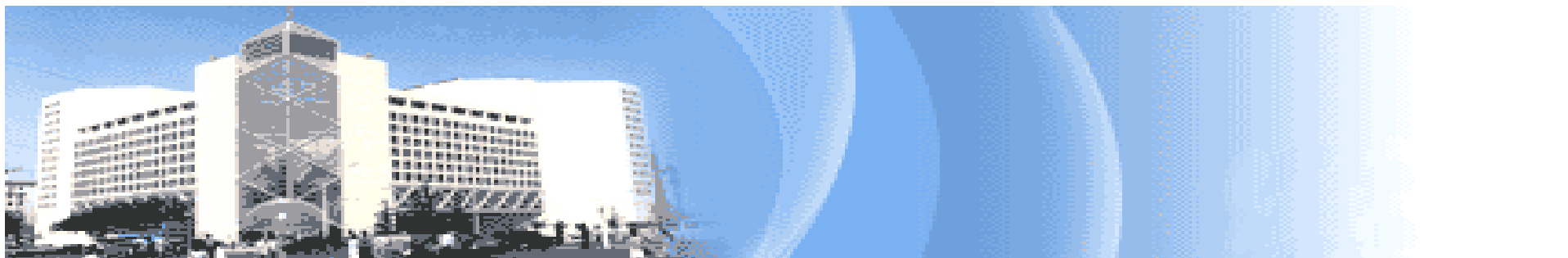




# **CNH Market--A Burgeoning Offshore RMB Market**

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September, 2011



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## I. Evolution of CNH Market

## Evolution of CNH Market

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International trade volume of China exceeded USD3,000 billion in the year of 2010. The world's largest trade balance surplus paved the way for the expansion of CNY settlement in cross-border trade and direct investment. As the CNY offshore deliverable market, Hong Kong provides services such as international trade settlement in CNY, financing, CNY-denominated bond issuance and wealth management.

# Evolution of CNH Market

## 1. Retail CNY Banking Businesses :

In December of the year of 2003, retail CNY banking businesses was permitted in Hong Kong, but only in CNY deposit accounts, CNY remittance and CNY credit card. And the amount for converting HKD to CNY limited to CNY20,000 per day.

## 2. Dim Sum Bond Market :

On June 8th, 2007, People's Bank of China (PBOC) and National Development and Reform Commission (NDRC) jointly issued *The Interim Measures for the Administration of the Issuance of RMB Bonds in Hong Kong Special Administrative Region by Financial Institutions Within the Territory of China* 《中国人民银行 国家发展和改革委员会公告【2007】第12号》. In July of 2007, China Development Bank became the first issuer in CNY-denominated bond, with a amount of RMB5 billion and a tenor of 2 years.

# Evolution of CNH Market

## 2. Dim Sum Bond Market :

On Dec 8th, 2008, General Office of the State Council issued *Several Opinions on Providing Financial Support for Economic Development (国办发【2008】126号)*, allowing corporations and financial institutions with substantial business in China to issue CNY bonds in Hong Kong.

On Feb 11st, 2010, Hong Kong Monetary Authority issued *Elucidation of Supervisory Principles and Operational Arrangements Regarding Renminbi Business in Hong Kong*, indicating “With regard to the RMB funds that have flowed into Hong Kong, Participating Authorized Institutions can develop RMB businesses based on the regulatory requirements and market conditions in Hong Kong, as long as these businesses do not entail the flow of RMB funds back to the Mainland.” and “The range of eligible issuers, issue arrangements and target investors can be determined in accordance with the applicable regulations and market conditions in Hong Kong.”

# Evolution of CNH Market

## 3. Cross-border Trade Settlement in RMB

In July, 2009, State Council approved Shanghai, Guangzhou, Shenzhen, Zhuhai and Dongguan for the experimental RMB settlement of Cross-boarder trade. On July 1st, 2009, PBOC and five other ministries released *Administrative Rules for Experimental RMB Settlement of Cross-boarder Trade.* ( *中国人民银行 财政部 商务部 海关总署 国家税务总局 中国银行业监督管理委员会公告[2009]第10号*). On July 3rd, PBOC issued the *Detailed Measures for Experimental RMB Settlement of Cross-boarder Trade.*

In June of 2010, the experimental cities expanded to 20 provinces, municipalities and autonomous regions including Beijing with all cross-boarder trade counterparties.

On Aug 23rd, 2011, PBOC and five other ministries released *A Notice on Extending Geographical Coverage of Use of RMB in Cross-border Trade Settlement, to the entire nation.*

# Evolution of CNH Market

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## 4. ODI in RMB

In Jan, 2011, PBOC and SAFE jointly formulated and issued Measures for Administration of Pilot RMB Settlement for Overseas Direct Investment.

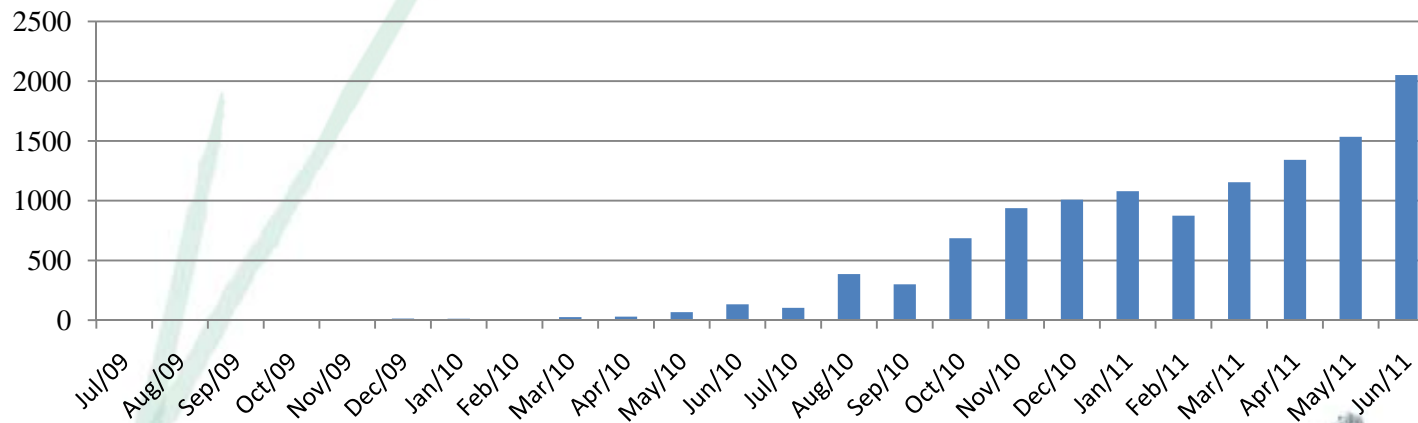


## II. Introduction of CNH Market

## ( I ) Cross-border RMB Settlement Volume in Hong Kong

After the implementation of Pilot Programme of cross-border trade settlement in RMB, we witness a rapid growth in cross-border RMB settlement volume in Hong Kong. The total RMB settlement amount increased to RMB205.1 billion in June from RMB153.4 billion of May. The total amount of the year of 2010 is RMB369.2 billion, while the one for the first half year of 2011 is RMB803.6 billion. The following chart illustrates the cross-border RMB settlement volume in Hong Kong since July of 2009. (Source: website of HKMA)

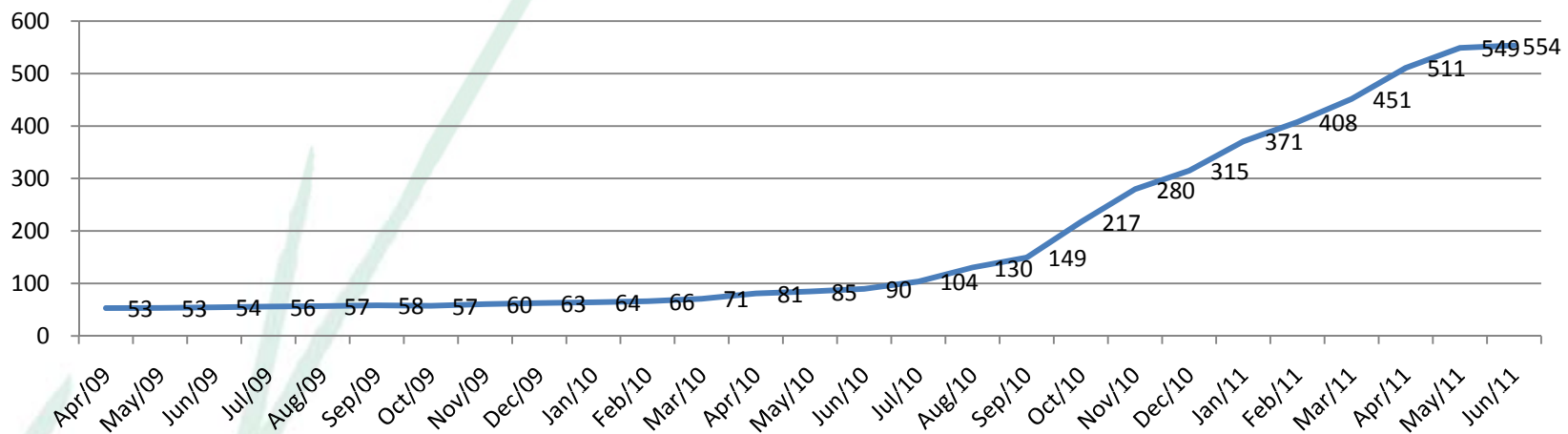
**Cross-border RMB Settlement Volume in Hong Kong (in RMB100 millions)**



## ( II ) RMB Deposit in Hong Kong

Pilot Programme of cross-border trade settlement in RMB also increased RMB deposit in Hong Kong. According to HKMA, as of June of 2011, RMB deposit in Hong Kong amounted to RMB553.6 billion. The following chart shows the RMB deposit in Hong Kong on HKMA's website since April of 2009 on a monthly basis. There is a sharp growth of 45.41% from RMB149.3 billion to RMB217.1 billion in October of 2010, 4 months after China extended the experimental cities of cross-border settlement in RMB to 20 provinces.

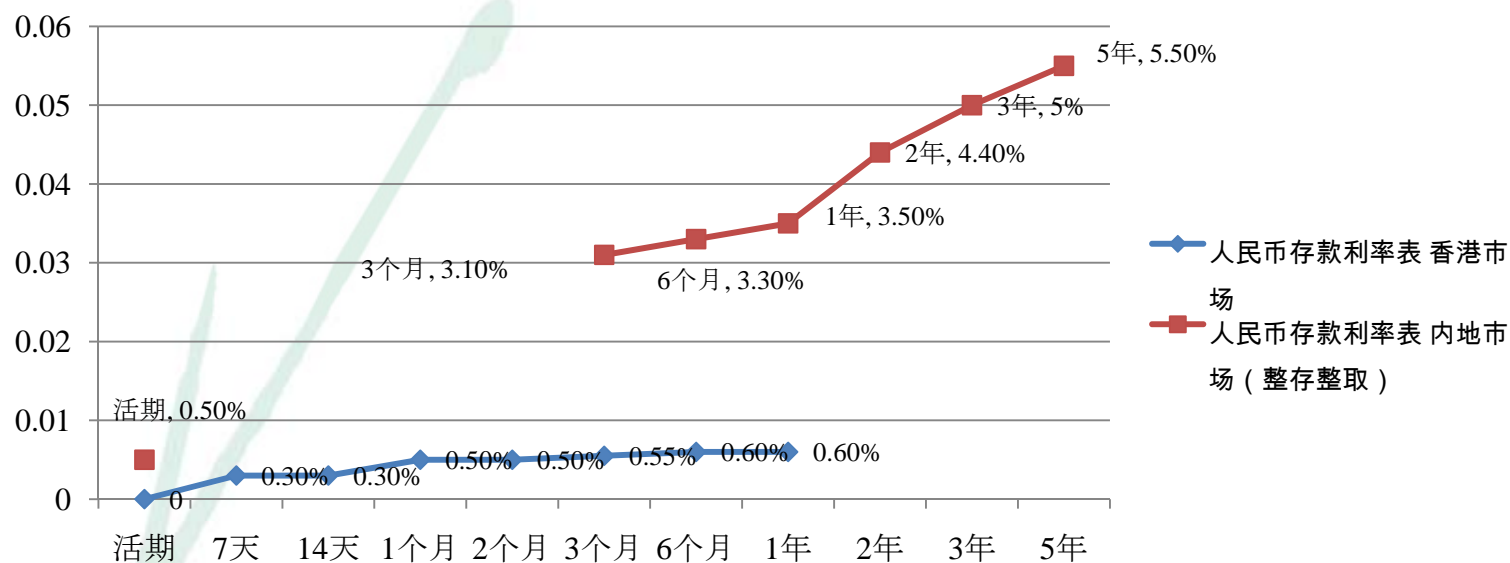
**RMB Deposit in HK (in RMB billions)**



## ( III ) Offshore RMB funds investment channels

### 1. Deposit to Banks in Hong Kong

We take the RMB deposit interest rates of BOCHK on Aug 25th and those of Bank of China Head Office. The interest rates for deposit in Hong Kong range from 0.3-0.6%. ( Note : BOCHK is a sole RMB clearing bank in Hong Kong, and participant banks, (PB) deposit the excessive RMB to BOCHK. )

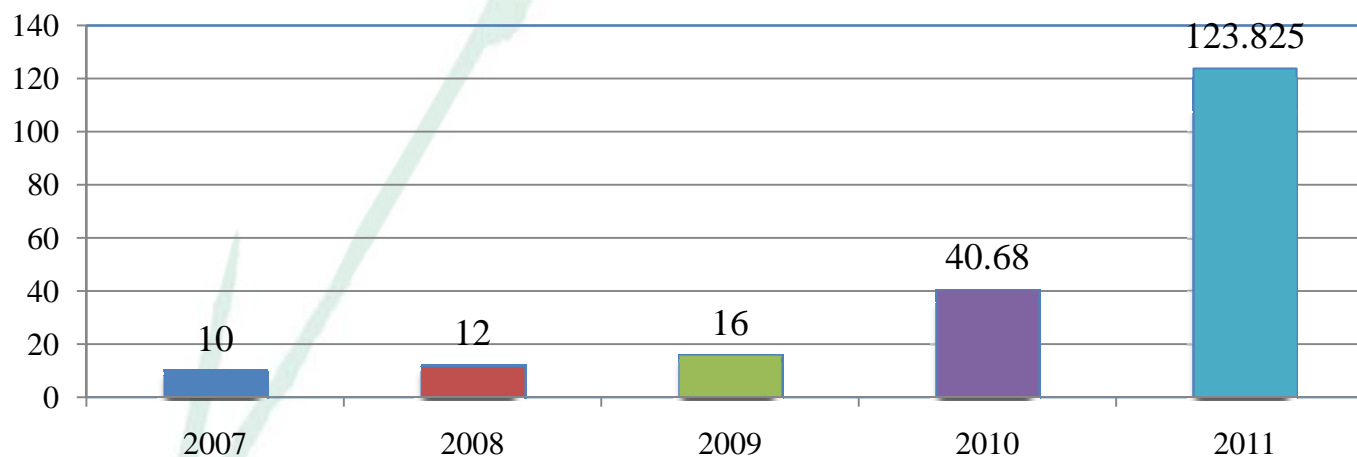


## ( III ) Offshore RMB funds investment channels

### 2. Investing in Dim Sum Bond Market—Total Issuance Amount

Dim Sum Bond refers to CNY-denominated bond issued in Hong Kong. In July of 2007, the first Dim Sum bond issued by China Development Bank. as of Aug 25th, 2011, total issuance amount of Dim Sum bond is RMB202.5 billion, and the outstanding amount is RMB176 billion. (Source: Bloomberg). Issuance in 2011 witnessed an explosive growth.

**Dim Sum Bond Issuance CNY (in RMB billions)**

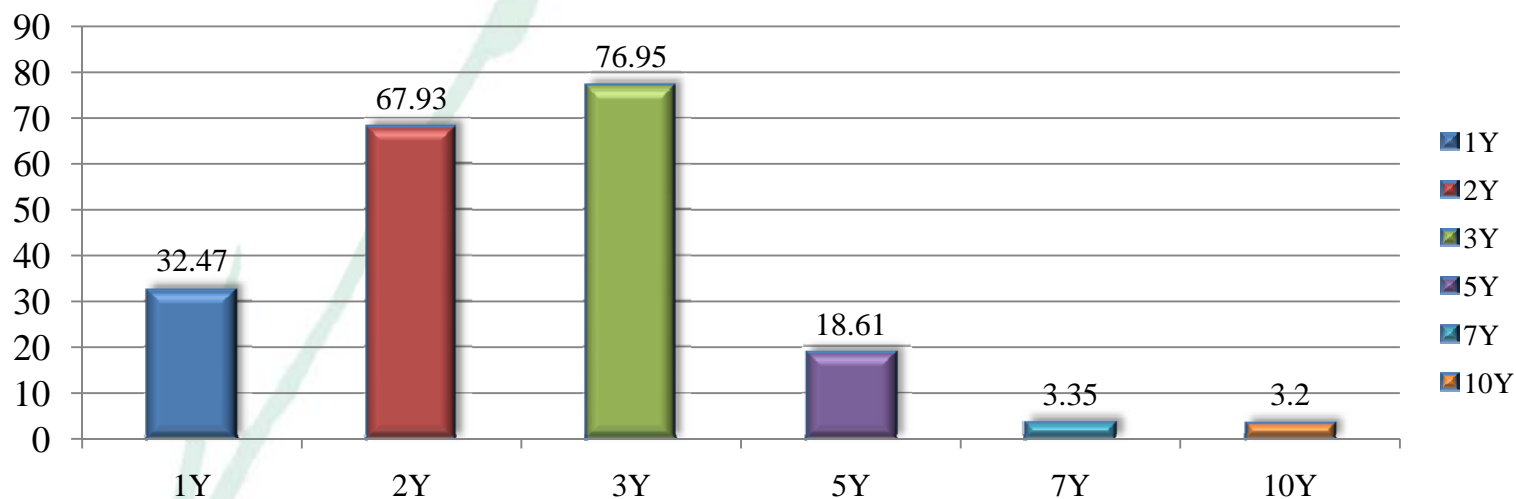


## ( III ) Offshore RMB funds investment channels

### 2. Investing in Dim Sum Bond Market—Tenor

In the total issuance amount of RMB202.5 billion, the following chart shows tenor distribution. (Data source: Bloomberg). Most of the dim sum m bonds' tenors locate in 3 years, accounting for 87.58%, and indicates market's tenor preference.

Issuance Amount by Tenor CNY(in RMB billions)

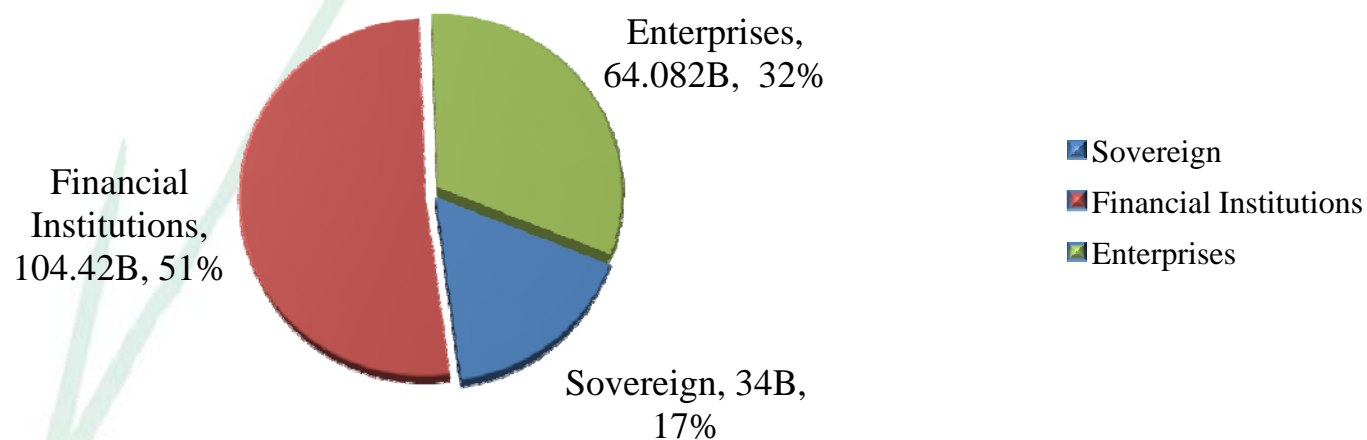


## ( III ) Offshore RMB funds investment channels

### 2. Investing in Dim Sum Bond Market—Issuer

There are several types of issuers, which are illustrated in the chart, including Ministry of Finance of Chinese government, foreign and Chinese banks and enterprises. Among the total issuance of RMB202.5 billion, sovereign accounts for 17%, while financial institutions constitute of 51% with a total issuance amount of RMB104.4 billion. ( Data source : Bloomberg )

**Dim Sum Bond Amount by Issuer CNY(in RMB billions)**

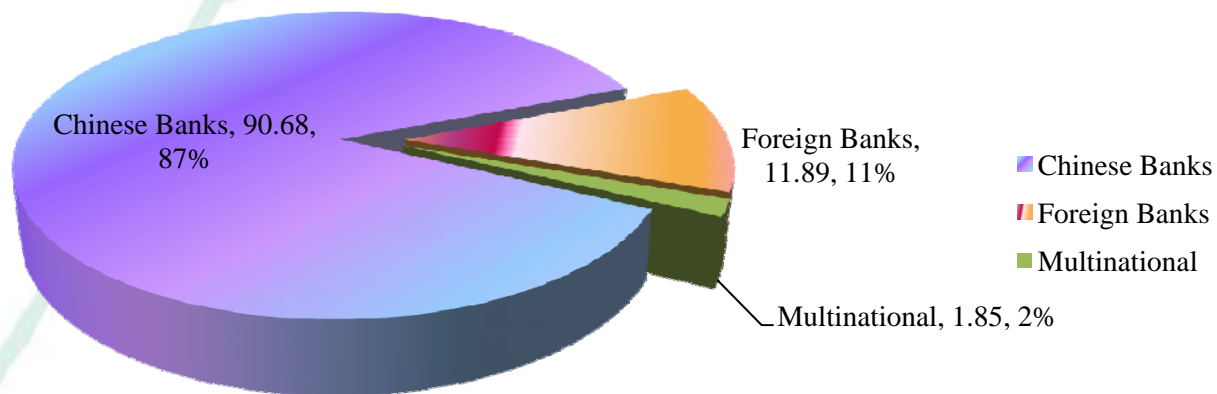


## ( III ) Offshore RMB funds investment channels

### 2. Investing in Dim Sum Bond Market—Issuer (Financial Institutions)

Chinese banks issued RMB90.68 billion, comprised 87% of the RMB104.4 billion issued by financial institutions. Foreign banks account for 11%, and super national issuers 2%, including Asian Development Bank, International Finance Corporation and IBRD. (Data source: Bloomberg).

**Financial Institutions Issuance Amount CNY (in billions)**

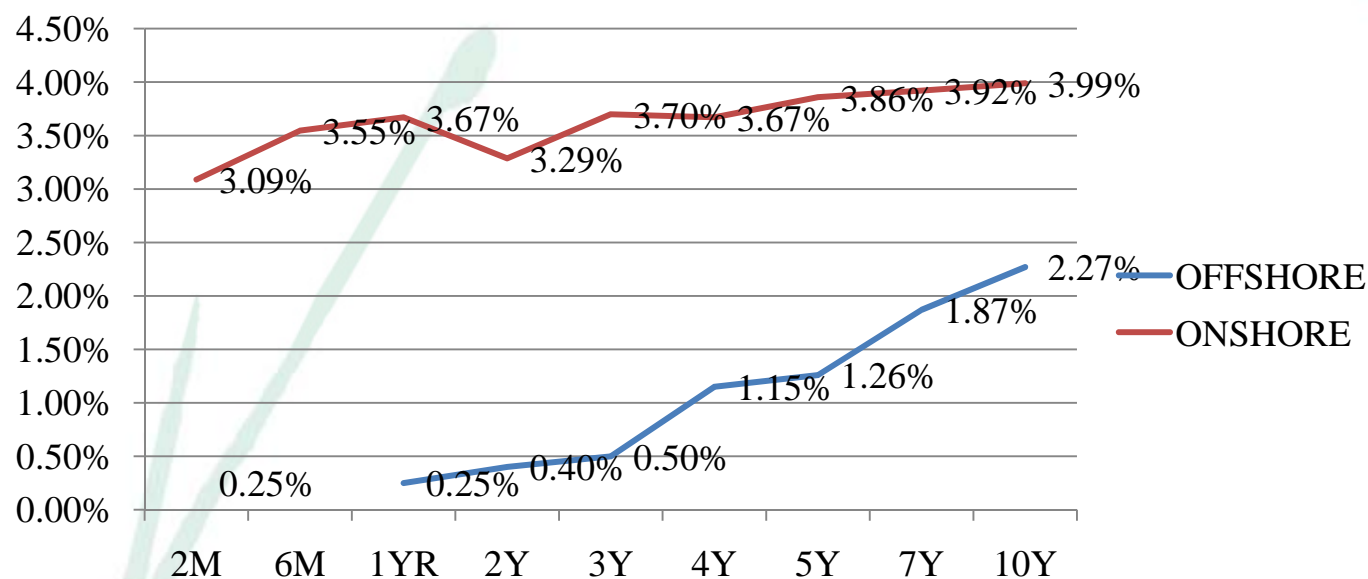




## ( III ) Offshore RMB funds investment channels

### 2. Investing in Dim Sum Bond Market— Yield Analysis

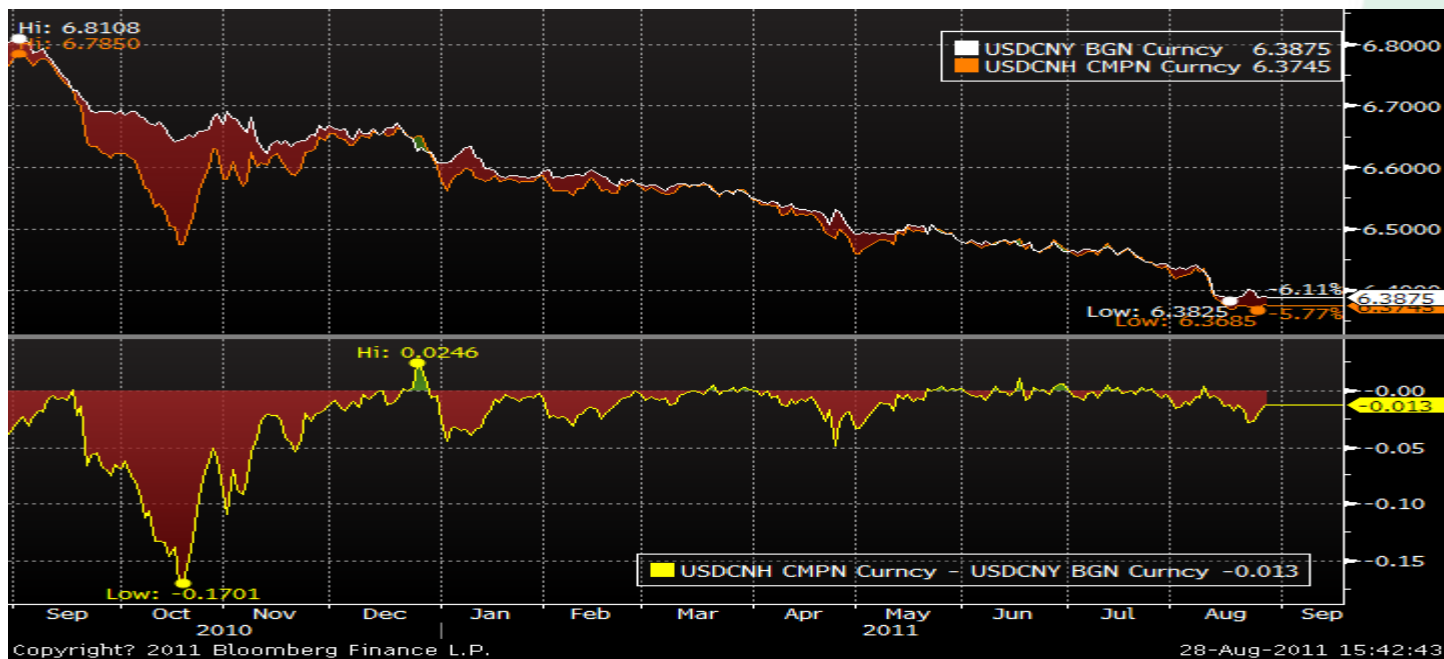
Since offshore deposit amount is far larger than investment products, yield of Dim Sum Bond is much lower than the domestic interbank bond market. (Data source: Daily report on China bond website on Aug 26th, and market price provided by foreign banks). The following chart demonstrates different yield of Chinese government bond on and off shore.



## ( IV ) FX Spot and Forward Market

USD/CNH spot trading debut in Hong Kong on Aug 23rd, 2010. which is different from onshore CNY spot trading and NDF.

USD/CNH spot has premium compared with onshore spot CNY. The following chart shows us the on and off shore spot rate and spread.

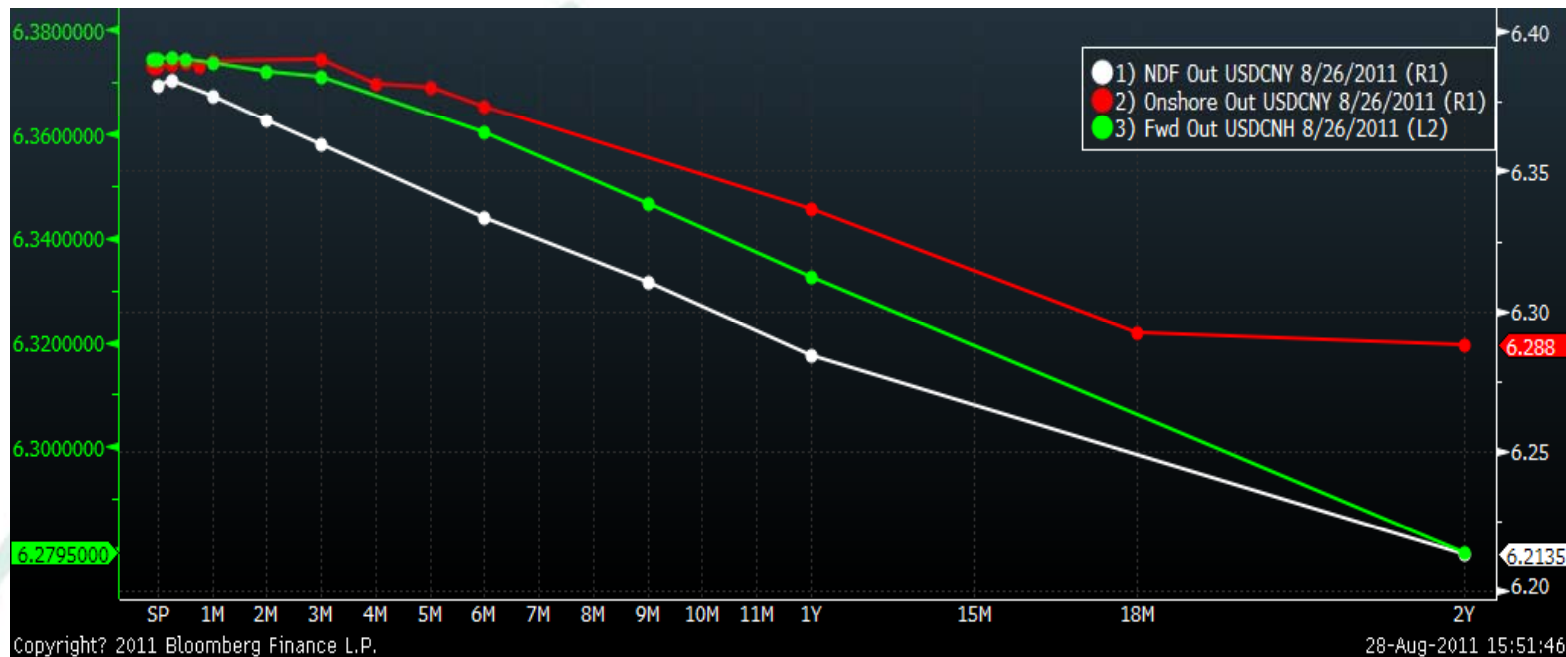


## ( IV ) FX Spot and Forward Market

Major difference between CNH and NDF

1. CNH spot trades real-time thus doesn't need an onshore fixing reference, different from CNY NDF, which takes a spot fixing from the onshore CNY market at 11am Beijing time;
2. CNH is deliverable in Hong Kong, while NDF is non-deliverable.

The following chart shows the CNH FORWARD , ON-SHORE CNY FORWARD and NDF FORWARD CURVE.



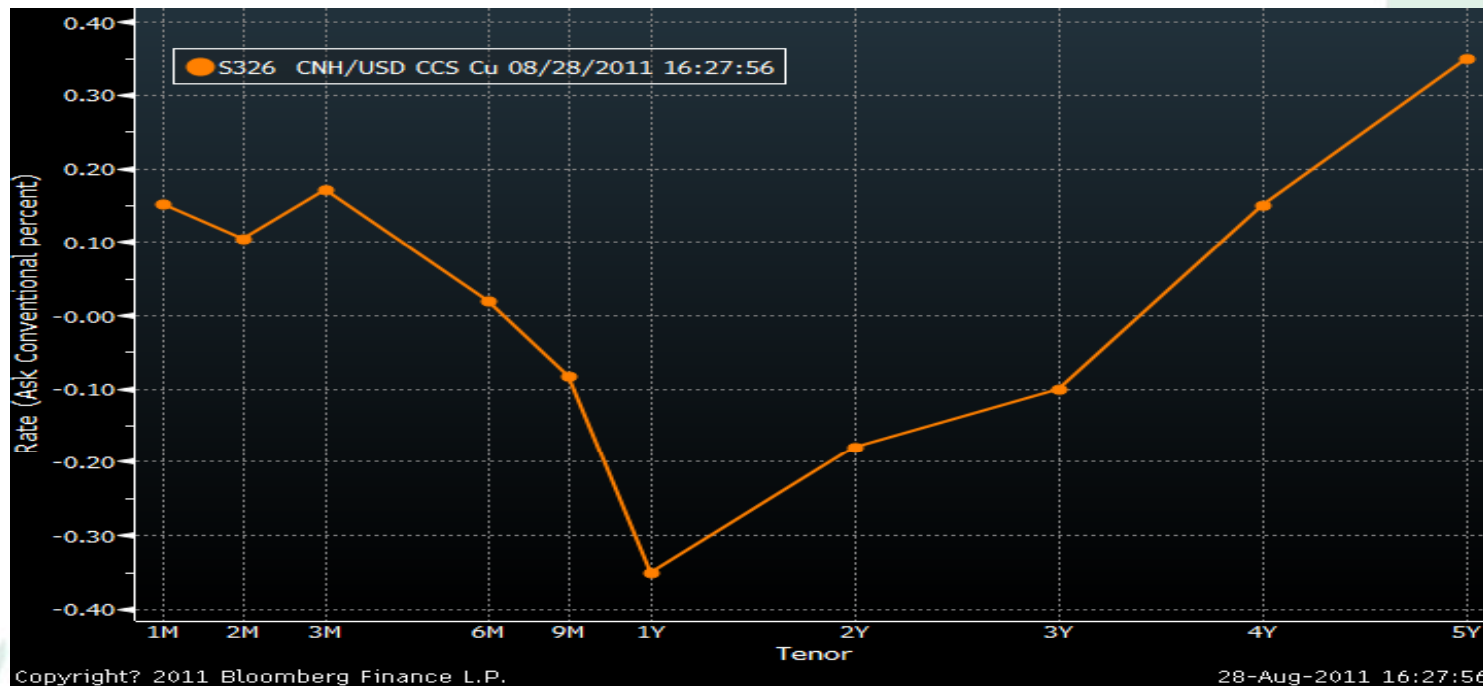
## ( V ) Interest Rate Swap Market

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Investors who buy fixed rate dim sum bond, have a need to swap the fixed rate to floating rate, thus emerged offshore CNH IRS market, taking on shore 3m SHIBOR as a benchmark.

## ( VI ) Cross Currency Swap

The CNH/USD CCS curve is inverted because of the market expectation for CNY appreciation. Investors of CNH bonds can swap the CNH to USD to get the yield pickup. While most of the investors prefer to maintain their CNH exposure to enjoy further appreciation.



### III. Future Development of CNH Market

## Future Development of CNH Market

Vice Premier Li Keqiang arrived in Hong Kong on Aug 16<sup>th</sup>, and announced the policies in a keynote speech he delivered at the economic forum during the day. And these measures cement Hong Kong's status as international financial center, and to support Hong Kong in developing itself into an offshore RMB center, including:

- a. Extend Cross-border trade settlements in renminbi to the whole country
- b. Pilot projects for foreign banks to replenish capital with renminbi will be launched
- c. Support will be given to Hong Kong enterprises to make direct investment in the mainland in renminbi.
- d. A quota of 20 billion yuan for qualified Hong Kong investors to buy yuan-denominated securities;
- e. Expand the sale of yuan-denominated bonds in Hong Kong and allow more mainland firms to issue debt in Hong Kong.
- f. Gradually increase the issuance amount of central government bond in Hong Kong.



## Future Development of CNH Market

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The isolation of the on and off shore markets creates the difference between the spot, forward and swap rates and bond yields. The offshore market is still in a developing progress, there is large room for the liquidity and market depth to improve.

And the measures announced by Vice Premier Li Keqiang also give us direction of the development of offshore CNH market in Hong Kong:

1. Improve the liquidity and market depth of offshore CNH market;
2. Open the channel for offshore CNH to go back to onshore, such as RQFII etc.



## IV. Bank of China's Participation in CNH Market

## Bank of China's Participation in CNH Market

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- ▶ Bank of China (Hong Kong) Limited (BOCHK) is the sole clearing bank in Hong Kong;
- ▶ BOCHK conducted the first RMB outward and inward remittance under cross-border trade settlement, and also the first trade finance;
- ▶ BOCHK did the first RMB business under cross currency agreement;
- ▶ BOCHK is the first bank to launch CNY HIBOR, which is a benchmark interest rate in trade finance and loan services we provide;
- ▶ BOCHK is the first bank to launch CNH spot and CNH DF and is the largest market-maker, i.e. we made one third of the CNH spot trading;
- ▶ BOC group takes the leading position in the RMB insurance market: BOC group accounts for 60% of the number of insurance; and accounts for 71% of the insurance amount.

## Bank of China's Participation in CNH Market

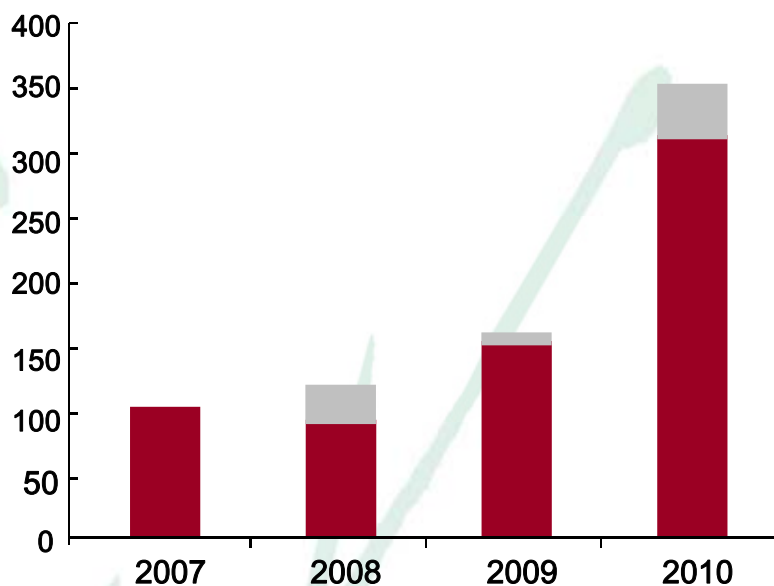
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- BOCHK is in a leading position in CNH bond market in Hong Kong as the originator of offshore RMB business.
- From the year of 2007 to the end of 2010, as primary lead and bookrunner, BOCHK arranged issuance of 21 yuan-denominated bond, with a total issuance amount of about CNY65 billion. And BOCHK first launched offshore CNY bond index.
- BOCHK is the lead and book-runner of first Dim Sum bond issued by enterprise and super national institution.
- BOCHK performs multi-function in a debt issuance, such as lead, bookrunner, market-maker and finance agent.

## IV. Bank of China's Participation in CNH Market

### Most Important Participant in Dim Sum Bond

人民币 (百万) ■ 中银香港安排发行 ■ 其它



### Mile Stone :

- First Dim Sum Bond (CDB in 2007)
- First Chinese Government Bond (Ministry of Finance, 2009)
- First Corporate Dim Sum Bond (2010年, 合和)
- First Supernational Bond (ADB, 2010)
- First publicly listed Dim Sum (ADB, 2010)
- First to use bond auction platform in CMU( Ministry of Finance, 2010)
- First dim sum bond issued by european institution ( L-BANK, 2011 )
- Dim sum bond issued by the largest multi-national corporation (Volkswagen, 2011)

## Bank of China's Participation in CNH Market

Bank of China actively participates in CNH market, including CD issuance and investment in Dim Sum bond.

1. Bank of China issued Dim Sum Bond with the amount of RMB3 billion, RMB 3 billion and RMB5 billion in the year of 2007/2008/2010 respectively, and the bid/cover ratio reached 2.78, 5.16, 5.4。
2. Bank of China Hong Kong Branch added CNH into the issuance currencies in the original CD Program, and launched CNH CD on May 18th, 2011. As of Aug 26th, total issuance amount reached RMB17 billion with a lowest funding cost among the big-four commercial bank.
3. Bank of China Hong Kong Branch and BOCHK invest in dim sum bonds, most of which are Ministry of Finance of Chinese government, policy banks and supernationals.
4. BOC Hong Kong Branch is ready for CNH FX swap and Cross Currency Swap and will be more involved in CNH market.



***Thank you!***

