

# RMB Internationalization and Its Implications for Korea's Capital Markets

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# Agenda

**I**

**RMB Internationalization Progress**

**II**

**Development of RMB Capital Markets**

**III**

**Implications for Korea's Capital Markets**

# **I. RMB Internationalization Progress**

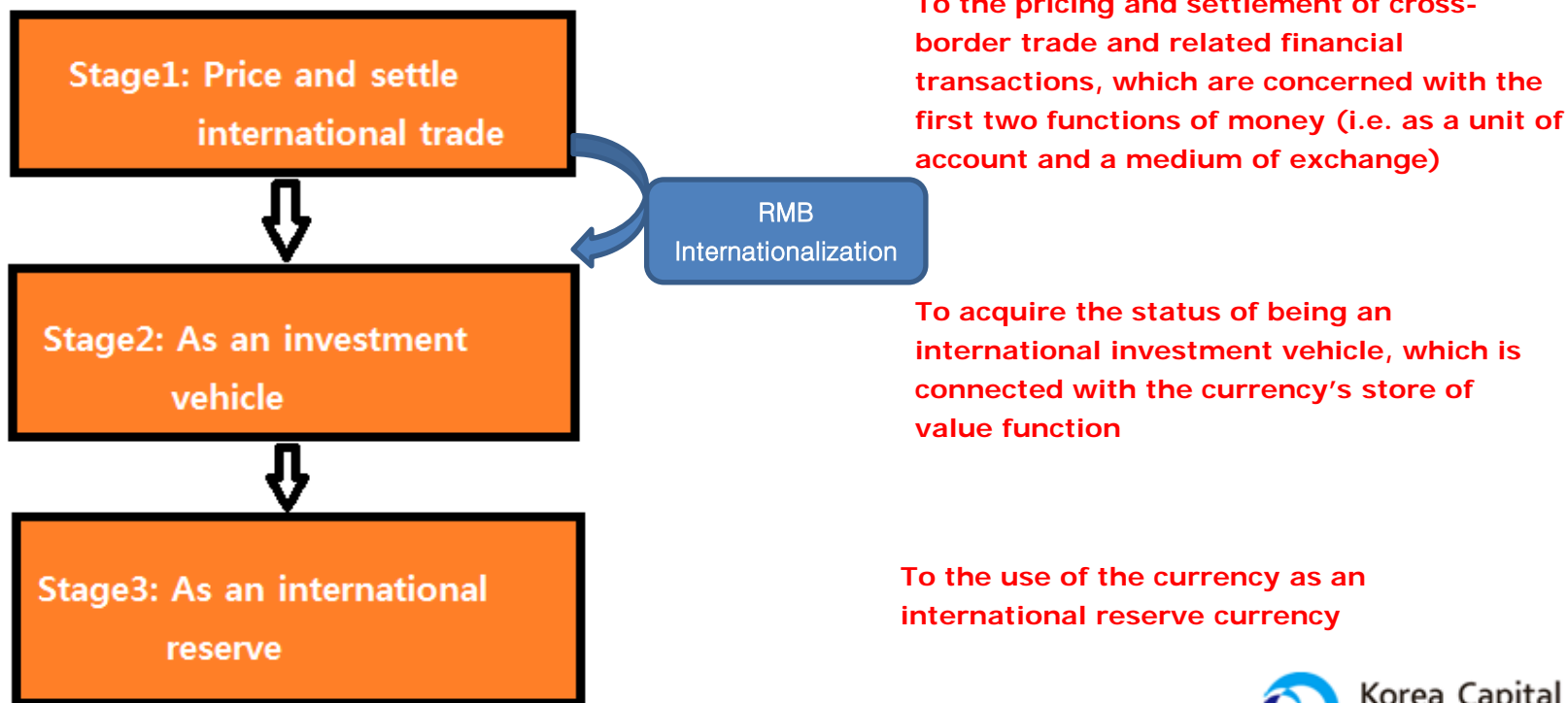
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- ◆ **Means of RMB Internationalization**
- ◆ **Progress in RMB Internationalization**
- ◆ **Future Steps**

# Means of RMB internationalization

- ❖ In theory, money has several economic functions, that is, as a unit of account, a medium of exchange and a store of value.
- ❖ We take RMB internationalization to refer to the relaxing of capital controls so that the RMB can become a more widely used *trade currency*, followed by its use as an *investment denomination*, and finally a *reserve currency*.

## Three Stages of transforming into an international currency



# Progress in RMB Internationalization

- ❖ The tough issue for the RMB internationalization is that: *whether there is a road map feasible for China to encourage the RMB to be used in Asia by way of both market need and policy motivation*, and then, gradually, for the RMB to be used internationally.

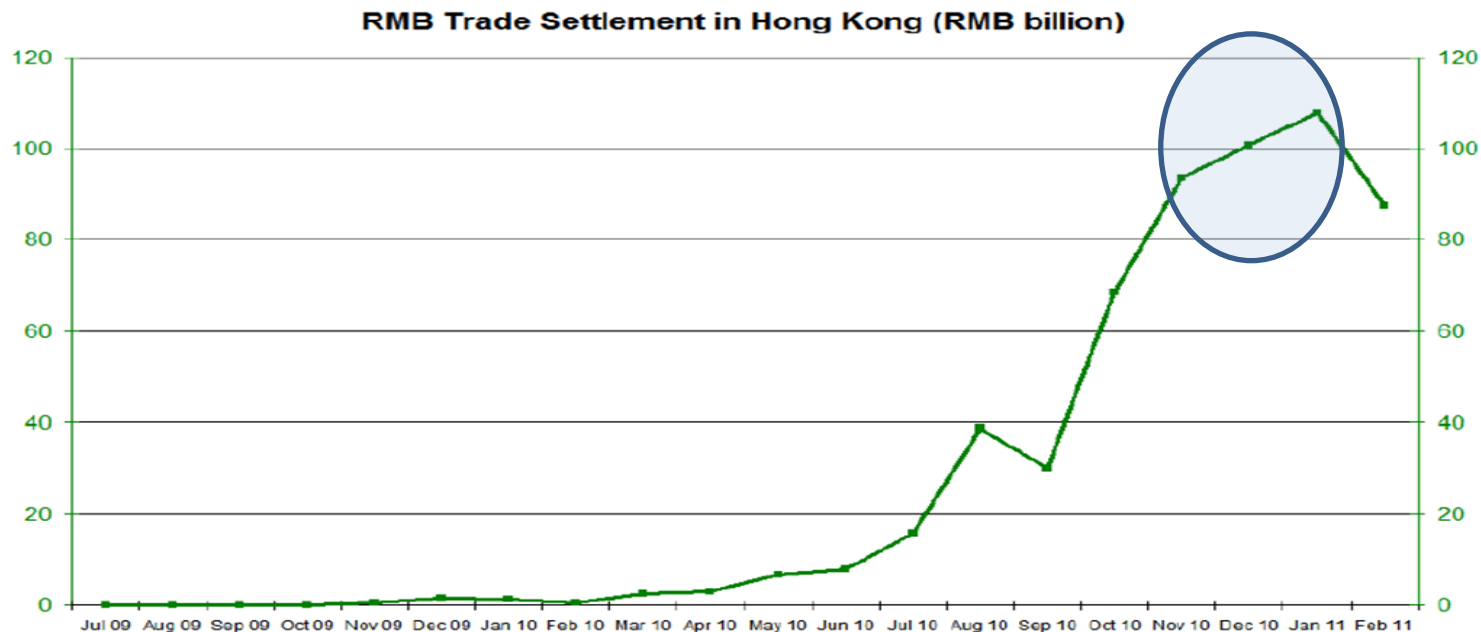
## What degree the RMB is used internationally/regionally

Step	Objective	Contents	Policy
Peripheralization	RMB is useful in the peripheral countries and regions as the hard currency	Peripheral settlement currency	<ul style="list-style-type: none"> <li>1.29" Hard cash circulation around neighboring countries (Hong Kong, Macau, Myanmar, Nepal, etc.)</li> <li>1.29" As of 2004, banks in Hong Kong can offer RMB deposit taking, currency exchange and remittances services</li> <li>1.29" Enterprises in 20 provinces and cities on the Mainland can now settle their trade transactions with any part of the world in RMB</li> </ul>
Regionalization	The RMB can be used in a certain region like the euro in Europe	Regional investment currency	<ul style="list-style-type: none"> <li>1.29" On July 2009, authorities in China announced that banks in HK, Macau and ASEAN countries (ID, MY, PH, SG, TH and VN) can participate in China's pilot scheme of RMB Cross Border Settlement</li> <li>1.29" Payment currency in BSAs (with Korea, Japan and the Philippines) under the CMI</li> <li>1.29" Bilateral swap arrangement between central banks (with Korea, HKMA, Malaysia and Belarus)</li> <li>1.29" Trade settlement in RMB (with Vietnam, Mongolia, Cambodia, etc)</li> <li>1.29" Regional bond investment vehicles (CGIM)</li> <li>1.29" Take initiative in formation AMF (Asian Monetary Fund) process</li> <li>1.29" RMB loans in HK</li> <li>1.29" RMB bond issuance in HK by policy and commercial banks</li> <li>1.29" RMB government bond issuance under ABF2</li> <li>1.29" RMB equity issuance (H share)</li> </ul>
Globalization	The internationalization of the terrain and level RMB to international reserve currency and eventually accepted by the foreign countries	To use the currency as an international reserve currency	<ul style="list-style-type: none"> <li>1.29" Expansion of the pilot program</li> <li>1.29" Expansion of the bilateral swap</li> <li>1.29" Offshore investments</li> <li>1.29" Expansion of IMF voting rights through increasing of IMF ownership</li> <li>1.29" Join SDR basket???</li> <li>1.29" Fully convertible RMB</li> </ul> <p>* Need to realize free convertibility of RMB and the capital market liberalization</p>

# RMB as a trade settlement currency

## ❖ RMB as a trade settlement currency will be enhanced

- The Pilot Program of RMB Cross-Border Trade Settlement is *an important step toward* the internationalization of the RMB
- *More than 75% of Mainland's RMB trade* transactions with the world are handled by banks *in Hong Kong*
- The pilot scheme of cross border RMB trade settlement was launched in July 2009. The cumulative amount of RMB trade settlement *increased rapidly* and reached **RMB 566.5 billion by the end of February 2011**



# Future Steps

- ❖ Policy challenges and impediments to the further development of RMB cross-border use
  - still *have limited incentives to hold* and use RMB
  - due to the *limited pool of offshore RMB*, *limited range of RMB investment opportunities and channels*
  - *the majority (80%) of trade transactions* involving RMB is concentrated *among Chinese importers* of foreign goods
  - *various restrictions of their remittance and usage within China*
- ❖ Although the RMB's internationalization is well underway, *it is just at the initial stage of going global*. It has *a long way to go* to become a widely accepted international currency
  - RMB internationalization also requires several conditions:
    - (i) the RMB valuation and settlement of international trade functions require a *strong value of the RMB*
    - (ii) for the international currency transactions of RMB functions , RMB *exchange needs to be free*
    - (iii) for the international storage capabilities *outside of the RMB needs to return to mainland*
- ❖ Next Steps → After all, the prospect of RMB internationalization is *closely associated with its convertibility as well as depth and openness of capital markets*

## **II. Development of RMB Capital Markets**

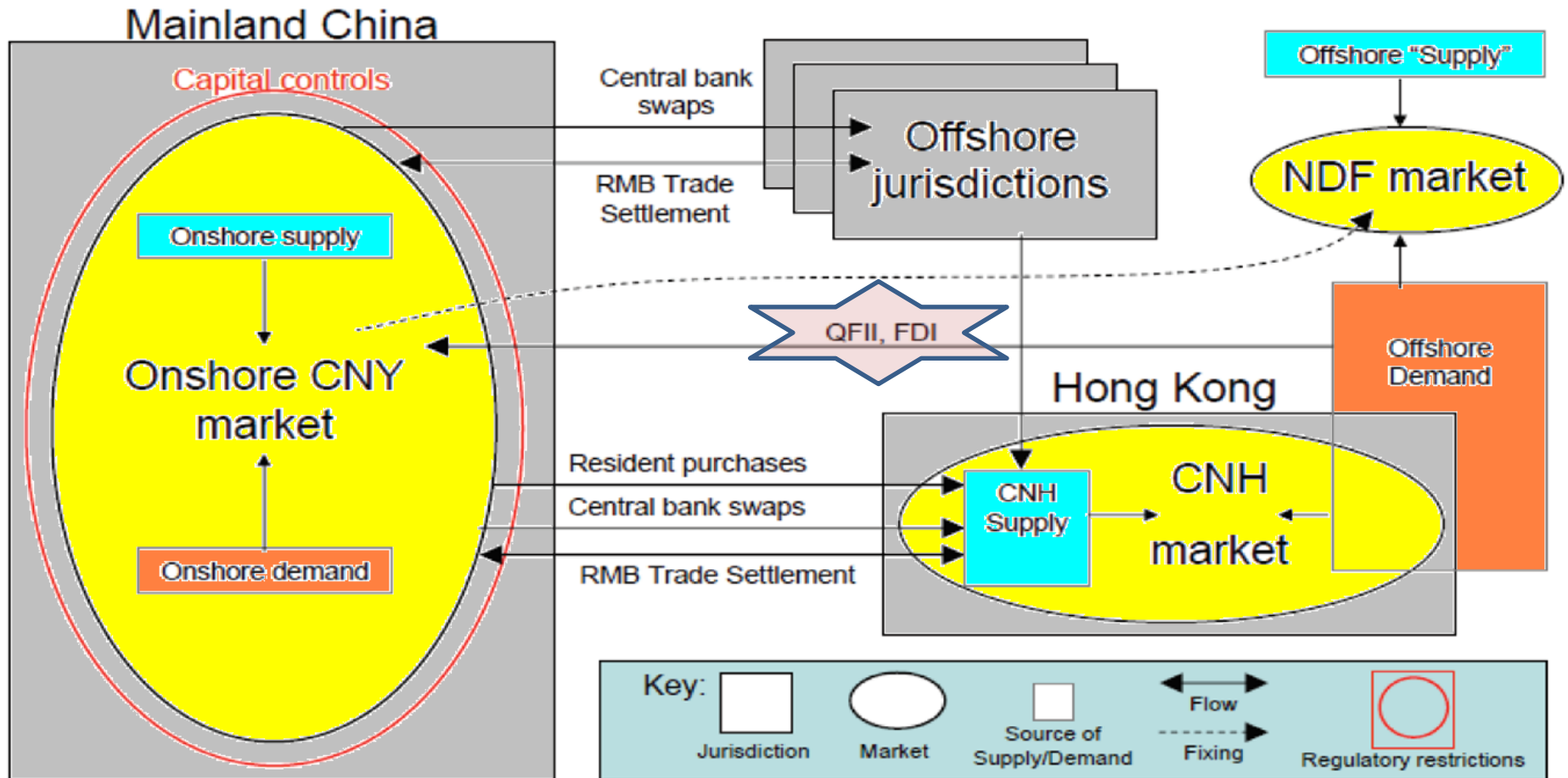
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- ◆ Onshore RMB Capital Markets
- ◆ Offshore RMB Capital Markets
- ◆ Prospect



# What is the RMB Capital market?

Diagram : One country, two systems, three currencies



Source: HSBC

# Onshore RMB Capital Market – Stock Market

- ❖ No change to onshore RMB within mainland China
- ❖ Primarily focused on import/export trade, extending into FDI and ODI i.e. *real economy activities*
- ❖ Objective is *to facilitate interaction and transaction* between Chinese enterprises and foreign companies

## ❖ Onshore RMB Direct investment

		Inflows*	Outflows*
Direct investment		Free. Inward remittance converted into Renminbi	Subject to SAFE reviewing sources of foreign exchange assets investments abroad.

## ❖ Onshore RMB Stock Market

		Inflows*	Outflows*
Stock market	nonresidents	Purchase B shares and QFIIs subject to a set of limitations	Sale B shares, repatriate of QFIIs
	residents	Sale B, H, N and S shares abroad#	QDIIs

QDII, QFII Nos and Total Quota ( \$billion)

		Nos	Quota
QDII		98	669.04
QFII		106	189.7
	KOREA	8	9.45

Source: Wind, 2011.03.11

\*Inflows: purchase locally by nonresidents; sale or issue abroad by residents.

\*Outflows: sale or issue locally by nonresidents; purchase abroad by residents

Source: SAFE, IMF, Exchange Arrangements and Exchange Restrictions, Annual Report 2007, Gao Haihong & YU Yongding (2009), Author's calculation

# Onshore RMB Capital Market – Bond Market

## ❖ Onshore RMB Bond Market

		Inflows*	Outflows*
Bonds and other debt securities	nonresidents	QFIIs	International development agencies are permitted <u>to issue RMB denominated bonds</u> locally, with the approval of the MOF, the PBoC, and the National Development and Reform Commission.
	residents	Prior approval by State Council for Examination and SAFE. Earnings should be repatriated.	Domestic insurance companies, securities firms and <u>qualified domestic banks</u> may <u>purchase foreign bonds</u> that meet rating requirement, subject to approval of the CIRC and the SAFE.

Month: 2011-03

Table 3. Panda Bonds Issued in China

Issue Date	Issuers	Size (billions, yuan)	Rates	Maturity (year)
October 2005	Asian Development Bank	1	3.34 percent	10
October 2005	International Finance Corporation	1.13	3.4 percent	10
November 2006	International Finance Corporation	0.87	3.2 percent	7
December 2009	Asian Development Bank	1	4.2 percent	10
May 2010	Bank of Tokyo-Mitsubishi UFJ (China)	1	Negotiated	2

Note: The Panda bonds that have been issued as of January 2011 are presented. The information is compiled by the authors.

## Bond Market Overview


In 100 Millions RMB

	This month		This year		Last year	
	volume	Number	volume	Number	volume	Number
Issuance						
RMB-dominated Bonds	10,563.64	212	16,919.83	413	95,088.33	1,167
USD-dominated Bonds(\$)	0.00	0	0.00	0	6.10	10
Spot Trading Volume						
Inter-bank Market	65,244.28	40,840	136,094.84	84,847	676,872.18	338,787
OTC Market	2.93	10,878	7.91	22,498	41.71	100,160
Repo Trading Volume	104,112.15	21,446	247,215.68	54,916	947,929.48	178,345
Collateral Repo	101,761.37	19,968	241,917.65	51,488	917,646.62	165,333
Buy-sell Repo	2,350.78	1,478	5,298.03	3,428	30,282.86	13,012
Forward Trading Volume	172.82	130	209.80	159	3,108.19	956
Principal Redemption Volume(Principal)	8,314.97	676	17,248.83	1,879	67,387.09	5,794

Source: <http://www.chinabond.com.cn/Channel/318702>

# Onshore RMB Capital Market – Others

## Onshore RMB Capital Market

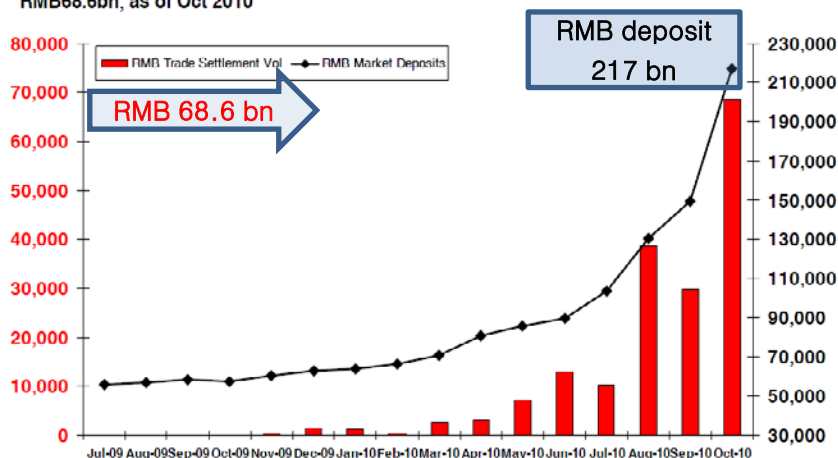
	Onshore RMB Money Market		Onshore RMB Collective Investment Securities Market		Onshore RMB Derivatives Market	
	Inflows	Outflows	Inflows	Outflows	Inflows	Outflows
<b>Nonresidents</b>	QFIIs	No permission	QFIIs invest in domestic closed-end and open-end funds	No permission	No permission 	No permission
<b>Residents</b>	Bonds with less than one year duration and commercial instruments, approval by the SAFE.	Authorized entities (insurance companies, securities firms and qualified domestic banks)	Prior approval by State Council for Examination and SAFE. Earnings should be repatriated.	No permission for residents, except authorized entities	Operations in such instruments by financial institutions are subject to prior review of qualifications and limited to open foreign exchange positions	Banking institutions with approval by CBRC for the purpose of risk hedging, not for speculation. Non-financial institutions through approved business of local financial institutions with no prior permission, but through foreign financial institutions with prior approval by the SAFE.

# Offshore RMB Market

- ❖ Recent development centers around offshore RMB since July 2009
- ❖ Since July 2010, *foreign companies are allowed to purchase, borrow and transfer offshore RMB freely outside China*, creating a more active and liquid FX, MM and investment market
- ❖ RMB deposits in Hong Kong reached **RMB 315 billion** at the end of December 2010

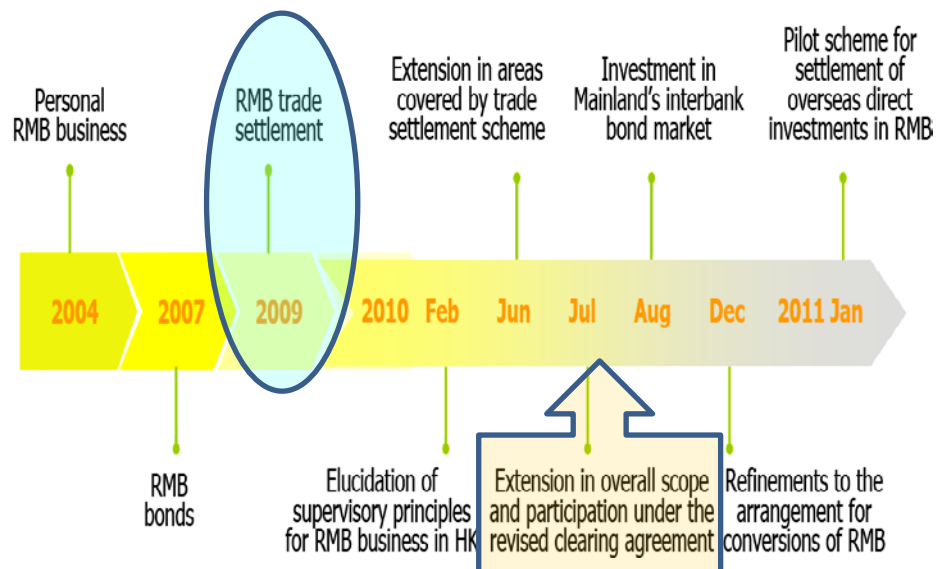
## Offshore RMB – Experience in Hong Kong

- Hong Kong's RMB business started as early as 2003
- Total RMB deposit amounted to RMB150bn as of Sep 2010, and RMB217bn as of Oct 2010
- 2.2m RMB demand and savings accounts opened as of Oct 2010
- Hong Kong RMB trade settlement volume surpassed RMB135bn; monthly volume around RMB68.6bn, as of Oct 2010



Source: <http://www.info.gov.hk/hkma/eng/statistics/mcb/attach/T030302.xls> (Figures from HKMA)

RMB Trade Settlement Volume – from HKMA and public media release



# Key Points of the Offshore RMB Capital Market Agreement

- ❖ Restrictions on RMB business transactions in Hong Kong were relaxed with the July 2010 amendment to the 2009 RMB clearing agreement between the PBoC and participating banks, **securities companies and asset management firms to sell RMB-denominated financial products.**
- ❖ **Key points of the agreement include:**

Key agreement	Contents
<b>Deposit taking</b>	<ul style="list-style-type: none"> <li>- Participating authorized institutions (AI's) are now able to open RMB deposit accounts for any enterprise (instead of the previously designated seven industrial sectors)</li> <li>- Also, there are no restrictions on the offer of RMB-denominated financial products</li> </ul>
<b>Currency conversion</b>	There is no upper limit on conversion services provided to enterprises if neither AI's have to square the corresponding open position with the clearing bank, nor do they need to square such open position with other participating AI's, suggesting that banks can use their own RMB deposits to satisfy enterprises' RMB conversion needs
<b>Remittance to and from the mainland</b>	It is no longer necessary for Hong Kong AI's to undertake background checks with respect to whether the remitter or recipient on the mainland is in compliance with mainland rules and requirements
<b>Interbank transfers, use of cheques and cash withdrawals</b>	<ul style="list-style-type: none"> <li>- There is no restriction on the transfer of RMB funds between different customers, whether within the same AI or not</li> <li>- The same goes for cash deposits and withdrawals from RMB-deposit accounts of corporate customers. However, participating AI's must exercise caution when handling cash transactions.</li> </ul>
<b>RMB loans</b>	<ul style="list-style-type: none"> <li>- There is no restriction on the type of corporations that can be granted an RMB loan or on the type of RMB loans that can be extended to a corporate customer</li> <li>- Separately, conversion of RMB for the repayment of trade finance can be conducted, and the associated open position can be squared with the clearing bank</li> </ul>
<b>RMB bonds</b>	<ul style="list-style-type: none"> <li>- Any customer with an RMB deposit account maintained with a participating AI can invest in RMB bonds issued in Hong Kong, AI's can issue a RMB certificate of deposit (CDs) in Hong Kong</li> <li>- Meanwhile, there is no restriction on remittance of proceeds raised from a RMB bond issuance of proceeds raised from a RMB bond issuance in Hong Kong to the mainland.</li> <li>- These proceeds can be converted into another currency without any restrictions.</li> </ul>



# Current Offshore RMB Capital Market Products

## ■ Current RMB products include:

- Bonds
- Bond funds
  - Haitong Global RMB Income Fund
  - Hang Seng RMB Bond Fund
  - ICBC (Asia) Investment Funds – Global RMB Fixed Income Fund
  - CCB International – RMB Fixed Income fund
- Banking products
  - Certificates of deposit
  - Non deliverable forward, mainly by institutional investors to hedge against exchange rate risk
  - Structured deposits - interest rate, FX and equity linked
- Insurance products
  - RMB denominated insurance policies

## ■ Potential new products:

- REITs
- Equities
- Derivatives

# Offshore RMB Bond Market

## Types of RMB bonds issued in Hong Kong

### ■ Dim Sum Bonds

- RMB denominated bonds settled in RMB
- The majority of RMB bonds issued in HK are Dim Sum Bonds
- As at end-February, the total outstanding amount is about RMB 63.41 billion

### ■ Synthetic Bonds

- RMB denominated bonds settled in other currencies such as US\$ and HK\$
- First issued in 2007 in the form of convertible bonds. Recently extended to straight bonds
- Meet the demand from investors who invest in US dollars and want to bet on the appreciation of RMB
- Some issuers favour this channel of synthetic issuance because of lower funding cost or difficulties in remitting onshore the RMB proceeds received from issuance of dim-sum bonds
- The total outstanding amount is about RMB19.75 billion

## RMB Bond Issuances in Hong Kong

- Since the first RMB bond issued in 2007, total amount of RMB bonds issued in Hong Kong was about **RMB81.41 billion**

Year	Issuer	Funds Raised (RMB billion)
2007	<ul style="list-style-type: none"> <li>• <b>Policy banks (7)</b> – China Development Bank, Export-Import bank of China</li> <li>• <b>Commercial banks (3)</b> – Bank of China</li> </ul>	10
2008	<ul style="list-style-type: none"> <li>• <b>Policy Banks (3)</b> – Export-Import bank of China</li> <li>• <b>Commercial Banks (9)</b> – Bank of Communications, China Construction Bank, Bank of China</li> </ul>	12
2009	<ul style="list-style-type: none"> <li>• <b>Government (6)</b> – China Ministry of Finance</li> <li>• <b>Policy banks (3)</b> – China Development Bank</li> <li>• <b>Commercial banks (7)</b> – HSBC (China), Bank of East Asia (China)</li> </ul>	16
2010	<ul style="list-style-type: none"> <li>• <b>Government (8)</b> – China Ministry of Finance</li> <li>• <b>Policy banks (10)</b> – Export-Import Bank of China, China Development Bank</li> <li>• <b>Supranational bodies (1.2)</b> – Asian Development Bank</li> <li>• <b>Commercial banks (5)</b> – Bank of China</li> <li>• <b>Companies outside the Mainland (8.96)</b> – Hopewell Highway Infrastructure, Sinotruk, China Resources Power Holdings, China Power International Development, China Merchants, Galaxy Entertainment</li> <li>• <b>Multinationals (2.6)</b> – McDonald's, Caterpillar, UBS, VTB Capital, ANZ Bank</li> </ul>	35.76
2011 (up to Feb)	<ul style="list-style-type: none"> <li>• <b>Supranational bodies (0.65)</b> – World Bank, International Finance Corporation</li> <li>• <b>Mainland, Taiwanese and Hong Kong companies (7)</b> – Sinochem, Beijing Capital Land, Road King, Yuen Foong Yu (YFY) Cayman, Printemps China Department (PCD) Stores</li> </ul>	7.65

Remark: \* Figure is provisional and subject to changes.

Sources: BOCHK Research, Goldman Sachs and various news reports



# Prospect

- ❖ The internationalization of the RMB may move forward much more quickly than expected during China's 12th Five Year Plan period (2011-2015). The convertibility of the RMB under the capital account has been **written into China's 12th Five-Year Plan.**
- ❖ More commercial transactions **denominated in RMB in Asia**, including FDI and ODI
- ❖ **Offshore RMB balance will grow**
  - Current interest rate differential and **expected RMB appreciation**
  - Expected **improvement in offshore RMB deposit yields** as offshore/onshore money market emerges
- ❖ Looking ahead, although the timing and sequencing has not been specified, the **Chinese authorities appear ready to advance the Pilot Program in several directions**, including:
  - → **Steps to broaden the channels of investing offshore RMB back into China.**
    - In addition to the domestic inter-bank bond market, other segments of the domestic capital market may be opened
  - → **Existing quotas under the Pilot Program are expected to be lifted**
  - → **Further development of the RMB offshore market in Hong Kong: RMB-denominated equities, derivatives market**
- ❖ The RMB internationalization process is well under way as **Shanghai** becomes an onshore RMB market and **Hong Kong(Singapore???)** operates as an offshore RMB market

# III. Implications for Korea's Capital Markets

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- ◆ What Does China Mean to Korea
- ◆ What is the Progress of Our RMB Market Development Work
- ◆ What Do We Need

# What does China mean to Korea?

- ❖ In light of the important economic links between China and the rest of Asia, the internationalization of the RMB is *likely to confer some positive impact on the region*
- ❖ The size of trade transactions between Korean and China is *huge* and *increasing quickly*

The total amount of the trade (US\$1000)

Rank	Country	2010 Value	Inc.Rate	2011 (1~03Month) Value	Inc.Rate
	<b>Total</b>	466,383,762	28.3	131,299,418	29.9
1	<a href="#">Pr.China</a>	116,837,833	34.8	31,303,267	17.8
2	<a href="#">U.S.A</a>	49,816,058	32.3	12,615,468	19.7
3	<a href="#">Japan</a>	28,176,281	29.4	8,922,961	49.9
4	<a href="#">Hong Kong</a>	25,294,346	28.7	6,850,806	21.3
5	<a href="#">Taiwan</a>	14,830,499	56.1	4,855,808	55.5
6	<a href="#">Singapore</a>	15,244,202	11.9	4,574,616	42.9
7	<a href="#">India</a>	11,434,596	42.7	3,351,564	36.7
8	<a href="#">Indonesia</a>	8,897,299	48.3	3,042,796	60.1
9	<a href="#">Brazil</a>	7,752,579	46	2,930,655	85

The total amount of the trade between Korea and China (US\$1000)

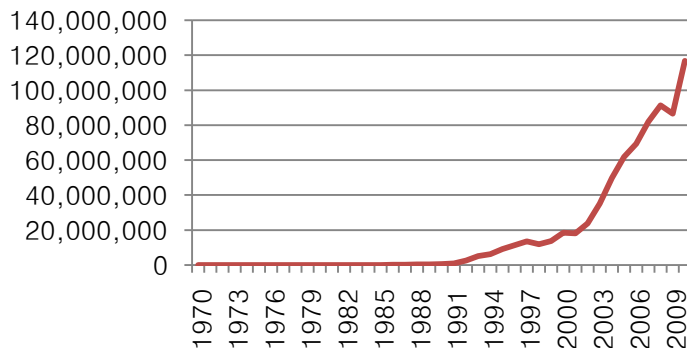
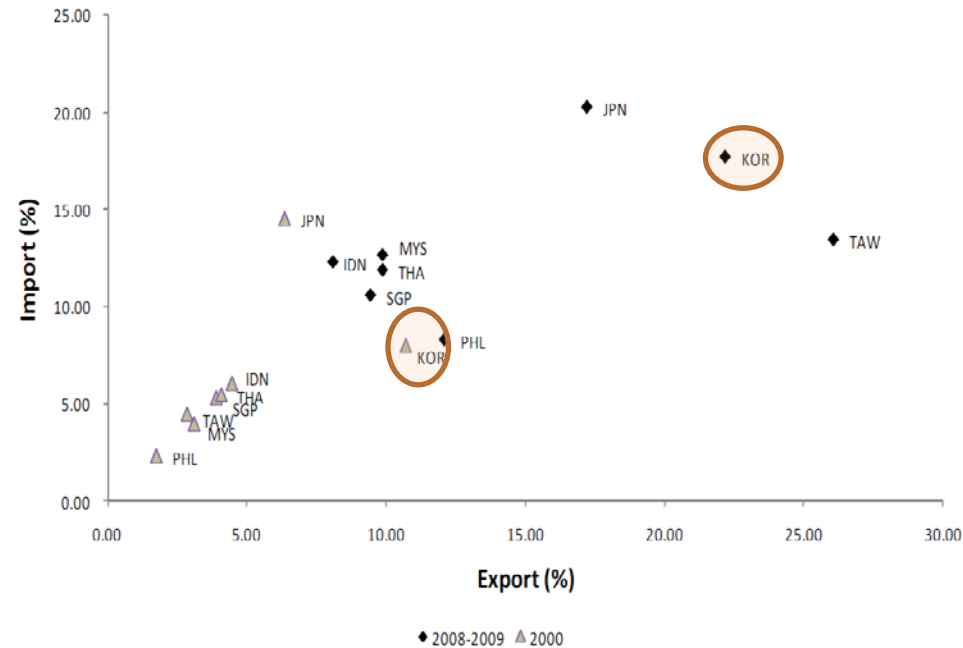


Figure 2. China's Share in East Asian Economies' Exports and Imports



Note: CHN=China, IDN=Indonesia, JPN=Japan, KOR=Korea, MYS=Malaysia, PHL=Philippines, SGP=Singapore, TAW=Taiwan, THA=Thailand  
Source: IMF, Direction of Trade.

# What is the progress of our RMB market development work?

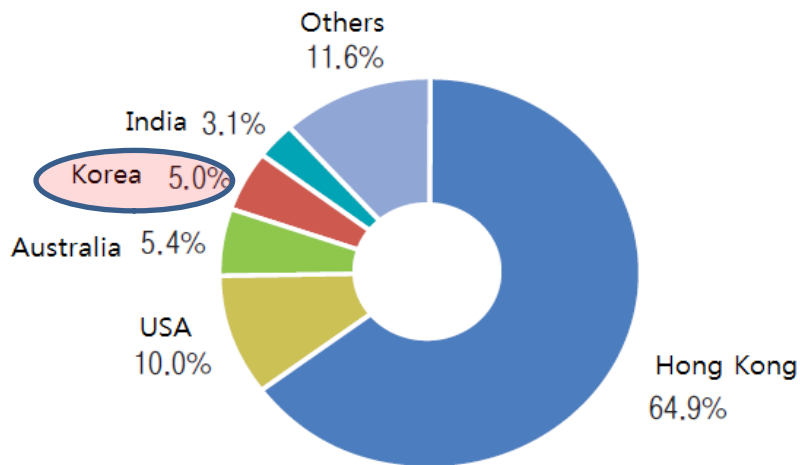
- ❖ Between Korea and China, capital transactions are **smaller than** the trade transactions

China net investment in Korea capital market  
(100 million won)

	Stock	Bond
2008	326	4.6
2009	734	1494
March,2010	378	3089

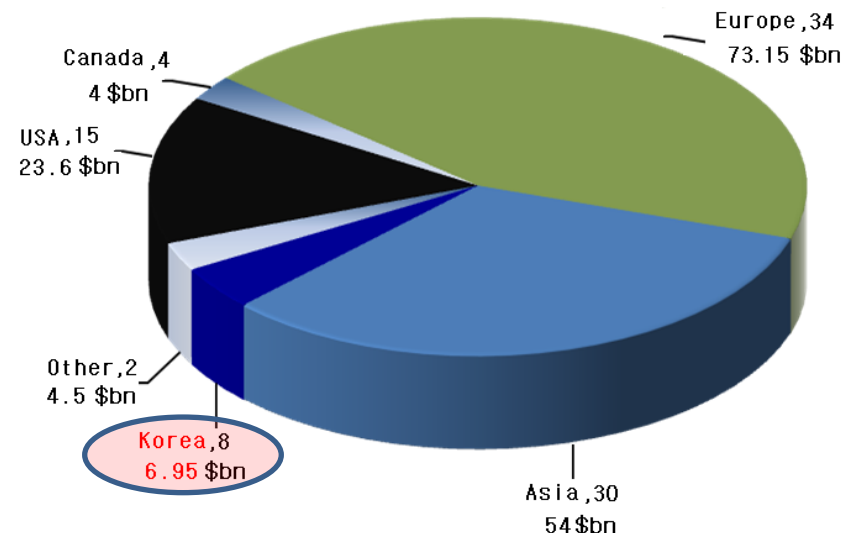
- ❖ As of end 2009, 93 financial institutions obtained QFII qualifications, US\$ **166.2 billion**, Korea has eight financial institutions allowed. The total amount is US\$6.95 billion, but the amount of weight is small at about **4.2%**

QDII Fund Investment in 2010 Q4



Source: Wind

QFII distribution chart(\$bn)



# What is the progress of our RMB market development work?

## Financial Institutions (2010.12)

	In Korea	In China
Bank	BOC, ICBC, CCB, BOCOM 4 banks  8 branches  1 representative office	4 Local corporation  31 branches  18 sub-branches  5 offices
Brokerage firms	Shenyin & Wanguo Securities  MOU: Haitong securities  China Merchants Securities  China Galaxy Securities  CICC	11 offices  ShangHai 7  BeiJing 4
Insurance company	Euler Hermes Credit Underwriters(HK) Ltd	4 Local corporations  12 offices  5 branches

## RMB Business in Korea Bank (2011.03)

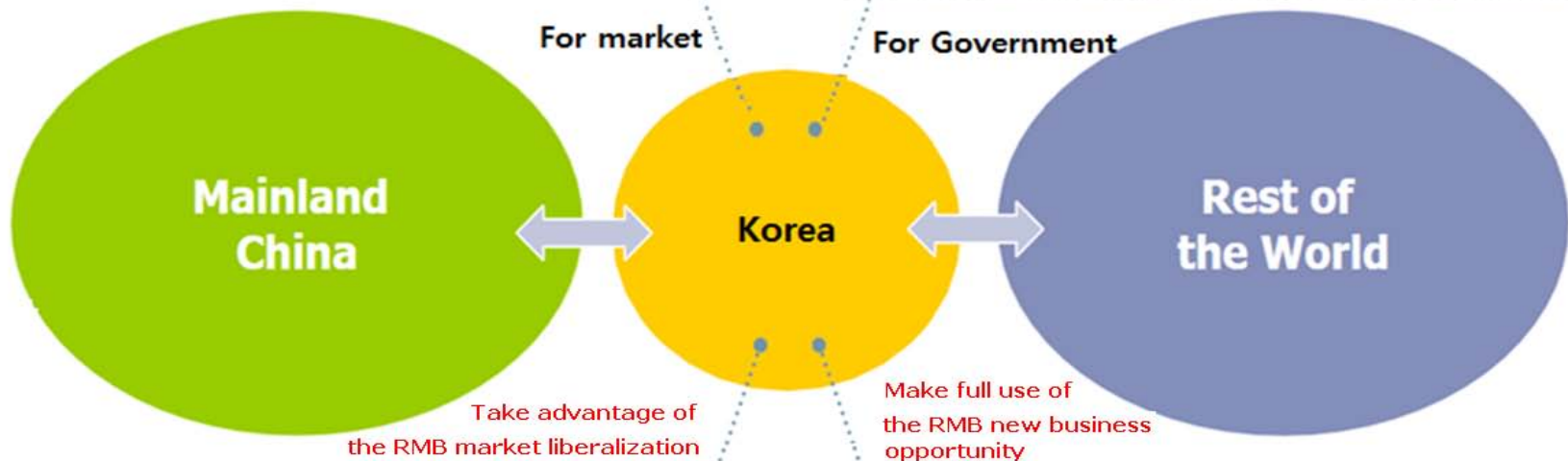
Bank	Business	Business strategy
KB	RMB Trade settlement	Joins hands with Chinese bank abroad  or  through Local foreign bank
Hana	Remittance of RMB	
Woori		
KEB	Open RMB L/C	
Shinhan	RMB deposit	
SC First		
Daegu	DLS (USD/CNY)	
Kjbank	Dim sum Bond	
Busan bank		



# What do we need?

- \* Build up "Liquidity Pool" to attract inflow of RMB to Korea from overseas and the Mainland
- \* Develop various RMB related products and businesses
- \* Currency risk management

- \* Introduce appropriate rules and systems for better functioning and regulation of the market
- \* Enhance monetary cooperation in Asia-Pacific region



- \* Open RMB account
- \* Trade and settle goods and services trade with enterprises in China or overseas in RMB, be it under Documentary Credit or Open Account
- \* Invest in RMB instruments including deposits, structured products, bonds, and even shares

For Corporation

- \* Purchase RMB FX or conduct RMB FX Forward/Swap /Option/IRS
- \* Borrow or raise RMB funding through bank borrowing trade finance and bond issuance, and soon equities
- \* Asset-Liabilities and currency risk management