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Offshore Renminbi – Resilience tested, again

- **May RGI rebounded after a disappointing April, but further headwinds remain on the horizon**
- **Cross-border payments made a strong comeback, while northbound investment stayed strong**
- **Dim Sum bonds look to perform well in the near term; CNY has shown signs of stabilisation of late**

Reasons to remain optimistic

The *Standard Chartered Renminbi Globalisation Index* (RGI) – our proprietary measure of Renminbi internationalisation – rose to 1,750 in May from a revised 1,711 in April (Figure 1). This is a welcome rebound after breaching the 2017 trough of 1,730 in April 2018. The 2.3% m/m increase is also the most since January, mainly driven by still-strong northbound investment flows, but also an impressive swing in cross-border payments, in part correcting a rather weak April. The risk, however, is that Renminbi internationalisation could face more headwinds in the coming months, as US-China trade tensions escalate and the Chinese yuan (CNY) stays under pressure for longer. We do not see a change in Beijing's strong policy backing, but any increased trade and CNY volatility could keep genuine users on the sidelines.

Since mid-June, the CNY has depreciated by c.3% both against the USD and the currency basket. Against this challenging backdrop, the offshore CNY (CNH) market showcased its much-improved resilience. For one, there was a notable absence of tightening CNH liquidity, despite the approaching half-year-end and the CNY selling off. Moreover, market expectations appear well anchored, with the 1Y NDF pricing in only c.1% depreciation from current levels. Timely comments from People's Bank of China (PBoC) officials have also proven effective in helping USD-CNY stay below 6.70. Finally, the Dim Sum bond market stayed supported despite CNY weakness in recent weeks. The market posted a total return gain of 0.4% in June, bringing the YTD total return to 2.6%. While supply looks likely to stay weak in the foreseeable future (which does not bode well for the RGI), we see Dim Sum bonds performing well in the near future.

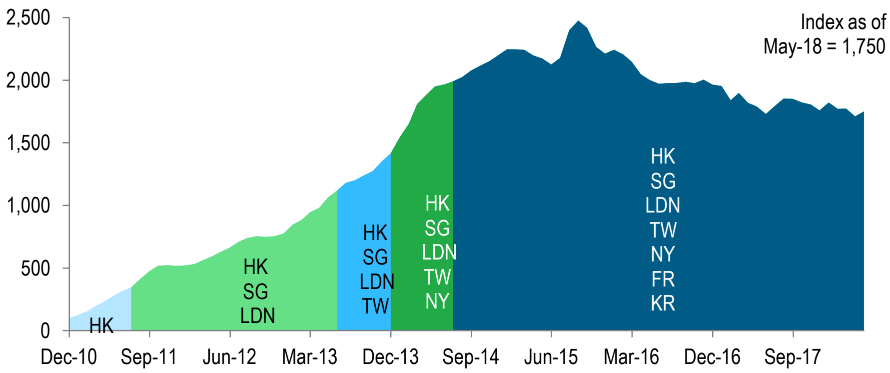
Kelvin Lau
+852 3983 8565
Kelvin.KH.Lau@sc.com
Senior Economist, Greater China
Standard Chartered Bank (HK) Limited

Becky Liu
+852 3983 8563
Becky.Liu@sc.com
Head, China Macro Strategy
Standard Chartered Bank (HK) Limited

Eddie Cheung
+852 3983 8566
Eddie.Cheung@sc.com
Asia FX Strategist
Standard Chartered Bank (HK) Limited

Chidu Narayanan
+65 6596 7004
Chidambarathanu.Narayanan@sc.com
Economist, Asia
Standard Chartered Bank, Singapore Branch

Figure 1: RGI rebounded 2.3% m/m in May, the most in four months



Note: RGI (Bloomberg: SCGRRGI <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

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RGI breakdown

More headwinds ahead for Renminbi trade settlement

Cross-border payments making a comeback

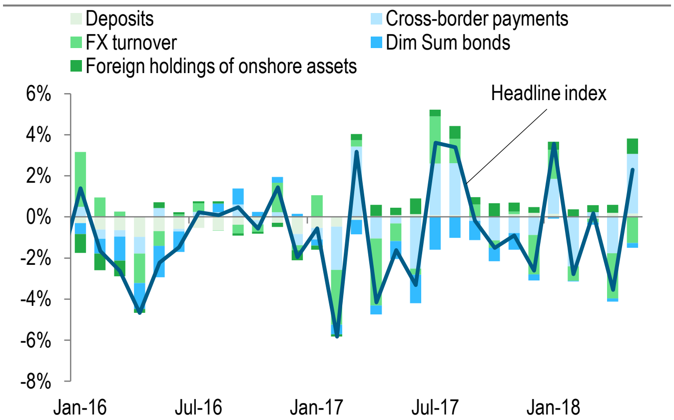
The 2.3% m/m increase in our RGI in June was the fastest in four months, driven mainly by the 2.9ppt contribution from cross-border payments, the most from the component in 14 months (Figure 2). That said, we remain cautious on calling for a sustained revival, because much of the payment outlook still hinges on Renminbi-denominated trade settlement. US-China trade tensions could weigh on volume in the coming months at least, and the sell-off in the CNY since mid-June could keep genuine corporate users on the sidelines for longer. Official data showed that 11.9% of China's total goods trade was settled in Renminbi in May, a slight improvement from April's 11.5%, matching Q1's 11.8% average (Figure 3).

Northbound investment stayed strong

Total foreign holding of China interbank bonds reached CNY 1,546bn at end-June. The CNY 110bn increase from May was the largest increase on record (Figure 4). Stock Connect flows showed a similarly resilient northbound bias, despite weak onshore market sentiment. All this bodes well for "foreign holdings of onshore assets" to remain the most reliable RGI driver in the foreseeable future.

Figure 2: Cross-border payments led the May rebound

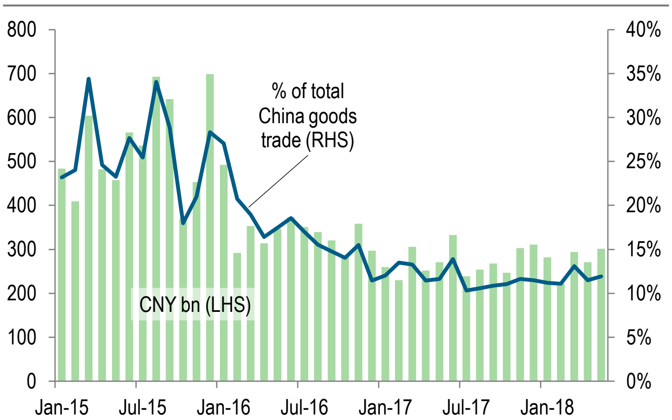
Contributions of RGI components to % m/m change



Source: Wind Info, Standard Chartered Research

Figure 3: Renminbi invoicing struggles to rebound

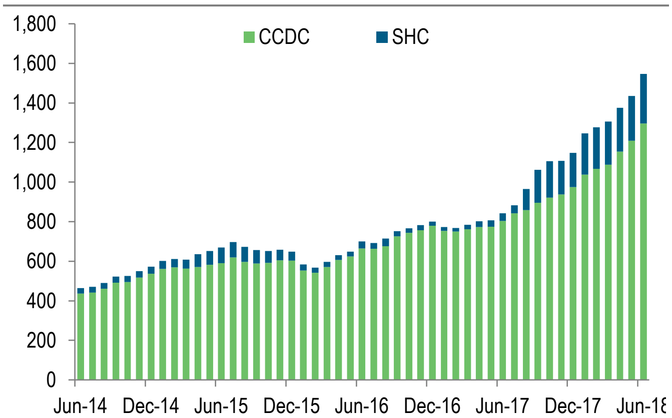
China's Renminbi-denominated goods trade



Source: CEIC, Standard Chartered Research

Figure 4: Foreign holdings of onshore bonds

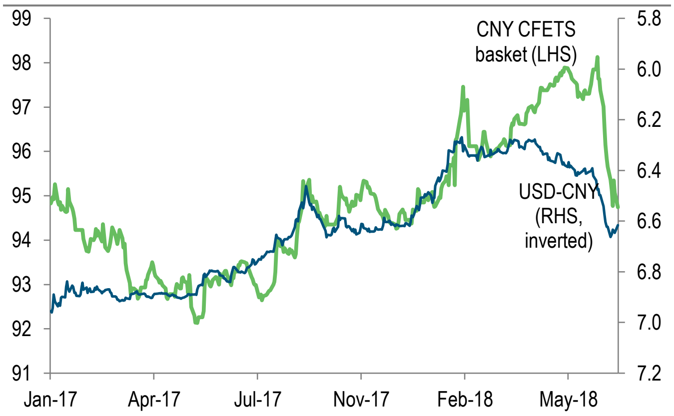
CCDC and SHC settled bonds, CNY bn



Source: CEIC, Standard Chartered Research

Figure 5: Steadying after steep drop

USD-CNY and CNY CFETS basket index



Source: Bloomberg, Standard Chartered Research

Dim Sum bonds to stay underpinned

Despite weaker FX outlook, we see Dim Sum bonds staying supported

The Dim Sum bond market stayed well underpinned despite CNY weakness in recent weeks. The market posted a total return gain of 0.4% in June, bringing the YTD total return to 2.6%. We see further modest downside for Dim Sum bond yields in the coming month on accommodative liquidity conditions and light supply, in particular for offshore government bonds (CNH CGBs) and investment-grade Dim Sum bonds. High-yield bonds, on the other hand, may stay under pressure given the sharp sell-off in their USD-denominated peers.

Supply has been light and is likely to remain so in the foreseeable future. Gross issuance of CNH CGB, according to an announcement by the Ministry of Finance (MoF), was only CNY 10bn in 2018, with CNY 5bn already issued this month and the remaining half to be issued later this year. This suggests that net issuance will fall deeper into negative territory, around -CNY 13.5bn in 2018, worsening from -CNY 6.5bn in 2017. Moreover, issuance of certificates of deposits (CDs) is also likely to decline on very accommodative liquidity conditions in onshore and offshore markets.

As such, we see more room for Dim Sum bonds to perform well in the near future, especially for the belly-to-long end of the CNH CGB curve, given the scarcity of supply and continuing easing expectations. We see the PBoC keeping onshore liquidity conditions accommodative following a change in policy stance in the latest monetary policy committee statement, which mentioned plans to maintain “reasonably accommodative” liquidity conditions. The chances of a repeat of CNH liquidity stress to counter FX weakness are very low at this stage, in our view, given the strong incentive to push forward Renminbi internationalisation.

CNY outlook

CNY is responding to verbal support from the PBoC

Heading into the implementation of tariffs between the US and China, the CNY has seen a very strong slide against the USD. Since mid-June, the CNY has depreciated by 3% against the USD, at one point trading above 6.70. The CNY basket, as measured by the daily fixings, has slid by the same amount.

We believe that the bulk of the CNY decline is done for now. First, comments by the PBoC have slowed the climb in USD-CNY. USD-CNY has steadied around 6.63 following a series of comments from PBoC officials assuring markets that they would maintain Renminbi stability and are not using its weakness as a trade-war tool. Second, the DXY has seen a turnaround since peaking at the end of June, which is helping to provide some support for emerging markets. Third and finally, the CNY basket appears to have steadied around 95.00, very near its end-2017 levels. We believe that authorities will be wary of allowing it to drop to far below its end-2017 level to avoid driving renewed CNY depreciation fears.

For now, market expectations appear to be well anchored. The 1Y NDF is pricing in about 1% depreciation from current levels, close to the lows for 2018. However, we caution against thinking that 6.70 may be a ‘line in the sand’ for USD-CNY. Divergent monetary policy between the Fed and the PBoC is likely to continue to weigh on USD-CNY. While we expect the Fed to hike interest rates, the PBoC signalled marginal easing in its Q2 monetary policy committee statement. Therefore, USD-CNY could climb anew if USD strength or fears over a trade war return.

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Document approved by
Shuang Ding
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