London RMB business volumes January-June 2014

City of London renminbi series

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Introduction

This publication continues the series on the development of the renminbi (RMB) market in London sponsored by the City of London Corporation. It is an interim report covering the first half of 2014 and gives an update on three principal RMB product and service categories: trade-related services, foreign exchange (or forex) and deposits. A fuller report covering the full year 2014 and a wider set of data will be published in spring 2015.

No recent announcements have been made by the Chinese authorities regarding their approach to the infrastructure of settling international RMB transactions. The public policy slant seems, for the moment, to have shifted away from the establishment of an integrated global settlement system known as the Cross-border Inter-bank Payments System (CIPS) toward a global network of local Chinese clearing banks located in the main financial centres. This would be a marked change in direction, though it does not detract from the overall goal of the Chinese authorities to continue to move toward the renminbi becoming a fully tradable global currency. This coupled with gradual relaxations of the barriers to investment flows, such as through extension of the RQFII[1] investment quotas, will eventually fully integrate the Chinese capital market into the world market.

Naturally this presents major opportunities for London's financial participants. 'The City of London initiative on London as a centre for renminbi business' has supported London's financial institutions in taking these opportunities with, as the results presented in these surveys show, considerable success. This latest survey shows a continuation of the rapid growth of renminbi activity in London. In the key area of forex/risk management, rapid growth has continued in the first half of 2014. Forex transactions have grown particularly rapidly with daily spot trading in the first half of 2014 increasing by 160% over the level in 2013 and overall forex activity increasing by 116%. Looking back to the first of these surveys covering 2011, spot forex trading per day in the first half of 2014 was almost 20 times the level of 2011. The findings have also shown changes in the mix of products being used as the market experiments and develops. Examples include the relative decline (but continued absolute growth) of non-deliverable forex products and the shift away from letters of credit towards other forms of trade finance.

The wider financial reform process in China has continued, with substantive changes aimed at further developing the local bond market and reducing systemic risks in the banking system this year. Since 1994 the Budget Law has prohibited local governments from direct bond issuance, resulting in the growth of off-balance sheet borrowing though funding platforms which were separate from but implicitly guaranteed by local governments and therefore by the central government. This borrowing was mainly in the form of bank debt as the State Council rationed bond issuance.

In August this year the Budget Law was reformed to allow local governments to borrow directly in the market. This was the other half of the policy which in 2012 attempted to restrict bank lending to funding platforms. In future it is expected that borrowing will be budgeted and subject to a quota set as part of the planning

[1] Renminbi Qualified Foreign Institutional Investor

process. The policies are a further illustration of the way the Chinese authorities are edging toward a fully-functioning, market-based financial system even in an area as central as local government financing, though there remain some questions over the capacity of institutions to support a fully market-based system.

On the corporate debt side China has today more outstanding non-financial corporate debt than any other country, having overtaken the US last year as reported in June by Standard & Poor, whose estimates showed that non-financial corporate debt in China reached US$14.2 trillion at the end of 2013, compared with US$13.1trillion in the US. Corporate debt issued by Asian borrowers is expected to exceed that of North America and Europe combined by 2016.

Throughout the report the terms renminbi, RMB or yuan are used when referring generally to the currency of China. When referring more specifically to either onshore or offshore currency the terms CNY for onshore renminbi and CNH for offshore renminbi are used as shorthand. Monetary amounts of yuan are denoted using the symbol ¥.

1 Further developments in the CNH market

The first half of 2014 has been rich in developments affecting the renminbi. Following the direction set in 2009, the internationalisation of the RMB continues to be a policy-led development in which the Chinese authorities set the pace and guide the market, though with increasing levels of input from the private sector. Their aim appears to be to encourage competition at all levels to further RMB business. Major developments have continued at a rapid rate with the authorisation of clearing banks in different financial centres across the world. Through these authorisations the Chinese authorities are driving competition not only between the different financial centres but also between the Chinese banks that are looking for their slice of the clearing pie. The same practice of distributing regulatory advantages across a range of centres and participants was seen with the establishment of the RQFII scheme with several cities and quotas authorised in short succession.

It was in mid-June, during the visit of Premier Li Keqiang to London, that China Construction Bank (CCB) was appointed the official RMB clearing bank in London. Just after that a similar announcement in Frankfurt appointed the Bank of China as the clearing bank in Germany. So the list of clearing banks is growing rapidly. To the existing list of Hong Kong (Bank of China), Singapore (ICBC) and Taipei (Bank of China) we have seen the additions of Frankfurt (Bank of China), London (CCB) and then Paris (Bank of China), Seoul (Bank of Communications), Luxemburg (ICBC), Australia (Bank of China) and Canada (ICBC). The clearing system of CCB between London and China went live on 29th July 2014.

It remains to be seen what will be the effects on competition and opportunity of choices for RMB traders and users in Europe. The multiplicity of clearing venues will not necessarily advantage one financial centre over another but will undoubtedly increase the competition between Chinese banks outside the mainland for the RMB clearing business.

The timetable for the establishment of CIPS remains unclear, although its establishment remains an intention of the Chinese authorities. It is uncertain as to how the appointment of a network of Chinese clearing banks across the world will affect these plans or how centrally the individual clearing banks will feature in the eventual CIPS design.

In September 2014 new regulation from the Prudential Regulatory Authority (PRA) came into force in the UK, which allows non-EEA banks in the UK to apply for wholesale branch licences, depending on whether the firm conducts any critical economic functions in the UK. This move was part of the regulator's wider strategy for supervising international banks, but was welcomed in particular by many Chinese banks located in the UK who had felt in the past restricted in having to operate as a subsidiary.

In the UK, the London Stock Exchange signed MoUs with the Bank of China and Agricultural Bank of China regarding wide-ranging collaboration across trading, clearing and product development. CCB also signed an MoU with the LSEG under which they agree to help to facilitate access to London's capital markets for Chinese companies.

UK Export Finance has added the offshore RMB to its list of supported currencies and the new clearing house of the Hong Kong Exchanges and Clearing-owned London Metal Exchange, LME Clear, intends to add the RMB as a collateral currency.

In parallel to the growing number of MoUs, a major innovation was launched in sovereign bonds. Following an announcement at the 6th UK-China Economic and Financial Dialogue (EFD) in September, on 14th October the UK Government issued the first non-Chinese sovereign offshore RMB bond. Used to finance the UK Government's reserves, the issue was for three years, raised RMB 3 billion (approximately GBP 300 million) and paid a 2.7% coupon.

Outside the UK, RMB activity also increased:

- The Monetary Authority of Singapore (MAS) announced in June that a facility for providing overnight RMB liquidity to financial institutions in Singapore was launched in July 2014.
- The Bank of France signed an MoU with the PBoC to establish a payment arrangement in Paris designed to facilitate and promote cross-border RMB transactions.

In China the Shanghai Free Trade Zone (SFTZ) received mixed reviews from industry participants in China and overseas. Some felt there was not yet enough evidence to suggest that setting up operations in the zone was essential to business development. That said, the SFTZ will continue to play a role in serving as a test zone for new RMB policies. One of the first tests, RMB two-way cash pooling, has already been announced as a success by corporates and as a result is due to be rolled out nationally.

Overall, the period covered in this report was marked by a high level of activity from the Chinese authorities to expand the use of the RMB, leading to substantial improvements in the trading, clearing and facilitation of the Chinese currency. In addition a number of agreements and partnerships were reached which although undoubtedly helpful in building market confidence, may take time to have a practical impact.

2 Survey results for January - June 2014

2.1 Methodology

The methodology for this study was the same as that used for the previous interim report for January - June 2013. The data collected is a subset of that used for the full year reports for 2013, 2012 and 2011 representing a subset of the financial instruments covered by full year surveys, namely trade-related services, foreign exchange and deposits.

In order to avoid any double counting of deals with Hong Kong, the definition of 'London' business used for this report is any deal generated and/or executed in London. Care has also been taken to avoid any misunderstanding in the definition of the individual financial instruments and the way these should be accounted for.

A sample of 13 banks was approached and are estimated to cover the majority (estimated at 85%) of the market. All responses were scrutinised for reasonableness including comparisons with previous submissions, and a number of queries were raised and resolved, either by revision of data or confirmation by the submitting banks.

As is normal, the quality of responses improves with repetition of such surveys and respondents are more able to gather the data and ensure data quality. The January - June 2014 survey obtained more comprehensive returns from some banks which previously had given less detailed data. More generally, the comparison of returns from the two periods has enabled the researchers to question apparent anomalies and improve data quality.

In the 2012 survey an additional piece of data was requested; the amount of forex business which respondent banks did outside London and mainland China (i.e. in other offshore centres). This was continued in the 2013 January - June and the 2014 January - June surveys. The response from banks this time has improved, with eight banks able to supply this information compared to five in 2012.

The data provided by the banks was then aggregated and extrapolated to produce total market figures. The extrapolation takes account of the proportion of the market covered by the banks providing returns.

Comparisons between this survey and the previous surveys were made between end-of-period levels for deposits and average daily volumes for forex trading. Business relating to trade services in this survey was compared in six month segments using the calculated figures for the last six months of 2012 and 2013; the published figures for the first halves of 2012 and 2013, and 50% of the total figure for 2011. Throughout the report, percentages are calculated on unrounded figures.

2.2 Trade related services

This category includes all the import/export finance related activities in RMB in London. Letters of credit includes those in RMB issued in London and does not include those issued to China in other currencies. Financing includes loans to importers/exporters for trade related activities in RMB in London. The results presented below show the totals for three categories of trade finance for six half-yearly periods[2] to give a better basis for comparison. Table 2.1 shows for each category:

Table 2.1 – Value of trade finance business – half yearly (HY) figures

RMB million	2011 (HY)	2012 H1	2012 H2	2013 H1	2013 H2	2014 H1
Letters of Credit	185	3,738	985	3,336	876	807
Import Financing	6,784	8,097	19,195	20,283	6,479	18,438
Export Financing	1,651	1,970	4,670	4,321	7,487	7,298
Total	**8,620**	**13,805**	**24,850**	**27,940**	**14,842**	**26,543**

The key results are:

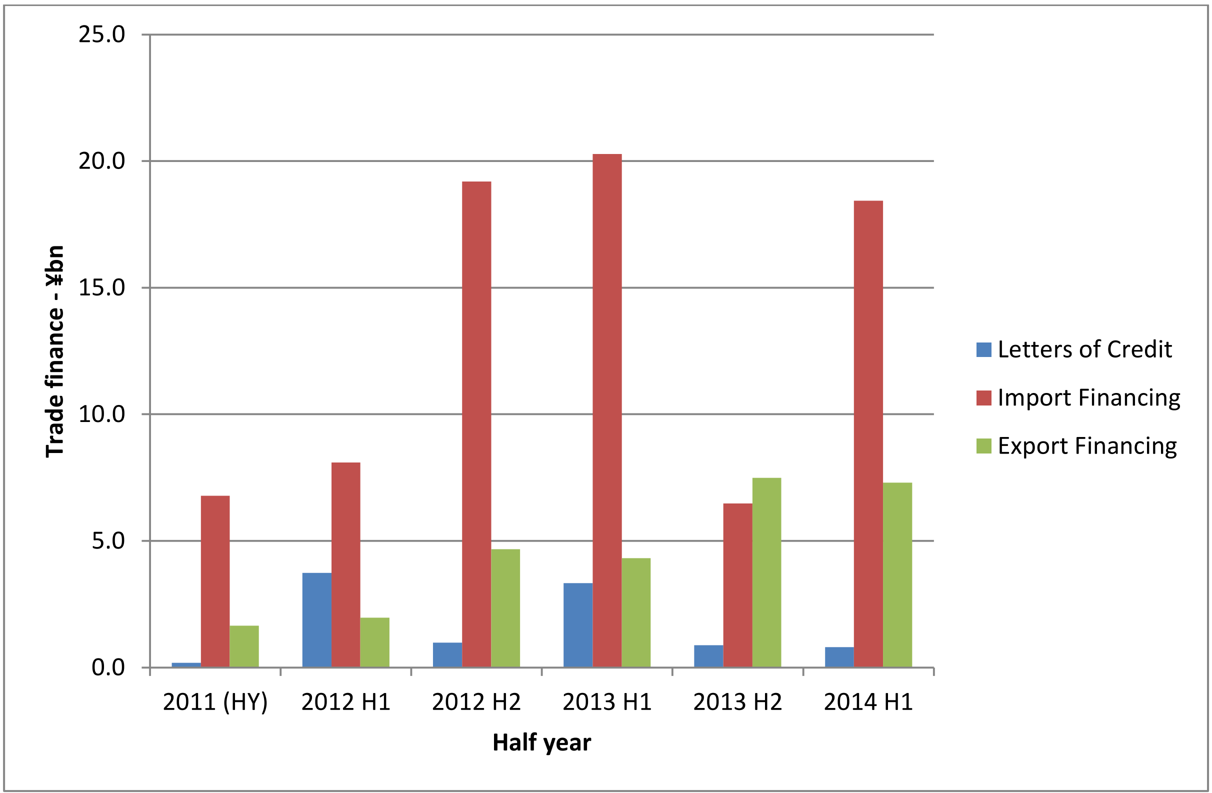
- Business in letters of credit contracted only slightly in the first half of 2014 to ¥0.8 billion, but current levels remain substantially below those seen in earlier periods.
- The 2014 H1 total for import finance (i.e. to finance imports of goods from China) was ¥18.4 billion, a substantial increase on the second half of 2013 maintaining levels similar to those recorded in 2012 H2 and 2013 H1, and 185% higher than in the second half of 2013.
- Export finance (i.e. finance for exports to China) was ¥7.3 billion, maintaining the high level achieved in the second half of 2013 and 69% higher than 2013 H1.
- Total trade finance rose 79% over the second half of 2013 to a total of ¥26.5 billion, similar to levels in 2012 H2 and 2013 H1.

[2] The July - December 2013 and July - December 2012 figures in Table 2.1 are calculated from the full year (FY) figures less the figures submitted for the first half of the year. The 2011half-year (HY) figures are calculated as 50% of the 2011 annual total.

Comments on trade results

The figures indicate a maintenance of the high figures seen in 2012 and 2013, reflecting earlier rapid growth. Surveyed banks have again commented that a growing number of their customers, both importers to and exporters from China, are making trade payments in RMB, with Chinese corporates being the dominant players. The detailed figures show a shift away from letters of credit, which are showing a steady decline in favour of alternative methods of trade finance. The decline in trade finance in late 2013 was attributed by respondents to the fact that the growth of the first half had exhausted annual quotas, but our expectation is that the quotas will have been increased so the second half of 2014 should not see the decline recorded in 2013 H2.

Chart 2.1 – Trade finance in RMB – half yearly



2.3 Foreign exchange

Overall forex activity in RMB products increased very rapidly in the first half of 2014; indeed total volumes of RMB forex trading more than doubled (up 116%) over the record high in the second half of 2013. In the first six months of 2014, total deliverable RMB forex business rose by 127%, giving a total average daily volume of US$42.4 billion. The relative shift in trading from non-deliverable products to deliverable continued with non-deliverable products decreasing to a 22% share of total business compared to 26% in 2013 and 76% in 2011. Table 2.2 below summarises the movements for the individual forex products:

Table 2.2 – Summary of London trading in forex products

Average daily value US$ million	2011 FY	2012 H1	2012 FY	2013 H1	2013 FY	2014 H1
Deliverable						
Spot FX	727	1,691	2,496	4,815	5,564	14,485
Forwards	717	1,151	1,288	2,646	2,335	6,562
FX Swaps	951	2,468	3,364	6,260	7,600	15,625
FX Options	113	175	554	1,828	3,131	5,571
Interest Rate Swaps	10	2	10	0	0	1
Cross Currency Swaps	12	41	14	8	37	173
Total deliverable	**2,530**	**5,528**	**7,726**	**15,557**	**18,667**	**42,417**
Average daily value US$ million						
Non-deliverable						
Forwards	4,945	3,722	4,889	3,679	3,493	5,565
FX Swaps	360	88	1,250	394	307	382
FX Options	2,716	2,027	2,624	2,665	2,125	5,928
Interest Rate Swaps	22	103	332	15	604	330
Cross Currency Swaps	51	161	28	7	89	30
Total non-deliverable	**8,094**	**6,101**	**9,123**	**6,760**	**6,618**	**12,235**
Total	**10,624**	**11,629**	**16,849**	**22,317**	**25,285**	**54,625**

2.3.1 Deliverable foreign exchange products

The forex category includes all transactions done on a currency basis including spot (for immediate delivery) and forward (for delivery in the future). The swaps and options are all traded over the counter (OTC) on a bilateral basis between two counterparties. The forex swaps, options, interest rate swaps and cross currency swaps are OTC derivative instruments used by banks for hedging and risk management purposes.

There was strong growth in the four main deliverable product lines:

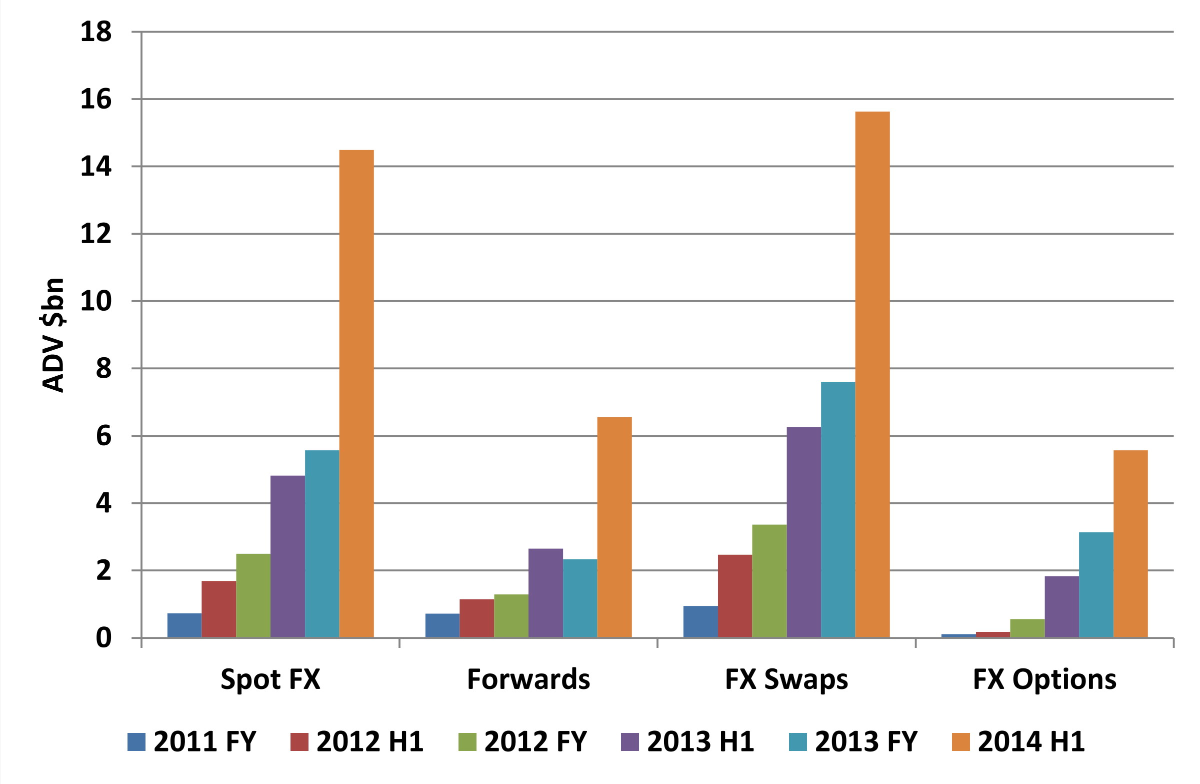
- Spot RMB forex grew to an average daily volume of US$ 14.4 billion, a 160% increase compared to 2013 and, to add context, almost 20 times the value of US$ 727 million reported in the first survey for 2011.
- Deliverable forwards grew to an average daily value of US$ 6.6 billion, a 181% increase compared to 2013.
- Deliverable FX swaps grew to an average daily value of US$ 15.6 billion, a 106% increase compared to 2013.
- Deliverable FX options grew by 78% compared to 2013, reaching an average level of US$ 5.6 billion per day.

Cross-currency swaps showed rapid growth, albeit from a small base, to US$ 173 million. Volumes in interest rate swaps, on the other hand, remained negligible.

Comments on deliverable forex results

The rapid growth shown in deliverable forex products in the latest half year represents a continued acceleration in RMB trading growth. This is reflected in all products as Chart 2.2 illustrates. Comments suggest that this growth is being experienced throughout the market as the growth in trading is encouraged as the RMB moves towards eventual convertibility. Respondents have suggested that RMB trading is becoming increasingly mainstream with substantial two-way order flow meaning that order matching is increasing, leading to lower costs of trading.

Chart 2.2 – Trading in deliverable RMB denominated foreign exchange products

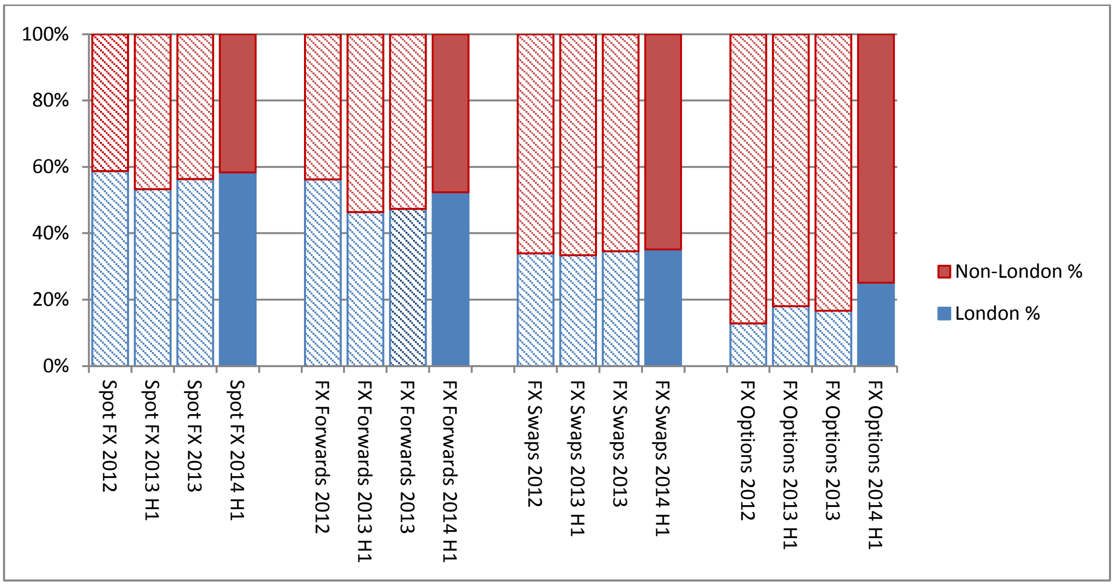


Forex business done in other centres

In the 2012 survey respondents were asked to report the amount of their forex business in the main deliverable forex categories which they did in other offshore centres, i.e. excluding business in mainland China but including Hong Kong, Singapore and business in other branches throughout the world. The results from this data, while not comprehensive since they only include business by banks that have a presence in London, are indicative of the business patterns and choices of the respondents. In 2012, five respondents were able to give this data and in the latest survey this increased to eight. In support of the data it is worth noting that the banks that were able to give this data were estimated to represent 98% of the total spot forex RMB turnover in London and a similarly high proportion of deliverable forex derivatives.

Chart 2.3 shows the results for the four main classes of deliverable forex in the first half of 2014 and compares this with earlier data (shown with fainter shading). The 2014 H1 results show that for spot trading the respondents conducted 58% of their offshore RMB business in London. The figure for forwards in the first half of 2014 was 52%, for swaps 35% and for options 25%. Compared to previous results the figures seem relatively stable – with slightly more variation in the options percentage – indicating that the global market for RMB forex trading is expanding at similar rates to those seen in the London market. Essentially, the pie is growing and London is sustaining its position.

Chart 2.3 – Offshore RMB forex – business done in other centres



2.3.2 Non-deliverable foreign exchange products

Non-deliverables are specific cash settled instruments for non-convertible currencies. RMB non-deliverable contracts are predominantly based on the onshore (CNY) exchange rate, traded offshore and settled in USD, specifically because trading in deliverable CNY is not possible outside China.

Overall non-deliverable volumes rose by 85% compared to 2013 to a daily value of US$ 12.2 billion. The individual products showed varying results:

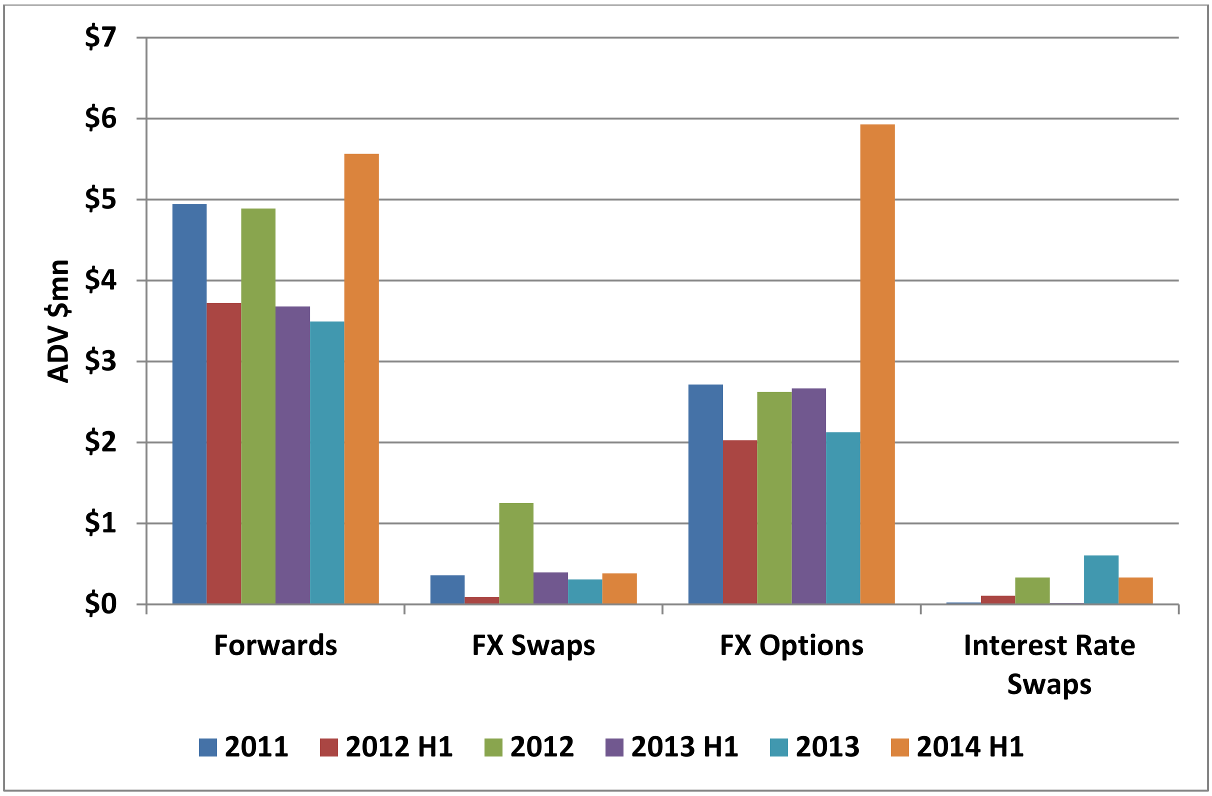
- Non-deliverable forwards rose to an average daily volume of US$ 5.6 billion (the highest ever value in these surveys), a 59% increase compared to 2013.
- Non-deliverable FX swaps volumes remained relatively small at US$ 0.4 billion after a sharp fall in 2013 H1.
- Non-deliverable FX options showed rapid growth to US$ 5.9 billion, a 179% increase compared to 2013 and the highest value recorded in these surveys.

Both non-deliverable interest rate swaps and non-deliverable cross-currency swaps continued to show very small levels of business.

Comments on non-deliverable forex results

Throughout the period covered by these surveys we have confidently predicted that non-deliverable trading would decline as liquidity in the deliverable contracts increased. While this has been partially correct in that non-deliverable trading has declined as a percentage of total RMB forex trading in London (as noted above, from 76% in 2011 to 22% in the latest half year), absolute volumes in non-deliverable products have remained substantial and indeed accelerated in 2014 H1.

Chart 2.4 – Trading in non-deliverable RMB denominated foreign exchange products



2.4 Total RMB deposits in London

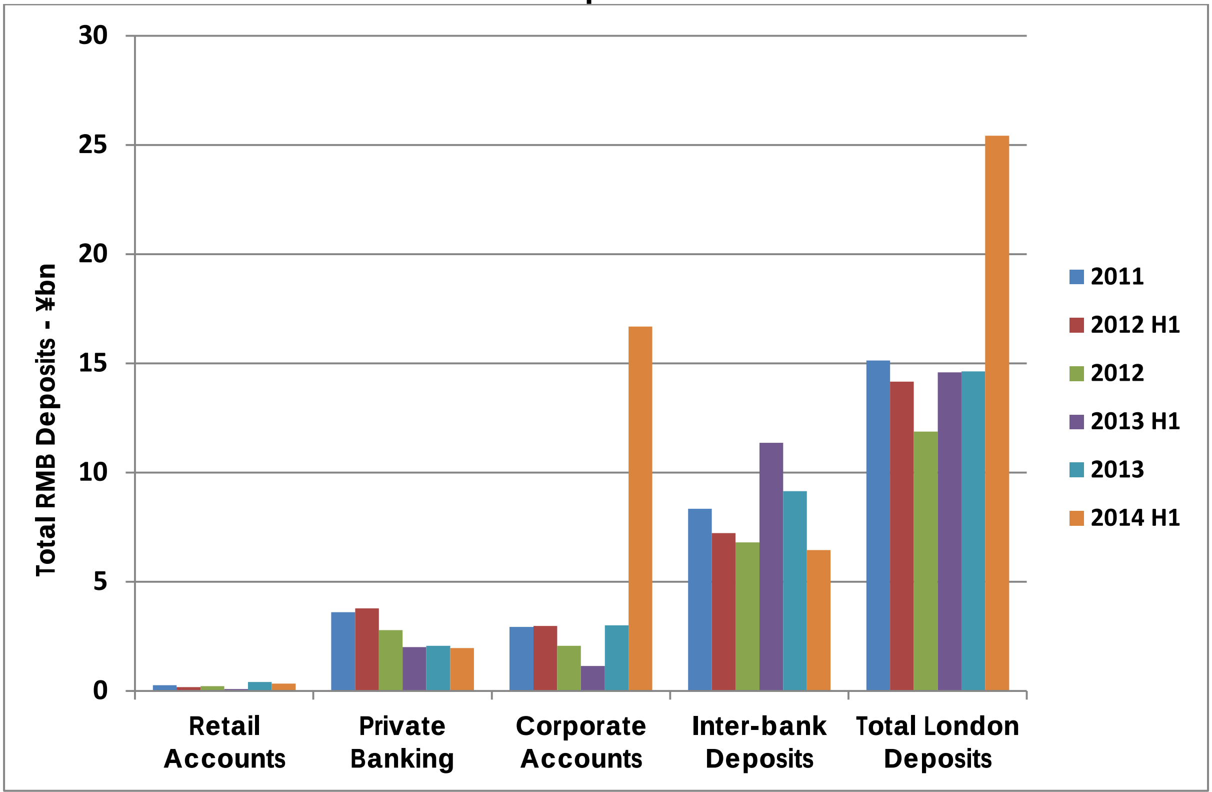
The levels of the different categories of London deposits have proved to be very variable and this continues to be the case in the latest survey. The variability continues in the responses of individual banks and in different categories of deposits. This variability reflects in part the relative newness of the market in London and in part the behaviour of deposits when they are held as an asset class.

Deposits at the end of June 2014 compared to those reported in the last survey for December 2013 were as follows:

- Total deposits reached a new high of ¥25.4 billion, surpassing by 74% the ¥14.6 billion recorded in December 2013.
- Deposits in accounts for personal customers (including private banking) fell slightly to ¥2 billion, the same level as at the end of June 2013.
- Inter-bank deposits declined to total ¥6.4 billion, a 30% decrease on end 2013 and a return to levels of end 2012.
- Deposits in accounts for corporate customers rose sharply to ¥16.7 billion, a 454% increase on end 2013 and a very much higher figure than seen before.

Comments on deposit results
The volatility of these deposits has been a constant feature in these surveys as Chart 2.5 shows. In 2014 H1 the results showed a marked decline in inter-bank deposits and a very substantial increase in corporate deposits. Respondents reported quite a few large RMB deposits by Chinese and UK companies. They attributed these to favourable RMB deposit rates in London as well as the opening up of new and existing channels of RMB outflows from the mainland this year.

Chart 2.5 – London RMB denominated deposit volumes



3 Conclusions

The most significant policy-led event during the period has been the appointment of CCB to act as the RMB clearing bank in London. There have been appointments also in other centres, suggesting that market-led competition amongst centres and amongst individual banks or other service providers can also be expected to increase. The officially appointed clearing banks do not have monopoly rights because global banks can settle business in whichever centre they choose, and therefore through whichever clearing bank they choose. The banks themselves recognise the need to offer a competitive product and are competing, for example by offering advantageous deposit rates. CCB (London) was appointed as the renminbi clearing bank for the UK and commenced operation in July 2014. It is backed by the resources of CCB's parent bank and has access to the mainland wholesale market through it.

A further significant development is the decision of the UK Government to issue an RMB denominated bond. The issue will support development of the offshore RMB bond market, which at present remains relatively small, and assist RMB market participants in further developing that market.

The results of this survey demonstrate that in the first six months of 2014 London grew its business in renminbi products and services at a very rapid rate. The key conclusions from the survey are:

Trade finance services

Trade finance recovered from the fall in the second half of 2013 to regain earlier levels. The figures continue to reflect both the growing use of RMB as a trade settlement currency outside China and also an acceleration of interest in this activity in London.

- Business in letters of credit contracted slightly in the first half of 2014 to ¥0.8 billion but current levels remain substantially below those seen in earlier periods. Letters of credit appear to be losing importance in London as a trade finance tool in favour of other methods of finance.
- Import finance rose to ¥18.4 billion, a substantial increase on the second half of 2013 maintaining levels similar to those recorded in 2012 and 2013 H1, and 185% higher than in the second half of 2013.
- Export finance was ¥7.3 billion, maintaining the high level achieved in the second half of 2013 and 69% higher than 2013 H1.
- Overall trade finance in the first half of 2014 was ¥26.5 billion, a strong recovery from the ¥14.8 billion in 2013 and back to levels seen in 2012.

Foreign exchange
There was again very strong overall growth in RMB forex trading in London. There was also a continuation of the relative shift in trading from non-deliverable forex products to deliverables with deliverable trading representing 78% of all RMB forex trading.

- The aggregate average daily volumes of deliverable RMB forex products in the first half of 2014 was 127% up on the average volume in 2013, with spot trading rising to a daily value of US$14.5 billion, a 160% increase over 2013. All deliverable derivatives saw substantial increases over 2013, with forwards up 181%, swaps 106% and options 78%. The continued growth of deliverable RMB forex trading is seen as evidence of the growing liquidity of the offshore RMB market, the increasing confidence of investors to trade in it and the growing diversity and sophistication of the offshore market.

- Non-deliverable trading volume also saw substantial increases, though declined as a proportion of all forex trading. Total trading was US$ 12.2 billion per day (up 85% on 2013). Forwards and options saw substantial growth to US$ 5.6 billion (up 59%) and US$ 5.9 billion (up 179%) respectively. Trading in non-deliverable swaps was US$ 0.4 billion, similar to recent levels.

- Banks trading in London continued to execute over 50% of their offshore RMB spot trades in London. The London percentages have not shown much movement since the measure was introduced in 2012 indicating that the global market in RMB forex is expanding at about the same rate as the London market.

Deposits
The level of London RMB deposits at June 2014 was ¥25.4 billion, a significant (74%) rise from the end of 2013. Within the total, the main growth was in corporate deposits, which totalled ¥16.7 billion and reflected increased use by both UK and Chinese corporates.

Overall
The results of the survey again show that London's RMB business continues to respond vigorously to the growth in the use of RMB for international trade and the appetite for a broader range of RMB denominated products and services from holders of offshore RMB.

The strong growth in RMB forex trading is building on the predominant position London has in the global foreign exchange market and demonstrating its ability to grow transactional business with holders of offshore RMB across the world. The data on respondents' business in other centres suggest that the global market for RMB forex is also growing very rapidly.

A full review of London products and services will be published in 2015 to provide a more comprehensive picture of the development of the market.

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