Offshore Renminbi – Staying anchored

- Our gauge of Renminbi internationalisation dipped in February due to weak cross-border payments
- Post-NPC policy continuity and rising foreign access to onshore markets remain bright spots
- We see full-blown trade war as only a tail risk, and a drastic weakening of the CNY as a last resort

All signs point to a preference for CNY stability

The international trade waters are getting choppy, as China has responded with tariffs of “similar scale and intensity” to the US’ Section 301 remedies. Other policy signals, however, point to more Chinese yuan (CNY) stability; this will likely keep CNY sentiment anchored and offshore CNY (CNH) activity supported, as long as a full-blown trade war remains a tail risk. The Standard Chartered Renminbi Globalisation Index (RGI) – our propriety measure of Renminbi internationalisation – fell to 1,767 from a revised 1,821 in January (Figure 1). The dip was primarily due to weaker cross-border payments during the Lunar New Year. On the other hand, foreign holdings of onshore assets were the biggest positive RGI contributor. We see more such inflows in the coming years, as Beijing favours more inbound channels to offset structural capital outflows, but also the inclusion of China bonds in global benchmarks, the latest being the Bloomberg Barclays Global Aggregate Index.

The National People’s Congress (NPC) meetings concluded with little shake-up in policy priorities. In particular, the appointment of Yi Gang as the new governor of the People’s Bank of China (PBoC) was a strong sign of continuity. Not only is Yi a veteran who has worked at the PBoC since 1997, he has previously said that a ‘clean float’ is China’s long-term exchange-rate policy objective, although the transition must be incremental and prudent (see Economic Alert, 19 March 2018, China – Yi’s appointment signals continuity, and more). Yi is also supportive of an orderly two-way opening of the capital market, which should help reinvigorate Renminbi internationalisation. Despite news of China studying currency depreciation as a trade negotiation tool, we believe a drastic weakening of the CNY will only be used as a last resort; we expect the CNY to stay stable on a basket basis.

Figure 1: RGI dipped in February, but remains higher than at end-2017

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

If you are in scope for MiFID II and want to opt out of our Research services, please contact us.
RGI drivers showing a mixed picture

More headwinds ahead for Renminbi trade settlement

Cross-border payments continued to underperform as an RGI driver

Cross-border payments subtracted 2.4ppt, the largest in eight months, from the headline RGI's 3.0% m/m drop in February (Figure 2). Much of this was due to slower activity around the Lunar New Year, mirroring weak Renminbi trade settlement volume over this period; we expect both to have rebounded in March. However, the absence of a recovery in Renminbi-denominated goods trade as a percentage of total China trade (11.1% in February versus 11.4% in Q4-2017) remains a concern; the combination of an improved CNY outlook and recovering global demand has yet to boost Renminbi usage among corporate users (Figure 3).

Foreign holdings of onshore assets keep rising

Foreign investors continued to hold more onshore assets, contributing positively to headline RGI growth for a 12th straight month in February. Beijing has been leaning heavily on the opening of northbound capital channels – especially via the China Interbank Bond Market (CIBM) programme and more recently the Bond Connect scheme – to boost inflows to counter outflow pressure. The RGI’s ability to capture this form of Renminbi internationalisation has been a key reason for the index bottoming out since mid-2017. The timelier bond holdings data shows such strong momentum having been carried over to March (Figure 4).

One major driver of northbound flows in the coming years will be the inclusion of onshore securities in global benchmarks. As such, the recent announcement that Renminbi-denominated government and policy bank bonds will be added to the Bloomberg Barclays Global Aggregate Index was encouraging. Subject to China addressing some outstanding operational and tax issues, inclusion will start in April 2019 and reach full weighting (c.5.5%) by November 2020.

Figure 2: February was the fifth m/m drop in six months

Contribution of RGI components to % m/m change

Figure 3: Renminbi invoicing struggling to rebound

Renminbi trade settlement (goods only)
CNY outlook amid choppy trade waters

As the dust settles in the aftermath of the NPC, we take a step back to assess our view on the CNY. We still expect the CNY basket to continue to be held in a range between 95 and 97 while broadly tracking the USD. Holding the CNY basket within this range allows for mild CNY appreciation against a basket, so that authorities can push back against comments that they are weakening the CNY. At the same time, the small appreciation achieves the dual goals of keeping CNY expectations steady (compared to being one sided) while lowering the impact on China’s trade competitiveness. China does not want to see one-sided expectations, so as to avoid having to deal with hot money inflows or capital outflows.

Despite rising US-China trade friction, we believe that a full blown trade war remains a tail risk. And as long as a trade war does not materialise, Beijing is likely to maintain its focus on its goal of keeping the CNY basket steady within a narrow range. So far, the CNY basket has even strengthened in the past few weeks, which goes against the view that the authorities will weaken the currency amid rising trade friction. In our view, a drastic weakening of the CNY will only be used as a last resort, and even then its benefits are unclear. A weaker CNY risks China’s capital picture returning to outflows after having just stabilised; this is something the authorities likely do not want.

The appointment of Yi Gang as the new governor of the PBoC is supportive of our stable CNY basket view. Yi is seen as a continuity candidate for the PBoC at a time when it will assume additional responsibilities for financial reform. While the PBoC Party Secretary role was given to Guo Shuqing, both are seen as proponents of market-oriented reform, along with Liu He, vice-premier in charge of economic and financial policy. We expect Yi to have an important role in the execution of monetary policy, and informing and influencing policy making, given his history of working closely with both men. Yi has previously stated that he sees a ‘clean float’ as the long-term objective of exchange rate reform, as a flexible exchange rate can absorb external shocks. Ahead of a possible clean float, we expect the authorities would want to maintain balanced expectations on the CNY, and hence a stable CNY basket.

Figure 4: Rising foreign holdings of onshore bonds

CCDC and SHC settled bonds, CNY bn

Source: Wind Info, Standard Chartered Research

Figure 5: The CNY has been much steadier in basket terms (USD bn)

Source: CEIC, Standard Chartered Research