Offshore Renminbi – Under the trade-war cloud

- **RGI was down 0.4% m/m in April; beware of further headwinds as US-China trade tensions continue**
- **Northbound flows into onshore equities and bonds still look strong based on timelier May data**
- **PBoC issues CNH bills to stabilise FX, draining CNH liquidity; net Dim Sum issuance stays weak**

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Looking for the bright spots

The *Standard Chartered Renminbi Globalisation Index* (RGI) – our proprietary measure of international Renminbi usage – continues its up-and-down trend YTD, falling to 1,932 in April after a brief rebound to 1,940 in March (Figure 1). The 0.4% m/m drop was primarily driven by weaker cross-border Renminbi payments, dragging headline growth down 0.9ppt, the most since November 2018. The good news is that much of this was seasonal – cross-border payments have fallen m/m every April since 2015, and this year's drop was largely in line with prior years' average. The risk, however, is that offshore Renminbi (CNH) usage could start suffering soon, as US-China trade friction flared up again in May with no sign of resolution on the horizon. Headwinds from renewed risk aversion and higher Chinese yuan (CNY) volatility are best demonstrated by the almost 5% drop in the RGI in Q4-2018.

So far, USD-CNY has managed to hold below 7.0, in part anchored by strong verbal support from officials, but also an exceptionally steady daily fixing; all this suggests no panic in the market, matching our call that the likelihood of breaching 7.0 in the near future seems low. Moreover, latest data on cross-border portfolio investment suggests manageable outflow pressure for now, strengthening the view that 'foreign holdings of onshore assets' look to remain among the more resilient RGI components. Dim Sum bonds, on the other hand, should remain a drag, as net issuance stays negative despite offshore bill issuance by the People's Bank of China (PBoC). More bill issuance is likely if CNY depreciation pressure persists, in our view, as the resulting tighter CNH liquidity helps lend FX support.

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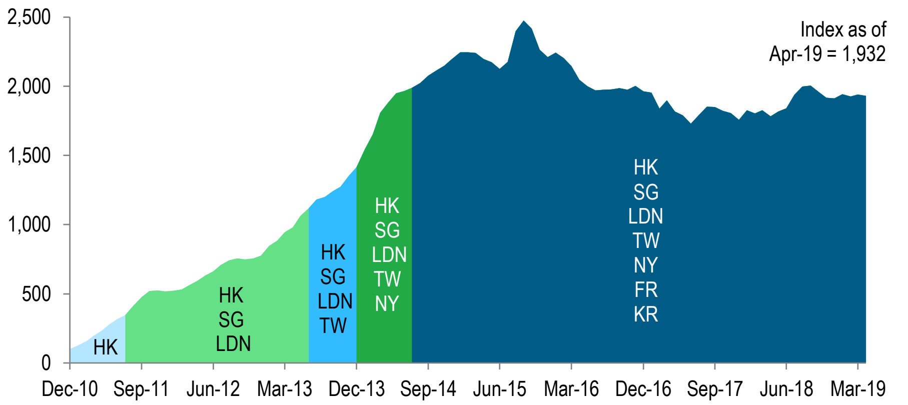
Figure 1: RGI struggles to rebound amid uncertain trade outlook



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://research.sc.com/research/api/application/static/chart-packs/RGI*; Source: Standard Chartered Research

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A closer look at the RGI drivers

Deterioration could cause more than a seasonal drop in cross-border payments

Cross-border payments continue to be the most volatile RGI component YTD, deducting 0.9ppt from the -0.4% m/m headline growth in April and almost erasing March's impressive gains of +1.1ppt (Figure 2). This matched China's disappointing export performance in April (-2.7% y/y). We note that until 2019, cross-border payments had been a negative contributor in April for four straight years, by an average of -5.2ppt, making the latest disappointment more of a seasonal issue. With US-China trade tensions escalating again since the start of May, we think cross-border payments could continue to weigh on the RGI for months to come. China maintained a solid 13.9% share of total goods trade settled in CNY in April (versus a 13.7% average in Q1); however, this can only help so much if the overall trade pie struggles to grow.

In contrast, CNH FX turnover (+0.4ppt) and foreign holdings of onshore assets (+0.3ppt) were the two bright spots. The former stems from renewed CNY weakness towards end-April that spilled over to May before stabilising; the lift from northbound portfolio flows, however, seems more sustainable. Foreign investor inflows to China onshore bonds recovered strongly in May (a CNY 109bn increase from April) following a total of CNY 40bn inflows in the first four months of 2019, based on data from China Central Depository and Clearing (CCDC) and Shanghai Clearing (SHC), as shown in Figure 3. Inclusion of China bonds in the Bloomberg-Barclays Global Aggregate Index on 1 April looks to have helped.

Even Stock Connect flows are beginning to turn the corner, returning to modest net northbound territory in early June following strong southbound pressure for much of April and May, when onshore equities corrected on external trade concerns.

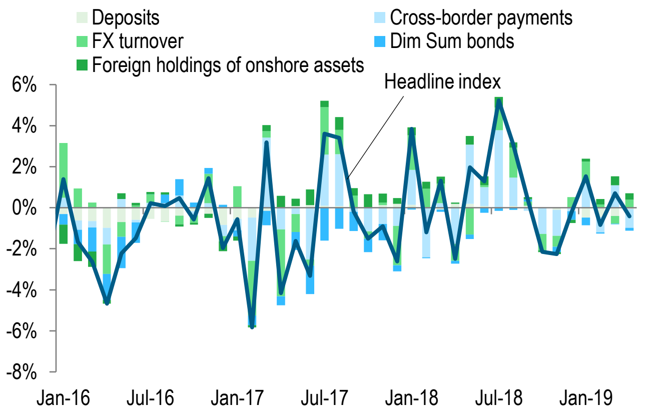
We are *Neutral* on the Dim Sum bond market

More volatile CNH liquidity conditions are likely

We lowered our outlook on the Dim Sum bond market (including CNH CGBs) in early May to *Neutral* from *Positive* following the tariff hike announcement, as we expect CNH liquidity conditions to turn more volatile (see *China – How to trade a potential stall in negotiations*). However, supply-demand technicals remain supportive of Dim Sum bonds.

Figure 2: Wrapping up a good Q1-2019

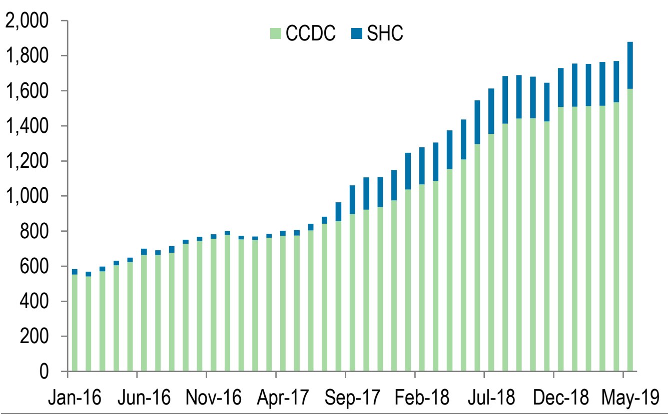
Contributions of RGI components to % m/m change



Source: Standard Chartered Research

Figure 3: Reacceleration in northbound bond flows in May

Foreign holdings of onshore bonds, CCDC and SHC (CNY bn)



Source: Bloomberg, Standard Chartered Research

More PBoC bill issuance likely to stabilise FX via liquidity tightening

Shortly after the third round of offshore PBoC bill issuance on 15 May, the PBoC on 21 May announced another round "near term". On 11 June, the PBoC said the issuance is scheduled for late-June. Although the PBoC did not announce an exact date, the timing of the bill issuance will likely be around the G20 meeting (on 28-29 June). This will be the first time that new bills are issued a significant time before the existing notes mature (the timing of the previous two issues coincided with when the previously issued 3M bills matured). The size has also not been announced, leaving it flexibility to increase the size if the meeting outcome is worse than expected.

More bill issuance is likely if CNY depreciation pressure persists, as this is one of the easiest ways for the PBoC to defend the CNY at a relatively low cost. CNH liquidity conditions will therefore be tightened and the ultra-loose situation earlier this year is unlikely to be repeated, although T/N (tomorrow-next) stays negative (partly due to Stock Connect outflows from A-share markets) in the foreseeable future. However, we do not expect extreme CNH liquidity conditions to re-emerge.

Supply-demand technicals continue to favour Dim Sum bonds

Dim Sum bond market (including CDs) net issuance YTD remains negative at -CNY 8bn, despite CNY 20bn net issuance of PBoC bills, and will likely remain so in the foreseeable future. Corporate issuance is low, with only three deals YTD, far fewer than the 11 over the same period in 2018. Dim Sum bond redemptions (ex-CDs) will stay relatively heavy, at CNY 12bn on average per month in H2, leading to strong reinvestment demand.

Strong pipeline from Panda bond sovereign issuers

YTD Panda issuance is down 54% from the same period in 2018

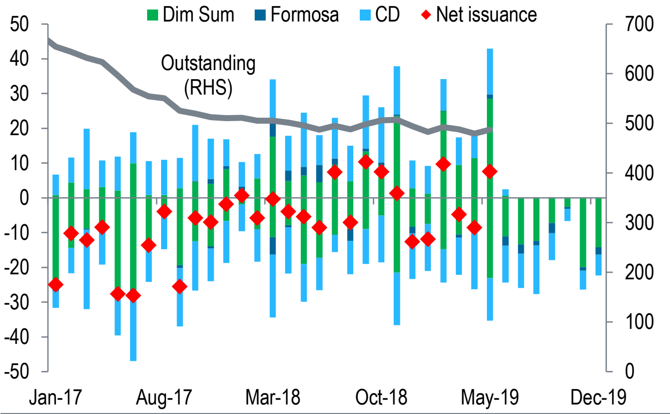
Similar to Dim Sum bonds, the Panda bond market also started the year slowly. Gross issuance is only CNY 23bn YTD, down 54% from CNY 50bn over the same period in 2018. This brings outstanding Panda bonds to CNY 275bn as of 6 June 2019, from CNY 267bn at end-2018.

Euro-area countries have started to tap the Panda bond market

However, sovereign issuance is rising. Portugal became the first Panda bond issuer from the euro area, issuing a CNY 2bn 3Y note at 4.09% on 30 May. The Republic of the Philippines issued its second Panda bond, a CNY 2.5bn 3Y note at 3.58%, on 15 May. Both issues met solid demand, with bid-to-cover ratios of 3.17x and 4.57x, respectively. The upcoming pipeline is also strong, with two other EU sovereigns – Italy and Austria – showing interest. Seven sovereign issuers have tapped the Panda bond market, printing 10 different notes totalling CNY 20.96bn since the Republic of Korea debut in December 2015.

Figure 4: YTD Dim Sum net issuance stays negative

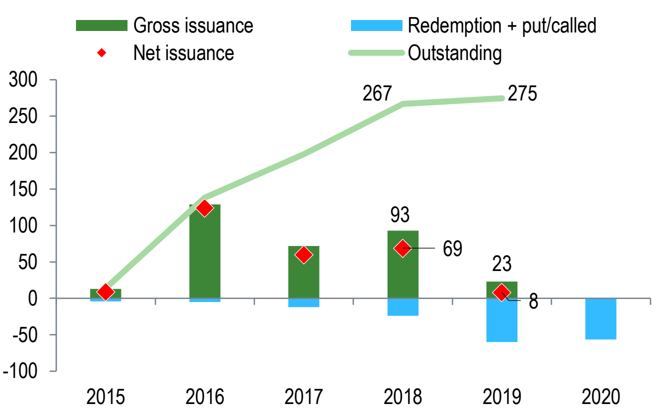
Outstanding amounts, issuance and redemption (CNY bn)



Source: Bloomberg, Standard Chartered Research

Figure 5: YTD Panda bond issuance 54% slower

Outstanding amounts, issuance and redemption (CNY bn)



*As of 6 June 2019; Source: Bloomberg, Standard Chartered Research

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