

News Release

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Malaysia to contribute towards RMB's final frontier.

The renminbi is approaching its Final Frontier: full convertibility and transformation into a “normal” currency used by companies and individuals worldwide in the same way the US dollar is today.

The renminbi's journey as a trade and investment currency over the past decade has been rapid and remarkable – and with reforms and international usage continuing to grow apace, the Final Frontier is now in sight.

In December 2015, China began publishing a new index measuring the renminbi's performance against a basket of trade-weighted currencies, highlighting that it was no longer “pegged” to the dollar¹. Last August 2015, China announced a change to the USD-RMB fixing rate, introducing more market orientation into the exchange-rate mechanism².

And on 1 October this year, the renminbi will join the IMF's Special Drawing Rights basket of leading reserve currencies. Its weight in that basket will be smaller than only those of the dollar and the euro, underlining that in some respects the renminbi is already one of the world's top three currencies.

¹ “Asian FX comment: RMB & a new basket”

<https://research.uk.hibm.hsbc/R/10/FqhFLW2ySZdH>

<http://www.bloomberg.com/news/articles/2015-12-14/china-s-new-yuan-index-here-s-what-the-market-needs-to-know>

² “Asian FX and Economics comment: A big bang for the RMB”

<https://research.uk.hibm.hsbc/R/10/lhgwB6MySZdH>

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In other areas, such as its usage in international payments, the renminbi trails not only the dollar and the euro, but also the British pound and the Japanese yen³. So clearly, the renminbi's internationalisation journey still has some way to go.

But there are two powerful engines that will continue to propel the renminbi along its internationalisation path. The first is the Chinese authorities' commitment to capital account liberalisation; the second is China's economic transformation towards sustained growth.

Over the past few years, China has gradually opened up its capital markets to foreign investors. Schemes such as the Shanghai-Hong Kong Stock Connect and the Renminbi Qualified Foreign Institutional Investor scheme are increasing the size of the foreign investor base permitted to trade in China's capital markets.

Foreign holdings of onshore renminbi-denominated bonds and equities remain miniscule when compared to the size of China's bond and stock markets – but further reforms will change the picture as we go forward.

The latest major change was announced just in February, when the authorities opened the China Interbank Bond Market up to “real money investors” – medium- and long-term institutional investors such as foreign banks, insurance companies and pension funds. The move, which could pave the way for sizable foreign portfolio inflows, followed an announcement in July 2015 that made it easier for foreign central banks and sovereign wealth funds to buy onshore Chinese bonds.

These deregulation measures reaffirm China's commitment to capital account liberalisation, and they send a powerful message: China will continue on the path of reform.

³ <https://www.swift.com/insights/press-releases/rmb-stands-fast-as-the-second-most-active-currency-in-malaysia-for-payments-with-china-and-hong-kong>

The second engine that will propel the renminbi towards the Final Frontier is the Chinese economy itself.

China's economy is now expanding at a more "normal" pace – 6.9% in 2015 despite a slowdown in export growth – but it is still one of the fastest-growing major economies in the world, and it added the equivalent of Turkey to global GDP in 2015⁴.

The recently-adopted 13th Five-Year Plan aims to keep annual GDP growth above 6.5% from now until 2020. This, combined with government initiatives such as the "Belt and Road" regional infrastructure investment push, as well as Chinese corporations' increasing efforts to expand their operations and capacity beyond mainland China, will ensure that the renminbi's role in world trade and investment continue to grow.

Already, an estimated 26% of China's trade in goods is settled in renminbi⁵. That is a remarkable number considering that the scheme for cross-border trade settlement in renminbi was launched only in 2009.

For now, the lion's share of this involves trade between mainland China and Hong Kong. The next step along the renminbi's internationalisation journey will happen when China's other major trading partners start to transact their trade with China in renminbi.

"Malaysia has been China's largest trading partner for the seventh consecutive year and is also China's top trading partner in ASEAN, with annual bilateral trade volume topping US\$100 billion. The usage of renminbi for payments in Malaysia with China and Hong Kong had increased by 68% over the last 12 months and by 214% over the last three years⁶. With a

⁴ HSBC Global Research, "China and the world: New Frontiers, Fresh Connections", May 2016

⁵ Trade: RMB24.5849trn; trade in goods settled in RMB: RMB6.3911trn

<http://zhs.mofcom.gov.cn/article/aa/201601/20160101233311.shtml>

<http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/3004953/index.html>

⁶ <https://www.swift.com/insights/press-releases/rmb-stands-fast-as-the-second-most-active-currency-in-malaysia-for-payments-with-china-and-hong-kong>

further increase in payment settling in renminbi, it would greatly increase the size of the offshore renminbi pool.” commented Mukhtar Hussain, CEO HSBC Bank Malaysia.

This is crucial, as the growth of the offshore market paves the way towards ever-greater international usage of the renminbi – in everything from cross-border payments to investment products for ordinary savers around the globe.

The ultimate measure of the renminbi’s “normality” will be when it begins to be used in transactions that do not even involve China: say, when a manufacturer in Korea pays its supplier in Thailand using renminbi – in much the same way that the dollar is already used by companies and shoppers around the globe to purchase goods that may have no connection to the US.

The pieces of the puzzle are now rapidly falling into place. There is still some way to go, but the renminbi is already more than half-way along the path towards this ultimate measure of normality. By staying on its path, it will become a truly global currency.

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About HSBC in Malaysia

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