

RMB Bond Market Evolution



Bank of China (Hong Kong) Limited
March 2015

RMB Bond Market Evolution

A. RMB the Next International Currency?

B. Policy and Market Development

C. Onshore RMB Bond Market Development

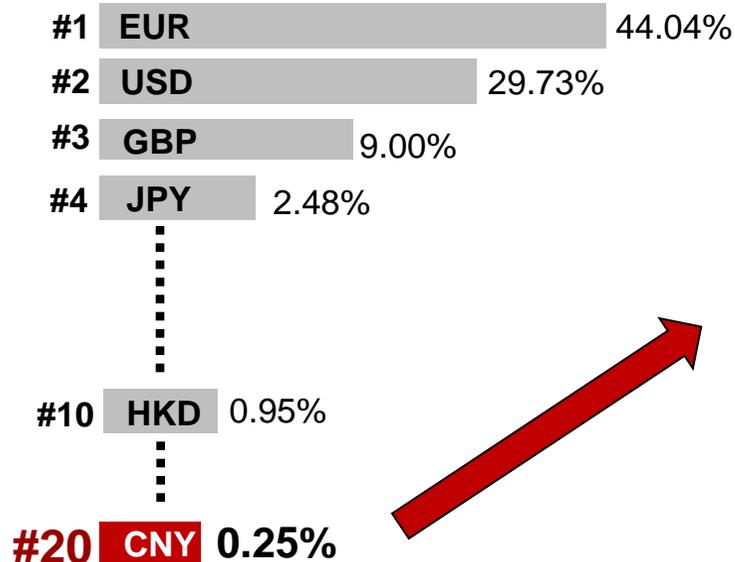
D. Offshore RMB Bond Market Development

RMB Internationalisation Gathers Pace

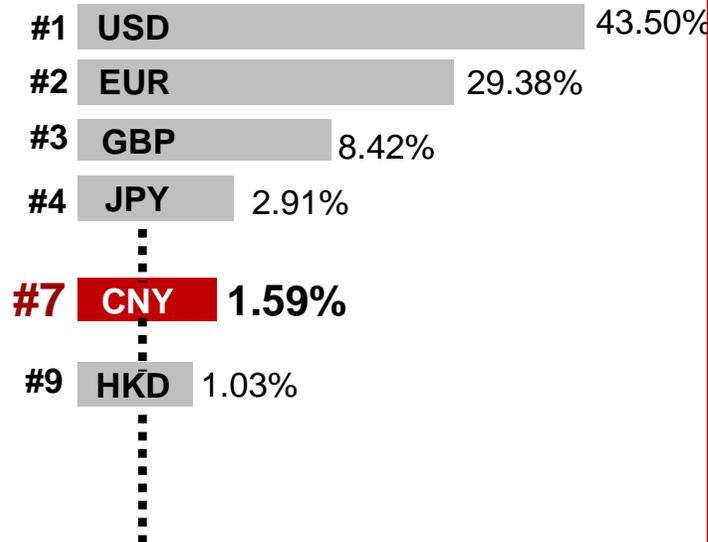
RMB has made great progress as a payment currency, a trade finance currency, an investment currency, and a reserve currency

World payments currency ranking & market share

Jan 2012



Oct 2014



RMB's ranking

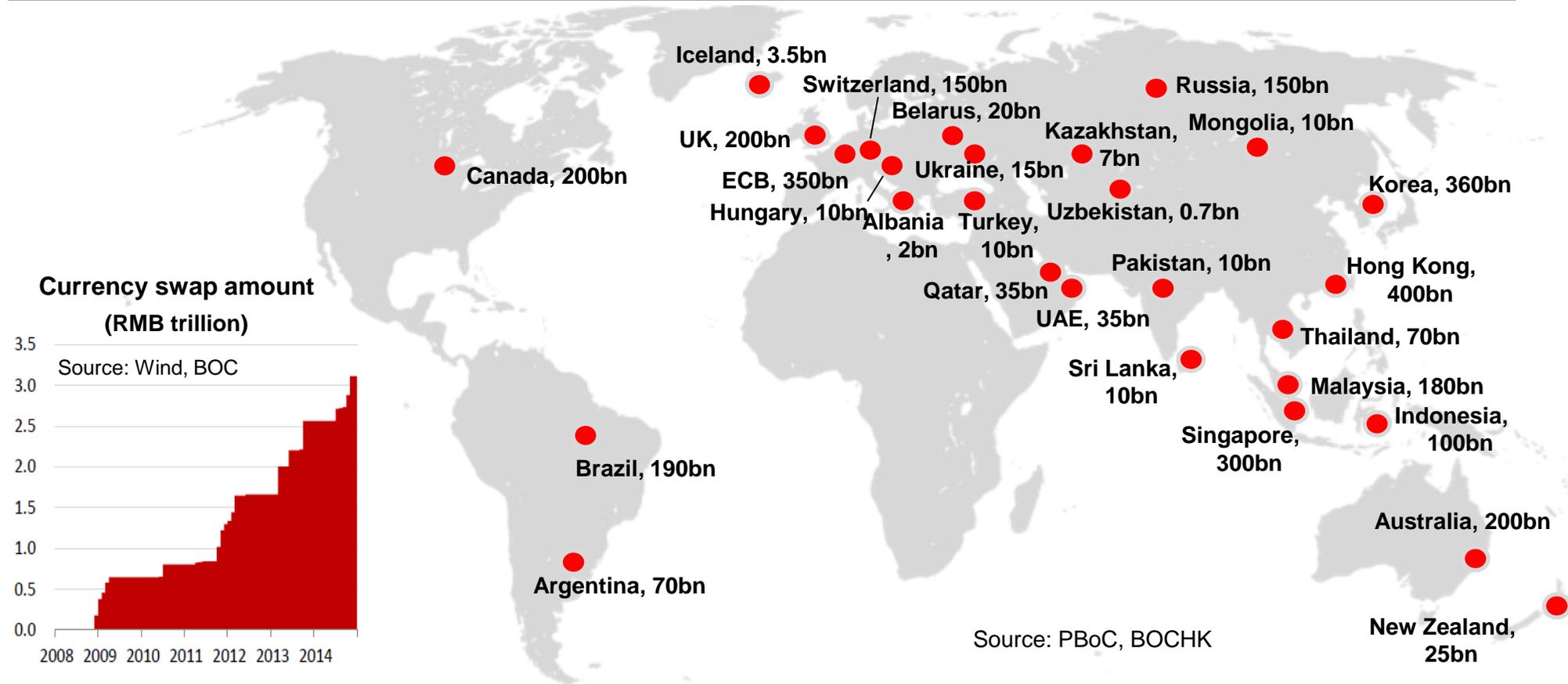
- Payment - 7th
- FX trading - 6th
- Trade finance - 2nd

Source: SWIFT

- According to the Central Banking Publication, around **32%** of the world's **central banks have used RMB for their reserve asset**

RMB's Growing Reputation among Central Banks

Many central banks around the world have signed bilateral currency swap agreements with People's Bank of China



- Bilateral currency swap agreements: with 28 central banks, amounted to **more than RMB 3,100 billion**
- The swap agreements serve as a backstop RMB liquidity facilities in those countries or regions

Strengthening RMB usage among major economies

Developed countries are increasingly involved in RMB businesses. New offshore RMB centers are emerging, and each has its own niche and strength.

Top 10 Regions – RMB Payment (billion USD)

Region	2014-Q3			2013-Q3			YoY Growth
	Rank	Value	%	Rank	Value	%	
Hong Kong	1	17,825	72.8%	1	9,806	80.0%	82%
Singapore	2	1,937	7.9%	3	428	3.5%	352%
United Kingdom	3	1,564	6.4%	2	662	5.4%	136%
United States	4	637	2.6%	6	218	1.8%	191%
Taiwan	5	602	2.5%	4	269	2.2%	124%
Australia	6	348	1.4%	7	101	0.8%	243%
France	7	340	1.4%	5	233	1.9%	46%
Korea	8	162	0.7%	15	30	0.2%	441%
Germany	9	161	0.7%	9	80	0.7%	102%
Luxembourg	10	147	0.6%	8	94	0.8%	57%
Japan	14	93	0.4%	13	38	0.3%	145%
Total(ex-China)		24,491*	100%		12,257*	100%	100%

Source: SWIFT

*Note: SWIFT recorded both sides of an transaction.

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Major milestones of the offshore RMB market

Offshore RMB business scope has been expanding in an orderly manner

- Bank of China (Hong Kong) was appointed as the RMB Clearing Bank in Hong Kong at the end of 2003, which marked the start of the Hong Kong offshore RMB market
- From July 2010, the revised Settlement Agreement on the Clearing of RMB Businesses enabled a broader range of RMB businesses in Hong Kong. Afterwards more policies were introduced to liberalize RMB and facilitate the usage globally

Phase 4: Increasing depth and breadth

Hong Kong's offshore RMB market taking shape

Phase 3: Cross-border RMB trade settlement

2009 – Implementation of Pilot scheme of cross-border RMB Trade Settlement

Phase 2: Offshore RMB bonds market

2007 – Issuance of RMB bonds in HK by Mainland financial institutions

Phase 1: Retail RMB banking service

Feb 2004 – Introduction of RMB business, including deposit-taking, remittance, currency conversion and bank card business

2004

2007

2009

2010

2013 onwards

Major policies development

China encourages the use of RMB in cross-border trade and investment

RMB Cross-border trade settlement

Trade has been *fully open* since 2012

24.8% of cross-border merchandise trade settled in RMB (Jan-Nov 2014)

1. FDI and ODI settled in RMB

FDI: RMB **587 billion** (2014Q1-Q3)

ODI: RMB **134 billion** (2014Q1-Q3)

3. RQFII (RMB Qualified Foreign Institutional Investor)

RMB **770 billion** of investment quota (Nov 2014)

5. Pilot Zones

Shanghai Free Trade Zone,
Qianhai Special Economic Zone

7. RQDII (RMB Qualified Domestic Institutional Investor)

Newly announced in Nov 2014

Trade

Capital



2. RMB Bond Markets

Onshore: Central banks, RMB CBs and PBs can invest in Mainland's inter-bank bond market

Offshore: RMB **440 billion** outstanding (Oct 2014)

4. Shanghai-Hong Kong Stock Connect

RMB **550 billion** of investment quota (Nov 2014)

6. Cross-border RMB Loan

Loan amt: Shanghai FTZ - RMB **17.4 billion** (Aug2014)

Qianhai – RMB **59.6 billion** (Sep 2014)

Current account has been fully liberalized

All companies in mainland China with import and export qualifications are now permitted to make and receive payments in RMB for goods, services and other current account transactions with their counterparts all over the world since 2012.

Items	Policies		
	Fully open	Partially open	Not yet open
Goods			
Import	✓		
Export	✓		
Service			
Finance	✓		
Insurance	✓		
Others	✓		
Others			
Labour	✓		
Investment income	✓		

Capital account liberalization is in progress

- Overseas Direct Investment (ODI) and Foreign Direct Investment (FDI) can be settled in RMB
- Foreign financial institutions including foreign central banks, clearing banks & participating banks can invest their RMB funds into China's domestic interbank bond market
- Eligible fund companies, securities firms and banks can invest into inter-bank bond market and securities market using their RMB through RQFII scheme

Items	Policies		
	Fully open	Partially open	Not yet open
Capital Inflow			
Foreign Direct Investment(FDI)		✓	
Inter-bank Bond Market		✓	
RMB Qualified Foreign Institutional Investor (RQFII)		✓	
Capital outflow			
Overseas Direct Investment(ODI)		✓	
Offshore Bond Market		✓	
Offshore Securities Market		✓	

Outlook of RMB Internationalisation

Global use of RMB gathers pace

- ✓ Apart from the strong position in Asia-pacific countries, western developed countries have also gained momentum to participate in RMB community
- ✓ Capital account liberalization will be the next policy focus
- ✓ Foreign investors are gaining more access to China's capital market
- ✓ **On track to be a global reserve currency:**

RMB is now in transition from a trading currency to an investment currency; the international reserve currency status will establish eventually



RMB Bond Market Evolution

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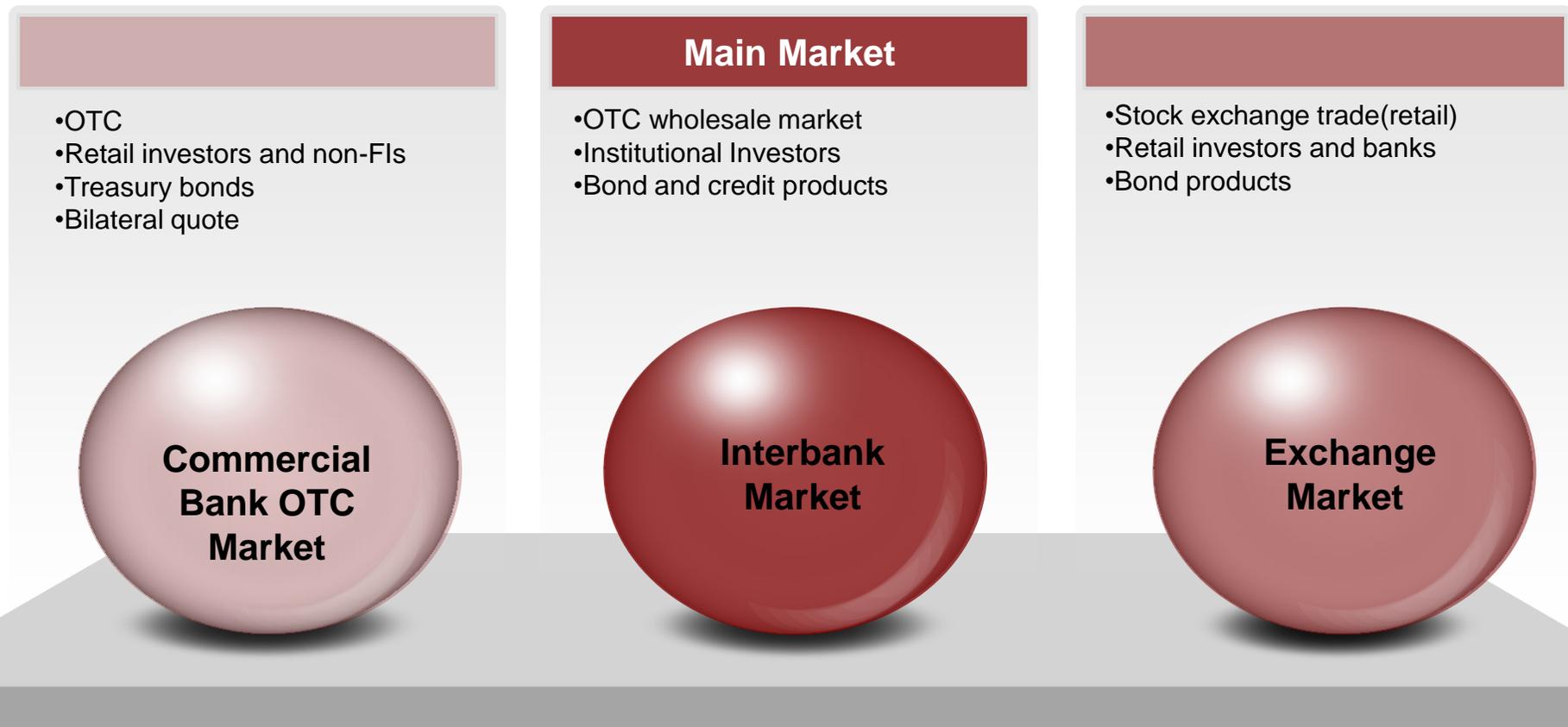
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Three Coexisting Onshore RMB Bond Markets

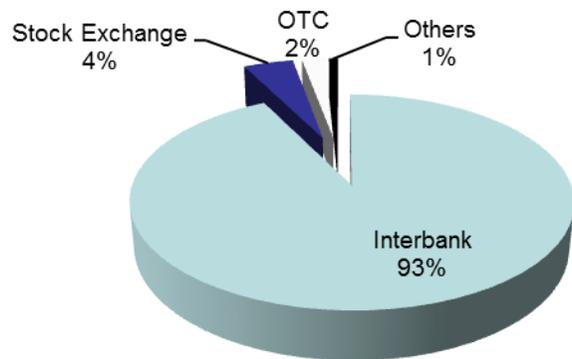
There are currently three coexisting bond markets in China: the interbank market, exchange market and commercial bank OTC market. Interbank bond market-traded bonds are settled through either the China Central Depository and Clearing (CCDC) or the Shanghai Clearing House (SHCH).



Overview of Onshore RMB Bond Market

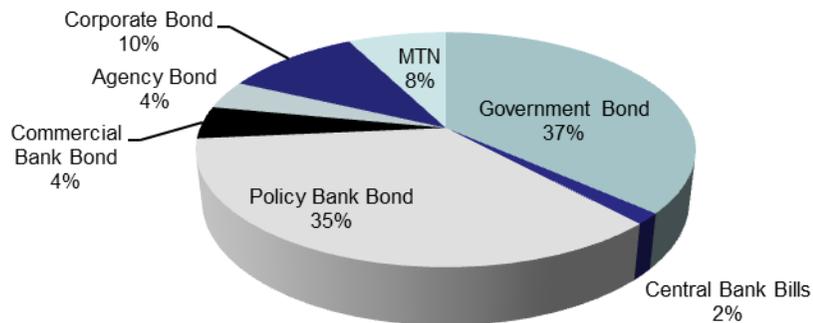
The interbank market is now the main fixed income platform, accounting for 93% of outstanding domestic bonds, of which treasury bonds and policy banks account for over 70 %.

Platforms of Outstanding Domestic Bonds



Source: CDCC, WIND, Nov 2014

Types of Outstanding Domestic Bonds



Source: CDCC, WIND, Nov 2014

Interbank Market

- Cash Bonds
- Pledged-style Repo
- Bonds outright Repo
- Forwards
- Bond Lending
- Credit Risk Mitigation Tools

Stock Exchange Market

- Cash Bonds
- Standardized Repo
- Bonds Outright Repo
- Treasury Bond Futures

Commercial Bank OTC Market

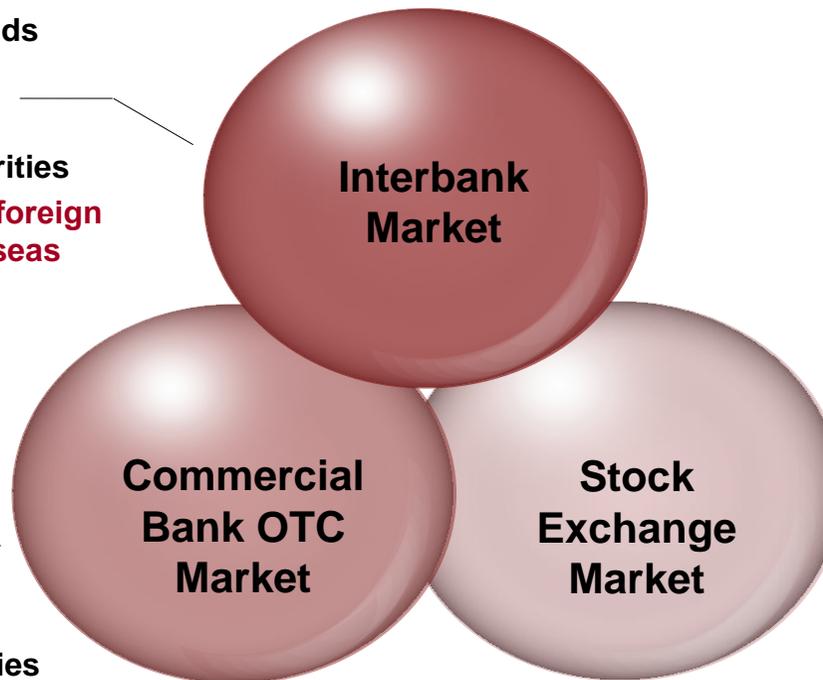
- Cash Bonds

Investor Base of Onshore RMB Bond Market

Among the three bond markets in China, the interbank market is the most active and has the largest investor base.

- Commercial banks and credit unions
- Onshore foreign FIs
- Securities companies and managed funds
- Insurance companies
- Non-FIs
- Corporate companies and public authorities
- “Three Types of Institutions” scheme: foreign central banks, RMB clearing banks, overseas participating banks
- RQFII
- QFII

- Retail investors
- SMEs and public authorities



- Retail investors
- Commercial banks
- Credit unions are not included

Trading Volume of Onshore RMB Bonds

China Interbank Market is an OTC market regulated and supervised by PBOC, where bonds are traded through the trading system of the China Foreign Exchange Trade System(CFETS). Policy bank bonds and government bonds are the most actively traded. The main participating institutions are commercial banks, securities companies and managed funds.

Cash Trading Volume in Interbank Market on Dec 2014 (By bond type)

Bond	Numbers of Trade	Trading Amount (bn)	YTM(%)
Policy Financial Bond	15500	1821.937	4.2057
Government Bond	4449	552.467	3.5157
Medium Term Note(MTN)	7453	509.443	5.6574
Corporate Bond	7287	392.619	6.1077
Commercial Paper(CP)	6860	383.833	5.5162
Short-term Commercial Paper(SCP)	2791	267.648	4.9740
Interbank Deposit	282	47.541	5.0865
Securities Company SCP	666	41.843	5.4061
Tier 2 Capital Tool	54	5.157	5.9931
Others	1916	232.548	21.3744
Total	47258	4255.036	4.7524

Cash Trading Volume in Interbank Market on Dec 2014 (By Institution)

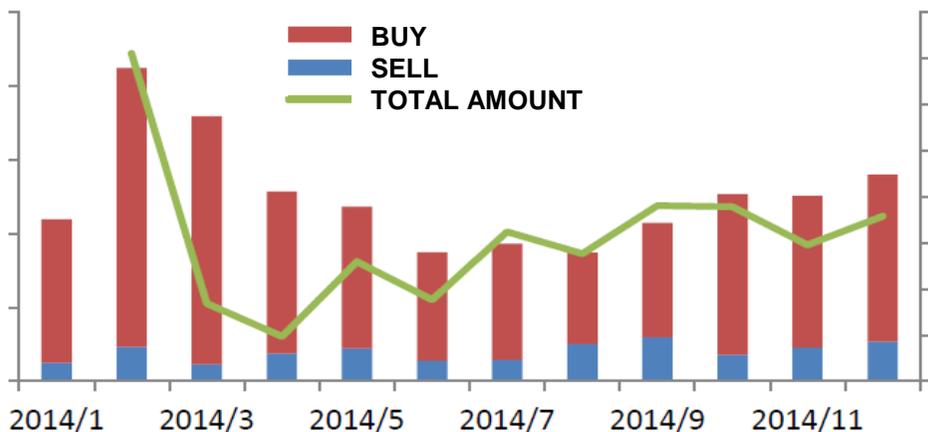
Institution	Numbers of Trade	Trading Amount (bn)	YTM(%)
Large Commercial Banks	2770	418.214	4.8456
Shareholding Commercial Banks	8397	1126.677	4.5576
City Commercial Banks	15105	2139.703	4.4528
Foreign Institutions	11541	1034.383	4.1444
Rural Commercial Banks and Cooperative Banks	7295	802.905	4.6744
Others	49408	2988.188	5.2602
Total	94516	8510.071	4.7524

Source : CFETS, Dec 2014

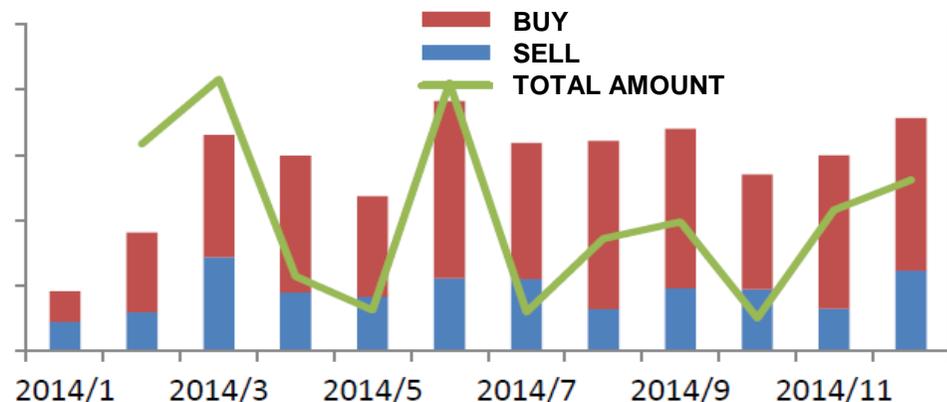
Overseas Participants in the Domestic Interbank Market

In 2014, 78 overseas financial institutions(not including overseas central banks, international financial institutions and SWFs) are able to invest in the domestic interbank market and open account in CFETs through “Three Types of Institutions” scheme(63 in 2013). 62 products are traded through RQFII scheme(22 in 2013).

Domestic investment of “Three Types of Institutions” in 2014



Domestic RQFII investment in 2014



Source : CFETS, Jan 2014

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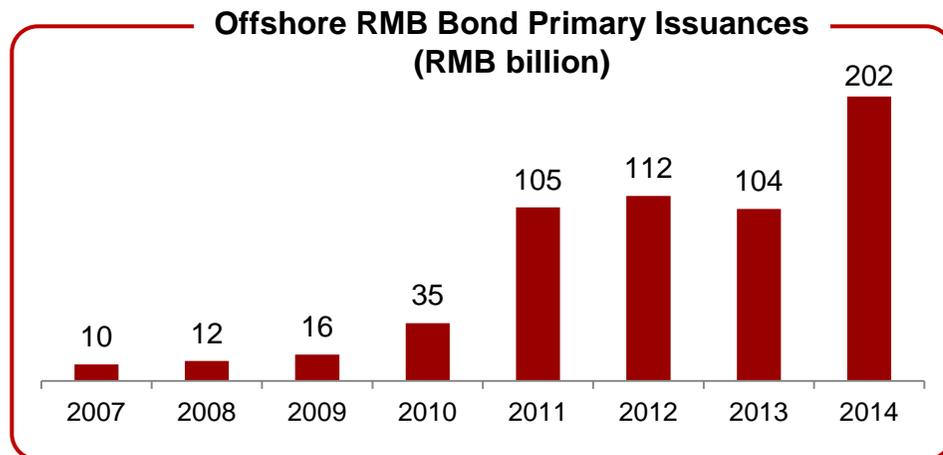
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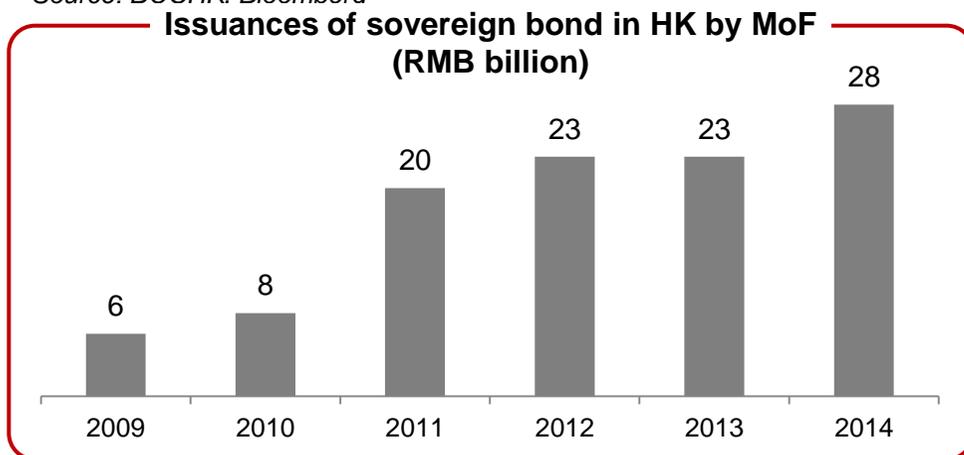
D. Offshore RMB Bond Market Development

Offshore RMB bond contributes the emergence of HK bond market

Rapid expansion of the offshore RMB bond market since the first bond issuance in 2007



Source: BOCHK, Bloomberg

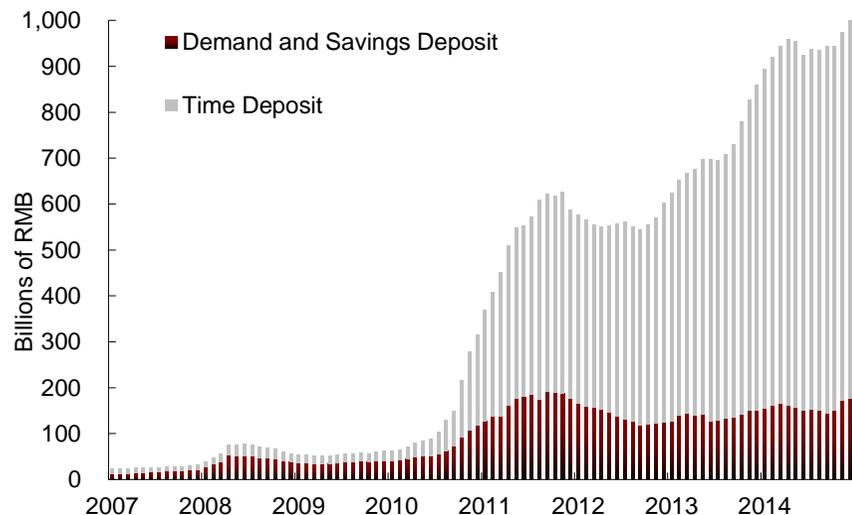


Source: BOCHK, Bloomberg

- Since the first RMB bond in HK in 2007, The offshore RMB bond market has developed rapidly
- The most important backbone to develop this RMB bond market in Hong Kong is the support from China's central government, especially the Ministry of Finance, state policy banks and some other major financial institutions
- RMB sovereign bonds and quasi-sovereign bonds together account for **more than 30%** of total offshore RMB bond issuance in 2014

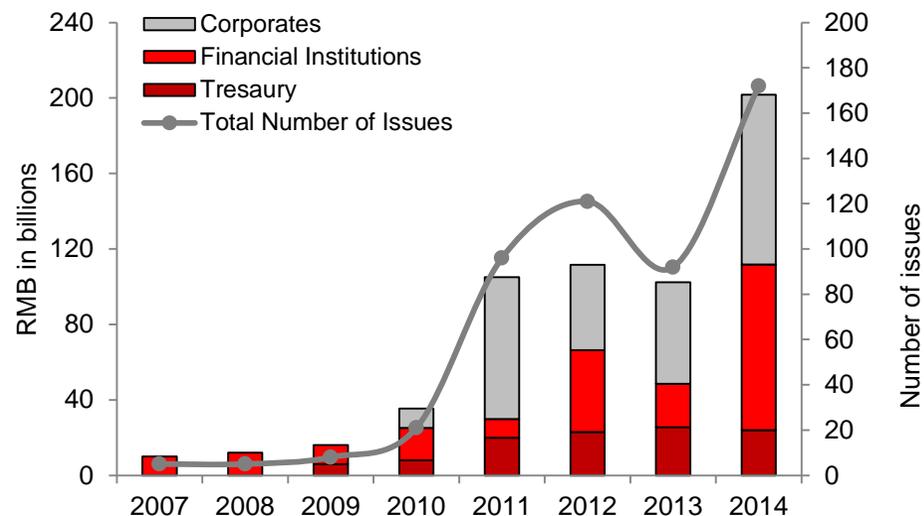
Offshore RMB Bond Market Development

Hong Kong RMB Deposits



Source: HKMA, as of Dec 31, 2014

Offshore RMB Bond Primary Issuances



Source: Bloomberg, BOCHK as of Dec 31, 2014

- **Fast accumulating off-shore RMB liquidity**

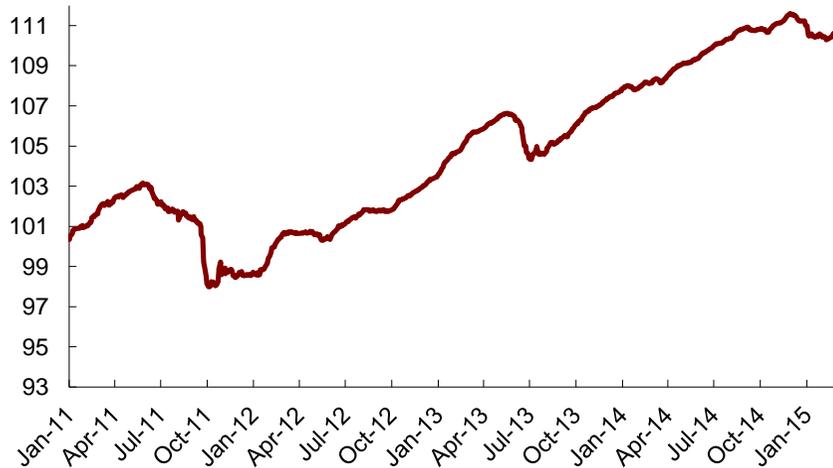
- As of November 2014, Hong Kong RMB deposits have reached RMB 974 billion, this represents a 13% increase from year-end 2013 and a 3,925% increase from the beginning of 2007, this rapid and continuing increase is laying solid foundation for the expansion of the dim sum bond market.

- **Dim sum bond issuances**

- From 2007 – 2014, the total issue size of dim sum bonds has reached RMB 594 billion. 2014 has been a record breaking year in terms of issuances; total issuance for 2014 reached RMB 202 billion, YoY, issuance value has increased by 97%.
- In 2010, BOCHK arranged the first corporate bond deal for Hopewell Infrastructure, which marked the take-off of offshore RMB bond. Corporate issuances have since then grown exponentially with many of the firsts coming to the market. The depth and width of the market also continue to develop substantially.

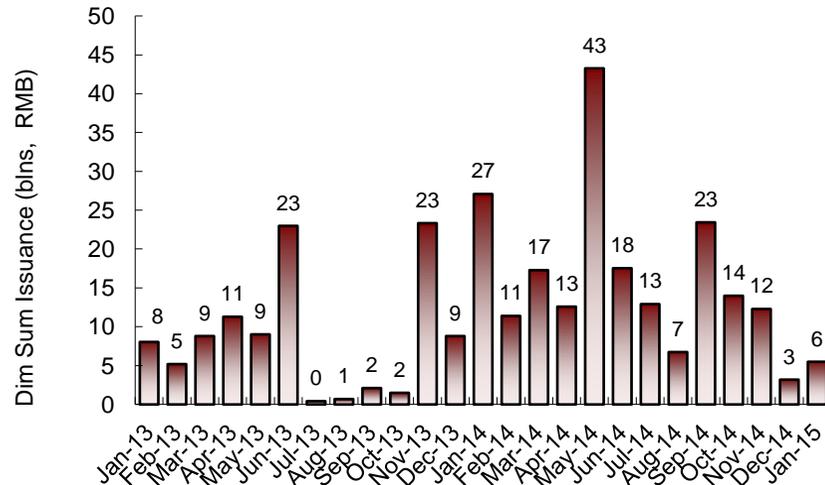
The Current Status of Offshore RMB Bond Market

FTSE-BOCHK Offshore RMB Bond Index



Source: Bloomberg, as of Mar 04, 2015

Offshore RMB Bond New Issuance



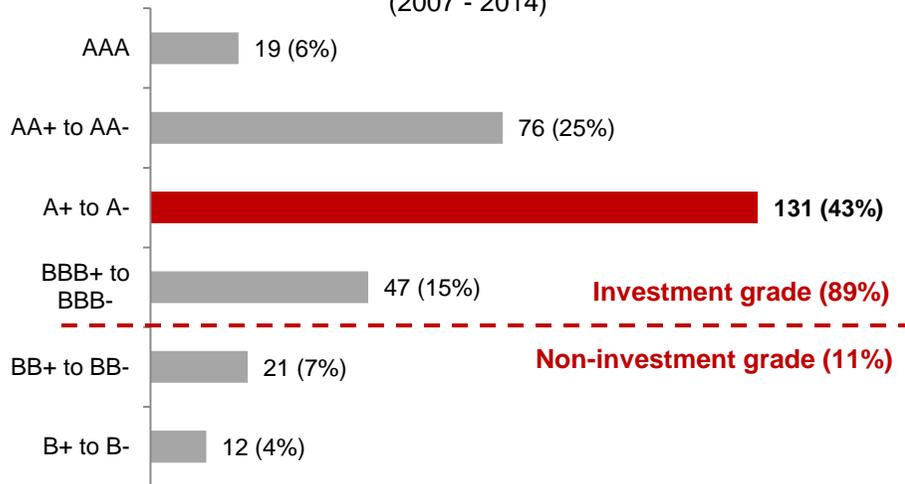
Source: Bloomberg, as of Feb 03, 2015

- **Offshore RMB bond Secondary Market:**
 - Entering 2014, the FTSE-BOCHK Offshore RMB Bond Index has been increasing steadily. Despite negative volatility in the past few years, the overall trend has been a steady increase.
- **Offshore RMB Bond New Issuance:**
 - Dim sum bond primary market has been very active entering 2014. There were 172 new issuances in 2014, amounting to total issue size of RMB 202 billion. Issuers include Chinese and multinational corporates (Founder Group, Chinese Electronics, Modern Land, Volkswagen etc.) as well as financial institutions (Bank of China London Branch, Agricultural Development Bank of China, Export-Import Bank of China, etc.).
- **Primary market outlook:**
 - 2014 has been a record breaking year for the offshore RMB market in terms of bond issuance value and size.
 - Issuances have softened recently due to higher CNH rates driven by tighter CNH liquidity. However, we expect issuances volumes to pick up again on the backdrop of:
 - Refinancing needs: more than 22% of outstanding dim sum bonds are maturing in 2015 with an additional 55% maturing in 2016/2017.
 - Recent swap rates: favors high-quality foreign issuer as the CNH/USD CCS rate continues to edge upwards.
 - PBOC's policies updates: such as the recently introduced RQDII scheme may help deepen offshore RMB liquidity pool.

Overview of Offshore RMB Bond Issuance

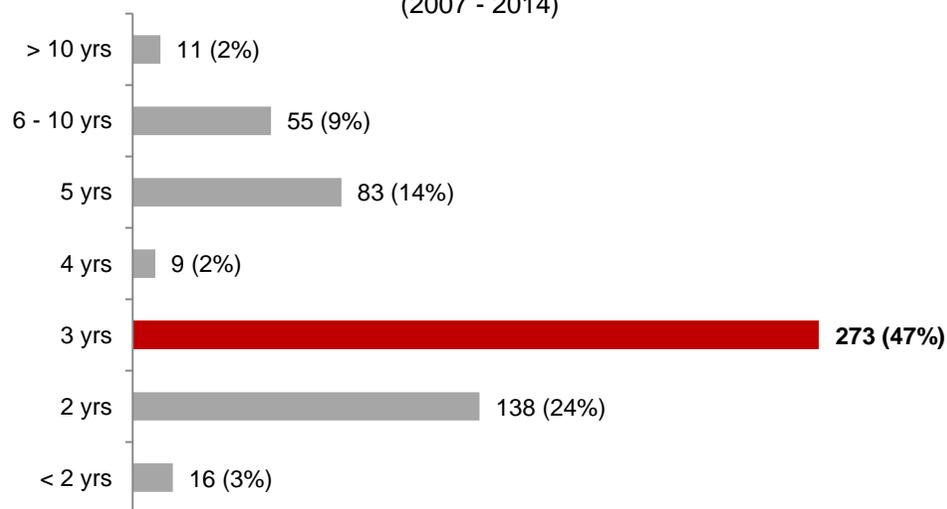
The offshore RMB bond market largely follows the rules of the Eurodollar bond market and is regarded as a convenient exposure to Chinese names of various credit profiles and tenor structures.

Rating Distribution of Dim Sum Bond Issuances
(2007 - 2014)



Rating agencies include S&P, Moody's and Fitch. Excludes certificate of deposit and tenors of lesser than 18 month, for split ratings, the highest rating is used.
Source: Bloomberg, BOCHK. as of Dec 31, 2014

Tenor Distribution of Dim Sum Bond Issuances
(2007 - 2014)



Excludes certificate of deposit and tenors of lesser than 18 month
Source: Bloomberg, BOCHK. as of Dec 31, 2014

● Rating at Issuance:

- Excluding certificate of deposit and tenors of lesser than 18 month, 48% of dim sum bonds were issued without a external rating by S&P or Moody's or Fitch. Of those which were rated, 89% were investment grade (BBB or above) with the majority of the bonds being rated A+ to A-.

● Tenor Distribution:

- Short-tenor bonds are the most prevalent in the dim sum bond market, the 3-year tenor structures alone makes up for 47% of the total issues. On the long end (tenor > 10 years), we see issuances by the Chinese government, Chinese policy banks and Chinese SOE banks.

Overview of Offshore RMB Bond Issuance (cont'd)

Chinese and Hong Kong issuers are still the primary issuers of dim sum bonds, accounting for 60% of the total issuances from 2007 – 2014. In addition, an increasing number of supranational, sovereigns and multinational corporate are making an entrance into this market.

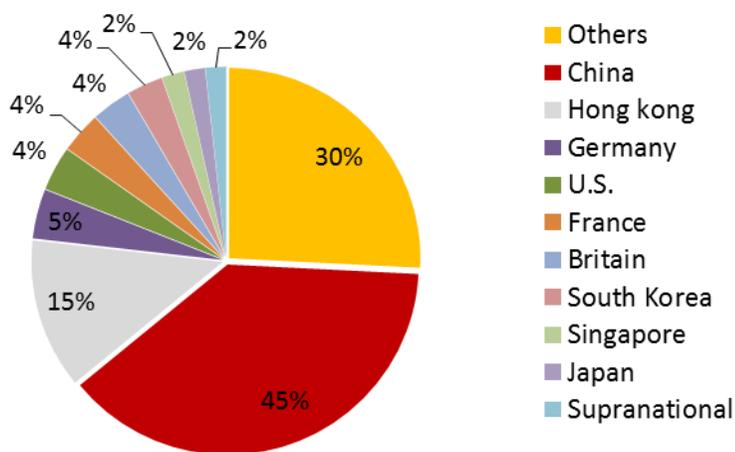
- **Country of Risks:**

- 45% and 15% of the issuers have risks originated from China and Hong Kong respectively. The dim sum bond market is geographically diversified, from 2007 – 2014, 30 countries have tapped the dim sum bond market, in addition, supranational entities accounted for 2% of the total issuances from 2007 – 2014.

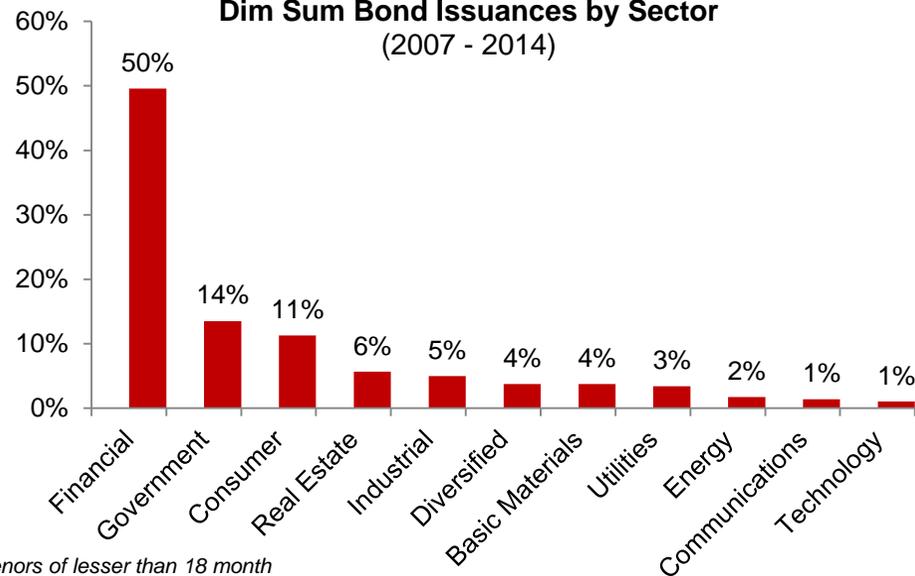
- **Sectors**

- Offshore RMB bonds issued by financial institutions contribute to 50% of the total issues. The second largest type of issuer is government or sovereign which accounts for 14% of the total issues.

Dim Sum Bond Issuances by Geography (2007 - 2014)



Dim Sum Bond Issuances by Sector (2007 - 2014)



*Excludes certificate of deposit and tenors of lesser than 18 month
Source: Bloomberg, BOCHK, as of Dec 31, 2014*

Offshore Market Non-Chinese Issuer Secondary Levels

Company	Rating (Moody's/S&P/Fitch)	CCY	Issue	Bid Yld	Sprd to 3m Libor
Renault SA	Ba1/BB+/BBB-	CNY	RENAUL 4.65 4/2016	5.63	118
		EUR	RENAUL 4.625 5/2016	0.78	110
Volvo Treasury AB	Baa2/BBB/BBB	CNY	VLVY 3.8 11/2015	5.03	85
		USD	VLVY 5.95 04/2015	0.97	71
Volkswagen Intl Fin	A3/A/A-	CNY	VW 3.75 11/2017	4.29	-20
		USD	VW 0 11/2017	n.a.	44
BSH Bosch Und Siemens HA	A (S&P)	CNY	BSHBOS 3.8 7/2017	4.48	0
		EUR	BSHBOS 1.875 11/2020	0.61	82.5
Caterpillar Financial SE	A2/A/A	CNH	CAT 3.4 11/2017	4.39	-6.6
		USD	CAT 1.25 11/2017	1.25	8.7

(As of March 18, 2015)

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- (iii) advice or recommendation based on any of the foregoing result or investment analysis.

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