

Offshore Renminbi – Riding the tailwinds

- Our Renminbi internationalisation tracker rose in July-October; all five components contributed
- Northbound portfolio flows stayed strong; China’s monetary policy normalisation helped Dim Sum bonds
- Stronger CNY outlook helps, but is not a condition for boosting genuine Renminbi usage offshore

Stronger CNY to keep offering support in H1-2021

The *Standard Chartered Renminbi Globalisation Index (RGI)*, our proprietary measure of international Renminbi usage, climbed for a fourth straight month in October. During this period, the RGI rose a cumulative 4.2% (to 2,224 from 2,134 in June), resuming its uptrend and exceeding the 3.9% increase for the entire preceding year (July 2019-June 2020). All five RGI sub-indices contributed positively to the headline improvement. ‘Dim Sum bonds and certificates of deposit (CDs) outstanding’ and ‘foreign holdings of onshore assets’ have been particularly strong drivers lately, accounting for an average c.70% of the m/m RGI increases in the four months through October.

China’s normalising onshore monetary conditions (from an accommodative stance earlier this year to support the post-COVID recovery) have spurred greater interest in Dim Sum bond issuance. The market is also supported by limited supply, improving offshore Renminbi (CNH) liquidity conditions, and a strong Chinese yuan (CNY) outlook. Expectations of currency appreciation have also boosted capital inflows to China’s bond and equity markets, which have been the most reliable driver of Renminbi internationalisation in recent years amid the increasing ease of onshore market access, allowing foreign central banks and investors to better diversify into China.

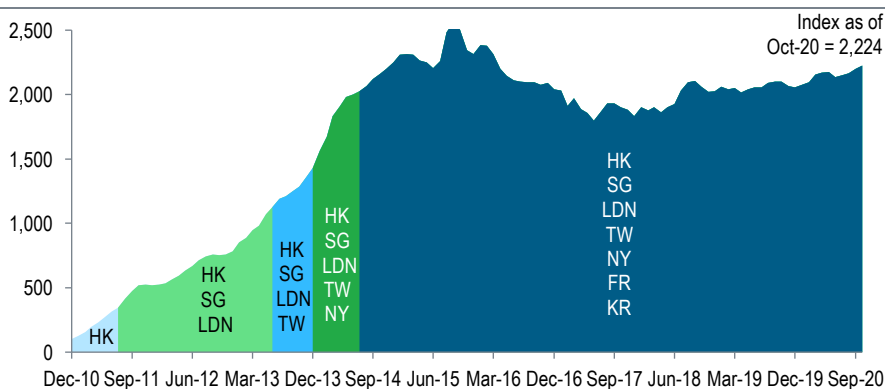
We forecast USD-CNY at 6.30 at end-H1-2021 on strong fundamentals (including favourable growth and interest rate differentials) and lower event risk premia following Biden’s election win. We believe a stronger CNY is a welcome tailwind but not a pre-requisite for Renminbi internationalisation to make a comeback. More important, in our view, is that China continue to improve the transparency of its FX regime while boosting genuine demand for Renminbi usage via policy support. Our RGI should help to track the Renminbi’s renewed global ascent in the coming years.

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Figure 1: Our RGI confirms renewed Renminbi internationalisation momentum



Source: Standard Chartered Research

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Broad-based improvement across RGI components

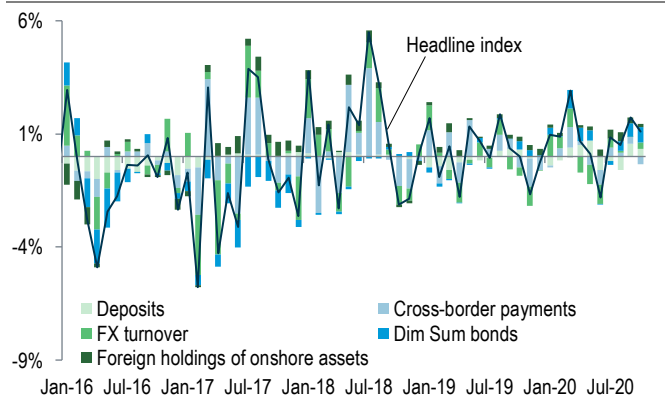
All five RGI components have improved in H2-2020 so far

The RGI resumed its year-long uptrend in July after a brief dip to 2,134 in June; from there, it continued to rise to 2,224 in October, the highest since March 2016. Sequential growth has also accelerated, from 0.8% m/m in July and 0.5% in August, to 1.7% in September and 1.1% in October. All five of our RGI components were net positive contributors to the headline index between July-October (Figure 2). Below, we look at each component in greater detail.

A stronger CNY further strengthens the case for foreign investors to keep divesting into Renminbi assets

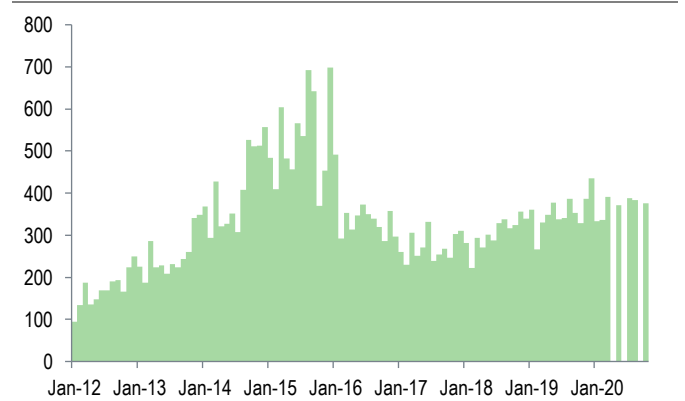
Foreign holdings of onshore assets accelerated further in Q3, rising at an average monthly pace of 37% y/y (up from 25% in Q2) to a total CNY 7.9tn across equities, bonds, loans and deposits (Figure 4). Equity and bond holdings led the way higher, rising 12% q/q and 16% q/q in Q3. More timely proxy indicators suggest a further improvement in foreign holdings in October: China Central Depository and Clearing (CCDC) data for the month showed a 49% y/y increase in bond-related foreign holdings, the fastest since December 2018 (Figures 5). All of this reflects global investors' continued interest in diversification as China continues to open up its financial markets; this has been further supported by the recent improvement in global risk sentiment (amid reduced political uncertainty following Biden's win), improving vaccine prospects, and still-accommodative major central banks thanks to low inflation.

Figure 2: Four straight months of m/m RGI increases
Contribution of RGI components to % m/m change



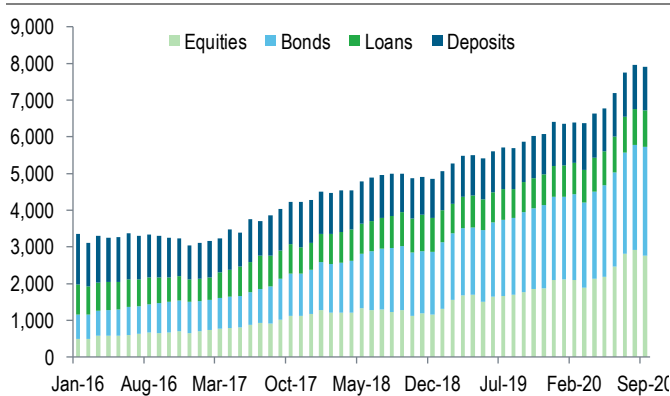
Source: Standard Chartered Research

Figure 3: Steady Renminbi invoicing post-COVID
China's Renminbi-denominated trade settlement, CNY bn



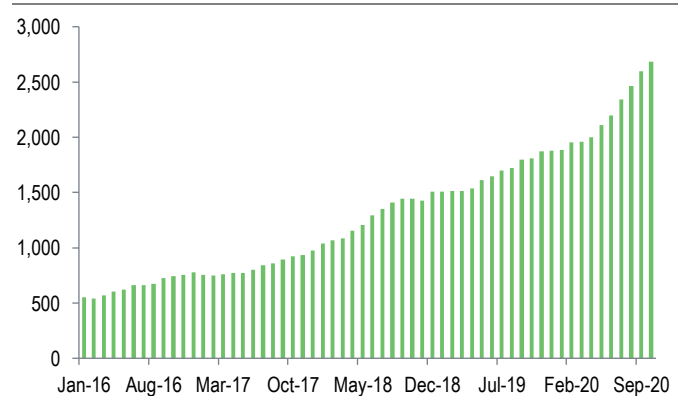
Source: CEIC, Standard Chartered Research

Figure 4: Foreign holdings of onshore assets accelerated further after breaching CNY 7bn in June (CNY bn)



Source: Bloomberg, Standard Chartered Research

Figure 5: Foreign holdings of onshore bonds kept rising in October (CCDC, CNY bn)



Source: Bloomberg, Standard Chartered Research



Strong northbound portfolio investment matched by strong southbound flows

CNH deposits in Hong Kong improved in Q3, despite strong northbound portfolio flows (which would normally be a drain on offshore liquidity). We see a number of offsetting factors replenishing the CNH deposit pool: (1) a more bullish CNY outlook, encouraging more holdings and/or conversion from deposits in other currencies; and (2) a pick-up in southbound portfolio flows as onshore investors increase their foreign asset purchases. This is consistent with the results of [our monthly capital flows tracker for China](#), which confirm persistent but modest net capital outflows, especially in recent months. This is despite a stronger CNY (or maybe *because of* a stronger CNY, as offshore assets become cheaper in CNY terms). Flows under the two Stock Connect schemes have also spent much of H2 so far in net southbound territory, despite still-strong northbound equity flows (Figure 6).

CNH FX turnover has contributed positively to the headline RGI for four straight months. This is not surprising, as FX turnover tends to increase when the market is trending directionally; USD-CNY traded all the way from above 7.0 in early July down to c.6.7 as of end-October. CNH FX turnover is likely to stay well supported, as [we see USD-CNY reaching 6.3 by end-H1-2021](#) on strong fundamentals.

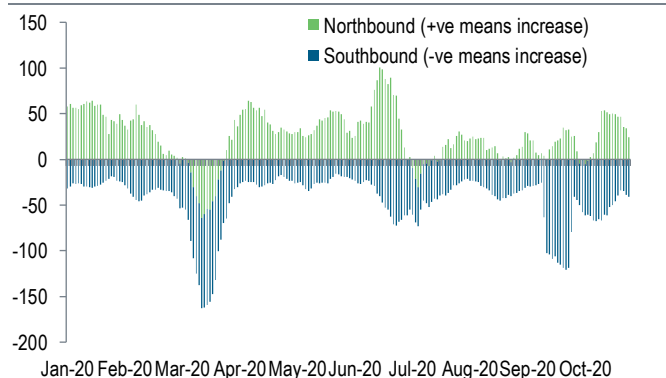
CNH liquidity is likely to loosen while onshore monetary policy normalises

Dim Sum bonds (and CDs) outstanding were the biggest RGI driver in September (+0.6ppt) and October (+0.7ppt), growing an average 14% y/y in July-October (Figure 7). We believe China's recent shift to a more neutral monetary policy stance (as the focus shifts to limiting leverage from outright monetary easing) has boosted appetite for borrowing offshore. Providing further support, offshore borrowing costs [look likely to remain lower than onshore costs for longer](#). For the first time since July 2019, the PBoC did not fully roll over maturing offshore PBoC bills in November; this appears to be an effort to stem recent rapid CNY appreciation, boosting CNH liquidity in the process.

More corporates need to get back into the game as China renews its Renminbi internationalisation push

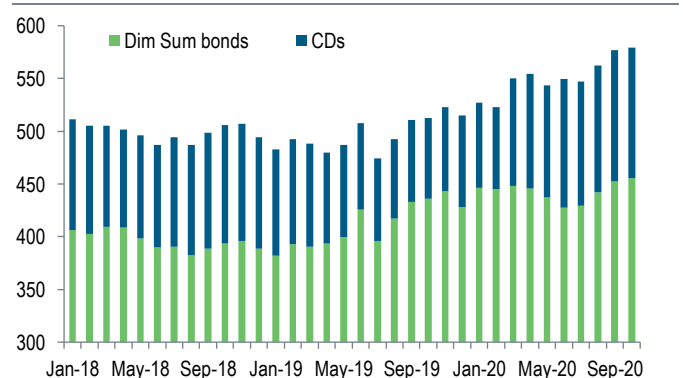
Cross-border Renminbi payments (based on SWIFT data) helped to push the RGI higher throughout Q3, before dipping in October. Another proxy that we track is official data on Renminbi-denominated trade settlement. While reporting has been intermittent recently, the data confirms steady cross-border activity both in volume terms (CNY 376bn for goods in October (see Figure 3) and percentage terms (just over 13% of China's total goods trade). [In our recent in-depth report](#), we argued that China can revive Renminbi trade settlement via increased policy support, as the re-acceleration of Renminbi internationalisation also needs to be driven by genuine corporate users. Renminbi trade settlement has plenty of lost ground to regain after its initial rise in 2010-15; this time, regional trade corridors, rather than Western multinational corporates, look likely to take the lead.

Figure 6: More southbound Stock Connect flows than northbound in H2 so far (10-day moving average, CNY bn)



Source: Bloomberg, Standard Chartered Research

Figure 7: CNH bond market is growing again Total outstanding, CNY bn



Source: Bloomberg, Standard Chartered Research



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