CNH – Introducing the Renminbi Globalisation Index

- **We launch the Standard Chartered RGI, which tracks the Renminbi's level of globalisation**
- **We also introduce our Offshore Renminbi Corporate Survey of local and global corporates**
- **As the CNY heads towards global reserve currency status, its broader use as a trade currency will be key**
- **Our measure of internationalisation has risen more than seven-fold since end-2010**
- **Singapore and London now each account for just over 10% of the RGI universe; Taiwan is next**
- **Our first Offshore Renminbi Corporate Survey shows strong appetite for offshore Renminbi activity**

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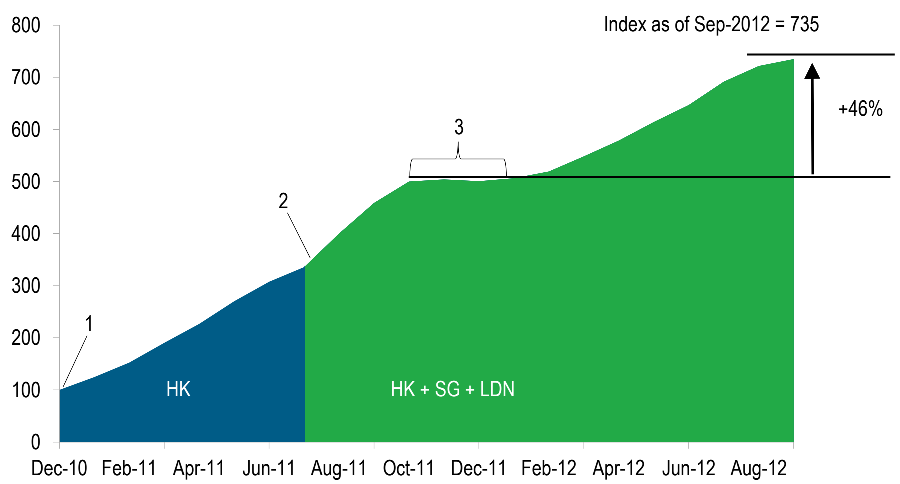
China's re-entry into the global economy was arguably the most important economic development of the past 30 years. One of the next major steps for China as it redefines its position in the world economy will be the emergence of the Chinese yuan (CNY) as a dominant currency in international trade and as a reserve currency. In this regard, rapidly increasing use of CNY for trade settlement and exponential growth in the offshore Renminbi (CNH) market are important milestones.

We have developed a new index to measure the extent of Renminbi internationalisation: the Standard Chartered Renminbi Globalisation Index (RGI). This index will allow us to track the ups and downs in the internationalisation process. We also introduce a comprehensive survey of local and global corporates that will help us to track the motives for, and next steps in, using the Renminbi offshore. We find a strong appetite among survey respondents to use the CNH market for China-related business. We will publish updates of the survey results quarterly and of the RGI once a month. Ultimately, we expect use of the CNH to reach a level to rival other reserve currencies.

This report is divided in three parts. Part I discusses the characteristics of major reserve currencies in history and compares them to the CNY today. Part II introduces the Standard Chartered RGI and the corporate survey, while Part III analyses their results. The Appendix provides technical details on how the RGI is constructed.

Figure 1: The RGI has grown more than seven-fold since December 2010



Note 1: An index base of 100 was set for Dec-2010, initially covering Hong Kong only
Note 2: Singapore and London became Eligible Markets and were added to the RGI in Aug-2012
Note 3: Brief pauses in the RGI uptrend in Q4-2011 and Q1-2012 reflect a period of caution and market consolidation following late Q3-2011 market turbulence triggered by global risk aversion

Source: Standard Chartered Research

I. Lessons from history for the CNY

Reserve currency status has many benefits (and pre-conditions)

The Renminbi's move towards reserve currency status could eventually lead to a truly multi-polar world in terms of reserve currencies, away from the current USD-dominated system. This would fundamentally alter the global financial system in a way not seen since the start of the Bretton Woods era in 1945.

Being a country with global reserve currency status carries major benefits. First, such a country is considered a safe haven in times of global risk aversion, even if it is the cause of the risk aversion. Second, wide international acceptance of a country's currency means it benefits from the famously described 'exorbitant privilege' (a term first used by France's Valéry Giscard d'Estaing to describe the USD's role in the global financial system in the 1960s). This means a currency is widely accepted as a store of value in itself because other countries use it to facilitate trade. China began to accelerate its push for Renminbi internationalisation in 2010. Over time, we expect the Renminbi to provide an attractive alternative to the USD, and share the gains of becoming a reserve currency status itself.

Historically, the country with the world's main reserve currency was usually the largest economy at the time. It has historically also usually been the largest exporter and net creditor. China is already the world's largest trading nation and a major global creditor. However, CNH assets may not match the depth and liquidity of the USD capital markets for a long time. Costs and ease of transactions have historically been a major determinant of reserve currency status. China is also an interesting case because it still has capital controls in place, even as policy makers push for greater international use of the Renminbi. Many would argue that full capital account convertibility is needed before the Renminbi can be taken seriously as a reserve currency.

II. The mechanics

The Standard Chartered Renminbi Globalisation Index (RGI)

Our index aims to measure overall growth in offshore Renminbi 'usage'. We count the currency's use as a store of wealth, a trade settlement currency and a means of capital raising, as well as its FX market trading volume. These are all key parts of the internationalisation story. The RGI also helps to identify inevitable setbacks on a promising long-term uptrend.

A detailed explanation of the methodology behind the RGI can be found in the Appendix. Here we summarise the key characteristics that help the index capture the CNH market's variety and increasing geographical scope:

- The RGI is computed on a monthly basis, based on four CNH market components with weights inversely proportional to their variance – (1) CNH deposits, (2) trade settlement and other international payments, (3) Dim Sum bonds and certificates of deposit (CDs) issued, and (4) FX turnover, all from an offshore perspective and denominated in Renminbi.

- We have chosen these components to represent the major areas of offshore Renminbi activity by corporates, and also taken into account the availability, reliability and trackability of the data.

- Both quantitative and qualitative thresholds are in place to determine an offshore market's eligibility for index inclusion. This adds scalability to our index as the CNH continues to extend its global reach.

- Location-specific data for each component is used to compute a corresponding global aggregate. The index initially covered only Hong Kong; Singapore and London were added in August 2011. As other centres, such as Taipei or New York, become more significant, we will add them to the index.

The Offshore Renminbi Corporate Survey

Complementing the RGI is the launch of our first Offshore Renminbi Corporate Survey. It is conducted independently by Asset Benchmark Research and will be conducted on a quarterly basis. The aim is not just to gauge the change in actual offshore Renminbi usage over the past six months, but also to measure expectations for the next six months. While the RGI tells us where things stand now, the survey gives us a forward-looking view, with the more qualitative questions providing added flavour and texture. Details on the factors that would motivate respondents to increase their offshore Renminbi use are particularly interesting.

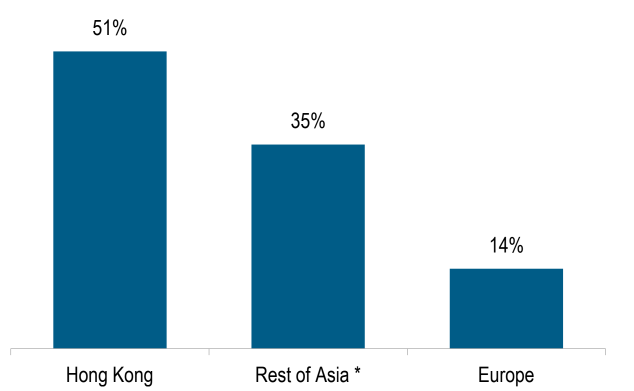
Corporates in various locations are asked whether they are (or plan to be) involved in six main areas of offshore Renminbi activity:

- Offshore Renminbi deposits
- CNY trade settlement
- CNH FX transactions
- Dim Sum bond issuance
- CNH loans
- Portfolio investments in Renminbi

Top managers of companies in 16 locations were interviewed for our first survey, conducted between mid-October and early November. Respondents comprise a mix of multinationals and companies with a more local/regional focus. They are generally chosen for the survey because they are likely offshore Renminbi users. Figures 2 and 3 show the breakdown of respondents, by location and by the number of offshore Renminbi product types they use (current versus potential).

Figure 2: Respondent locations

% of respondents



** Including those in mainland China;*

Sources: Asset Benchmark Research, Standard Chartered Research

Figure 3: A tendency to use more products

% of respondents

No. of CNH products currently using	No. of additional products respondents may use in 6 months' time						
	0	1	2	3	4	5	6
0	23.66%	5.34%	1.53%	3.05%	3.05%	1.53%	0.76%
1	4.58%	5.34%	1.53%	0.76%			
2	8.40%	5.34%	3.82%	0.76%			
3	9.16%	4.58%	1.53%	1.53%			
4	8.40%	2.29%	0.76%				
5	1.53%	0.76%					
6							

Sources: Asset Benchmark Research, Standard Chartered Research

Both the Standard Chartered RGI and the survey will become an integral part of *The Renminbi Insider* – our bi-monthly flagship report covering on- and offshore Renminbi macro and market developments. The next survey will be conducted in February 2013. We will continue to expand the number of respondents and geographical locations covered by the survey.

III. The results

The RGI – Recovery in all areas but deposits

Figure 1 on the front page shows the RGI going back to December 2010, at which point a base of 100 was set. This is a natural starting point. In H2-2010 the Renminbi was first being allowed to trade freely on a strictly offshore basis for non-trade-related purposes (which led to different onshore and offshore pricing, or CNY and CNH), and offshore Renminbi business was allowed to be developed freely as long as it does not involve the flow of Renminbi back into mainland China (non-trade cross-border Renminbi remittances are subject to quotas or case-by-case approval). The birth of CNH trading incentivised corporates to switch to Renminbi trade settlement, which boosted Renminbi deposits and, in turn, supported Dim Sum bond issuance.

It is therefore unsurprising to us that, in a little less than two years since December 2010, the RGI has grown more than seven times in size, and now stands at a reading of 735. Below are more of our observations on the RGI:

- The 'pause' in the uptrend in Q4-2011 and Q1-2012 reflected the setback in the CNH market then. This sell-off took place in September 2011, when the global financial markets were still reeling from the escalating European sovereign debt crisis. Growth expectations were scaled back on a global scale, led not only by the US and Europe, but also by mainland China. The CNH and Dim Sum bonds, which were among the last markets to succumb to risk aversion, sold off along with the rest of the Asian FX and credit universe. This left many investors shaken, and offshore Renminbi activity slowed markedly across all four of our index components in the subsequent months.

- While Renminbi deposits in Hong Kong have yet to return to pre-shock levels, the recovery in the RGI has been impressive, driven by a swift rebound in all three of the other index components. As of September 2012, the index was 46% higher than its previous 'peak' in Q4-2011. This is in line with our long-standing view that, looking beyond the deposit accumulation story, there is plenty of momentum behind further CNH market growth.

- We believe the stalling of Renminbi deposit growth in Hong Kong year-to-date has been driven by a combination of (1) more balanced import and export flows denominated in Renminbi; (2) the absence of CNY appreciation expectations; (3) the creation of new channels, such as R-QFII, to bring money back into China; and (4) leakage to other emerging Renminbi financial centres. While the days of exponential deposit growth in Hong Kong are likely to be difficult to repeat (barring further major policy liberalisation), we believe Hong Kong deposits are well supported by now-elevated CNH interest rates driven by bank competition. The likely resumption of CNY appreciation in 2013 should also help. More offshore users will also mean more accounts are opened.

- The expansion of the CNH's geographical reach has also helped to boost the RGI's performance over the past year. Both Singapore and London met the index entry requirements in August 2011, and have since been contributing to headline RGI growth. They have so far been neck-and-neck in the race to become the next big offshore Renminbi financial centre. As of September, excluding Dim Sum bonds (which are global in nature and should not be associated with a particular location), the ratio of the relative sizes of Hong Kong, Singapore and London was 78:12:10.

Looking ahead, there are a few things to keep an eye out for:

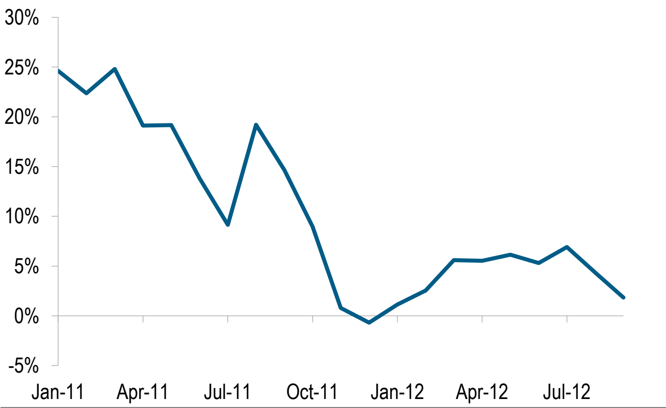
- Month-on-month growth in the RGI has slowed over the past several months, to 1.9% in September from 4.4% in August and 6.9% in July (Figure 4). This moderation has been broad-based. This could be a result of the downward adjustment in global growth expectations (led by China) in Q3-2012, and the subsequent hit to global sentiment. Over time, as the nominal base grows larger, double-digit month-on-month growth rates could be difficult to repeat. But for now, our expectation is that the bottoming of China's economy and a gradual recovery in 2013 will bring new impetus to the index.

- Both London and Singapore are looking to shift up a gear in their race to outdo each other. The second Hong Kong-London Forum, a private sector-led co-operation initiative between the two cities aimed at jointly promoting CNH business and developing CNH capabilities, will be held in London in early December. Singapore, meanwhile, recently issued full banking licences to two Chinese lenders, a move widely seen as paving the way for the establishment of a Renminbi clearing bank soon.

- Taiwan is set to have a CNY clearing bank before Singapore, possibly before end-2012, after the signing of a Memorandum of Understanding by the central banks on both sides of the Taiwan straits in late August. As outlined in our latest *Renminbi Insider* report, we expect the extension of Renminbi business to Taiwan's Domestic Banking Units (DBUs) from Offshore Banking Units (OBUs) to lead to a surge in Renminbi activity in Taipei. For example, Renminbi deposits in Taiwan are set to surge to CNY 150bn by end-2013, in our view, from CNY 18bn as of September 2012 (Figure 5). We project that Taipei will qualify for RGI inclusion as early as H1-2013; when that happens, the pie will get bigger.

Figure 4: Not immune to the global slowdown

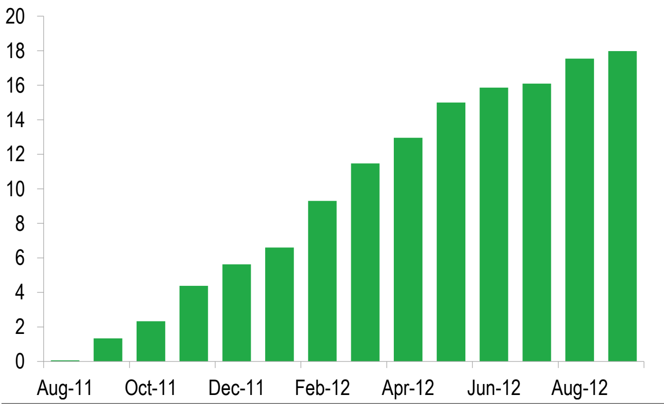
Change in RGI, % m/m



Source: Standard Chartered Research

Figure 5: Taipei is next in line to join the RGI

Renminbi deposits in Taiwan OBU accounts, CNY bn



Sources: CBC, Standard Chartered Research

The Renminbi offshore survey results

Our inaugural survey results confirm strong underlying growth momentum over the past six months across the key CNH products (Figure 7). They also provide a forward-looking view suggesting that the GRI is likely to remain on an uptrend in the next six months (Figure 8). We summarise other key observations below.

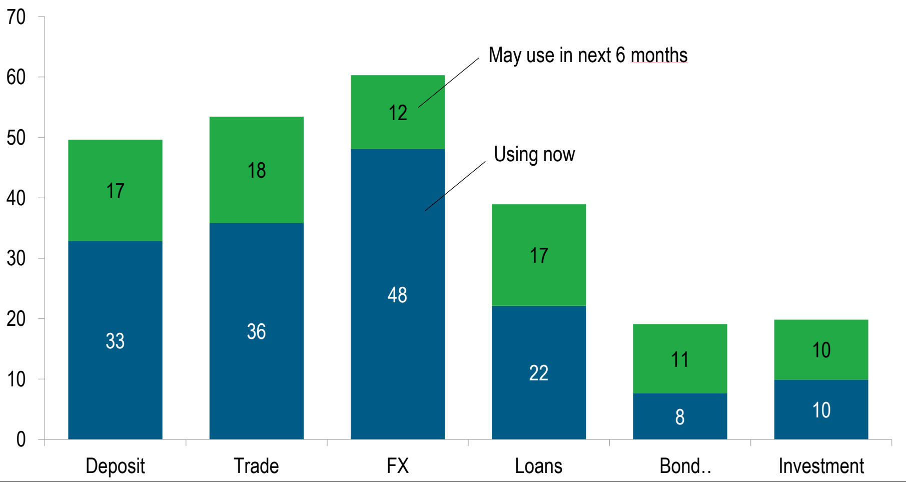
- 76% of our respondents are either conducting business in at least one of the six areas of offshore Renminbi activity we asked about, or may consider doing so over the next six months (Figure 3).
- Existing offshore Renminbi users are more willing to expand their usage, with 48% saying they may start to use one or more of the offshore Renminbi products they are not currently using in the next six months. This contrasts with only 39% for current non-users (Figure 3).
- The most common offshore use of Renminbi is for FX transactions (by almost half of our respondents, or 60% if one includes potential users), driven by hedging needs (Figures 6 and 10).
- For Renminbi trade settlement, potential users are mainly eyeing the benefits of better FX risk management, while a higher share of existing users appreciate the improvement in timeliness or are doing so at the request of onshore counterparts (Figure 9).
- According to the survey responses, the two main drivers of Dim Sum bond issuance are the lower cost of funds and the expansion of financing channels; more than half of the relevant respondents said they will use the proceeds to make investments onshore (Figures 11 and 12).
- The need to fund investment in, and finance trade with, China is set to drive future growth in CNH loans (Figure 13).

We also had the opportunity to conduct one-on-one interviews with some of our respondents. Below are key takeaways and quotes:

- On the question “What qualities do you look for in a Renminbi offshore financial centre?”, answers ranged included liquidity, stability, China’s backing, genuine currency need (as opposed to speculation), system efficiency, risk management, infrastructure and network.

Figure 6: CNH FX is the most widely used product

Current and potential users (% of respondents)



Sources: Asset Benchmark Research, Standard Chartered Research

"I think the necessary quality for a Renminbi centre should include first of all a lot of people actually holding sufficient deposits."
– Company A (Hong Kong corporate).

"*A lot of participation from the users will create a better market*."
–Company B (Hong Kong corporate).

- Answers to the question "What are the key challenges to using RMB offshore?" included pricing, currency fluctuation, scepticism towards the system, operational procedures for settlement, limited usage of CNH offshore, and cumbersome regulatory and administrative requirements.

  "The key challenges are risk in currency exchange management and the procedure for the settlement – operational procedure, whether it's efficient, is also very important to us."
  – Company C (Multinational corporate in Hong Kong and headquartered in Japan)

  "Not sure – this is something we are still just exploring."
  – Company D (multinational corporate in Singapore, headquartered in the US, already using four of the six main Renminbi products)

- We also asked a question specifically targeting multinationals: "Was it difficult to convince your headquarters to do Renminbi business in [respondent's location]?" None of the relevant respondents indicated any difficulty *per se*. One (headquartered in mainland China) is already managing its FX out of Hong Kong anyway, while another mentioned that a bit of persuasion was needed – see below.

  "We shouldn't use the word difficult. We have to prove to them how viable and feasible it could be to do RMB business. Because for our customers – they didn't have any special requests for us to trade in RMB currency."
  – Company C

IV. Future enhancements

Incorporating 'ease of use'

We will continue to look for ways to improve the RGI index to make it even more representative of the necessary conditions to become a reserve currency. The forward-looking components of our survey provide useful insights into this. One message from both the academic literature and market participants is that 'ease of use' is paramount in a reserve currency. It is difficult to see companies choosing to use a currency in which it is more costly to transact. This is directly linked to the breadth and depth of the market and to regulatory constraints. We will look for a way to measure this in a sub-index that could be added to the RGI.

We will also build a benchmark against which to compare the RGI. The most logical comparison would be to current reserve currencies; the GBP and USD are the best examples. This is not immediately needed, however, given that the Renminbi is still far from achieving reserve currency status on many of the key metrics.

About Asset Benchmark Research

Asset Benchmark Research conducts in-depth, product-specific surveys in Asia's financial markets. Part of the group that publishes The Asset magazine, the research team specialises in accessing senior corporate decision-makers and institutional investors to provide accurate quantitative and qualitative data to assist in management decisions.

Appendix: Standard Chartered RGI methodology

Index computation and components

Four parameters were chosen for the calculation of the Index, as they best represent the major areas of offshore Renminbi activity by corporates. The weights of each parameter (WD, WT, WS and WF) are inversely proportional to their variance. The index level for each month, in respect of the immediately preceding month, is computed in accordance with the following formula:

$$\mathrm{GRI}(t) = GRI(t-1) \times \left[WD \times \frac{DEPO(t)}{DEPO(t-1)} + WT \times \frac{TSIP(t)}{TSIP(t-1)} + WS \times \frac{DSCD(t)}{DSCD(t-1)} + WF \times \frac{FXTO(t)}{FXTO(t-1)} \right]$$

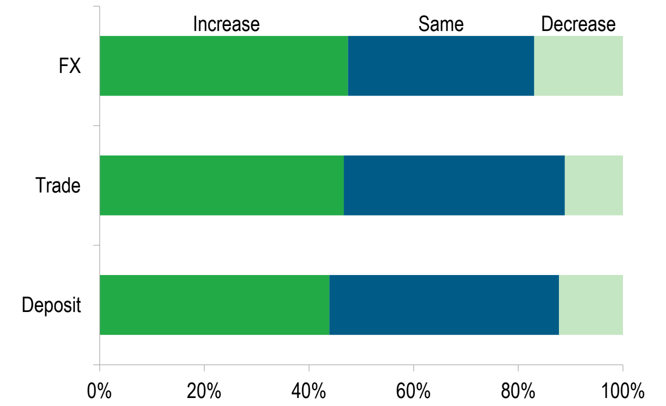
where (sources in brackets):

- **RGI(t)** means, in respect of month t, the Index level as calculated, with a base of 100 as of December 2010;
- **DEPO(t)** means, in respect of month t, the sum of the three-month moving average of offshore Renminbi deposits outstanding across eligible markets (local central banks, monetary authorities, or other credible official sources, using the latest data available if not regularly reported);
- **TSIP(t)** means, in respect of month t, the sum of the three-month moving average of monthly Renminbi trade settlement and other Renminbi international payments across eligible markets (SWIFT WATCH);
- **DSCD(t)** means, in respect of month t, the three-month moving average of outstanding issues of Dim Sum bonds and offshore Renminbi-denominated CDs globally (Bloomberg); and
- **FXTO(t)** means, in respect of month t, the sum of the three-month moving average of monthly offshore Renminbi (CNH) FX trading turnover across eligible markets (Standard Chartered's own estimates).

An **eligible market** refers to an offshore market that has met the three main eligibility criteria for it to be included in the index. First, data on the market needs to be available, reliable and trackable over time. Second, an eligible market, for the month when it is first added to the index, must have offshore Renminbi flows equal to or larger than the size of Hong Kong's as of the index base year. Third, the market needs to be widely recognised as an offshore Renminbi centre, or have the potential to become one.

Figure 7: Change in usage over the past six months

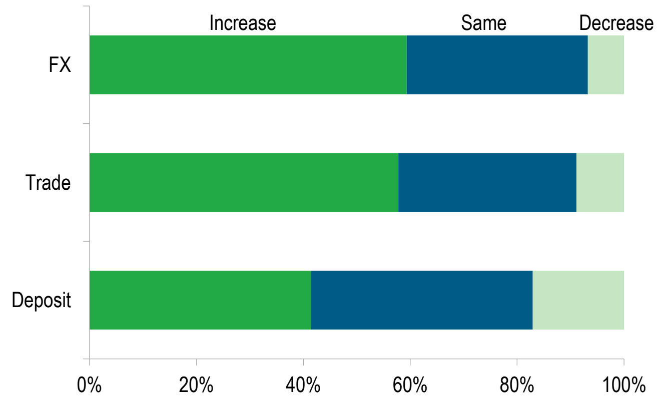
% of respondents



Sources: Asset Benchmark Research, Standard Chartered Research

Figure 8: Expected change in usage in the next six months

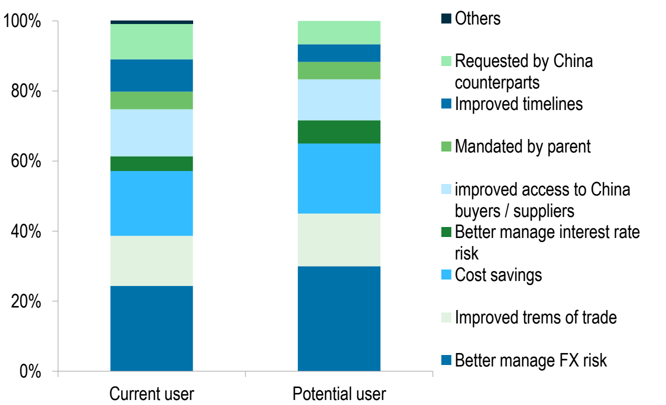
% of respondents



Sources: Asset Benchmark Research, Standard Chartered Research

Figure 9: FX risk management drives RMB invoicing

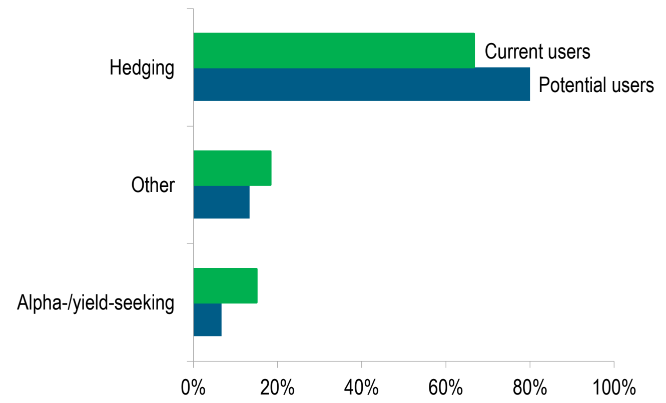
Factors driving corporates' use of RMB trade settlement



Sources: Asset Benchmark Research, Standard Chartered Research

Figure 10: Hedging is the main purpose for FX use

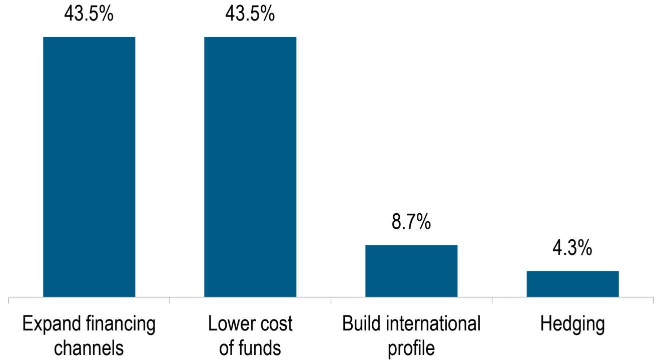
Main purpose of CNH FX transactions (% of respondents)



Sources: Asset Benchmark Research, Standard Chartered Research

Figure 11: Lower costs, diversification of financing tools

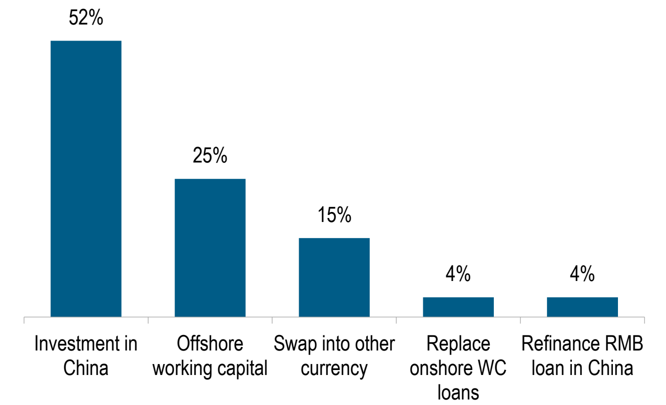
Motivations for considering RMB bond issuance



Sources: Asset Benchmark Research, Standard Chartered Research

Figure 12: Investment in China is the main driver

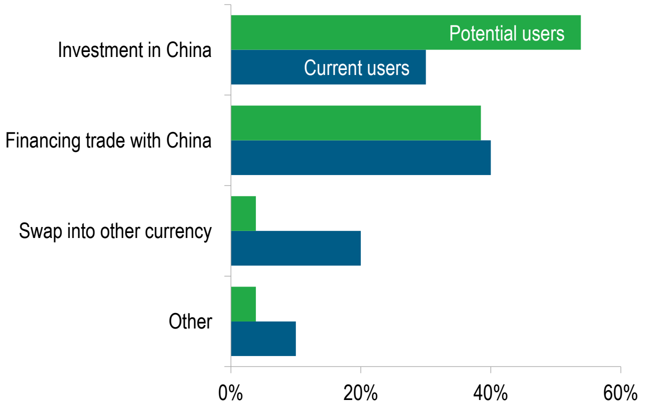
Uses for funds raised via CNH bonds (% of respondents)



Sources: Asset Benchmark Research, Standard Chartered Research

Figure 13: China-related business is the main driver of loans

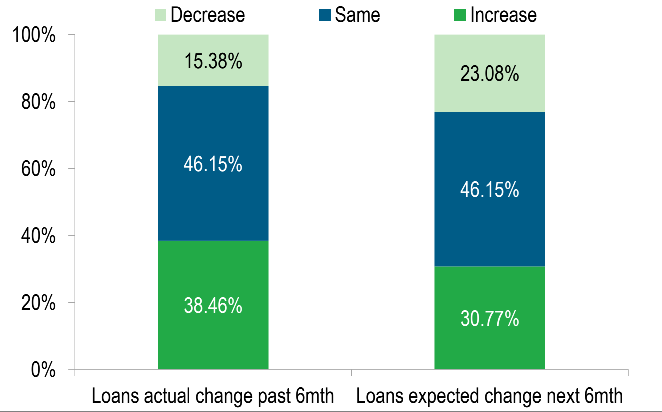
Main purpose of CNH loans (% of respondents)



Sources: Asset Benchmark Research, Standard Chartered Research

Figure 14: Most respondents are positive on CNH loans

Actual change in amount, last 6M vs. expectations of next 6M



Sources: Asset Benchmark Research, Standard Chartered Research

Disclosures Appendix

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