DBS RMB Index for VVinning Enterprises (DRIVE) - 1Q13

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In 1Q13, RMB internationalisation has achieved many milestones. Taiwanese banks started accepting RMB deposits in February, while the People's Bank of China designated a Chinese bank in Singapore to undertake RMB clearing services.

While RMB activities have clearly expanded to regions like Taiwan and Singapore, there is still ample room to deepen RMB penetration locally. The 1Q13 reading of DRIVE is 55.1, compared to the initial reading of 54.9 in 4Q12 due to a marginal increase in the usage and acceptance of RMB. In Hong Kong, the popularity of RMB for trade settlement, financing, and day-to-day business transactions is still low relative to the HKD and the USD.

Of companies that used any RMB products, 40% were using FX spot and 28% were using savings/cheque accounts. While the market is speeding up on the launch of RMB products, usage was still concentrated on simple product types. To take local RMB usage to a new level, it is imperative that Hong Kong's trading partners prefer to use RMB. That's because many overseas buyers determine the currency used for trade settlement, and USD is still their preferred choice. Even if certain exporting companies in Hong Kong prefer to accept RMB – an appreciating currency – the counterparty may not want to pay in RMB. In that sense, the government's strategy to promote RMB usage in nearby Asian economies is in the right direction.

In the investment space, there is room to increase the scope of investment products. Currently, only one company has listed RMB shares on the Hong Kong Stock Exchange. Consequently, the demand for RMB-denominated structured products such as RMB equity-linked notes (ELN) and equity-linked deposits (ELD) has been muted. On the other hand, RMB financing in Hong Kong is unattractive at the moment due to RMB appreciation and higher lending rates than USD loans. That said, RMB is still considered one of the top three currencies for financing purposes.

RMB internationalisation is still in its infancy stage

It is widely believed that RMB appreciation will aid internationalisation at the macroeconomic level. However, two things are worth noting. Firstly, our findings reveal that, at the micro level, many companies reckon appreciation will negatively impact business. This means that currency hedging products will be very useful to companies, especially at a time when RMB is appreciating even amid slower economic growth. Secondly, appreciation alone does not guarantee a quicker speed of internationalisation. This is exactly the case in Hong Kong as RMB penetration has increased only marginally despite quicker RMB appreciation in 1Q13. To quicken RMB penetration locally, Hong Kong needs to enhance a self-sustainable cycle of RMB alongside with more repatriation channels for offshore RMB.

The index results realistically reflect the fact that RMB internationalisation is still in its infancy stage. RMB is currently ranked No.13 with a tiny share of 0.6% as a global payment currency. This contrasted sharply with the 40.2% and 33.5% share of the euro and USD respectively, the two most-used currencies for global transactions. While the breadth of RMB internationalisation has increased, local penetration of RMB is also deepening on the back of favourable regulatory support. Many more opportunities abound in RMB trade settlement, financing and investments.

Key findings and DBS insights

Comparable figures from last quarter are in parentheses.

1. HKD and USD are still the preferred currencies for payment and receivables/trade settlement

- 10% (16%) of respondents converted RMB or used spot RMB in the past 12 months (Charts 1a & 1b)
- 7% of respondents had used RMB savings and cheque accounts in the past 12 months (Charts 1a & 1b)
- 47% (42%) of companies surveyed kept RMB as part of their liquid assets in the past 12 months (Chart 2)
- 2% (3%) of companies that used payment and receivable/ trade services (all currencies) preferred to use RMB for payment and receivables/trade settlement (Chart 3)
- Of the companies that used payment and receivable/trade services, 73% (70%) preferred to use HKD while 22% (26%) preferred to use USD for payment or trade settlement (Chart 3)

DBS insights

HKD remains the predominant currency used by companies for payment and commercial transactions. The use of the RMB in Hong Kong is not expected to lead to the substitution or marginalisation of the HKD. Local companies' preference to use RMB may be affected by their trading partners' willingness to accept/make payments in RMB. Without an additional policy push by Beijing, the share of companies whose preference is for using RMB will be stable but low.

2. Interest in RMB usage is growing

- 6% of companies that used trade services (all currencies) had used RMB trade services in the past 12 months, 11% that used trade services (all currencies) but are not currently using RMB trade services will consider using them in the next 12 months
- 18% of companies surveyed are currently using RMB payments and receivables. 4% that do not currently use RMB payments and receivables will consider using them in the next 12 months
- Business needs for RMB are expected to increase in the next 12 months. While 43% (41%) of companies surveyed indicated that they had RMB customer orders/invoices in the last 12 months, 52% (50%) claimed that they would be using RMB for these purposes in the next 12 months. Meanwhile, usage of RMB is already quite common among large corporations (turnover over HK$1billion). Some 90% (99%) of large corporations indicated that they had customer orders/invoices in the last 12 months

DBS insights

Our findings are consistent with the usage of RMB for trade purposes onshore. Official figures released by the People's Bank of China indicated that around 12% of China's trade was settled in RMB in 2012, compared with 80% of US trade invoiced in US dollars and 30% of Japan's trade invoiced in Japanese yen respectively. RMB trade settlement is considered to be still in its infancy.

3. Need for RMB financing is generally lacking

- Only 1% (0%) of the respondents are currently using RMB financing
- 85% (80%) of respondents indicated they are quite unlikely or very unlikely to apply for RMB financing in the next 12 months, with most saying their company uses other currencies and that there is no need to use RMB loans (Chart 4)
- 61% (55%) of the respondents didn't know if there were sufficient RMB financing products in the market. The results suggest knowledge in this space is particularly weak amongst companies surveyed

DBS insights

These findings reflect that RMB loan business of banks in Hong Kong has been lagging behind other areas of RMB offshore development. As of December 2012, RMB loans outstanding were RMB79 billion [2], compared with RMB237 billion dim sum bonds outstanding. That said, the demand for offshore RMB financing activities is expected to become more robust going forward, given the loosening of RMB lending restrictions and an increasing scale of cross-border lending activities.

4. Large corporations have higher potential to take out RMB loans or issue RMB bonds

- Out of the large corporations surveyed (annual turnover larger than HK$1 billion), 20% intend to take out RMB bank loans in the next 12 months, while 11% intend to issue RMB bonds

DBS insights

Hong Kong's Treasury Markets Association will start compiling CNH Hong Kong Interbank Offered Rate fixing in June. The fixing is expected to facilitate the growth of the offshore RMB lending market (the total outstanding RMB loans amounted to RMB79 billion, merely a fraction of the RMB668 billion deposits offshore). The move will also address a widespread concern about a lack of hedging options that has restrained enthusiasm for holding RMB offshore. Meanwhile, the Hong Kong Monetary Authority will eliminate the net open position rule and the 25% liquidity requirement, putting RMB on the same status as other currencies when it comes to calculating the statutory liquidity ratio for banks. As banks no longer need to hoard additional reserves of RMB in cash, the regulatory refinement is expected to release more RMB into the interbank system and thereby improve offshore liquidity.

We expect market participants will continue to tap the dim sum bond market to broaden their fund raising base when the price is favourable. Indeed, cost saving has become attractive again this year due to the divergence of on and off-shore benchmark yields. On the demand side, sentiment has clearly improved amid the better global macro outlook, improving liquidity, and renewed appreciation expectation of the RMB.

5. Companies may find RMB hedging products useful

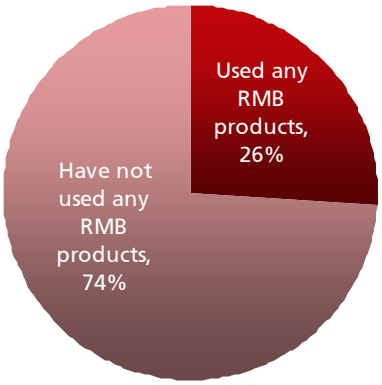
- 58% (63%) of respondents reported that RMB appreciation had impacted their cost of business operation, and 58% (61%) of respondents reported RMB appreciation had impacted their sales and revenue (Charts 5 and 6)
- 21% of those surveyed indicated that the increasing popularity of the RMB had a negative impact on their businesses, of which 77% cited rising costs. Only 16% of those surveyed thought the increasing popularity of the RMB had a positive impact, of which 57% cited more business opportunities. Companies may find RMB hedging products valuable to mitigate the risk of margin erosion due to RMB appreciation

DBS insights

Capital flows triggered by worldwide quantitative easing have exerted appreciation pressure on the RMB, despite the surprise slowing of China's economy. USD/CNY is projected to reach 6.07 by the end of 2013, implying some 2.5% appreciation this year. Meanwhile, Beijing has to loosen its grip on the country's capital account against the backdrop of RMB internationalisation. The USD/CNY's trading band must hence be widened gradually as international experience indicates that capital account openness does not reconcile well with a rigid exchange rate mechanism. As the currencies' two-way flexibility will become more apparent, the demand for RMB hedging products is expected to rise in tandem.

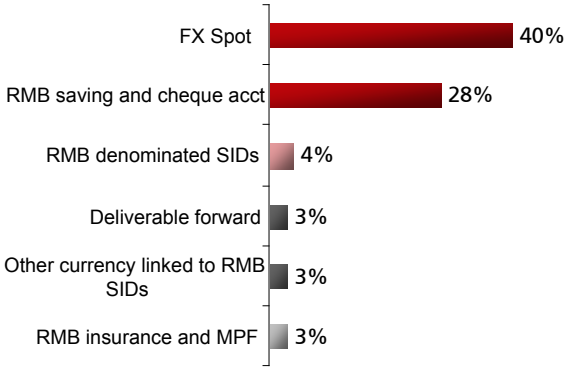
Key charts and graphs

Chart 1a: Usage of RMB products



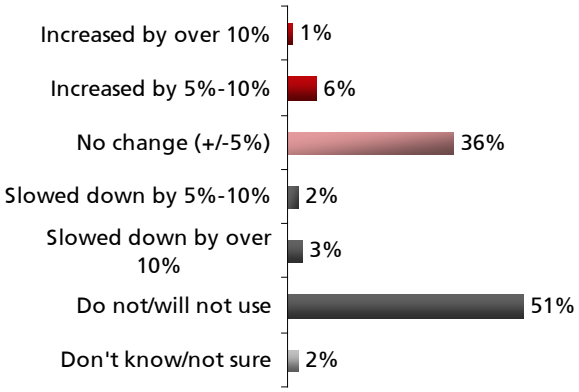
Base: All companies (n=212)

Chart 1b: RMB products used



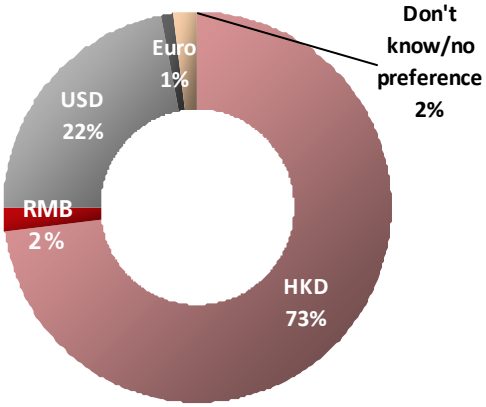
Base: Companies using any RMB product (n=64)
Weighting adjustment explains difference in main text and chart

Chart 2: Change in RMB liquidity in the last 12 months



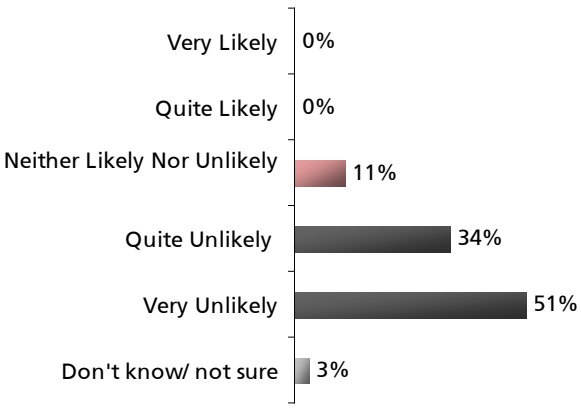
Base: All companies (n=212)

Chart 3: Preferred currency for settlement



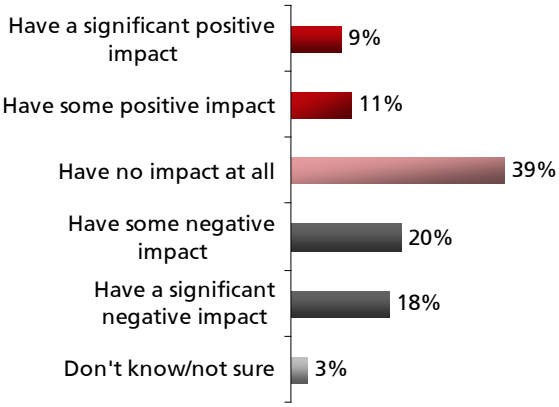
Base: Companies which used payment and receivables/trade services (n=163)

Chart 4: Likelihood of getting RMB financing in the next 12 months



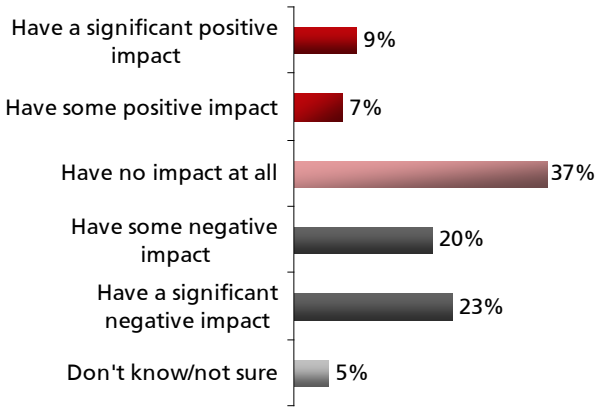
Base: All companies (n=212)

Chart 5: Impact of RMB appreciation on sales and revenue



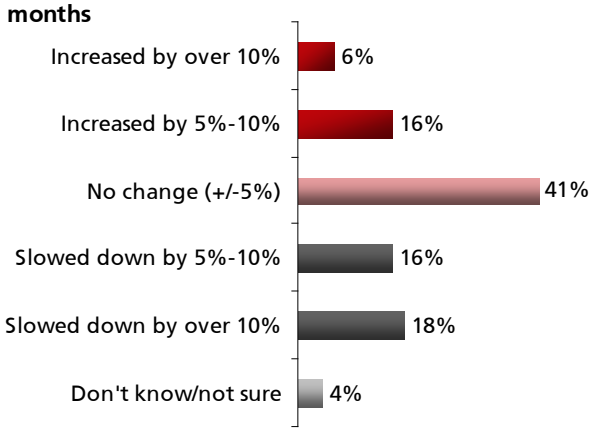
Base: All companies (n=212)

Chart 6: Impact of RMB appreciation on cost of business operation



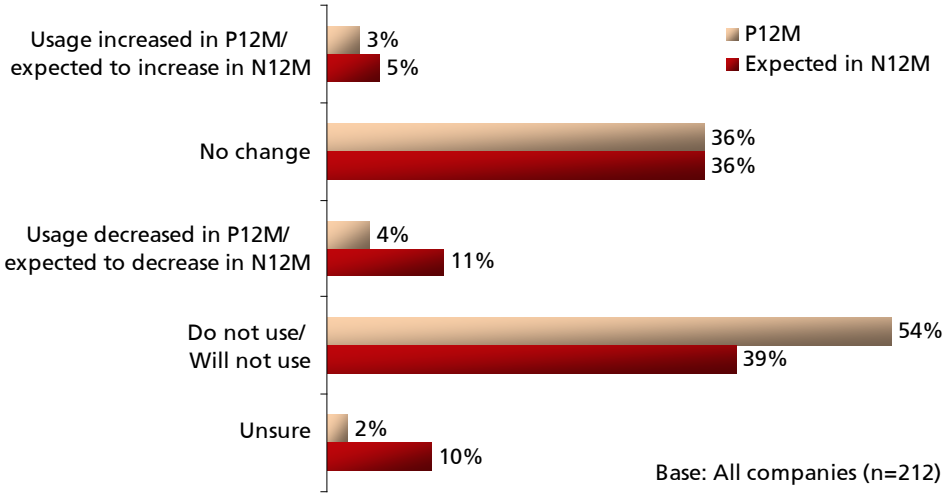
Base: All companies (n=212)

Chart 7: Business performance in the past 12 months



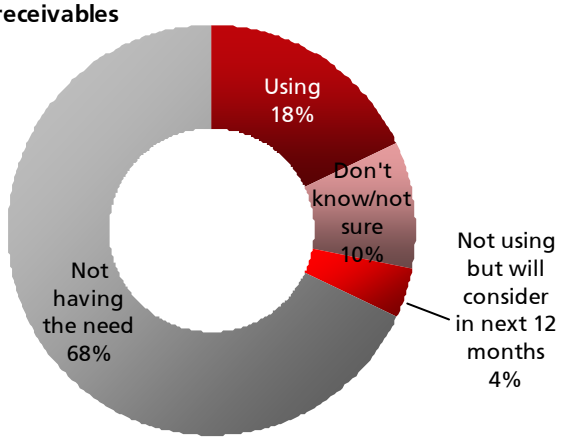
Base: All companies (n=212)

Chart 8: Business demand on RMB



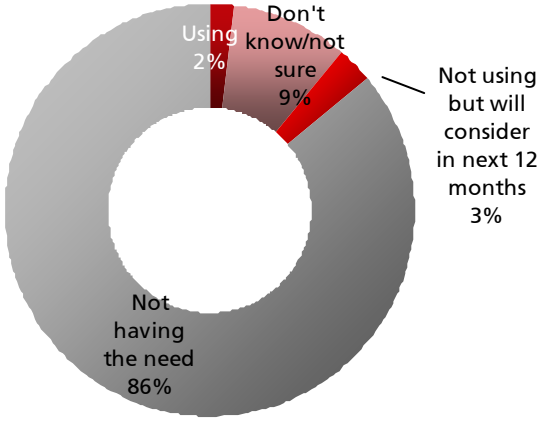
Base: All companies (n=212)

Chart 9a: Usage of RMB payment and receivables



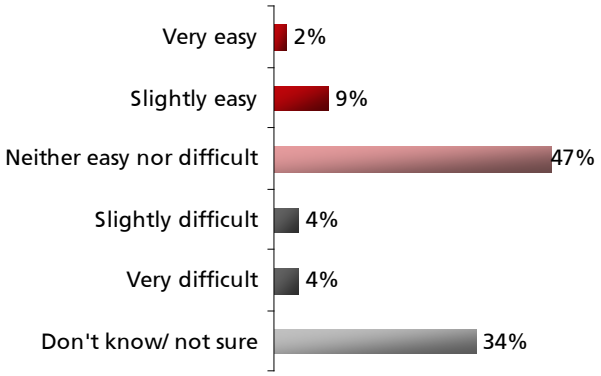
Base: All companies (n=212)

Chart 9b: Usage of RMB trade services



Base: All companies (n=212)

Chart 10: Ease of getting access to RMB loans



Base: All companies (n=212)

About the index

The DBS RMB Index for VVinning Enterprises (DRIVE) is the first index in the industry that is specifically designed to gauge the level of RMB usage, acceptance and penetration among companies registered in Hong Kong, as well as companies' inclination to use RMB in the future. Although macroeconomic data on the circulation of offshore RMB are widely available, they are not able to offer an in-depth perspective on the developmental progress of Hong Kong as an RMB offshore centre. By focusing on the level of RMB usage and acceptance among Hong Kong-registered companies, this index aims to serve as the first benchmark to measure the pace of RMB internationalisation in Hong Kong. Policy-makers, businesses and investors alike will find this index a useful strategic tool over time.

DBS Bank (Hong Kong) Limited has commissioned an independent research house (Nielsen) to compile DRIVE and conduct the related survey on a quarterly basis, starting from the fourth quarter of 2012. DRIVE is a composite index based on six questions measuring four key dimensions driving business adoption and internationalisation of RMB in Hong Kong for both local and global transactions. These four dimensions are: (1) Actual business performance in the last 12 months and expectations for the next 12 months as the underlying conditions driving corporate demand for RMB (Chart 7); (2) Past and future demand for RMB in business operations (Chart 8); (3) Usage of RMB for trade services and payment receivables (Chart 9); and (4) Ease of access to RMB financing (Chart 10).

A weighted sum of these attributes gives an overall composite index value, ranging from 0-100. The higher the reading, the higher the usage/acceptance of RMB is at the company level. A higher reading indicates higher RMB usage/penetration among Hong Kong-registered companies.

The second reading of the index is 55.1, higher than the initial reading of 54.9.

Subsequent index values will be released on a quarterly basis and over time will reveal a lot more about the pace of development of Hong Kong as an offshore RMB centre. Corresponding policy recommendations can thus be drawn from analysing the future time series. In future, the index may be extended to cover other countries which are also offshore RMB centres.

Methodology

Decision makers of companies registered in Hong Kong with annual sales turnover of HK$200,000 and above were interviewed by telephone. A total of 212 companies were surveyed between mid February and late March 2013. The sample comprised 202 SMEs (with annual sales turnover of HK$200,000 to HK$1 billion) and 10 large corporations (with annual sales turnover of over HK$1 billion). The SMEs were selected via quota sampling based on company industry and sales turnover distribution released by the Census and Statistics Department (C&SD). The final sample was weighted to ensure it was representative of the business landscape in Hong Kong, referencing C&SD's distribution information (Tables 1 and 2).

Index computation and components

The quarterly index aims to gauge the level of RMB usage, acceptance and penetration among Hong Kong-registered companies. It is based on six questions measuring four key dimensions driving business adoption and internationalisation of RMB in Hong Kong. They are: 1) Actual business performance

in the last 12 months and expectations for the next 12 months as the underlying conditions driving corporate demand for RMB; (2) Past and future demand for RMB in business operations; (3) Usage of RMB for trade services and payment receivables; and (4) Ease of access to RMB financing. The index is the weighted average based on the factor analysis [1] applied to these key areas. The weightings are based on the statistical variance and correlation between each of the key areas. The calculated values are then rescaled to between 0 and 100.

The index for each quarter is computed using the following formula:

Index (i,j) =

Where,

N = Sample size for current wave

K = Number of selected questions

Q*ij = Response of selected questions (adjusted to 0-100)

Wj = Weighting for individual questions

Notes

[1] Factor analysis is a statistical treatment to provide approximation to describe the variability of the parameters used to calculate the index

[2] HKMA

Table 1: Company industry coverage

Manufacturing	Restaurants
Construction	Hotel/ Real Estate
Wholesale	Transportation/ Communication
Retailing	Business Services
Import/ Export	Personal Services

Table 2: Company annual sales turnover (source: C&SD 2011)

Over HK$1 Billion	0.3%
Over HK$50 Million to HK$1 Billion	4.1%
Over HK$20 Million to HK$50 Million	5.4%
Over HK$10 Million to HK$20 Million	4.1%
Over HK$1 Million to HK$10 Million	47.0%
Over HK$ 200,000 to HK$1 Million	39.1%

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