Offshore Renminbi Markets: Capitalizing on Growth Momentum

The development of renminbi (RMB) offshore hubs worldwide combined with China’s roll out of policy incentives promoting cross-border fund flows have provided corporates with more financing options and greater flexibility to manage their RMB flows than ever before.

Prior to 2009, RMB was largely a domestic Chinese currency as cross-border fund flows were not allowed due to restrictions on current account and capital account. China’s gradual liberalization of its economy in recent years has spurred the development of RMB offshore markets, where the Chinese currency can be converted and used freely.

Offshore: Flourishing of Multiple Hubs

As the first designated offshore RMB center in 2003, the offshore RMB market in Hong Kong is the largest, accounting for more than 70% of RMB deposits and trade settlement. However, the offshore RMB growth story is not just a Hong Kong story — it is a global phenomenon with 17 offshore centers established to date. The latest additions include Toronto, Canada and Doha, Qatar.

Other key RMB hubs in Asia include Singapore and Taiwan, which are major trading partners with mainland China. Outside Asia, London has developed into a dominant global CNH FX market, with daily spot trading in the first half of 2014 reaching USD 14.4 billion, an increase of 160% over the level in 2013.

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1 London RMB business volumes January-June 2014, a policy practitioner paper published by City of London (December 2014)
Liquidity Challenges
Increased usage of RMB offshore, and liberalization of cross border controls to enable two-way fund flows have increased pressure on offshore RMB liquidity. In addition, there are still controls which restrict co-mingling of the CNH-CNY RMB balance sheet and limit access to funding. The fragmented infrastructure caused by the setup of numerous offshore hubs and clearing centers has also exerted incremental pressure.

That said, positive progress has been made, primarily with Hong Kong Monetary Authority’s (HKMA) appointment of primary liquidity providers for the offshore RMB market in Hong Kong in November 2014.

As a designated primary liquidity provider, Citi has access to a dedicated repo facility of RMB 2 billion provided by the HKMA to promote offshore RMB liquidity and facilitate RMB transactions for clients.

One Currency, Two Systems
Today, RMB exists primarily in two forms, namely CNY for the onshore market, and CNH denoting the currency in the offshore markets.

The existence of two RMB FX rates onshore and offshore is largely due to the continued presence of cross-border controls where the Chinese regulators impose a daily trading band for CNY to fluctuate against USD. In contrast, a free and open offshore RMB market has been created where CNH is freely traded against the global currencies. The one currency, two system approach has given rise to an active offshore market where CNH-USD exchange rate could diverge from the onshore CNY-USD rate.

To move towards greater convertibility, China’s central bank has relaxed its active management of the onshore FX market in recent years so that RMB can be more responsive to market dynamics. For instance, China allowed the widening of the RMB-USD trading band to two-way swing of 1% in 2012. The trading band was doubled to +/-2% in March 2014.

With increased adoption of RMB globally as a trade and investment currency, RMB FX trading daily volume totaled about USD 120 billion for both onshore and offshore markets, with around USD 20 billion transacted in Hong Kong, and USD 18 billion in London. Daily volume of global RMB rates trading amounts to about USD 15 billion2.

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2 Bank of International Settlement’s Survey 2013

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### Comparison of Global Offshore RMB Hubs

<table>
<thead>
<tr>
<th>Issuer</th>
<th>Hong Kong</th>
<th>Singapore</th>
<th>London</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share of Global RMB SWIFT Payments Value (2014)</td>
<td>71%</td>
<td>8%</td>
<td>6%</td>
</tr>
<tr>
<td>RMB Deposits</td>
<td>RMB 1,004 bn (Dec 2014)</td>
<td>RMB 257 bn (Sep 2014)</td>
<td>RMB 25.4 bn (Jun 2014)</td>
</tr>
<tr>
<td>RMB Bond Issuance (2013)</td>
<td>RMB 200 bn+</td>
<td>N.A.</td>
<td>RMB 4 bn+</td>
</tr>
<tr>
<td>RQFII Quota</td>
<td>RMB 270 bn</td>
<td>RMB 50 bn</td>
<td>RMB 80 bn</td>
</tr>
<tr>
<td>Currency Swap Agreement</td>
<td>RMB 400 bn</td>
<td>RMB 300 bn</td>
<td>RMB 200 bn</td>
</tr>
<tr>
<td>Focus on Market Development</td>
<td>Greater China treasury management, and financial products</td>
<td>Southeast Asia treasury center, and commodities</td>
<td>Global treasury management and FX trading</td>
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As China facilitates integration between the two markets, spot rates in both markets have gradually converged (see Figure 1).

**Different Interest Rate Curves**

The interbank RMB lending rates in mainland China are guided by Shanghai Interbank Offered Rate (SHIBOR)\(^3\). Recognizing the need for a reliable benchmark offshore, the Treasury Markets Association (TMA) in Hong Kong announced the launch of the CNH Hong Kong Interbank Offered Rate (CNH HIBOR) fixing in 2013. This serves as a pricing reference for market participants for RMB loan and interest rate contracts.

The different yield curves between the onshore and offshore RMB markets provide both opportunities and challenges for corporates managing RMB flows. Figure 2 shows the overnight SHIBOR and CNH HIBOR curves, denoting historical variances between the two benchmarks. As an example, companies with cross-border intercompany

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**Figure 1: Snapshot of CNH-CNY Spot Rates**

![Figure 1: Snapshot of CNH-CNY Spot Rates](image)

**Figure 2: CNY-CNHN Interest Rate Differential**

![Figure 2: CNY-CNHN Interest Rate Differential](image)

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\(^3\) SHIBOR is calculated by the National Interbank Funding Center in Shanghai. It offers a no-guarantee, wholesale interest rate benchmark calculated by arithmetically averaging all the interbank RMB lending rates offered by the price quotation group of select banks operating in the domestic market.
loans will need to evaluate both yield curves to determine the appropriate arms-length pricing to use.

**Investment Options**
RMB’s accessibility continues to grow globally, and 30 central banks are holding RMB in their reserve portfolios to date. Along with plain vanilla deposit instruments such as CNH deposit and time deposit accounts, China’s capital markets can be accessed through multiple channels such as offshore RMB bond markets, RMB-denominated initial public offering in Hong Kong, and pilot schemes in the Shanghai Free Trade Zone (SFTZ), Qianhai in Guangdong, and Stock Connect scheme, which allows cross-border trading of equities listed at the Hong Kong and Shanghai bourses.

Portfolio investment of onshore bond and equities markets can be executed in RMB through special schemes such as Renminbi Qualified Foreign Institutional Investors (RQFII).

To increase usage of offshore RMB for investment, the RQFII program has since been extended to more than 10 countries globally. Among them, Singapore and London were granted quotas of RMB 50 billion and RMB 80 billion, respectively. The cap on the RQFII was later expanded, and the scope and eligibility of its participants was further relaxed. The RQFII scheme is expected to expand to more financial centers globally with increased quota assigned.

Mutual recognition of funds (MPF) between mainland China and Hong Kong will be realized in July 2015, with an initial quota of RMB 300 billion (USD 48.4 billion) for in and out flows. The MPF will open up a new frontier for the mainland and Hong Kong’s asset management industries, and make available a wider selection of products to investors in both markets. The project is another key step after the Shanghai-Hong Kong Stock Connect launched in November 2014, as China accelerates the pace of capital market and RMB internationalization.

**FX Solutions**
FX has been the largest driver of growth for RMB offshore. Corporates have access to a wide range of CNH FX products, including spot and forward contracts, FX options and non-deliverable options.

Corporates have traditionally relied on USD-CNY non-deliverable forwards (NDF) as a hedging tool. With the growth of RMB offshore markets, the use of a deliverable forward (DF) either onshore or offshore is gaining popularity as its usage entails no basis risk. NDF contracts may not be the optimal FX hedging tool as onshore spot differs from SAEC fixing.

Exporters with RMB exposures can look at various hedging methods, to address their specific needs. Some typical examples are outlined below:

1. **RMB bill discounting with FX spot**
   - **Benefits**
     - Counterparty risks are fully hedged
     - Deposit the received CNH into structured investments
     - Potentially more favorable pricing to exporters as the end clients do not need to hedge their USD FX risks
   - **Drawback**
     - High CNH discounting costs

2. **USD loan with USD-CNH forward**
   - **Benefits**
     - FX risks are fully hedged
     - Low USD funding costs
     - Potentially more favorable pricing to exporters as the end clients do not need to hedge their USD FX risks
   - **Drawback**
     - Paying the USD-CNH premium swap point

3. **Structured USD loan with USD-CNH forward**
   - **Benefits**
     - Same as USD loan with USD-CNH forward, but exporter does not lose out to all the premium swap point of the USD-CNH forward depending on markets condition

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4 Subject to market conditions.
Corporates should review their FX risk policies and ensure the appropriate RMB products are covered. Last but not the least, withholding tax considerations and business tax impact should be thoroughly evaluated.

**Looking Ahead**

Convergence between the onshore and offshore markets is expected to continue, bridging the difference between CNY-CNH spot rates. In addition, controls on deposit rates in China are expected to be further liberalized, creating greater balance between the two markets.

It is anticipated that offshore financial institutions (FIs) and corporates will increase their issuance of Panda bonds and other financial products onshore. Offshore FIs will also be keen to participate in RMB bonds repo transactions in the China interbank bond market.

With the RMB on an upward trajectory to become a truly global currency, seamless two-way flow of RMB needs to be realized. To attain that goal, we envision that more channels will be developed to funnel offshore RMB funds back to China as well as further growth in the RMB investment market.

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