

DBS RMB Index for VWinning Enterprises (DRIVE) - 1Q15

DBS Group Research

20 May 2015

Chris Leung

(852) 3668 5694

chrisleung@dbs.com

Nathan Chow

(852) 3668 5693

nathanchow@dbs.com

Lily Lo

(852) 3668 5695

lilylo@dbs.com

1Q15 DRIVE reading fell to record low

The 1Q15 reading of DRIVE fell to 55.1 from 57.2 in 4Q14 (Chart 1). Actual business performance was generally stable compared to the previous quarter (Chart 2a). China's economic slowdown has impacted the volume of RMB customer orders/invoices and trade settlement, as well as the intention for its use in the next 12 months. Overall RMB product usage levels fell slightly, as usage of both RMB payment and receivables and RMB trade services fell. Also, access to RMB loan/credit facilities became more difficult, and interest in RMB financing remained muted.

Key findings and DBS insights

Unless stated otherwise, figures in parentheses represent findings in the previous survey (4Q14)

1. Business needs for RMB fell

- Only 23% (29%) of respondents said they had RMB customer orders/invoices and trade settlement in the past 12 months — this is a historical low. Some 66% (70%) of companies reported that they had no RMB customer orders/invoices in the past 12 months (Chart 3a).
- Only 32% (51%) claimed that they would use RMB for these purposes in the next 12 months (Chart 3b). This is also a historically low level.

DBS insights

Business needs for RMB, measured in terms of the use of RMB customer orders/invoices and trade settlement, is a key indicator of actual RMB acceptance and usage levels at the corporate level. There is evidence of a downtrend in business needs for RMB since 2Q14. This could be due to the increased volatility in the RMB exchange rate. Meanwhile, companies' business performance and business outlook also declined persistently since 2Q14 owing to the slowdown of the China's economy, and may have also contributed to the decrease in business needs for RMB.

2. Positive relationship between appreciation expectations and business needs for RMB

- More companies (34% in 1Q15 versus 14% in 4Q14) anticipate RMB depreciation in the next 12 months. The average RMB/USD exchange rate during the fieldwork period (10 Feb 2015 to 18 Mar 2015) was 6.26, compared to 6.21 at year-end 2014, meaning the RMB depreciated 0.8% against the USD over this period.

DBS insights

After tracking the index for 10 quarters, we observed that the adoption of RMB in Hong Kong corporations has been growing very slowly. This could be due to the fact that 98% of Hong Kong companies are SMEs, whose needs for RMB is more limited compared to large corporations.

RMB appreciation expectations seems to affect Hong Kong companies' business needs on RMB (RMB customer orders/invoices and trade settlement). In 1Q15, when RMB depreciation expectations increased sharply, business needs on RMB fell. In fact, there is a consistent positive correlation between appreciation expectations and business needs for RMB over the course of our study (Chart 4). On the other hand, the relationship between RMB appreciation expectations and RMB product usage is less clear (Chart 5).

On a global scale, however, RMB internationalisation is not so constrained by appreciation expectations for the currency. For corporations trading with China, the use of RMB can lower their foreign exchange costs and risks. They can also enjoy price discounts offered by some Chinese companies. Settling trades in RMB can also help foreign enterprises broaden their network of buyers and suppliers, thereby improving their purchasing power. In short, foreign corporations are likely to adopt RMB as long as it serves their long term business goals.

Empirically, international use of RMB has been increasing. According to SWIFT, the RMB overtook the Canadian dollar as the fifth most-used currency for global payments in December 2014. The proportion of transactions denominated in RMB climbed to a record 2.2%, after hovering around 1.5% over the past year. The US dollar, euro, pound, and yen remained the four most-used currencies with respective shares of 44.6%, 28.3%, 7.9%, and 2.7%.

Ongoing capital account liberalization has also lifted the popularity of the yuan as a reserve currency. It is increasingly being held by not only foreign corporations/financial institutions but by central banks as well. In particular, the UK last year raised RMB 3 bn via the landmark issuance of an offshore sovereign yuan bond. The proceeds were held as foreign reserves rather than converted into dollars or euros. The ECB has also laid the groundwork to add yuan to its forex reserves. Australia's central bank has acknowledged a 3% allocation of its forex reserves to yuan. To date, more than 50 central banks, sovereign institutions, and supranationals have invested in yuan either through QFII/ RQFII schemes, the China Interbank Bond Market (CIBM), or offshore CNH markets. Such investment will only accelerate when the yuan becomes part of the IMF's Special Drawing Rights (SDR), which seems likely to occur this year (see "CNH: Going abroad", 10 Dec 2014).

3. RMB product usage fell

- The percentage of companies using RMB products [1] fell slightly to 27% from 29% in 4Q14 (Chart 6). The highest historical value was 34%, recorded in 2Q14.
- 24% (29%) of companies said they are currently using or will consider using RMB deposits in the next 12 months.
- 5% (10%) of companies said they are currently using or will consider using RMB trade services in the next 12 months.
- Of the companies that were using trade services, some 36% have either used RMB payment and receivables or would consider using them for these purposes in the next 12 months, compared with 56% in 4Q 2014 (Chart 7). Some 11% have either used RMB trade services or would consider using them for these purposes in the next 12 months, down from 42% in the previous quarter (Chart 8).

DBS insights

Companies using trade services showed a decreasing need for RMB services, such as deposits, payment and receivables, and trade services, in their operations. But this will not alter the RMB's long-term growth prospects.

China is the world's largest trading country, and 25% of its foreign trade is now settled in RMB, which is not too far from the 30%–40% level for the yen for Japanese trade. Amid ongoing liberalisation efforts, more RMB capital will flow abroad and the number of transactions will increase, meaning spreads should narrow and the cost of trade should fall. That will further incentivise market participants to trade in RMB. We expect the RMB to surpass the yen and rank fourth for global payments by year-end 2015.

The use of RMB products is expected to increase going forward as corporates adopt various hedging strategies to mitigate increasing exchange rate volatility. Also, more small- and medium-sized enterprises tend to invoice in RMB because they may not have the experience and/or expertise to hedge foreign exchange risks effectively.

4. Interest in RMB financing remained low

- Since the launch of the DRIVE survey in 4Q12, the overall interest in RMB finance has remained at a consistently low level. In 1Q15, 97% of respondents expressed no intention to apply for RMB finance in the next 12 months (Chart 9), same as the previous quarter. Of these respondents, some 69% (65%) claimed that their company did not need RMB or they were mainly using other currencies. Only 2% (3%) attributed fluctuations in the RMB exchange rate as the reason for not applying for RMB finance.
- Fewer respondents (10% in 1Q15 versus 16% in 4Q14) claimed that getting access to RMB loans or credit facilities was easy (Chart 10). Meanwhile, 11% claimed access was difficult, same as the previous quarter. More than one-third of respondents who claimed that access was difficult said it was either due to strict approval standards or that the amount approved was small.

DBS insights

Looking ahead, greater currency volatility and less structural appreciation pressure will further support the offshore loan business. Some companies are trying to reduce their foreign exchange risk by borrowing in RMB instead of US dollars or by using derivatives to lock in stable funding costs on US dollar debt. Adding to this is the potential expansion of cross-border loan programmes amid the establishment of new free-trade zones.

The outlook: Short-term fall in DRIVE is expected; RMB internationalisation to continue

Looking ahead, the economic slowdown in Hong Kong and China will negatively impact companies' business performance and business outlook. Furthermore, the use of RMB customer orders/invoices is expected to decline in tandem. RMB product use may also fall as companies' volume of mainland businesses affects RMB product usage. For companies already using RMB products, 42% of them believed company business (more mainland customers/higher acceptance of RMB trading and settlement by customers/business expansion) is a key factor affecting their usage of RMB (including RMB customer orders/ invoices, RMB trade services, RMB financing and investments).

We therefore project DRIVE to fall further in 2Q15. However, short-term instability should not alter the longer-term course for RMB internationalisation and the development of offshore RMB markets. In addition, RMB personal investment, which is not captured in DRIVE index values, has the potential to expand on the back of favourable policies.

Apart from the Shanghai-Hong Kong Stock Connect and the anticipated Shenzhen-Hong Kong Stock Connect, China is seeking to provide domestic residents with more investment channels. According to the People's Bank of China, China's citizens will be able to buy overseas equities and real estate. China will likely further expand cross-border investment channels for individual investors, via pilot programmes such as the Qualified Domestic Individual Investor. Talks are underway to give locals access to RMB capital markets in Singapore and London via an RQDII scheme. Apart from boosting offshore liquidity, such measures would help China achieve better balance between capital inflows and outflows (see "CNH: To break fresh ground in 2015", 17Nov14).

In short, for the yuan to become a more common and widely held reserve currency, there needs to be greater access for foreign investors in domestic capital markets, a larger offshore yuan liquidity pool, and wider cross-border flow channels. All of the aforementioned are developing more quickly than most envisioned just one or two years ago.

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 is widely available, it is not able to offer an in-depth perspective on the developmental progress of Hong Kong as an offshore RMB 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 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. 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 by 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\$1 million or above were interviewed by telephone. A total of 210 companies were surveyed between February 2015 and March 2015. The sample comprised 193 SMEs (with annual sales turnover of HK\$1 million to HK\$1 billion) and 17 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).

Table 1: Company industry coverage

Manufacturing	Hotel and catering
Construction	Real estate
Wholesale	Information, communication
Retailing	Business services
Import/ Export trade	Community, personal services
Transportation, Storage	

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

Company size in terms of sales turnover	Weighting
Over HK\$ 1 Billion	0.5%
Over HK\$50 Million to HK\$1 Billion	6.7%
Over HK\$20 Million - HK\$50 Million	8.8%
Over HK\$10 Million - HK\$20 Million	6.8%
Over HK\$1 Million - HK\$10 Million	77.2%

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 the internationalisation of the RMB in Hong Kong. They are: 1) Actual business performance in the last 12 months and expectations for the next 12 months; (2) Past and future demand for RMB in business operations; (3) Usage of RMB payment and receivables services and trade services; and (4) Ease of access to RMB financing. The index is the weighted average based on the factor analysis [2] 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) =

$$\text{Index (i,j)} = \frac{\sum_{i=1}^N \sum_{j=1}^K W_j Q^*_{ij}}{N}$$

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] RMB deposits (including CNY time deposit/CNY deposit, current and saving accounts), RMB payment and receivables services (including Auto Pay, TT/ Remittance). RMB investment services, RMB financing services (including loans, issuing bonds, securities etc.), RMB trade services (including trade

finance, L/C, bills etc.), RMB insurance products, RMB MPF products, RMB hedging products

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

About The Nielsen Company

The Nielsen Company (NYSE: NLSN) is a global information and measurement company with leading market positions in marketing and consumer information, television and other media measurement, online intelligence, mobile measurement, trade shows and related assets. The company has a presence in approximately 100 countries, with headquarters in New York, USA. For more information on The Nielsen Company, visit www.nielsen.com

Key charts

Chart 1: DRIVE index

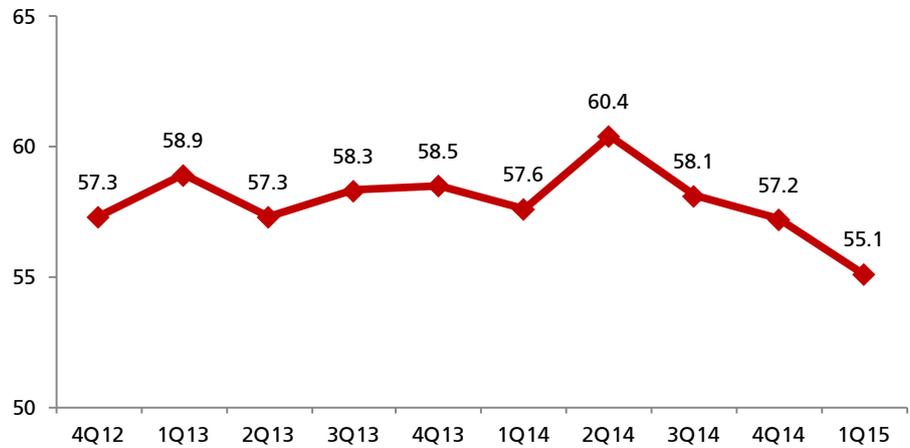
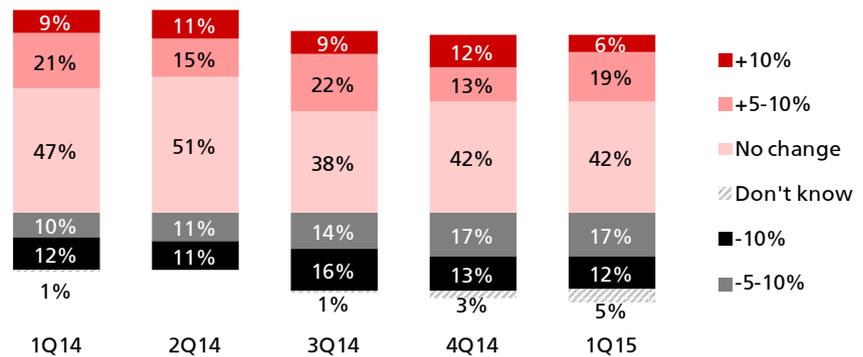
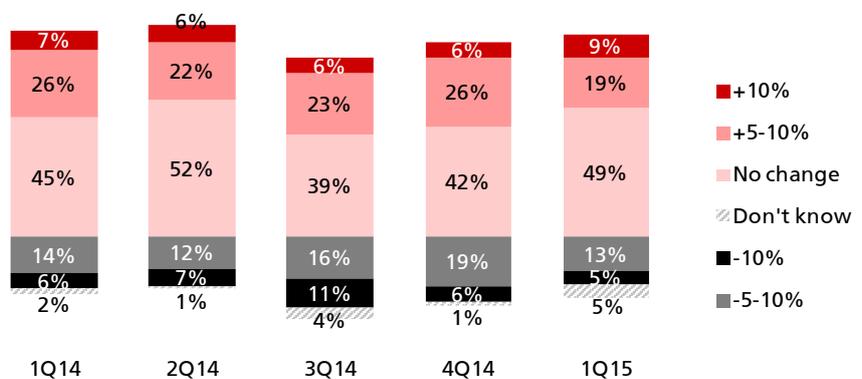


Chart 2a: Business performance in the past 12 months (sales turnover)



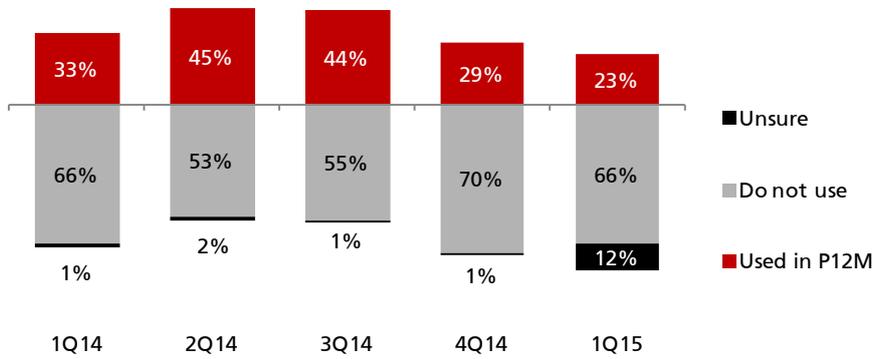
Base: All companies

Chart 2b: Business performance outlook in the next 12 months (sales turnover)



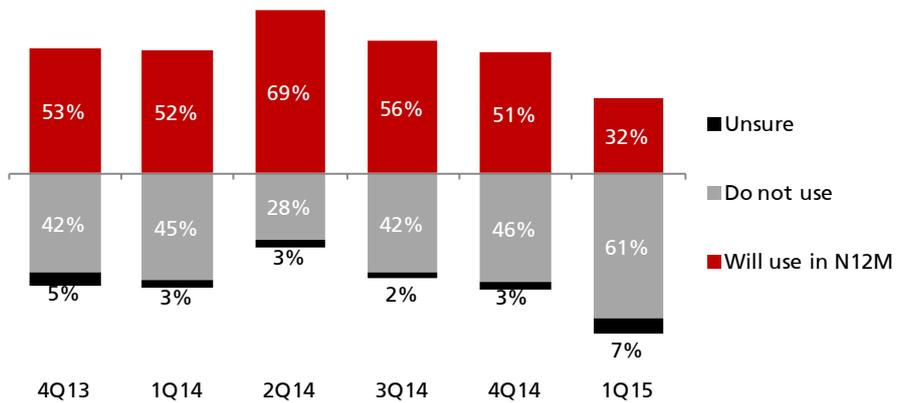
Base: All companies

Chart 3a: Change in RMB customer order/invoices and trade settlement in P12M



Base: All companies

Chart 3b: Change in RMB customer order/invoices and trade settlement in N12M



Base: All companies

Chart 4: Relationship between RMB appreciation expectations and business needs for RMB

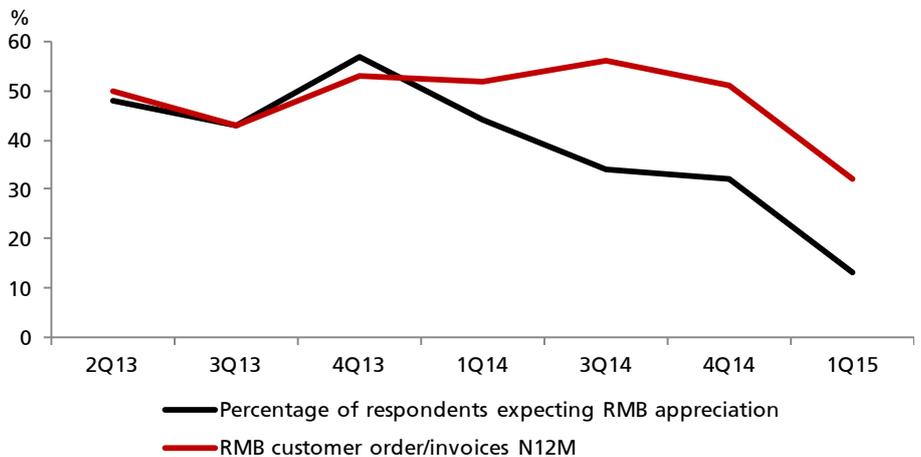


Chart 5: Relationship between RMB appreciation expectations and RMB product usage

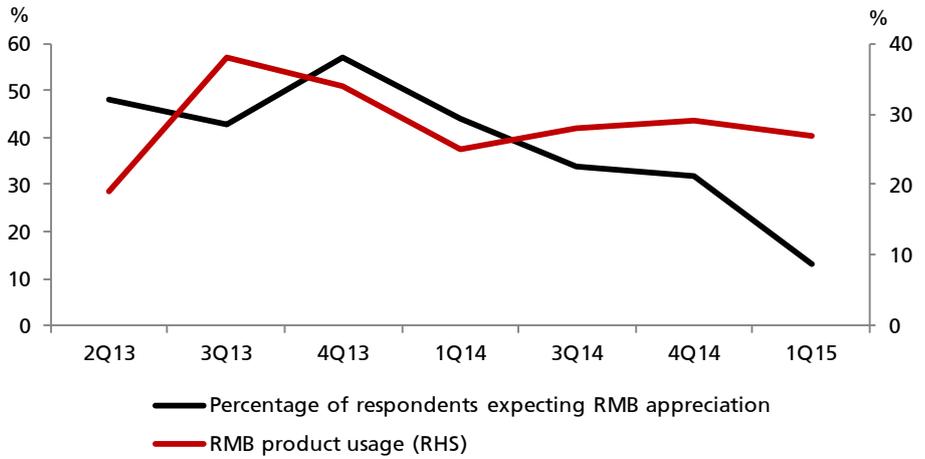
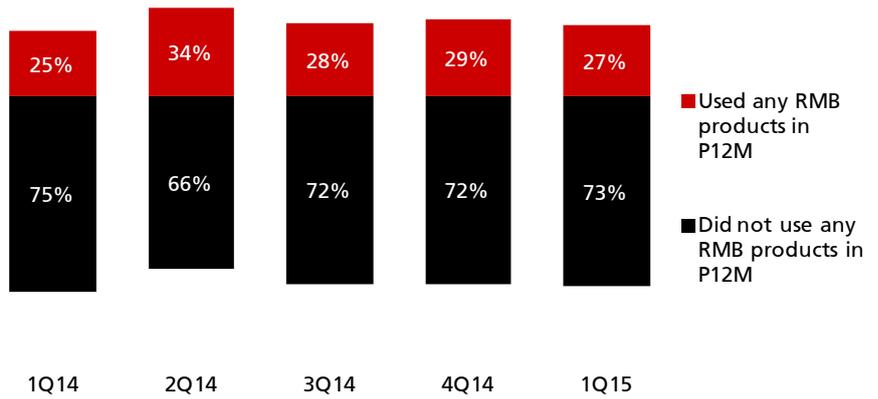
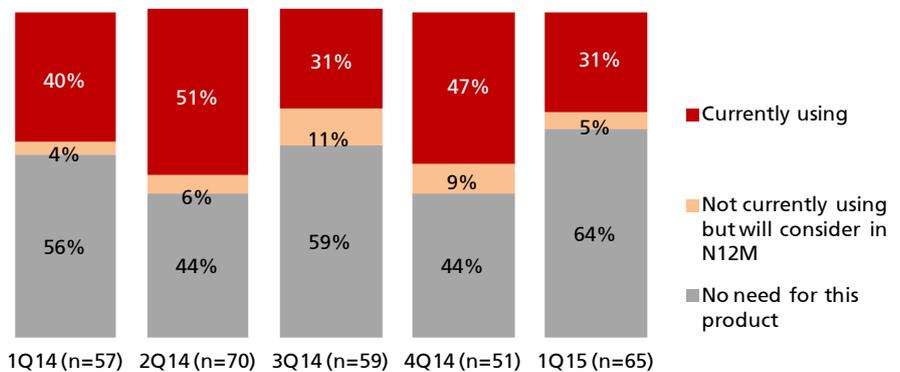


Chart 6: Overall RMB products or services usage



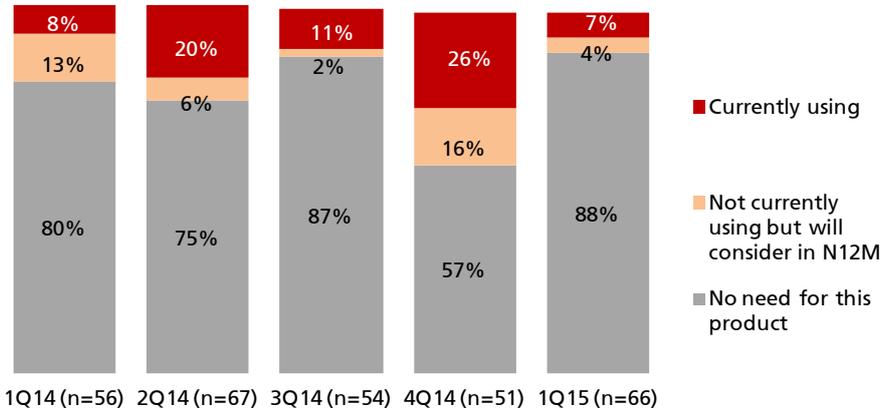
Base: All companies

Chart 7: Usage and needs for RMB payment and receivable



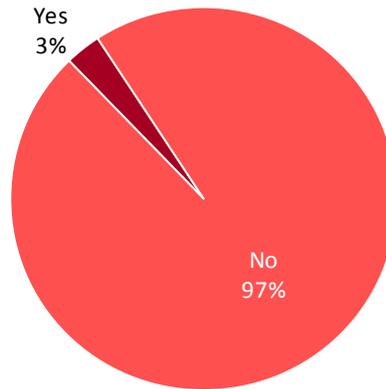
Base: Companies using trade services

Chart 8: Usage and needs for RMB trade services



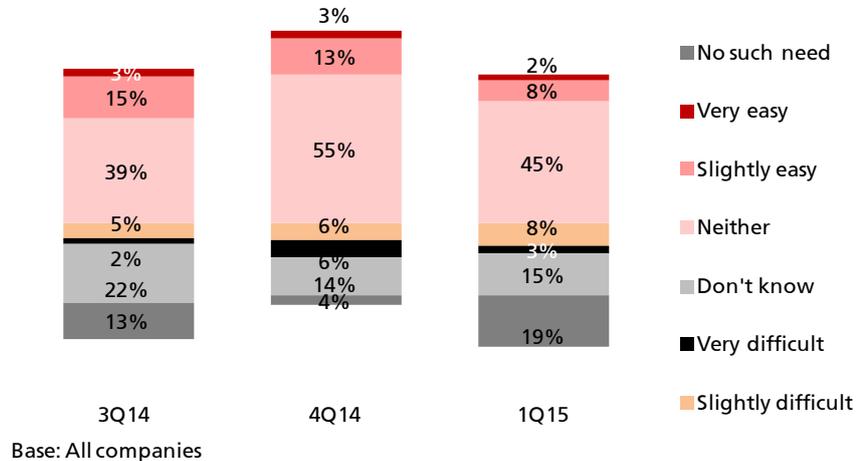
Base: Companies using trade services

Chart 9: Intention to apply for RMB finance in the next 12 months



Base: All companies

Chart 10: Ease of getting access of RMB loan or credit facilities



Base: All companies

Recent Research

Asia: breaking new new ground	11 May 15	IN budget: Growth trumps fiscal goals	2 Mar 15
CNH: "Q" expansion heralds next stage of capital account liberalization	6 May 15	ID: No shift in BI's tight policy bias	27 Feb 15
Greece: the clock is ticking	4 May15	SG budget: Shaping Singapore's future	24 Feb 15
MY: limited options	29 Apr15	India budget: A balancing act	17 Feb 15
India and Indonesia: taking stock	29 Apr 15	US: Substantial deflation here, now	16 Feb 15
US: over the hump (and sliding fast)	28 Apr 15	SG: Jubilee budget 2015	10 Feb 15
Asia bonds: floating on a yield cushion	27 Apr 15	USD Rates: Market vs Fed	10 Feb 15
Asia: breaking new old ground	22 Apr 15	CN: The need for a better unemployment gauge	4 Feb 15
JP: portfolio rebalancing underway	16 Apr 15	IN: Facing ECB QE and a strong dollar	30 Jan 15
US: Fed funds and such	14 Apr 15	Asia: Are currencies too strong?	28 Jan 15
CN: more inclusive urbanization policies	13 Apr 15	ID: Delivery is key	28 Jan 15
TH: further cuts unlikely	13 Apr 15	SG: Old problem, new approaches	27 Jan 15
Asia cyclical dashboard: an eerie calm	8 Apr 15	KR: Explaining low inflation	21 Jan 15
IN: policy to be data dependent	7 Apr 15	Global crude: low for long?	19 Jan 15
SGD: Making room for volatility	6 Apr 15	IN: Falling oil prices – good or bad?	19 Jan 15
CN: Recalibrating monetary policy	2 Apr 15	IN: RBI cuts rates, more to come	15 Jan 15
ID: Tax targets are too optimistic	1 Apr 15	CN: Restarting SOE reforms	13 Jan 15
CNH: The growing influence of yuan settlement in forex reserves	31 Mar 15	JP: mixed impact of low oil prices	12 Jan 15
CN: Fiscal reforms to accelerate	27 Mar 15	UST yields: Downward distortions	12 Jan 15
IN: Assessing RBI priorities	24 Mar 15	Asia: vulnerability dashboard	19 Dec 14
KR: Wither export competitiveness	19 Mar 15	Qtrly: Economics-Markets-Strategy 1Q15	10 Dec 14
CNH: A freer China	17 Mar 15	CNH: To break fresh ground in 2015	17 Nov 14
Qtrly: Economics-Markets-Strategy 2Q15	12 Mar 15	CNH: Conversion cap finally lifted	12 Nov 14
		JP: The impact of QQE2	7 Nov 14

Disclaimer:

The information herein is published by DBS Bank Ltd (the "Company"). It is based on information obtained from sources believed to be reliable, but the Company does not make any representation or warranty, express or implied, as to its accuracy, completeness, timeliness or correctness for any particular purpose. Opinions expressed are subject to change without notice. Any recommendation contained herein does not have regard to the specific investment objectives, financial situation and the particular needs of any specific addressee. The information herein is published for the information of addressees only and is not to be taken in substitution for the exercise of judgement by addressees, who should obtain separate legal or financial advice. The Company, or any of its related companies or any individuals connected with the group accepts no liability for any direct, special, indirect, consequential, incidental damages or any other loss or damages of any kind arising from any use of the information herein (including any error, omission or misstatement herein, negligent or otherwise) or further communication thereof, even if the Company or any other person has been advised of the possibility thereof. The information herein is not to be construed as an offer or a solicitation of an offer to buy or sell any securities, futures, options or other financial instruments or to provide any investment advice or services. The Company and its associates, their directors, officers and/or employees may have positions or other interests in, and may effect transactions in securities mentioned herein and may also perform or seek to perform broking, investment banking and other banking or financial services for these companies. The information herein is not intended for distribution to, or use by, any person or entity in any jurisdiction or country where such distribution or use would be contrary to law or regulation.