decreased significantly for FIs from 45% in 2018 to 13% in 2019.

Figure 37: Offshore RMB (CNH) deliverable forwards/swaps emerged as an important tool for managing currency volatility

Preferred way to hedge RMB exposure



Source: Asian Banker Research

Special Column 4: Impact of COVID-19 global pandemic on RMB internationalisation

The COVID-19 pandemic represents an unprecedented disruption to the global economy and world trade, as production and consumption are scaled back across the globe. The IMF predicts the global economy will shrink by 3% this year and that the world's economic output will plummet $9 trillion over two years. The pandemic is adversely affecting different business sectors, including tourism, transportation, trade, manufacturing and financial services.

With market participants seeking a "flight to safety", there will be a rising demand for safe assets. Notwithstanding the rise of the dollar, the RMB is well positioned to capitalise on the expected return to normalcy of business activities in China as a result of effective pandemic mitigation and economic stimulus measures taken by the government.

Given that market optimism in China is returning gradually the RMB has stabilised compared with other major global currencies that are seeing significant drops in value. For international market participants this is reflected in less foreign exchange volatility marking RMB denominated investments as the preferred asset class of choice and currency in settling cross-border payments. Resumed business activity will also bolster support in the RMB as business confidence is restored. China's domestic capital markets continue to perform and the number of investors in China's A-Share market has increased by over 1.24 million as of November 2019 compared with end of 2018.[2]

[2] Source: CSDCC

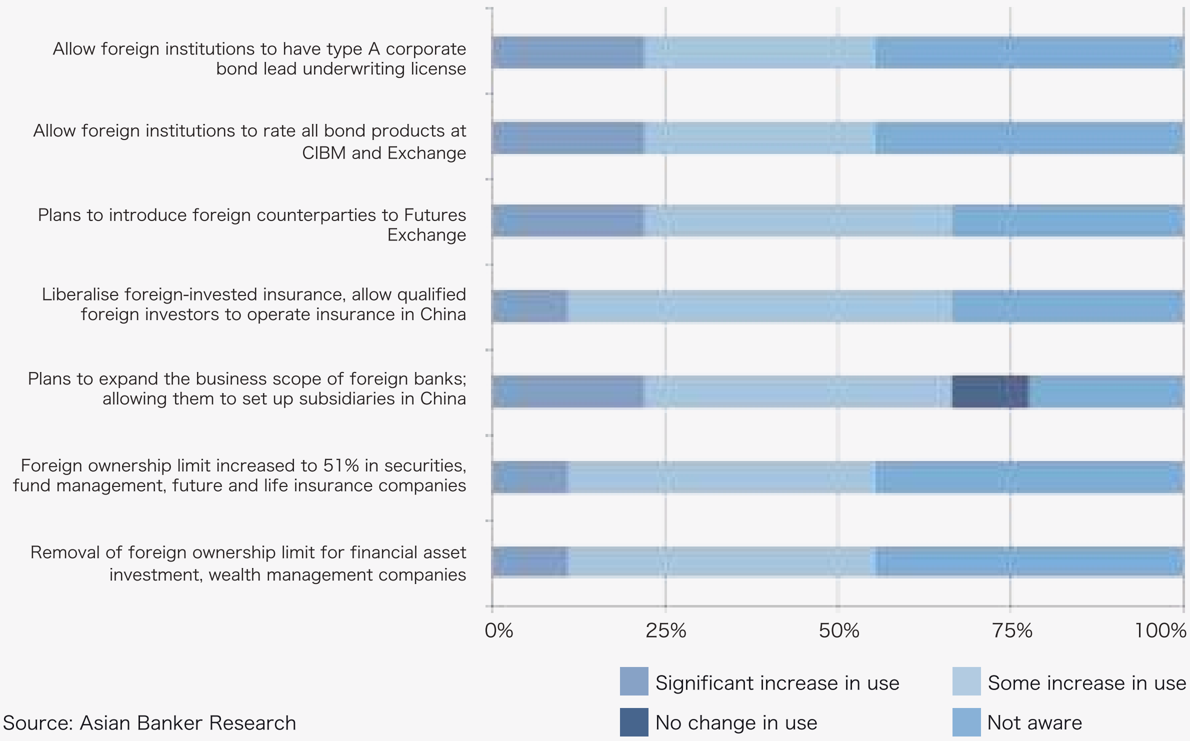
7. Future strategies on RMB internationalisation

7.1. Opening of financial markets

Financial institutions were asked about the expected impact of these reforms on their institutions and most institutions responded positively to these reforms.

Figure 38: The majority of financial institutions expect to see greater use of RMB following the reforms

Impact of opening of financial markets on use of RMB

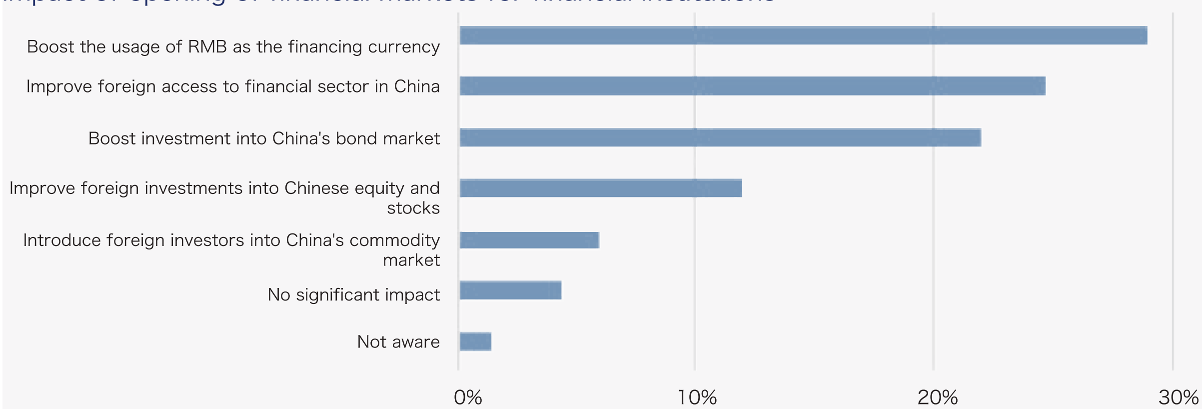


Source: Asian Banker Research

The FIs were also asked about the likely impact of the opening of financial markets for their institution and 29% said they expect these initiatives to boost the usage of RMB as a financing currency while 25% of respondents expect these measures to enhance access by foreign financial institutions to China's financial sector. 22% and 12% also expect more investment into China's bond market and stock market respectively following further opening, while 6% mentioned commodity market.

Figure 39: 29% of FIs expect that the opening of financial markets will boost the usage of RMB as a financing currency

Impact of opening of financial markets for financial institutions



Source: Asian Banker Research

7.2. Freedom of trade

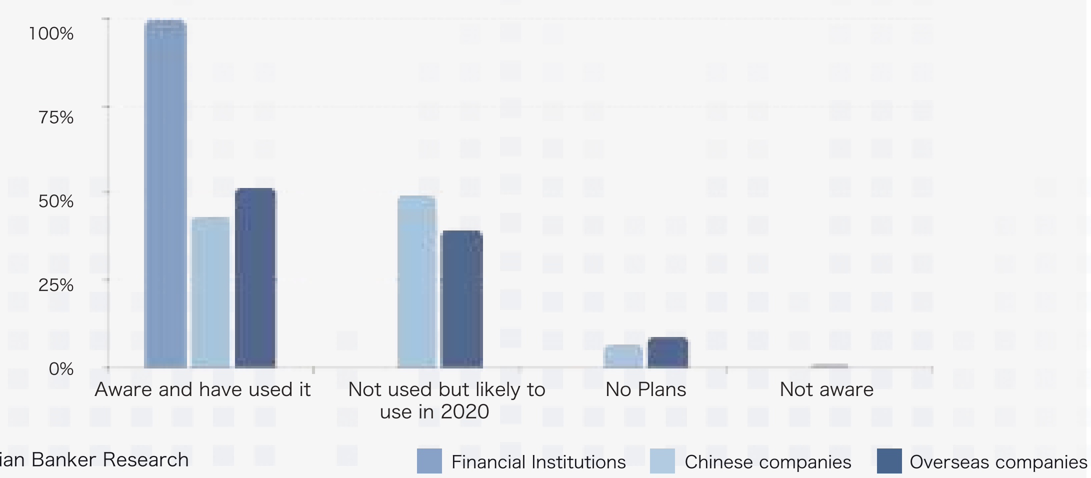
In August 2019, the State Council approved the establishment of six free trade zones, which are respectively set up in the six provinces and regions of Shandong, Jiangsu, Guangxi, Hebei, Yunnan and Heilongjiang. In the overall plan for this new batch of free trade zones, lies the pivotal role of regional economies and international cooperation. For example, among the six free trade zones, there are Shandong for China-Japan-South Korea cooperation, Guangxi for China-ASEAN cooperation, and Heilongjiang for China-Russia cooperation.

These trade zones will further drive China's integration within global supply chains, strengthen trade linkages with key economic partners and deepen capacities of regional economies.

The survey shows that the awareness of these free trade zones remains high with 100% of FIs, 52% of overseas companies and 43% of Chinese companies already utilising them, an increase on last year's 68% of FIs and 39% of overseas companies. In addition, another 49% of Chinese and 39% of overseas companies said that they plan to begin using them in 2020.

Figure 40: All FIs have utilised free trade zones

Awareness and Use of Free Trade Zone



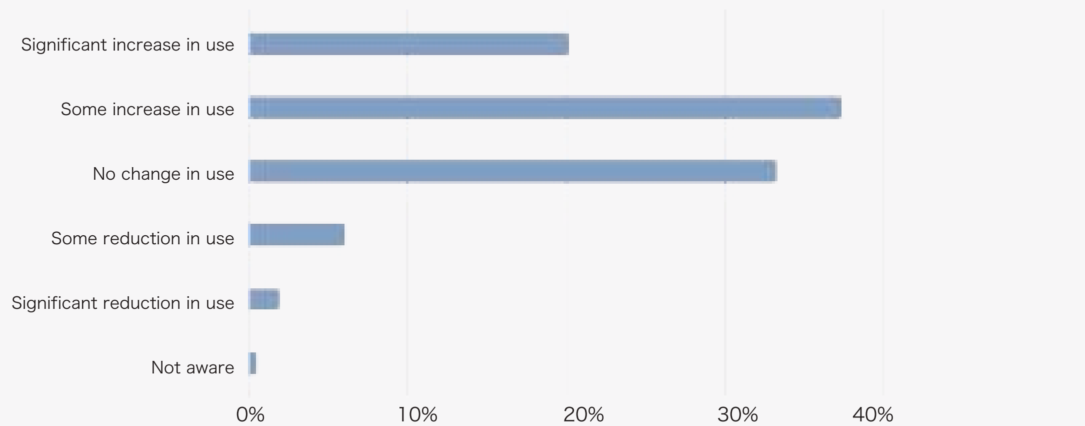
Source: Asian Banker Research

7.3. Belt and Road Initiative and potential impact

China's Belt and Road Initiative, a vast infrastructure and connectivity initiative spanning the Asia Pacific, Middle East, Africa and Europe, is one of the key drivers of RMB internationalisation. Our survey revealed that 20% of overseas companies reported that the BRI has brought about a "significant increase" in the international use of RMB, and 37% considered it to have brought "some increase" in use.

Figure 41: 57% of overseas companies believe the Belt and Road Initiative led to an increase in use of RMB cross-border products

Impact of Belt and Road Initiative



Source: Asian Banker Research

7.4. Prospects of digital currencies

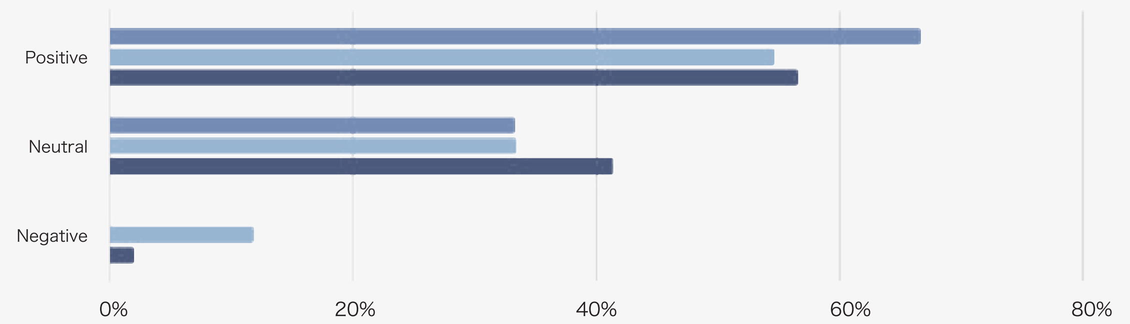
The potential launch of a digital currency DC/EP by PBOC in conjunction with further financial market reforms will complement efforts to steadily internationalise the RMB. With the underlying technology and regulatory framework underpinning the basic functions of a digital currency encompassing circulation, payment, issuance and anti-money laundering largely in place or being finalised, the imminent launch of a national digital currency is in progress.

Our survey revealed that FIs (67%) have a positive view to a national digital currency being issued by the PBOC and this favourable sentiment resonated strongly with overseas (57%) and Chinese (55%) companies respectively.

On using the national digital currency, 52% of overseas companies and 44% of FIs are willing to use it once all institutional frameworks governing the currency are in place, more proactive than Chinese companies (27%). 61% of Chinese companies and 56% of FIs took a more cautious approach adopting a wait and see stance before making any decision on whether to use.

Figure 42: Overwhelmingly positive perception of a national digital currency

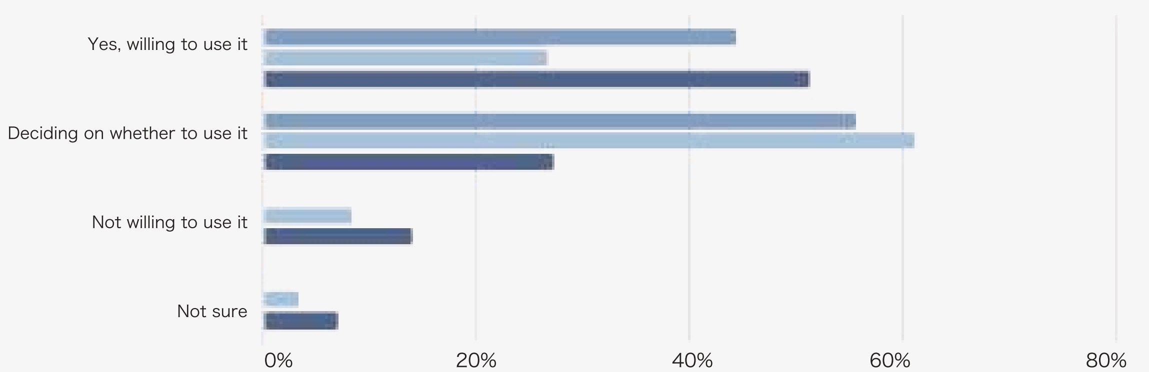
View on digital currency



Source: Asian Banker Research

Figure 43: Overseas companies and FIs are more proactive on using the national digital currency

Use of digital currency to conduct financial transactions

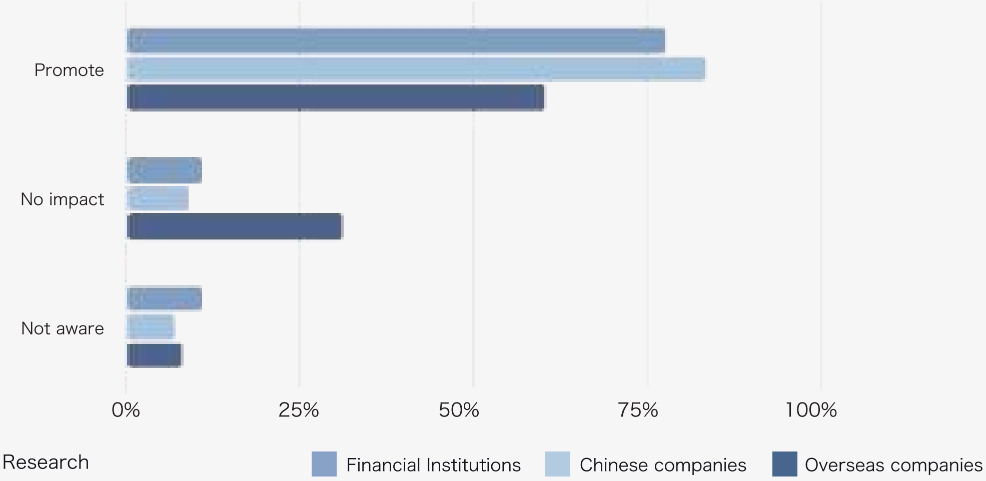


Source: Asian Banker Research

Corporates and financial institutions view the introduction of a digital currency and its impact on RMB internationalisation favourably. Among overseas companies, 61% state that a digital currency will promote RMB internationalisation, while 31% indicate there will be no impact. Chinese companies registered the most positive view on the digital currency, with 84% indicating that the impact will be positive. Over three quarters of financial institutions (78%) positively view the impact of a digital currency on RMB internationalisation.

Figure 44: Over 60% of respondents positively view the impact of the national digital currency on RMB internationalisation

Impact of the national digital currency on RMB internationalisation



Source: Asian Banker Research

8. Conclusion

New regulations and frameworks introduced by various Chinese agencies during 2019 has provided greater impetus to the drive for RMB internationalisation. The introduction of new Free Trade Zones, expansion of the Belt and Road Initiative, inclusion of China "A" shares in the MSCI index are among key elements contributing to the increased use of RMB globally. Compared to 2018, cross border transactions conducted in RMB continues to experience sustained growth according to the responses of market participants, while foreign institutions are quietly building up their total domestic RMB denominated financial assets.

Although concerns over tariffs on trade, currency volatility and the COVID-19 pandemic remain, the respondents surveyed were cautiously optimistic on the use of RMB into 2020 as they track evolving developments in the global economy.

For the RMB to attain international currency status, the current path of opening up of financial markets must be maintained to facilitate the greater use of RMB across the world while enhancing the interconnectivity and integration of both on-shore and off-shore market infrastructure.

The RMB is proving to be remarkably stable and resilient amidst adverse and uncertain economic conditions and 2020 is expected to see the introduction of more robust internationalisation measures to shore up and strengthen the RMB.

9. Appendix - survey respondents' profile

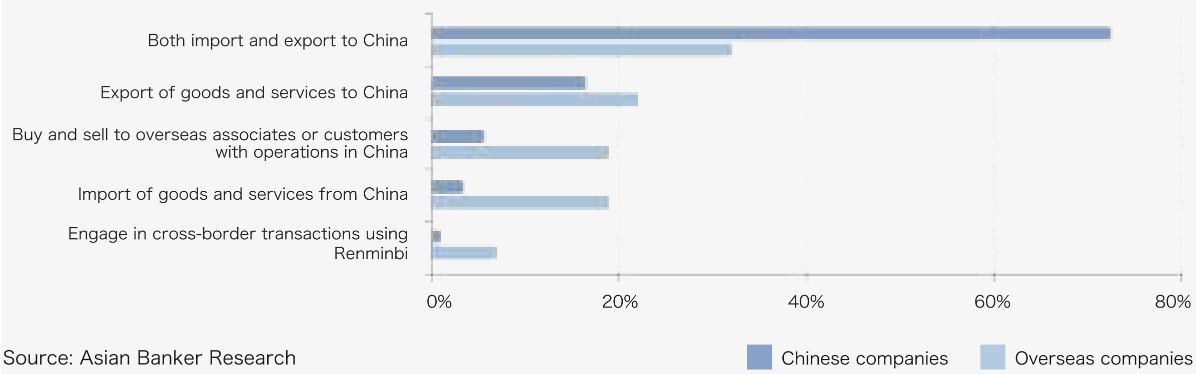
The comprehensive survey conducted in December 2019 and January 2020 covered 497 Chinese companies (Mainland China), 110 overseas companies from North America, South America, Europe and Asia-Pacific (including Hong Kong, Macao and Taiwan), and 36 financial institutions around the world. Only companies that engaged in cross-border operations with China were invited to participate in the survey. Across the report, "Mainland China" is shortened to "China" and excludes Hong Kong, Macao and Taiwan, while the "Greater China" reference includes Hong Kong, Macao and Taiwan.

The survey was conducted across senior executives in finance, including chief financial officers, corporate treasurers and senior executives in treasury. Only those executives that were involved in RMB products or financing participated in the survey.

The companies surveyed are spread across industries with the highest proportion of companies coming from the industrial and manufacturing sector (50% Chinese and 25% overseas companies), followed by 39% of overseas companies from the financial sector and 25% of Chinese companies with information technology operations. In addition, a survey was also carried across senior executives in 36 financial institutions.

Figure 45: The majority of companies surveyed conduct both import and export of trade and services to and from China.

Main cross-border operations of companies

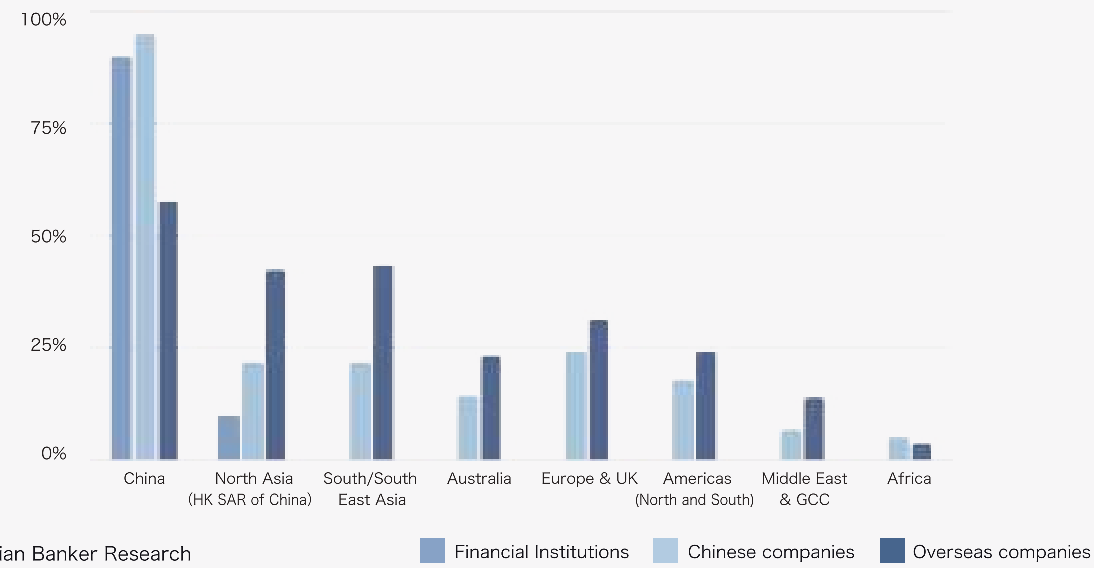


Source: Asian Banker Research

A majority of Chinese respondents cover China and North Asia (including Hong Kong) and thereafter the South/Southeast Asia region. Comparatively, overseas respondents are more evenly spread across different geographical regions, besides China.

Figure 46: Respondents covered regions across different continents

Main geographical region covered

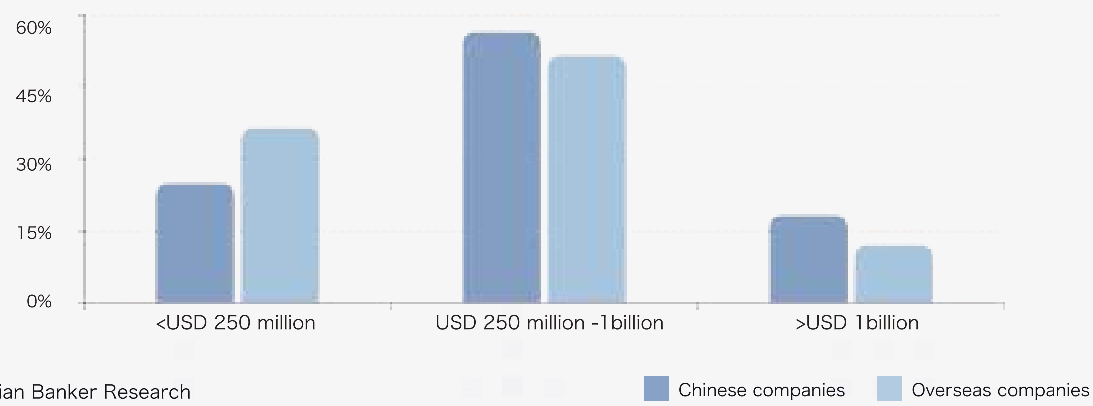


Source: Asian Banker Research

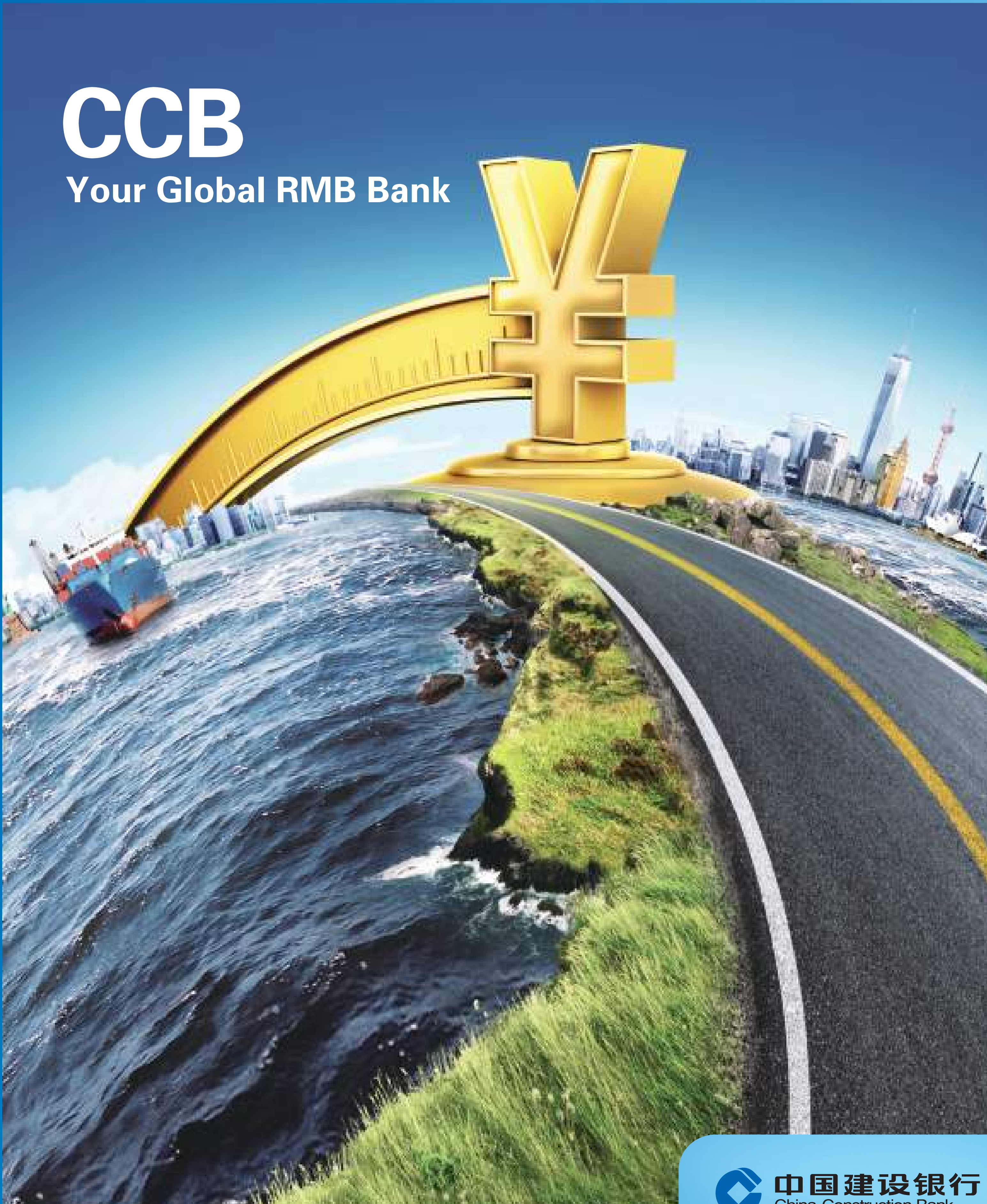
While the companies vary in size, over 55% of companies are mid-sized with global turnover ranging between $250 million to $1 billion.

Figure 47: Majority of the respondents are mid-sized

Size of respondents' companies



Source: Asian Banker Research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