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Where do you Renminbi?

A comparative study of cross-border RMB centres

pwc

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As China has gradually evolved into the world's largest exporter over the past decades, it comes as no surprise that its currency – the Renminbi – has also gained in prominence in global trade transactions. The remarkable economic journey of China is now undoubtedly being followed up by a gradual move towards further liberalisation of capital accounts and the internationalisation of the Renminbi.

Financial centres across the world are positioning themselves to assist China in this momentous journey of the Renminbi towards a global reserve currency. After gaining a prominent role in international trade settlement, the next phase of this transition is the increasing significance of the Renminbi as a global investment currency.

The Luxembourg financial centre, which has its historical roots in serving international finance, has been at the forefront of this development. Thanks to our recognised investment fund infrastructure, global clearing and settlement capabilities and leading Eurobond listing centre, Luxembourg is ideally placed to facilitate cross-border investment flows.

Challenges and opportunities lie ahead for the world's global financial centres when it comes to the Renminbi, and I am sure this new and very timely publication by PwC will empower market players to seize the momentum arising out of this historic journey of the Chinese currency.

Pierre Gramegna
Minister of Finance, Grand Duchy of Luxembourg

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Executive summary

The internationalisation of the Chinese Renminbi (RMB or ¥) could be one of the most significant developments in global finance for the coming decade. Economists and futurists have been predicting the "Chinese Century" for years and myriad indicators suggest it has finally arrived. Since the dollar eclipsed the pound as the world's most influential currency, China has become the world's largest exporter and second largest importer of goods and the Chinese government hopes its currency will soon reflect this reality. Hence, internationalising the RMB is one of China's utmost priorities.

China's progress in internationalising its currency during the past decade has been truly remarkable. Ten years ago, the RMB was used only in mainland China and Hong Kong. Today, the currency serves as tender in trade settlement in 220 different countries. Governments and investors all over the world are using RMB for investment and reserve currency purposes and trading in Renminbi has more than tripled over the past three years to $120 billion per day[1].

As internationalisation of the RMB has accelerated, financial centres in Asia and Europe have begun to develop individual competencies with respect to the currency.

Cross-Border RMB Centres in Asia

Hong Kong has been the direct recipient of policies put in place by mainland authorities to create and develop the cross-border RMB market at a controlled pace. Consequently, Hong Kong's offshore RMB centre has established itself as the largest of its kind in the world. Its first-mover status, close economic ties with mainland China, efficient market infrastructure and other advantages differentiate it from similar financial centres. In particular, it is the global hub for both Renminbi trade settlement and offshore Renminbi foreign exchange trading.

Singapore also plays a vital role in China's relationships, especially with other ASEAN (Association of Southeast Asian Nations) countries. Distinguished as the busiest intermediate trading port in the world, it is the largest recipient of outward direct investments among the ASEAN countries. Singapore is home to the only RMB clearing bank outside of Greater China and, thus, acts as a bridge between China and Southeast Asian countries in trade, investment and capital movement.

Taiwan and China enacted the Economic Cooperation and Framework Agreement (ECFA) in September 2010 in order to promote the normalisation of cross-strait economic and trade relations. In February 2013, following the designation of Bank of China (BOC) Taipei as an RMB clearing bank, Taiwan officially announced its plans to develop RMB business.

Cross-Border RMB Centres in Europe

Luxembourg is home to the European headquarters of three of China's largest banks, giving the Grand Duchy a sufficient prerequisite to develop its cross-border RMB business. Luxembourg has the largest pools of RMB in Europe in terms of deposits, loans, listed bonds and assets in mutual funds and serves as the main hub and entry point for Chinese investors into the Eurozone. Luxembourg is also China's primary direct investment destination in Europe and holds the largest portfolio of European investments in China.

London has been playing a key role in the integration of international capital markets and has strong ambitions to support the internationalisation of the RMB. The UK was the first G7 country to sign a currency swap agreement with China and the first outside of Greater China to receive an RQFII quota.

Germany and **France** are China's most important trading partners in Europe. Germany has the largest trading volumes, and France has the fourth largest. An increasing portion of trade between China and these two countries is being settled in Renminbi.

Toward a market-driven approach...

Given China's size and growth prospects, the likelihood of the RMB joining the ranks of the dollar and the euro seems inevitable. The Chinese government is taking every measure necessary to remove obstacles in its way: working to open the capital account, extending swap lines and approving RQFII licenses are major initiatives that demonstrate China's commitment to internationalise the RMB.
Historically, China's economy has been driven by the Chinese government's regulatory policy. However, in the spirit of advancement, deregulation is now allowing the market to play a bigger role. Thus, the RMB is moving away from a regulatory-driven currency and toward a market-driven currency.

[1] BIS Triennial Central Bank Survey of Foreign Exchange and Derivatives Markets, 2013.

Overview of cross-border RMB centres in Asia and Europe

Asia	Hong Kong	Macau	Singapore	Taiwan
RMB deposits	¥1,053 bn	¥83 bn	¥172 bn	¥215 bn
RMB loans	¥116 bn	n.a.	n.a.	¥13 bn
RQFII quota/used amount	¥270 bn/¥168 bn	-	¥50 bn/-	¥100 bn/-
Number of listed RMB bonds (End 2013)*	98	-	74	13
Average daily trading volume of RMB foreign exchange (Apr 2013)	$49.5 bn	n.a.	$23.7 bn	$2.6 bn
Designated RMB clearing and settlement bank	BOC	BOC	ICBC	BOC
Currency swap with China (Jan 2014)	¥400 bn	-	¥300 bn	-
Goods Trade with China (2013)	$401 bn	n.a.	$76 bn	$197 bn
FDI flow into China (2013)	$78 bn	n.a.	$7 bn	$5 bn
OFDI stock from China (End 2012)	$306 bn	$2.9 bn	$12 bn	$0.1 bn
Portfolio investment into China (End 2012)	$288 bn	$12 bn	$50 bn	n.a.

Europe	Luxembourg	United Kingdom	France	Germany
RMB deposits	¥64 bn	¥14.5 bn	¥20 bn	n.a.
RMB loans	¥54 bn	n.a.	n.a.	n.a.
RQFII quota/used amount	-	¥80 bn/-	-	-
Number of listed RMB bonds (End 2013)*	40	15	4	3
Average daily trading volume of RMB foreign exchange (Apr 2013)	$0.4 bn	$24.2 bn	$1.1 bn	$0.5 bn
Designated RMB clearing and settlement bank	-	-	-	-
Currency swap with China (Jan 2014)	¥350 bn**	¥200 bn	¥350 bn**	¥350 bn**
Goods Trade with China (2013)	$2 bn	$70 bn	$50 bn	$162 bn
FDI flow into China (2013)	n.a.	$1 bn	$0.8 bn	$2 bn
OFDI stock from China (End 2012)	$9.0 bn	$8.9 bn	$4.0 bn	$3.1 bn
Portfolio investment into China (End 2012)	$38 bn	$33 bn	$13 bn	$3 bn

All figures are based on the latest data available.

Source: PwC analysis based on various sources

* According to the primary listing place
** Luxembourg, France and Germany benefit from the currency swap agreement between the People's Bank of China and the European Central Bank

...and more collaboration

If the Chinese regulator continues to deregulate the capital account, as it likely will do to achieve full convertibility of the RMB, the market will play the dominant role in the development of the currency's cross-border market. Consequently, the cross-border RMB market will become a diversified sector in which financial centres scattered across the globe can easily connect with one another to pioneer new applications for this currency.

Introduction

During the last two centuries, the pound and the dollar respectively have dominated the global financial system. There is a lot of discussion nowadays about the international financial system's dependency on one dominant reserve currency. The Chinese Renminbi (RMB or ¥) is well-suited to become a viable additional option, along with the euro.

China is the world's second largest economy after the United States, as well as the world's largest exporter and second largest importer of goods. However, the international use of its currency, the Renminbi, is not commensurate with China's economic status. Hence, the Chinese government embarked on a mission to internationalise its currency beginning with the designation of the Bank of China (BOC) in Hong Kong as a clearing bank for RMB (2003). For the first time, local residents were allowed to hold RMB in bank accounts outside of mainland China. The process gained momentum in 2009 when a series of pilot programmes were launched to promote Renminbi first as a trade settlement currency and then as an investment currency.

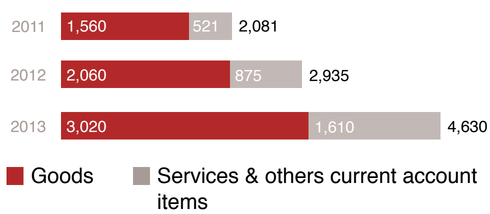
RMB is rapidly growing as a trade settlement currency

Seeking to establish Renminbi as a standard pricing and settlement currency in cross-border trades, China launched a pilot programme to that end in 2009. The initiative's overwhelming success prompted China to expand it domestically from its original five cities to the whole country and internationally from East Asia to the global market. The programme gained traction and in 2013, the overall volume of RMB cross-border settlement reached ¥4.63 trillion, with ¥3.02 trillion in goods trade and ¥1.61 trillion in services and other current account items.

To augment efforts to bolster trade settlement, currency swap agreements have been initiated with China's trade partners. Starting from as early as 2008, China has signed currency swap contracts with 23 monetary authorities to expand Renminbi's use throughout the world. By 2013, currency swaps between the People's Bank of China (PBC) and other monetary authorities reached ¥2.5 trillion.

While such swap agreements are mainly used to support trade in Argentina, Malaysia and Indonesia, they may serve other functions elsewhere. For example, the RMB swap is also used as a source of liquidity to deepen the RMB capital market in Hong Kong. The latest RMB swap agreement was signed with the European Central Bank (ECB) in October 2013. It will serve as a backstop liquidity facility to ensure the stability of financial markets in the context of the rapid growth of RMB in trade settlement and investment throughout the euro area.

RMB cross-border trade settlement (¥ bn)

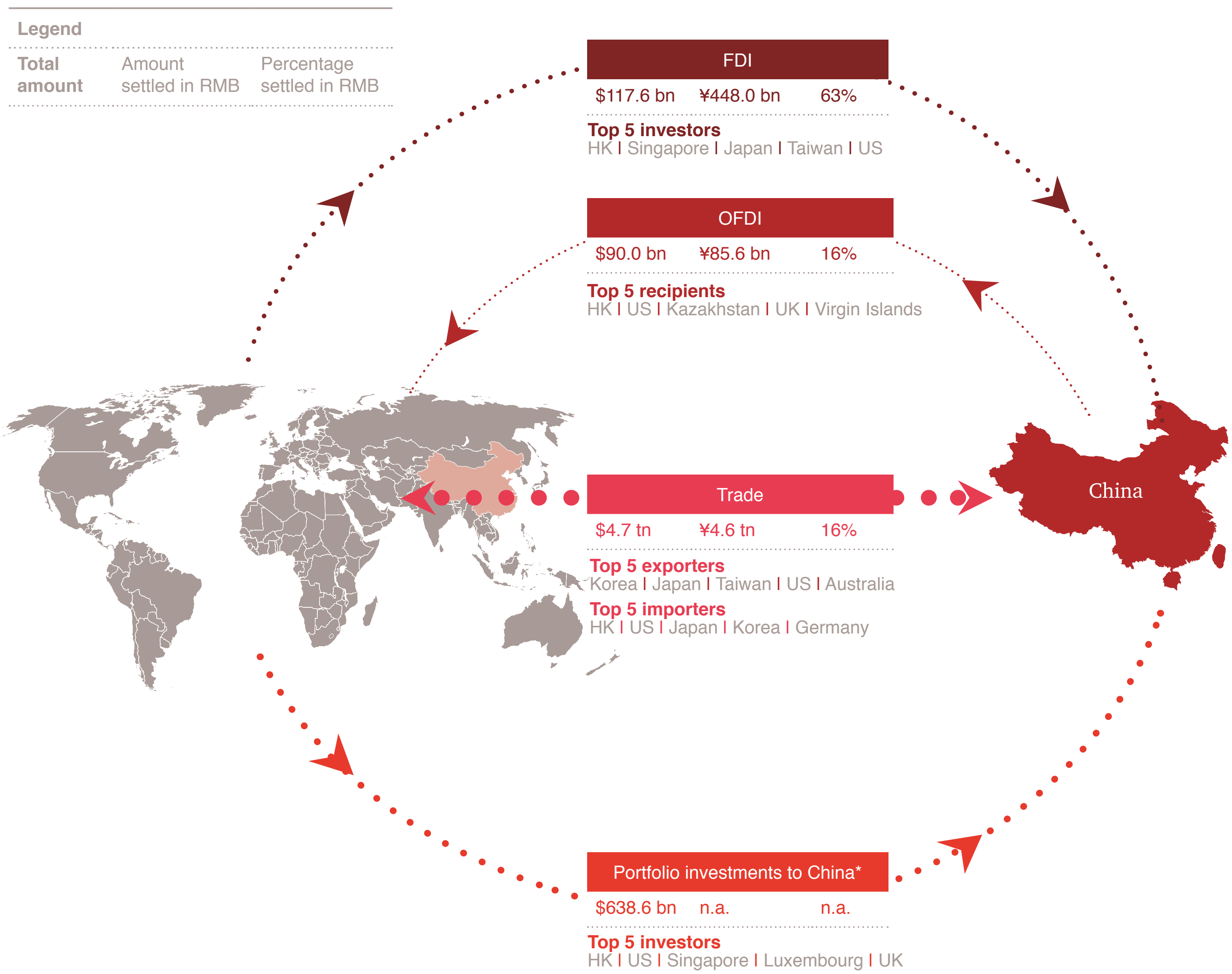


Source: People's Bank of China

Trade and investment flows in and out of China

The Renminbi is increasingly used in cross-border trade and investment, as is demonstrated by its growing proportion of trade and investment flows. The graph below captures the flows in and out of China (trade of goods and services, FDIs, OFDIs and portfolio investments), and the extent to which RMB has been involved.

Overview of trade and investment flows in and out of China



All figures are at end 2013 except those for portfolio investments which are at end 2012.

* According to IMF's definition, portfolio investment covers transactions in equity and debt securities, including stocks, bonds, notes, money market instruments, and financial derivatives. While Chinese Qualified Domestic Institutional Investors can invest in foreign securities, the total amount of portfolio investment from China is not available.

Source: PwC analysis based on various sources

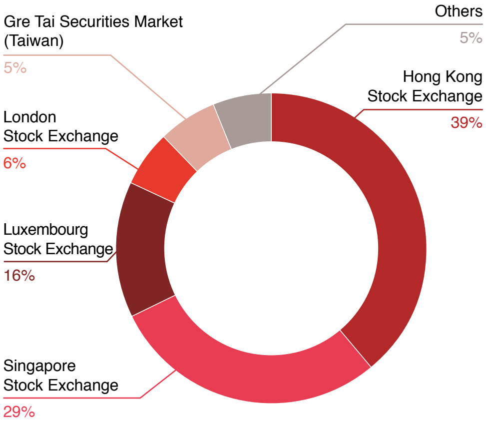
RMB is becoming an investment currency

In keeping with the experimentation of RMB trade settlement, China started liberalising its capital account and partially opening its domestic capital markets in 2011 through a number of pilot programmes that allow banks and enterprises to carry out RMB foreign direct investments.

Growing offshore RMB bond market

In January 2007, PBC launched a pilot programme allowing financial institutions to issue RMB bonds in Hong Kong, which the China Development Bank (CDB) did six months later. Since then, more than 360 RMB denominated bonds have been issued, with around ¥340 billion being raised[2]. The issuance location has also expanded outside of Hong Kong and the listing location has increased to more than ten stock exchanges throughout the world[3].

Primary listing locations of RMB denominated bonds (%), December 2013



Source: PwC analysis based on Bloomberg data

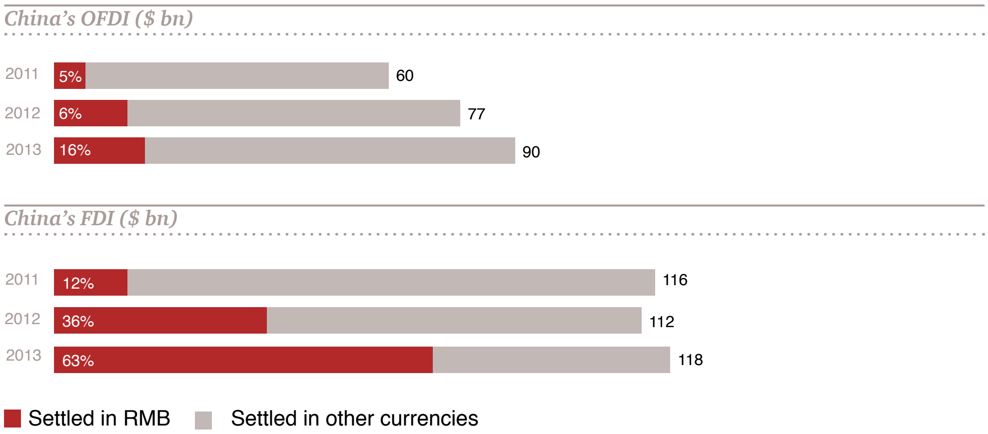
[2] PwC analysis based on various sources.
[3] Not all of the RMB bonds are listed, although listing is preferred by certain investors.

Increasing use of RMB in Foreign Direct Investments

Since the launch of the RMB FDI scheme in 2011, RMB is increasingly being used in Foreign Direct Investments (FDI).

While overall FDI and Outward FDI (OFDI) increased notably in 2013 (by 5% and 17% respectively over the previous year), the real jump has been seen in the volumes of FDI and OFDI settled in RMB, which saw an increase of 78% and 197% respectively during the same period.

Since 2011, the share of FDI and OFDI settled in RMB went from 12% and 5% to 63% and 16% respectively[4].



Sources: PwC analysis based on PBC and MOFCOM data.

Opening access to the Chinese capital markets

- **QFII Scheme**[5]
  China launched a Qualified Foreign Institutional Investor (QFII) scheme in 2003, allowing approved foreign institutional investors to convert a certain amount of foreign currency, based on the granted quotas, to RMB in order to invest in China's domestic capital markets.
- **Inter-bank bond market**
  In 2010, China launched a pilot programme to allow three types of foreign financial institutions, namely foreign central banks/monetary authorities, cross-border RMB clearing banks and cross-border RMB settlement participating banks, to invest in the Chinese inter-bank bond market as part of the RMB cross-border settlement programme. RQFII and QFII were granted the right to invest in China's interbank bond market in 2012 and 2013 respectively. By year-end 2013, 138 foreign institutions had entered China's interbank bond market.
- **RQFII Scheme**[5]
  The RMB Qualified Foreign Institutional Investor (RQFII) pilot programme was introduced in December 2011, allowing Hong Kong branches or subsidiaries of mainland securities and fund management companies to invest offshore RMB in the domestic Chinese bond and equity markets through the use of quotas. The programme was later expanded to include mainland banks and insurance companies' Hong Kong subsidiaries or branches and registered financial institutions with major operations in Hong Kong. In 2013, the pilot programme expanded to include Taiwan, London and Singapore, with ¥100 billion, ¥80 billion and ¥50 billion quotas respectively.

RMB: the next reserve currency?

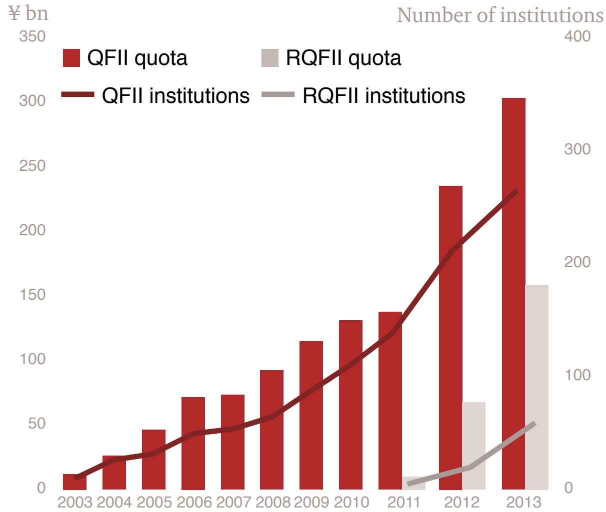
As the RMB is becoming an international currency, a growing number of central banks are investing part of their Foreign Exchange Reserves (FER) in RMB. On 6 September 2011, the Central Bank of Nigeria announced that RMB was chosen as its FER currency in which to diversify its foreign exchange assets. There are small amounts of RMB assets in FERs of Malaysia, South Korea, Cambodia, Belarus, Russia and the Philippines, as well. Others national banks are also considering investing some of their reserves in RMB, including the Bank of Japan and the Reserve Bank of Australia.

[4] At year-end exchange rates.
[5] See Appendix 1.

Focus on QFII and RQFII programmes

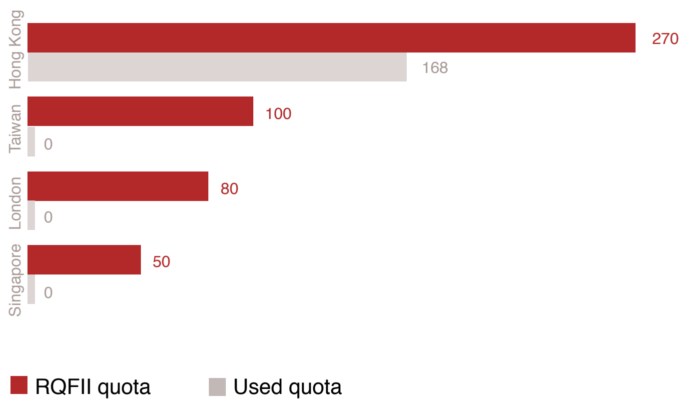
Last year, 44 institutions were granted QFII status and 29 were given RQFII licenses. Thus, the total approved quota increased rapidly in 2013 reaching $49 billion (¥300 billion) in QFII and ¥157 billion in RQFII. However, compared with the total market capitalisation of the Chinese bond market (¥29 trillion) and the stock market (¥ 23 trillion), the overall size of QFII and RQFII is still tiny.

Total approved quotas and numbers of licensed institutions



Sources: SAFE, CSRC

Total RQFII quotas and used quotas in ¥ billion as of January 2014

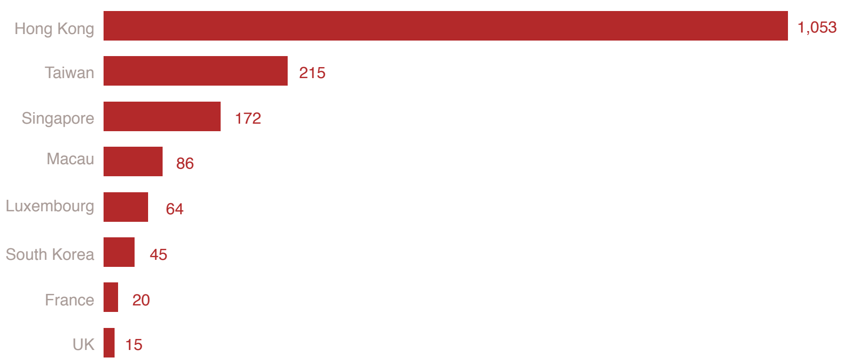


Sources: SAFE, CSRC

Cross-border RMB centres are emerging

Targeted efforts and increasing demand have created swelling accumulations of RMB in several international financial centres. During the past two years, there has been a significant upsurge in RMB deposits, one of the main indicators to gauge the importance of cross-border RMB centres.

Cross-border Renminbi deposits by country in ¥ billion as of January 2014



Sources: PwC analysis based on CBC, City of London, HKMA, Luxembourg for Finance, Monetary Authority of Macao, Bank of Korea, Monetary Authority of Singapore and Paris Europlace

Hong Kong started its RMB operations as early as 2003 and holds an enviable position among the emerging offshore centres. As a part of China, it has a first-mover advantage and also benefits from being China's experimental platform for the internationalisation of its currency. Other leading offshore RMB centres include Taiwan and Singapore; both have strong ties to China. In Europe, Luxembourg ranks first in terms of RMB deposits, but RMB activities are also developing rapidly in other financial centres such as London and Paris.

In this report, we focus on eight main cross-border RMB centres, including four in Asia (Hong Kong, Macau, Singapore and Taiwan)[6] and four in Europe (Luxembourg, London, Paris and Frankfurt), to look at how RMB activities have emerged and to analyse the latest developments in the cross-border RMB market. While we are aware of the developments of RMB activities in other places such as Zurich, Sydney, Tokyo, Toronto, Abu Dhabi and Seoul, we will not address them at this time.

This report also considers the future of RMB internationalisation, specifically with respect to the influence new schemes launched by the Chinese government could have on cross-border RMB centres as well as the currency's future. Our intention is to provide readers with an overview of the Renminbi's maturation and consequent impact on global financial markets. We have conducted this exercise based on public information available as of January 2014.

[6] PBC designated an RMB clearing and settlement bank in each of these markets.

Cross-Border RMB centres in Asia

Hong Kong and Macau
The pioneers

Due to its unique position as both a Special Administrative Region (SAR) of China ("one country, two systems") and as an established international financial centre, Hong Kong has been the direct recipient of policies put in place by mainland authorities to create and develop the offshore RMB market at a controlled pace. China's 12th Five-Year Plan (2011-2015) outlines the central government's plans to strengthen Hong Kong's position as a financial centre, especially in the area of offshore RMB business.

Consequently, Hong Kong's offshore RMB centre has established itself as the largest of its kind in the world. Its first-mover status, close economic ties with mainland China, efficient market infrastructure and other advantages differentiate it from similar financial centres. In particular, it is the global hub for both Renminbi trade settlement and Renminbi foreign exchange trading (34% of trading volume). Macau is another pioneer developing the offshore RMB market. However, due to its domestic focus, its influence is more limited.

1,053 RMB bn

RMB deposits

83 %

Cross-border RMB trade settlement market share

Key milestones

2003 - 2006
- 2003: BOC Hong Kong is established as an RMB clearing bank
- 2004: Mainland authorities allow licensed Hong Kong banks to offer personal RMB services to local residents
- Sept 2004: BOC Macau is designated by the PBC as an RMB clearing bank

2007 - 2009
- 2007: The first offshore RMB bond is issued by China Development Bank (CDB)
- 2008: HKMA signs a ¥200 bn currency swap with PBC
- 2009: The first offshore RMB sovereign bond is issued by the Chinese Ministry of Finance (MOF)

2010
- June: Chinese authorities relax the rules on the issuance of offshore RMB bonds
- August: The first offshore RMB bond is issued by an overseas corporate (McDonald's)

2011
- April: The first RMB IPO is listed on the Hong Kong Stock Exchange
- June: BOC Macau lists the first RMB bond fund
- Nov: PBC and HKMA renew and enlarge the currency swap to ¥400 bn
- Dec: The RQFII pilot scheme is launched in Hong Kong with a ¥20 bn initial quota and the issuance of dim sum bonds is extended to mainland non-financial institutions

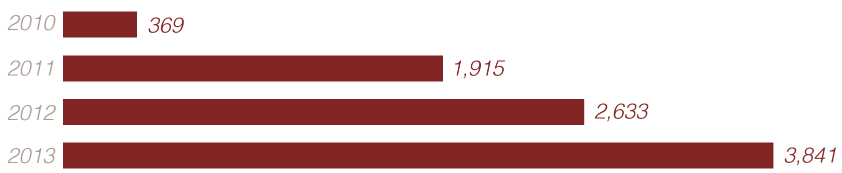
2012
- April: The RQFII quota is increased by ¥50 bn
- July: The first RQFII A-share ETF is listed on the Hong Kong Stock Exchange
- April: The RQFII quota is increased by ¥200 bn

2013
- June: HKMA launches an interbank reference rate for the offshore Yuan (CNH) market
- June: The first RMB sovereign bond with a 30-year tenor is issued by the MoF in Hong Kong

Cross-border RMB trade settlement

With the introduction and the subsequent expansion of the pilot scheme for Renminbi trade settlement, cross-border trade transactions settled in RMB through banks in Hong Kong have increased noticeably since early 2010. In 2013, the total amount of mainland China's cross-border trade settled in RMB amounted to ¥4.63 trillion of which Hong Kong handled ¥3.84 trillion (i.e. 83%).

RMB trade settlement handled by banks in Hong Kong (¥ bn)

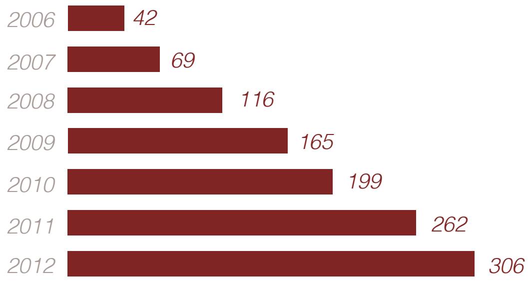


Source: HKMA

China's outward FDI (OFDI)

Hong Kong is the largest destination of Chinese OFDI. By the end of 2012, mainland China had set up more than 5,300 foreign-invested enterprises in Hong Kong and the OFDI stock had reached $306 billion, accounting for 57.6% of the total.

China's outward FDI stock in Hong Kong ($ bn)



Source: MOFCOM

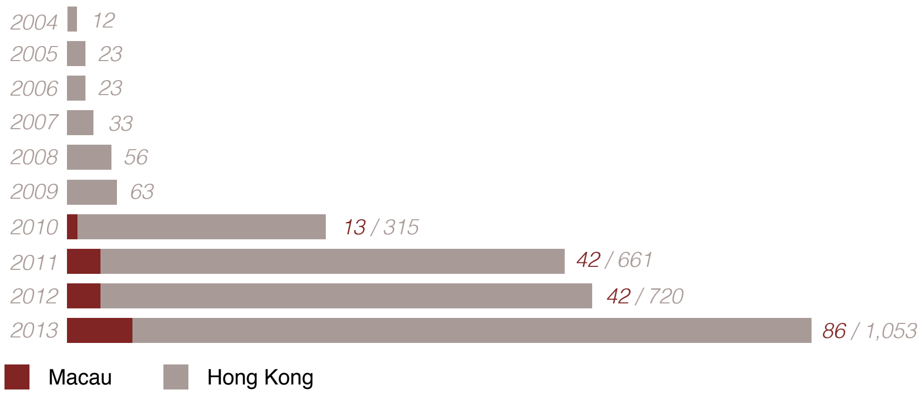
RMB deposits and loans

Hong Kong has the world's largest offshore pool of RMB liquidity. Renminbi customer deposits grew rapidly from ¥12 billion in January 2004 to ¥1,053 billion by December 2013 – a monumental increase over the course of one decade.

Growth was initially driven by retail deposits on the expectation of Renminbi appreciation. It was later fuelled by the increase in RMB receipts from corporate customers who engaged in cross-border trade settlement transactions after the expansion of the pilot scheme for RMB trade settlement in 2010.

RMB loans in Hong Kong increased, as well, to ¥115.6 billion at end 2013, a 46% increase from the year end 2012. However, the loan-to-deposit ratio remained low at 11%.

RMB deposits (¥ bn)



Sources: HKMA, AMCM

RMB bonds

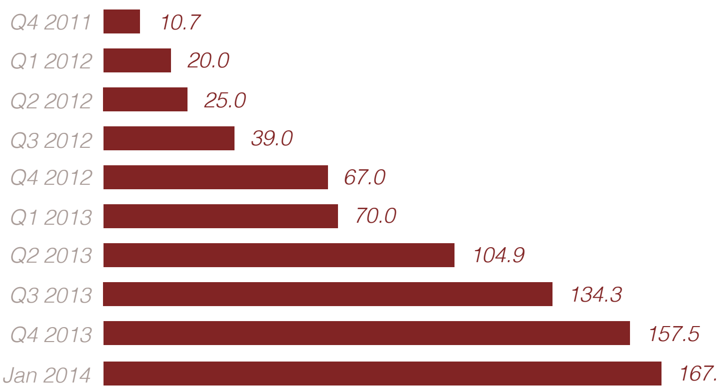
The RMB or dim sum bond market, in Hong Kong is the largest outside of mainland China. The issuance of dim-sum bonds totalled ¥116 billion in 2013 (similar to ¥112.2 billion in 2012). Outstanding dim sum bonds amounted to ¥309.2 billion at end 2013, a growth of 30% from end 2012.

RQFII quotas

As of January 2014, 61 asset management companies were granted RQFII licenses by the China Securities Regulatory Commission (CSRC), among which 57 companies have received quotas totalling ¥167.8 billion. All of these management companies are either Chinese financial institutions' branches or Hong Kong-based asset management companies (with the sole exception of London-based Ashmore).

By the end of 2013, there were 11 RQFII A-share ETFs listed on the Hong Kong Stock Exchange with a total Assets under Management (AuM) of ¥36.9 billion.

Approved RQFII quota by SAFE in Hong Kong (¥ bn)



Source: SAFE

[7] Mainland China and Hong Kong signed a new supplement to the Closer Economic Partnership Arrangement (CEPA) on 29 August 2013. This is the tenth supplement (Supplement X) since the CEPA was concluded in 2003. Supplement X introduces 73 further liberalisation measures for the services sector, financial sector, as well as trade and investment facilitation.

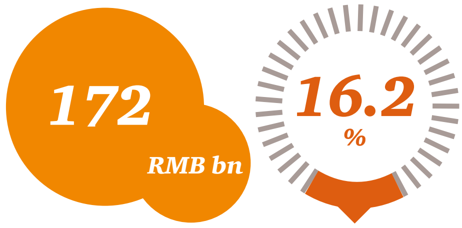
Latest developments

- China and Hong Kong are currently in the final stages of negotiation for a mutual fund recognition agreement. This arrangement will allow investment funds based in both markets to distribute to retail investors on either side.
- Besides confirming the mutual recognition of funds between Hong Kong and China, the tenth supplement to the Closer Economic Partnership Arrangement (CEPA X[7]) specified that Qualified Hong Kong-funded financial institutions will be allowed to set up joint venture fund management companies in the Mainland in accordance with relevant Mainland requirements. The shareholding percentage of these Hong Kong-funded institutions could exceed 50 %.
- The Hong Kong Monetary Authority (HKMA) has proposed that Chinese authorities remove a ¥20,000 ($3,280) daily currency-conversion limit on the city's permanent residents, which would allow Hong Kong residents to have full convertibility of RMB.

Singapore
The South East Asian hub

Singapore plays a vital role in China's relationships with other ASEAN countries. Distinguished as the busiest intermediate trading port in the world, it is the largest recipient of China's outward direct investments among the ASEAN countries. Singapore is home to the only RMB clearing bank outside of Greater China and, thus, acts as a bridge between China and south east Asian countries in trade, investment and capital movement.

Singapore is also one of the largest foreign exchange trading centres for the Renminbi and the second preferred listing place for RMB bonds after Hong Kong.



RMB deposits

RMB Forex trading Market share

Key milestones

2008 - 2011

- April 2008: the Singapore Stock Exchange (SGX) opens a Representative Office in Beijing
- July 2010: The Monetary Authority of Singapore (MAS) signs an ¥150 bn bilateral currency swap with PBC
- February 2011: Dim sum bonds start to list on SGX

2012

- March: SGX allows for dual currency trading (SGD and RMB)
- June: The MAS establishes a representative office in Beijing
- September: ARA Asset Management gets SGX approval to list an RMB denominated REIT*

2013

- February: ICBC Singapore is designated by PBC as an RMB clearing bank
- March: MAS and PBC renew the currency swap and enlarge it to ¥300 bn
- October: Singapore is granted a ¥50 billion RQFII quota; the Singapore dollar becomes the fifth currency to directly trade with RMB

* A month later, ARA Asset withdraws Dynasty REIT IPO owing to a weak market.

Cross-border RMB trade settlement

Singapore is a key trading hub between China and the ASEAN region, with trade between China and Singapore accounting for nearly 20% of China-ASEAN trade. To facilitate greater use of the RMB for trade, China and Singapore agreed in July 2012 on enhanced banking services commitments under the China–Singapore Free Trade Agreement (CSFTA). Thus, Chinese authorities appointed a Chinese bank to clear RMB transactions in Singapore.

After being designated as an RMB clearing bank in April 2013, ICBC's Singapore branch started an RMB clearing service one month later. By the end of the year, 67 institutions had opened RMB interbank accounts, with a total clearance volume reaching ¥2.6 trillion.

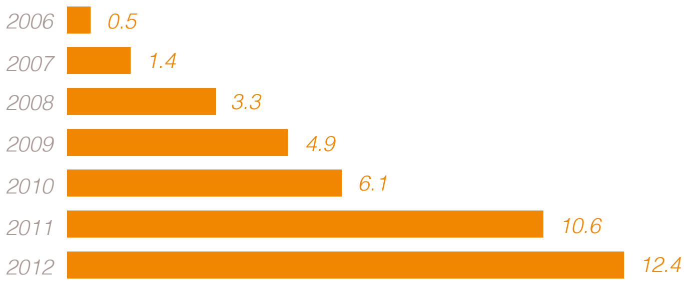
Total cumulative amount of RMB clearing in ICBC Singapore (¥ bn)

Source: ICBC Singapore

China's outward FDI Stock

Singapore is the largest destination of Chinese OFDI among the ASEAN countries. By the end of 2012, the stock value of China's OFDI to Singapore reached $12.4 billion, accounting for 44% of total OFDI into ASEAN countries.

China's outward FDI stock in Singapore ($ bn)

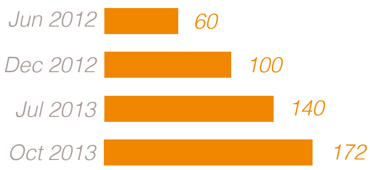


Source: MOFCOM

RMB deposits

Singapore has the largest RMB deposits among ASEAN countries. As of October 2013, the RMB deposits in Singapore stood at ¥172 billion, with a 70% increase over a period of ten months.

RMB deposits (¥ bn)



Source: MAS

RMB foreign exchange trade

Singapore is one of the largest currency trading hubs in the world. In terms of volume, Singapore ranked third after the UK and the US in the most recent BIS Triennial Central Bank Survey of Foreign Exchange and OTC Markets (September 2013).

However, recently Singapore was overtaken by the UK as the largest RMB forex trading location outside of China and Hong Kong. According to the BIS survey, average daily turnover of RMB foreign exchange reached $23.9 billion, accounting for 16.2% of total forex trading worldwide and 37.0% of forex trading outside of China and Hong Kong. The RMB forex volume accounts for 6.2% of total forex trading volume in Singapore, which is the third highest in the world after Hong Kong (18%) and Taiwan (10%).

RMB denominated securities

As early as 2008, the Singapore Stock Exchange (SGX) started to attract RMB denominated bonds to list and it is now the second preferred listing place for RMB bonds after Hong Kong.

According to Bloomberg, there were 78 dim sum bonds listed on the Singapore Stock Exchange as of January 2014. Following the establishment of a clearing bank in May 2013, Standard Chartered issued the first RMB denominated bond in Singapore, so called "Lion-City" bond, in the same month. Since then, five banks (including one Chinese bank) have issued RMB bonds in Singapore, raising a total ¥4.5 billion, according to SGX.

Latest developments

- In December 2013, ICBC Shanghai and Baosteel Singapore launched the first two-way cross-border cash pool business in the Shanghai Free Trade Zone (FTZ) and Singapore. It was also the first financial reform programme to be implemented in the Shanghai FTZ.
- The Singapore-based Oversea-Chinese Banking Corporation (OCBC) has launched a $100 million private equity fund in China under the Shanghai Qualified Foreign Limited Partner (QFLP) programme, which makes it the first South Asian institution to qualify for the QFLP programme.
- In January 2014, Haitong Securities, China's second-largest trading house by assets, opened a unit in Singapore, which is its first branch outside of Greater China.

Taiwan
The cross-strait partner

Improvement in political relations between mainland China and Taiwan led to the enactment in September 2010 of the Economic Cooperation and Framework Agreement (ECFA) which aimed to promote the normalisation of cross-strait economic and trade relations. But mainland banks were not allowed to open branches across the strait until February 2012. As a result, despite active trade, Taiwan began developing its RMB business late in the game. In February 2013, following the designation of Bank of China (BOC) Taipei as an RMB clearing bank, Taiwan officially announced its plans to develop RMB business. Since then, RMB activities have expanded rapidly and RMB deposits increased from ¥39 billion to ¥215 billion by January 2014.

215 RMB bn

RMB deposits

1.9 RMB tn

RMB clearing amount

Key milestones

2012

- February: Bank of China and Bank of Communications are allowed to open branches in Taiwan. They are the first two mainland banks to do so
- August: Taiwan's Central Bank signs an MoU with PBC on cross-strait currency settlement
- December: PBC announces the appointment of BOC Taipei as an RMB clearing bank

2013

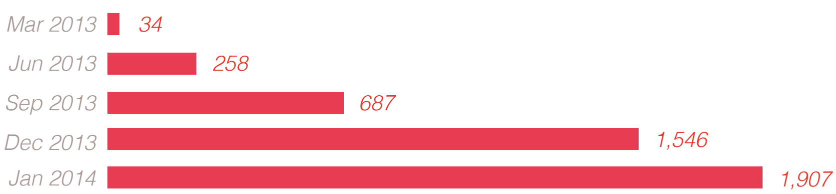
- January: BOC signs an RMB clearing business agreement with BOC Taipei
- February: Taiwan's central bank (CBC) announces the kick start of offshore RMB business in Taiwan
- March: The first RMB denominated bond is issued in Taiwan by Chinatrust Commercial Bank
- June: Taiwan is granted a ¥100 bn RQFII quota by PBC
- December: The first Formosa bond (RMB denominated) is issued by a mainland bank.

Cross-border RMB trade settlement

Taiwan's trade volume with China has steadily grown during the past two decades, and today, Taiwan is one of China's most important trade partners. Specifically, China's largest deficit among its trade partners is against Taiwan.

The US dollar has traditionally been used as Taiwan's primary settlement currency for bilateral trade, but usage of RMB is increasing - particularly since BOC's Taipei branch began providing RMB clearing services in February 2013. The clearance volume reached ¥1.5 trillion by the end of that year, with an average monthly increase of 53%.

Total cumulative amount of RMB clearing in BOC Taipei (¥ bn)

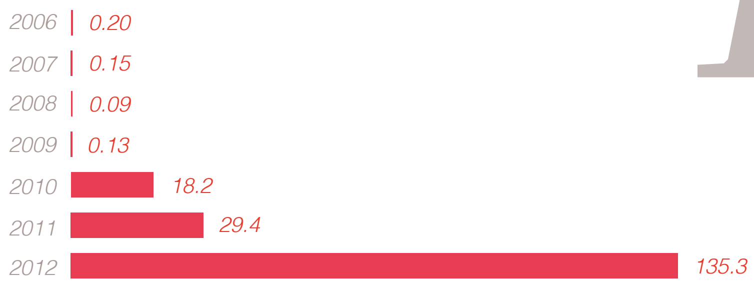


Source: Central Bank of Republic of China (Taiwan)

China's outward FDI Stock

Due to political factors, the stock value of China's outward FDI to Taiwan is very small compared to other countries. This situation has gradually begun to change in recent years. The political environment in Taiwan is improving and the government is treating mainland direct investment as an economic issue rather than a political one. Hence, the potential for OFDI is great.

China's outward FDI stock in Taiwan ($ mn)

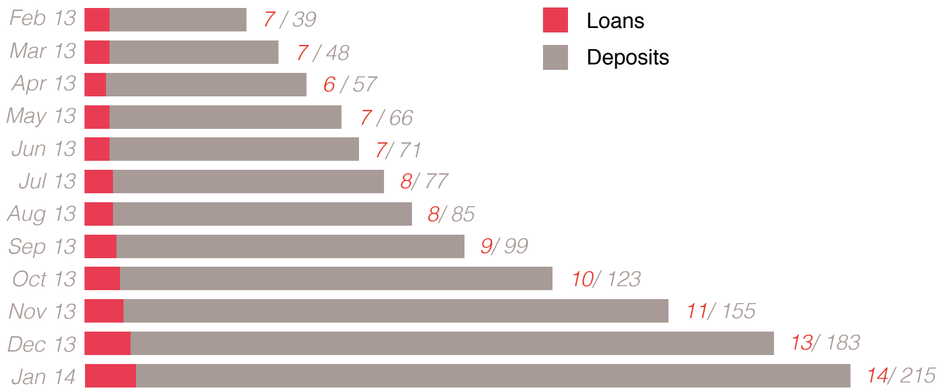


Source: MOFCOM

RMB deposits and loans

Taiwan's large trade surplus with China has resulted in an increasing RMB pool. The RMB deposits in Taiwan's banking system increased rapidly after Taiwan officially started developing cross-strait RMB business. From February to December 2013 RMB deposits in Taiwan increased more than four times over from ¥39 billion to ¥183 billion.

RMB deposits and loans (¥ bn)



Source: Central Bank of Republic of China (Taiwan)

RMB foreign exchange trade

Although Taiwan is not a global centre for forex trading, with a market share of only 0.4%, RMB forex volume accounts for 10% of its total forex trading volume, while in Hong Kong the RMB represents 18% of total forex trading value. According to the Triennial Central Bank Survey, published by BIS in September 2013, average daily turnover of RMB forex reached $2.5 billion, accounting for 1.7% of global trading volume.

Taiwan and RQFII

The Chinese government has promised Taiwan ¥100 billion in RQFII quotas. So far the quota has not been used and no asset managers in Taiwan have received an RQFII license.

In February 2014, Citi Bank announced its plan to cooperate with ChinaAMC (HK) to launch the first RQFII ETF in Taiwan using the quota from Hong Kong.

RMB bonds

In March 2013, Chinatrust Commercial Bank, a local Taiwanese bank, issued the first RMB denominated bonds in Taiwan, so-called "Formosa" bonds. A boost was given to the RMB debt market when the Taiwanese Financial Service Commission (FSC) allowed Chinese commercial and policy banks to issue RMB bonds in Taiwan to be sold to professional institutional investors (November 2013). However, mainland issuers are still facing an overall cap of ¥10 billion a year for the issuance of Formosa bonds. By January 2014, 11 issuers, including four state-owned mainland banks, had issued a total of ¥12.1 billion in bonds in Taiwan.

Latest developments

- Taiwan's Central Bank and PBC have begun negotiations for a cross-strait swap agreement that is expected to be signed by mid-2014.
- The FSC announced in January 2014 that it may consider raising the limit on Yuan bonds issued by mainland Chinese banks in Taiwan, depending on the size of RMB deposits.
- Agricultural Bank of China (ABC), China Construction Bank (CCB) and Ping An Bank set up their cross-strait RMB clearing centres in Xiamen in July, November and December 2013, respectively.

European Cross-Border RMB centres

Luxembourg
The hub for the Eurozone

After the founding of the People's Republic of China (PRC) in 1949, the country chose Luxembourg as the destination for its first overseas bank. Today, three of the largest Chinese banks (Bank of China, Industrial and Commercial Bank of China and China Construction Bank) have established their European headquarters in Luxembourg, giving the Grand Duchy a sufficient prerequisite to develop its offshore RMB business. Today, Luxembourg has the largest pools of RMB in Europe in terms of deposits, loans, listed bonds and assets in mutual funds. Luxembourg already serves as a hub and entry point for Chinese investors into the Eurozone and, conversely, as a conduit for European investments into China.

64 RMB bn

RMB deposits

256 RMB bn

Investment funds' AUM in RMB denominated assets

Key milestones

2008 - 2010

- 2008: The "Commission de Surveillance du Secteur Financier" (CSSF) signs an MoU with the China Banking Regulatory Commission (CBRC)
- 2010: The Central Bank of Luxembourg (BCL) signs an MoU with the PBC
- October 2010: China AMC launches China AMC China Opportunity fund, a Luxembourg SICAV investment fund, becoming the first Chinese asset management company to launch an investment fund in Europe

2011 - 2012

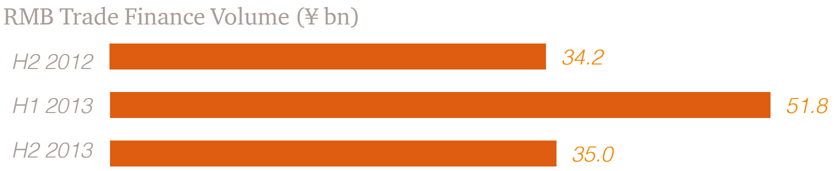
- January 2011: ICBC sets up its european headquarter in Luxembourg
- May 2011: The first dim sum bond issued by a European corporate is listed on the Luxembourg stock exchange
- November 2011: The first UCITS fund launched by a Chinese asset manager (CSOP Asset Management) is domiciled in Luxembourg
- 2012: CSSF signs an MoU with the CSRC

2013 - 2014

- May 2013: A private/public initiative to support RMB activities is launched by the Ministry of Finance
- September 2013: The Luxembourg Stock Exchange signs an MoU with Shenzhen stock exchange
- October 2013: China Construction Bank (CCB) opens its European headquarter in Luxembourg
- October 2013: ECB and PBC sign a currency swap of ¥350 bn
- November 2013: The first UCITS-compliant direct replication China A-shares fund on the CSI 300 index is approved by CSSF
- January 2014: The first RMB bond issued by a foreign government is listed on the Luxembourg Stock Exchange

RMB trade related finance

Due to its size, Luxembourg's trade volumes with China are relatively low. However, due to its active role as a hub for RMB financing activity, the RMB trade finance business is developing rapidly in the Grand Duchy. In 2013, the total volume of RMB trade finance reached ¥86.8 billion.

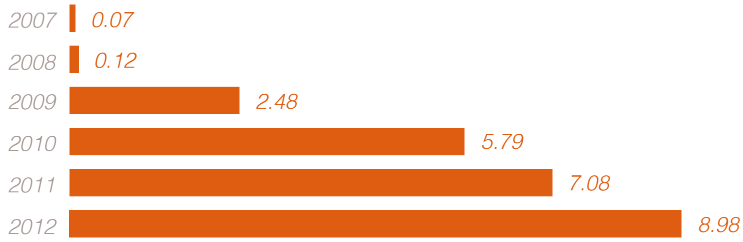


Source: PwC

China's outward FDI Stock

Luxembourg serves as a point of entry for Chinese investments into Europe. According to the Ministry of Commerce of the People's Republic of China, Luxembourg is the largest recipient of Chinese FDI stock into Europe. As of year-end 2012, China's outward FDI stock in Luxembourg had reached $8.98 billion, accounting for 28.5% of the EU and 47.7% of the Eurozone.

China's outward FDI stock in Luxembourg ($ bn)

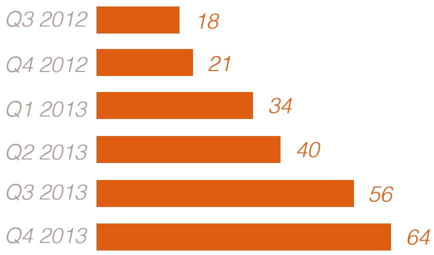


Source: MOFCOM

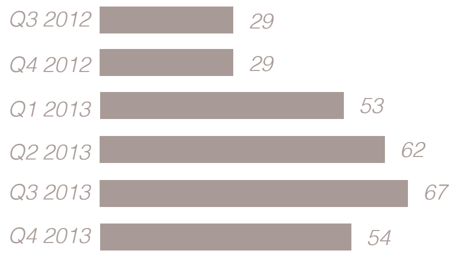
RMB deposits and loans

Luxembourg has the largest pool of RMB loans and deposits in Europe. RMB activities in Luxembourg have been growing rapidly for the last 12 months: deposits tripled to ¥64 billion and loans nearly doubled to ¥54 billion. This reflects Luxembourg's important role as a European hub for financial flows in and out of China, especially in the EU and the Eurozone.

RMB deposits (¥ bn)



RMB loans (¥ bn)



Source: PwC based on various sources

RMB denominated bonds and investment funds

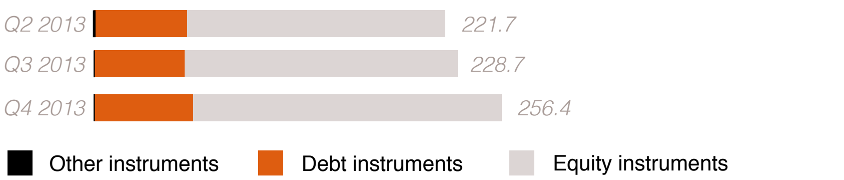
Luxembourg is the leading centre for international bond listing and also the first listing place for RMB denominated bonds outside of Asia. As of February 2014, 44 dim sum bonds from 29 international issuers with a volume of ¥29.7 billion are listed on the Luxembourg Stock Exchange.

With over €2.6 trillion in AuM, Luxembourg is the second-largest investment fund centre in the world after the United States and its funds are distributed in more than 70 countries. Multiple asset managers have already established RMB denominated funds, as well as funds investing in China, in Luxembourg with a total of nearly ¥256 billion in RMB denominated AuM.

In November 2013, CSSF became the first regulator to authorise an RQFII fund under a UCITS scheme allowing it for cross-border distribution to the European single market and beyond. For the first time, an RQFII quota allowed in Hong Kong was wrapped into a European product.

The development of RMB bonds and investment funds is supported by Luxembourg's infrastructures including custodian banks and the International Central Securities Depository (ICSD). According to Clearstream, RMB denominated securities settlement turnover in Luxembourg exceeded ¥635 billion in 2013.

RMB denominated assets held in Luxembourg domiciled investment funds (¥ bn)



Source: CSSF

Latest developments

- In January 2014, the first dim sum bond issued by a foreign government (British Columbia of Canada) was listed on the Luxembourg Stock Exchange with a landmark ¥2.5 billion size.
- Also in the same month, Deutsche Asset & Wealth Management (DeAWM) and Hong Kong-based Harvest Global Investments Limited launched the first UCITS-compliant direct replication China A-shares in Europe. The fund is domiciled in Luxembourg and is the first RQFII fund under a UCITS scheme that is authorised by a European regulator.
- Agricultural Bank of China (ABC) expressed an interest in setting up its European headquarters in Luxembourg later this year. The press reported that other Chinese banks are considering doing likewise.
- Clearstream is developing a triparty repo market to facilitate further growth in the RMB bond and fund markets.

London
The international capital markets centre

As one of the world's leading financial centres, London has been playing a key role in the integration of international capital markets and has strong ambitions to support the internationalisation of the RMB. During the fourth Economic and Financial Dialogue (EFD) in 2011, UK and Chinese officials agreed to support the development of RMB business in London. The UK was the first G7 country to sign a swap deal with China and the first outside of Greater China to receive an RQFII quota. With its well-developed financial sector, London provides a wide range of RMB products and services and differentiates in terms of trading volumes. In particular, London recently overtook Singapore as the largest RMB foreign exchange trading place outside of mainland China and Hong Kong.

14.5 RMB bn

RMB deposits

16.5 %

RMB Forex Trading Market share

Key milestones

2011

- September: Chancellor George Osbourne and Vice Premier Wang Qishan agree to collaborate on the development of RMB-denominated financial products and services in London
- December: The City of London initiative to make London a centre for RMB business is established

2012

- January: The Hong Kong Monetary Authority (HKMA) and UK Treasury announce the launch of a private-sector forum to enhance cooperation between Hong Kong and London on the development of RMB offshore business
- April: HSBC issues the first RMB denominated bond in London. Also, the City of London officially launches itself as a centre for RMB business
- November: The first subsidiary of a Chinese bank, CCB London, issues RMB denominated bonds in London

2013 - 2014

- June 2013: the PBOC signs a three-year currency swap with the Bank of England totalling ¥200 billion or £20 billion
- October 2013: China extends its RQFII pilot scheme by giving London an ¥80 billion quota; GBP becomes the fourth currency to directly trade against RMB; the UK allows Chinese banks to set up branches
- November 2013: ICBC issues RMB bonds in London and becomes the first Chinese Bank to do so at the group level
- January 2014: Ashmore Group becomes the first institution outside of Hong Kong to be granted a RQFII license
- January 2014: BOC London issues a ¥2.5 billion bond in London

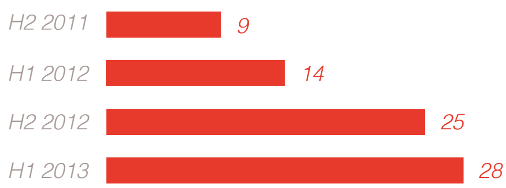
RMB trade related finance

The UK is one of China's most important trading partners in Europe. Goods trade between the UK and China reached $70 billion in 2013, ranked third after Germany and the Netherlands and accounted for 12.5% of total goods trade between China and the EU.

In July 2010, HSBC completed the first UK cross-border RMB trade settlement transaction in Hong Kong. In the absence of an RMB clearing bank and to facilitate European transactions, Hong Kong and the UK agreed, during a private sector forum in May 2012, to extend the operating hours of the RMB RTGS System.

The value of RMB trade finance business in London reached ¥28 billion in the first half of 2013, with a 102% year-on-year increase from the previous year.

RMB trade finance volume (¥ bn)

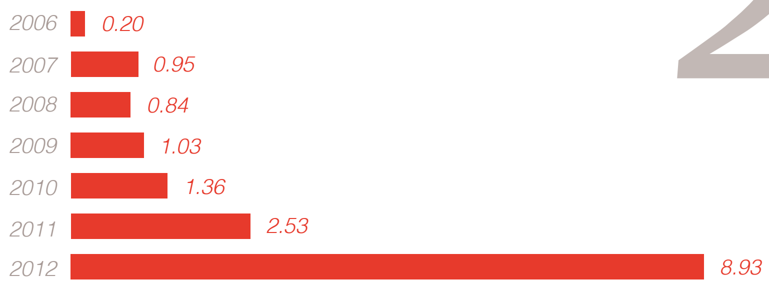


Source: Bourse Consult, City of London

China's outward FDI Stock

The UK has the second largest Chinese OFDI stock in Europe after Luxembourg. The cumulative value of capital inflows reached $8.93 billion by the end of 2012, with a huge increase from the prior year. According to MOFCOM, the UK was also the second largest EU investor (after Germany) in China as of year-end 2012, with a cumulative direct investment value of $18.76 billion.

China's outward FDI stock in the UK ($ bn)



Source: MOFCOM

Note: 2012 data was recomputed by MOFCOM after adjustment of historical data

RMB deposits and loans

Overall, RMB deposits in London have remained relatively stable since 2011, at between ¥14 to ¥15 billion. While inter-bank deposits make up the bulk of the RMB pool, private banking and corporate accounts constitute nearly ¥4 billion and ¥3 billion respectively.

According to the latest report by the City of London, "The relative insignificance of RMB deposits in London reflects the City's role as a trading, financing and risk-management venue rather than a centre for deposit taking." *

RMB deposits (¥ bn)

Source: Bourse Consult, City of London

**City of London and Bourse Consult, London RMB Business Volumes January-June 2013, January 2014.*

RMB foreign exchange trade

The UK is the leading foreign exchange trading centre in the world, conducting more than 40% of global forex trading - over twice as much as its biggest competitor, the US.

The RMB forex market is also quite active in the UK. According to BIS, average daily turnover of RMB forex trading reached $24.3 billion (April 2013), accounting for 16.5% of worldwide RMB forex turnover and overtaking Singapore as the leading RMB trading centre outside of China and Hong Kong. That said, as the overall size of RMB forex is still relatively small, it only accounts for 0.9% of total forex trading in the UK, whereas in Hong Kong it is 18%.

RMB denominated bonds and investment funds

While issuers tend to favour Luxembourg for the listing of RMB bonds, London remains an important centre for fundraising and trading activities. To date, 17 RMB bonds are listed on the London Stock Exchange including three issued by Chinese banks CCB, ICBC and BOC. The total issuance size of the listed RMB bonds reached ¥13.1 billion by January 2014.

In October 2013, London was granted an ¥80 billion RQFII quota. So far, the quota has not been used. In January 2014, the London-based Ashmore Group was granted an RQFII license by CSRC, which makes it the first non-Hong Kong-based institution to invest directly in the Chinese capital market.

Latest developments

- The UK regulatory authorities have agreed to consider applications from Chinese Banks to establish branches in the UK on the basis that any such branches only carry out wholesale banking activities.
- In January 2014, Hong Kong based asset management company CSOP and Irish-based Source listed the first RQFII ETF on the London Stock Exchange.

Paris and Frankfurt

The trading partners

China's most important trading partners in Europe are Germany, with the first largest trading volumes in China, and France, with the fourth largest. As China is promoting RMB as a trade settlement currency, an increasing portion of trade between China and these two countries is being settled in Renminbi. German and French corporates are also among the most active issuers of RMB bonds.

In November 2012, Paris Europlace announced a roadmap to contribute to RMB internationalisation. Paris aims to develop RMB commercial transactions and to leverage on its expertise when dealing with African countries to support Sino-African trade and investment flows.

Frankfurt has also joined the race. In July 2013, the Minister of Economy, Transport and Development of Hessen announced the establishment of a working group that will take measures to position Frankfurt as an international RMB centre.

20 ***RMB bn***

RMB deposits in France

162 ***RMB bn***

Goods trade between Germany and China

Key milestones

2011

- May: Volkswagen is the first German company to issue RMB denominated bonds with a size of ¥1.5 bn
- September: Air Liquide is the first French company to issue RMB denominated bonds with a size of ¥1.75 bn

2012

- August: During the second Sino-German Government Consultation, co-chaired by Prime Minister Angela Merkel and Premier Wen Jiabao, the two countries agree to use more RMB and Euros to settle their trade
- November: Paris Europlace sets up a working group, gathering the French and Chinese major banks based in Paris, as well as the market authorities, to participate in the internationalisation of Renminbi

2013

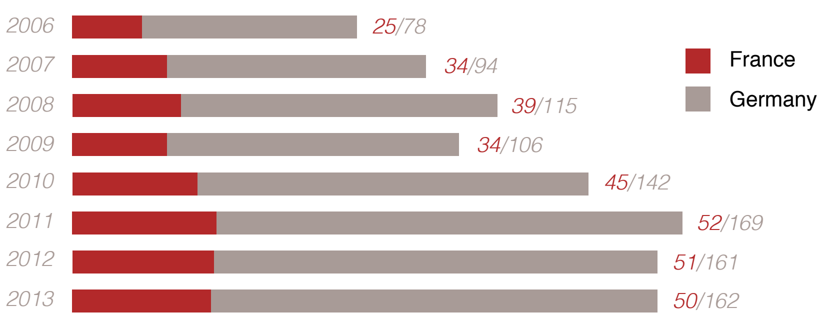
- July: The Minister of Economy, Transport and Development of Hessen announces the establishment of a working group to position Frankfurt as an international RMB centre
- November: The first China-France High-Level Economics and Financial Dialogue is held in Beijing

Cross-border RMB trade settlement

Germany is China's most important trading partner in Europe, with the largest goods trade volume in Europe and the fifth largest in the world (excluding Hong Kong) after the US, Japan, Korea and Taiwan. In August 2012, during the second Sino-German Government Consultation, the two countries agreed to use more RMB and Euros to settle their trade. However, there is no data published regarding the volume of RMB cross-border settlement.

France has the fourth largest trade volume with China in Europe. According to Paris Europlace, nearly 10% of Sino-French trade is settled in RMB. In addition, France ranked first in the Eurozone and fourth in the world for RMB payments value (excluding China and Hong Kong) according to SWIFT.

Goods Trade between China and Germany and France ($ bn)

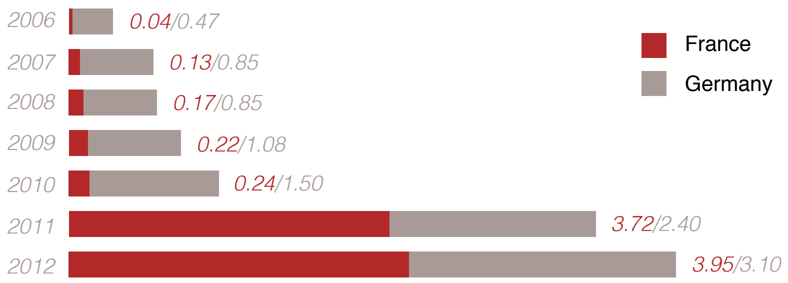


Source: General Administration of Customs of China

China's outward FDI Stock

Compared to the steady increase of China's OFDI into Germany, the OFDI into France has higher volatility. In 2011, France saw a significant increase in China's outward direct investment inflows, whereas in 2012, the total value increased marginally.

China's outward FDI stock in France and Germany ($ bn)



Source: MOFCOM

RMB deposits

According to Paris Europlace, the RMB deposits in Paris were approximately ¥20 billion by the third quarter of 2013, with a 100% increase from the year end 2012 level.

Paris currently holds the second largest RMB deposits pool in Europe, after Luxembourg. Information regarding Frankfurt and Paris RMB loans is not available.

RMB deposits (¥ bn)

Source: Paris Europlace
Note: No data is available for Frankfurt

RMB foreign exchange trade

RMB foreign exchange activity in Paris and Frankfurt is not significant. According to the BIS survey, average daily turnover of RMB foreign exchange in France and Frankfurt was $1.2 billion and $0.5 billion respectively in April 2013, accounting for less than 1% of total RMB forex turnover.

RMB denominated bonds

French companies are among the top issuers of RMB denominated bonds in Europe, with 16 bonds issued by six corporates and three banks amounting to a total value of ¥10 billion so far.

To date, more than 40 RMB bonds are listed in Germany but mainly for secondary listing (on the "quotation board").

French and German companies are the major European issuers of RMB bonds in Hong Kong, and also account for over one-third of RMB bonds issuance on the Luxembourg Stock Exchange.

Latest developments

- In November 2013, the first China-France High-Level Economics and Financial Dialogue was held in Beijing. China and France agreed on further cooperation to support the development of the Paris offshore RMB market, including the assessment of the need for designating an RMB clearing bank in Paris. China will also consider actively supporting Paris through the RQFII arrangement within a reasonable timeframe.
- In December 2013, Germany ranked fourth after China, Hong Kong and Singapore in terms of RMB trade finance according to the latest figures from SWIFT.

Looking forward

The internationalisation of the RMB will continue to be a priority for China

During its annual working/planning meeting in January 2014, PBC set "continuing expansion of RMB cross-border usage" as one of eight top priorities for the year. China has unveiled ambitious financial reforms, including further relaxation of capital markets, interest rate liberalisation and gradual implementation of convertibility under the capital account as well as RMB exchange rate liberalisation. Within this context, the government is launching additional schemes, developing a settlement system that will simplify cross-border transactions and has recently inaugurated the Shanghai Free Trade Zone (FTZ).

Shanghai FTZ boosts China's reform efforts

In September 2013, China announced the establishment of the FTZ, a small 28-square kilometre area of the Pudong district, which serves as an experiment for policies ranging from liberalising interest rates to opening capital accounts. The FTZ will operate as an international settlement centre for international trade, allowing banks within its borders greater flexibility in conducting business. The implications of this will reach far beyond China to the rest of the global economy. Renminbi convertibility within the FTZ represents a significant measure by the Central Government to boost China's reform. This measure is particularly important because, going forward, the interest rate will be driven by the market instead of the central bank. Also, companies that were previously required to engage in a lengthy authorisation process with the national regulator in order to establish a presence in the country will now simply register with the FTZ to begin business.

Based on the experience of earlier cross-border RMB loans pilot programmes in Qianhai and Kunshan, Shanghai FTZ officially launched a cross-border RMB two-way cash pooling business in December 2013. This will serve as an additional channel to facilitate cross-border RMB financing.

China's International Payment System will improve clearing efficiency

To further support RMB cross-border transactions, the PBC is developing an additional clearing and settlement system called China International Payment System (CIPS). CIPS will be modeled after the US Clearing House Interbank Payment System (CHIPS) and is expected to be fully operational by the end of the year. This initiative will further consolidate current Renminbi cross-border payment systems and improve cross-border clearing efficiency. The new system will also assist in developing RMB transactions across different time zones and improving trading security in an environment where cross-border trade flows are growing markedly. Given that CHIPS currently processes over 95% of the large value USD payments, we may expect that, in the long run, CIPS will play a major role in China's payment system.

Investment schemes will extend to new markets

Currently, there are three investment schemes available for institutional investors in the asset management sector, namely QDII, QFII and RQFII. When the Chinese government decides to expand the current schemes, we expect other financial centres, such as Luxembourg and Paris, to be considered by China as the next RQFII destinations.

Furthermore, the Chinese authorities may launch additional schemes, including RQDII, for institutional investors and to expand the current schemes to individual investors (e.g. RQDII2 and RQFII2) *(See Appendix 1)*.

In October 2013, Singapore was given consideration as an investment destination for RQDII, while other centres are also seeking such a designation.

The circulation of the RMB outside China will rise

Over the last ten years, trading in RMB saw a significant rise and, in less than a decade, it overtook 22 other currencies according to BIS figures. HSBC expects the RMB to enter the top-three global trading currencies by 2015 with the euro and dollar[8].

In 2015, the International Monetary Fund (IMF) is set to review the composition of the basket of currencies it uses to define Special Drawing Rights (SDR), and China anticipates the RMB will be added alongside the dollar, euro, pound sterling and yen. All of this will further facilitate the development of the Renminbi.

RMB will be increasingly used for international transactions

China was on a steady course to overtake the US as the largest goods trading nation in 2012, reporting just $15 billion less than America in total trade. While only 12% of China's total trade was denominated in RMB that year, various reports estimate RMB trade settlement will reach 28% of total Chinese trade settlements, amounting to $3 trillion by 2020[9].

In addition, according to a Standard Chartered Survey, 73% of corporate treasurers think the RMB will be at least the world's third most important currency for the next decade[10]. For companies located in Asia, this figure rises to 85%.

> *"By 2020, we expect 28% of China's international trade to be denominated in Renminbi, some $3 trillion a year."*
>
> Standard Chartered, Do you Renminbi?, 2012

RMB will be widely traded

A study, gathering the opinions of 90 High Net Worth Individuals also found that the majority of its participants (69%) predict RMB will be one of the three strongest currencies in the world throughout the next 30 years[11]. The offshore RMB debt market is expected to grow 30% per year, to ¥3 trillion ($500 billion) by 2020, according to Standard Chartered, who predicts the dollar, the euro and the Chinese Yuan (CNY FX) rates will dominate global financial markets by 2020. According to this forecast, daily CNY FX turnover should grow from the current $120 billion to exceed $500 billion (¥3 trillion).

> *"In a recent study, 69% of High Net Worth Individuals predicted RMB will be one of the three strongest currencies in the world throughout the next 30 years."*
>
> Flemming Family & Partners, The World in 2043, 2013

The use of the RMB as a reserve currency will increase

The Renminbi is well on its way to becoming a global reserve currency. After the dollar seized up in 2008, the need for an alternative reserve currency became apparent and many countries began taking the RMB more seriously. China's prodigious global output and trade combined with its efforts to facilitate international use of RMB have created substantial "buy in" from monetary authorities around the world. Although hurdles like capital account restrictions and limited exchange rate flexibility have yet to be overcome, the currency is on the fast track to complete internationalisation. "The Chinese Renminbi appealed to some reserve managers," reported the European Central Bank in a recent study, "but its lack of convertibility was often cited as an obstacle to investment. Within the next five to ten years, however, 37% of the [reserve managers] indicated that they would consider investing in the Chinese Renminbi[12]."

> *"Within the next five to ten years, 37% of the [reserve managers] indicated that they would consider investing in the Chinese Renminbi."*
>
> European Central Bank, The International Role of the Euro, 2013

Given China's size and growth prospects, the likelihood of the RMB joining the ranks of the dollar and euro seems inevitable. The Chinese government is taking every measure necessary to remove obstacles in its way: opening the capital account, extending swap lines and approving RQFII licenses are major initiatives that demonstrate China's commitment to internationalise the RMB. But the effort to establish a third global currency is not limited to China. Asia and Europe have joined the effort, showing support through substantial participation in these initiatives. Brazil and Argentina have signed swap agreements with China in order to further support trade relationships. And the US and Africa have taken noteworthy strides in this direction.

[8] HSBC, The Year of the Renminbi, 2013
[9] Standard Chartered, Do you Renminbi ?, October 2013
[10] Standard Chartered, Offshore Renminbi: Current & planned usage by corporate treasurers, July 2013
[11] Flemming Family & Partners, The World in 2043, December 2013
[12] European Central Bank, The International Role of the Euro, 2013

The US could play a bigger part in RMB development

Economic ties between the US and China have expanded substantially over the past three decades, rising from $5 billion in 1981 to an estimated $559 billion in 2013. China is currently the United States' second-largest trading partner, its third-largest export market, and its biggest source of imports[13]. By all accounts, the two countries are natural partners for economic development. However, appetite for developing RMB in the US lags far behind European backing of the currency.

That said, America has taken a couple of notable steps toward integrating RMB into the financial fabric of its economy. For instance, Harvest Global Investments recently partnered with DeAWM to list the db X-trackers Harvest CSI 300 China A-Shares Fund on the New York Stock Exchange (November, 2013). The launch gave American investors direct access to China's A-market for the first time and attracted $100 million (€74.5 million) of initial investment[14]. Following the fund's success, Chinese asset management firm CSOP announced a collaborative effort with London-based Source to apply for an ETF in the US (January, 2014). This will be the second ETF listed in the US under the RQFII scheme, (after DeAWM and Harvest)[15]. While these initiatives are not commensurate with efforts made in Europe and Asia, they, nevertheless, contribute to the internationalisation of the RMB.

Africa is also looking to get into the game

Over the years, China and Africa have cooperated in bilateral trade that has evolved into a partnership that governs billions of US dollars. More recently, China has begun to invest heavily in Africa, specifically in its infrastructure. The symbiosis between Africa's development needs, which China can address, and China's need for raw materials, which Africa can provide, has created a solid platform to further strengthen economic ties.

At year-end 2012, China had signed bilateral investment treaties with 32 African countries and established joint economic commission mechanisms with 45 of them[16]. Last year, several key developments took place on the African continent: South Africa signed an MoU with the PBC for a $1.5 billion quota of investments in China's interbank bond market, the State Bank of Mauritius imported ¥5 million in cash to meet the growing demand for Chinese currency[17], and Kenya announced its aim to host Africa's first RMB clearing house.

Aside from obvious benefits like reducing the need for dollar settlements, expediting the process and curtailing costs, such a development would bring Kenya major reputational credibility by allowing the country to serve as Africa's gateway to the Asian economy. If the RMB were to serve as a common settlement currency in the coming years, it could realistically be used for official flows such as bilateral loans or aid that is currently denominated in dollars. According to Standard Bank, by the year 2015, nearly 40% of trade transactions between China and Africa will be settled in RMB[18].

While these actions have accelerated the process of internationalising the Renminbi, much remains to be done. But considering China's determination and the rate at which it is moving toward full convertibility, it won't be long before the RMB is seen as a bona fide international currency. In the meantime, investors all over the world have a front row seat at what could be one of the most important economic developments of the century.

[13] Congressional Research Service, Morrison, Wayne, China-US Trade Issues, 13 January 2014.
[14] Deutsche Banque Media, DeWAM to launch First US ETF, 5 November 2013.
[15] Reuters, Chinese asset firm CSOP to launch US fund, 28 January 2014.
[16] Xinhua, China's investment in Africa increases 20.5% annually, 29 August 2013.
[17] ChinaDaily, Renminbi Rising, February 2014.
[18] Standard Bank, BRIC-Africa, the redback's rise, 29 August 2011.

Conclusion

With ardent backing from the Chinese government, the internationalisation of RMB has made giant strides in recent years. Initially, the currency was used in trade settlement, but soon countries throughout the world began using it for investment and reserve currency purposes. During the past decade, notable levels of RMB have accumulated in international financial centres throughout the world making an indelible impact on the global cross-border markets.

In the early stages of internationalisation, development of the RMB was mainly driven by the Chinese government's regulatory policy. However, more recently, especially since 2013, market factors have played an increasingly important role in this process and the Renminbi is moving away from a regulatory-driven currency to a market-driven currency.

While Hong Kong is by far the most developed RMB offshore centre with sufficient liquidity and a broad range of RMB products, other RMB international centres have developed individual areas of expertise. For example, London and Singapore are known mainly for trade and forex, Taiwan and Germany have the advantage on goods trade and Luxembourg is a financial hub, serving as a gateway between China and Europe for investment and asset management.

The diversity and aptitude of these financial centres is the result of the market's influence in their development. Within this context, cooperation between different RMB cross-border centres becomes increasingly important, not only because of the complementary roles they play, but also because collaboration prevents the fragmentation of offshore RMB markets. For example, Hong Kong extended the opening hours of the RTGS system in order to facilitate RMB clearing and settlement for European countries, the stock exchanges in Singapore and Hong Kong cooperate on the secondary listing of RMB bonds and asset managers have begun using their RQFII quotas in Luxembourg UCITS funds.

While these are welcome developments, they are not without a certain degree of risk. The impact RMB internationalisation will have on exchange rates and interest rates remains unclear. An asymmetry between international supply and demand for Yuan could lead to a higher level of volatility. Additionally, there is a risk (albeit a small one) of China not opening its capital account completely or failing to achieve full convertibility.

In the foreseeable future, we expect that the Chinese regulator will continuously deregulate the capital account and achieve full convertibility of RMB by 2020. When that happens, the market will play the dominant role in the development of cross-border RMB activities. We will see a diversified cross-border RMB market in which financial centres scattered across the globe are closely connecting with one another. The realisation of internationalising the RMB is no longer an ambitious aspiration, but a reasonable likelihood.

Appendix 1
Investment schemes

Existing and expected investment schemes

Type of investors		Institutional investors	Individual investors
Domestic (Chinese) investors	Non-RMB Scheme	**QDII*** “Qualified Domestic Institutional Investors” QDII refers to a Chinese qualified domestic institutional investor which has approval from the CSRC to raise funds in Mainland China and to use the proceeds to invest offshore through a quota granted by the State Administration of Foreign Exchange (SAFE).	**QDII2**** PBOC announced plans to launch the QDII2 programme. When this programme comes into effect, certain qualified domestic individuals will be permitted to invest in offshore securities markets (likely through Chinese securities companies).
	RMB Scheme	**RQDII**** The authorities could introduce an “RQDII” scheme, allowing qualified institutional investors in China to invest offshore using RMB-denominated funds, with the ultimate assets being held in either RMB or another currency.	**RQDII2**** The upcoming QDII2 programme is expected to eventually extend to RMB, as it is consistent with the central government’s objective to balance the inflow and outflow of RMB. The launch of this programme will allow qualified individual investors in China to invest in the offshore RMB market using RMB.
Foreign investors	Non-RMB Scheme	**QFII*** “Qualified Foreign Institutional Investors” was introduced by the Chinese government in 2002 to allow eligible foreign investors to invest in listed domestic securities subject to a quota approved by SAFE. QFII quotas are usually funded through foreign currencies from foreign investors.	**QFII2**** Officials at CSRC and SAFE have indicated that there have been internal discussions on plans to launch “QFII2”, although there is no definitive timeline. This would allow offshore individual investors to directly access China’s securities market in the same manner as existing QFIIs.
	RMB Scheme	**RQFII*** “Renminbi Qualified Foreign Institutional Investors” allowed qualified foreign fund management companies to invest offshore RMB in the domestic Chinese market. RQFII funds can invest offshore RMB directly in mainland bond and equity markets through the quotas granted by SAFE.	**RQFII2**** Officials at CSRC and SAFE have indicated that there have been internal discussions on plans to launch “RQFII2” programme, although there is no definitive timeline. This would allow offshore individual investors to directly access China’s securities market in the same manner as existing RQFIIs (i.e. invest offshore RMB in the domestic Chinese market).

* Existing schemes
** Expected schemes

Appendix 2
Glossary

ABC	Agricultural Bank of China
AMCM	Monetary Authority of Macau
ASEAN	Association of Southeast Asian Nations
A-Share	Specialised Shares of mainland China-based companies quoted in RMB that trade on Chinese stock exchange
AuM	Asset under Management
BCL	Banque Centrale du Luxembourg
BIS	Bank of International Settlement
BOC	Bank of China
CBC	Central Bank of Republic of China (Taiwan)
CBRC	China Banking Regulatory Commission
CCB	China Construction Bank
CDB	China Development Bank
ChinaAMC	China Asset Management Company Limited
CHIPS	Clearing House Interbank Payments System
CIPS	China International Payment System
CNH	Currency code for offshore Renminbi
CNY	Currency code for onshore Renminbi
CSI 300	A capitalisation-weighted stock market index designed to replicate the performance of 300 stocks traded in the Shanghai and Shenzhen stock exchange
CSRC	China Securities Regulatory Commission
CSSF	Commission de Surveillance du Secteur Financier
Dim-sum bond	RMB denominated bond issued in Hong Kong
ECB	European Central Bank
ETF	Exchange-Traded Fund
FDI	Foreign Direct Investment
FER	Foreign Exchange Reserves
Forex	Foreign exchange
Formosa Bond	RMB denominated bond issued in Taiwan
FTZ	Free Trade Zone
Greater China	Mainland China, Hong Kong, Macau and Taiwan
HKEx	Hong Kong Stock Exchange
HKMA	Hong Kong Monetary Authority
ICBC	Industrial and Commercial Bank of China
IPO	Initial Public Offering
LuxSE	Luxembourg Stock Exchange
MAS	Monetary Authority of Singapore
MOFCOM	Ministry of Commerce of People's Republic of China
MoU	Memorandum of Understanding
NAV	Net Asset Value
OCBC	Oversea-China Banking Corp.
OFDI	Outward Foreign Direct Investment
PBC	People's Bank of China
QDII	Qualified Domestic Institutional Investors
QFII	Qualified Foreign Institutional Investors
QFLP	Qualified Foreign Limited Partner
REIT	Real Estate Investment Trust
RMB	Renminbi
RQDII	Renminbi Qualified Domestic Institutional Investors
RQFII	Renminbi Qualified Foreign Institutional Investors
RTGS	Real Time Gross Settlement
SAFE	State Administration of Foreign Exchange
SAR	Special Administrative Region
SDR	Special Drawing Right
SGX	Singapore Stock Exchange
SICAV	Société d'Investissement à Capital Variable
SWIFT	Society for Worldwide Interbank Financial Telecommunication
UCITS	UCITS is the acronym for Undertakings for Collective Investment in Transferable Securities. The term refers back to EU Directive 85/611/EC of 20 December, 1985, the objective of which was to create the legal framework for a single European market for retail investment funds, while at the same time ensuring a high level of investor protection.

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