News Release

26 July 2016

The rise of Renminbi as the next global investment currency will benefit Malaysian investors

Kuala Lumpur: The road to establishing an international currency might be a long one, but in less than a decade China has made significant progress in promoting the use of the Renminbi outside of its borders. With the Renminbi firmly established as a medium of trade, the focus is shifting towards the currency's evolution into an investment currency – a process that will be pushed forward by a number of upcoming developments to prompt fund managers across the world to buy Chinese securities.

"China remained as Malaysia's largest trading partner since 2009. With growing bi-lateral trade with China, ongoing financial reforms and surge in the usage of Renminbi in trade – Malaysian investors can look forward to reaping the benefits of Renminbi's growth as a global investment currency." commented Mukhtar Hussain, CEO of HSBC Malaysia.

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 years[1].

Foreign investors traditionally only had restricted access to China's capital markets. That all changed in late 2014, when the Shanghai Hong Kong Stock Connect programme went live, which grants mutual access to traders in both cities – effectively opening up China's domestic stock market to the world. That said, equities in the mainland – known as A-shares – are still not yet considered by many as an integral component of a global portfolio.

That looks set to change, as A-shares become a part of the indexes that professional investors use to measure their performance. Index provider FTSE has already added Chinese domestic stocks to some of its indexes[2]. The next big step will take place if MCSI finally decides to include A-share in its widely followed Emerging Markets Index.

Upon first consideration, all of these developments might seem distant from the interests of an individual investor. Indexes and structural market reforms are supposedly only relevant to the managers of large pension or mutual funds. But it would be a mistake for an individual to disregard these trends.

In its most recent annual review held in June, MSCI decided against putting A-shares in the index. If anything, this is only a temporary obstacle to eventual inclusion, because the bourses in Shanghai and Shenzhen are too important to exclude for much longer. We should see the

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[1] SWIFT

[2] Preparing China's inclusion in global benchmarks
http://www.ftse.com/products/downloads/Preparing_for_Chinas_Inclusion_in_Global_Benchmarks.pdf

index provider's decision within the broader context of Chinese capital market's opening up to the world.

In a statement[3], MSCI said that the delay was due concerns among the investment community relating to the accessibility of the A-share market. But at the same time, the company said that there had already been significant improvements over the past year – a sign that Beijing is working hard to clear any further impediments. In particular, it highlighted improved rules relating to trading suspensions and changes in policy that affect the mobility of capital and the allocation of quota given to international investors.

We should look at these moves as proof that things can move quickly in China, and that A-shares might become part of the Emerging Markets Index in the near future. Furthermore, we might not have to wait until next annual review in June 2017, since MSCI has said that the shares could be added before then if enough developments take place to warrant a new decision.

When A-shares are added to the index, the long-term impact could be profound, as it would result in global money managers allocating more of their portfolio towards A-shares. Full inclusion in the MSCI EM index, which may take 5-10 years, could lift the A-share weighting to over 18%, with China accounting for around 40% of the index. We estimate foreign fund inflows could surpass USD500bn, around 10% of the total floatable A-share market cap.[4]

Index inclusion could also take place with bonds, since China's domestic fixed income market is also absent from the major international benchmarks. Although there is no set timetable for inclusion, it would be benign for Chinese bonds to be added following a number of recent landmarks for the asset class that have whetted international appetite for Renminbi-denominated bonds.

Most notably, the International Monetary Fund late last year decided to add the Renminbi to the basket that makes up the Special Drawing Rights, a move that granted it reserve currency status and makes it a viable investment vehicle for central banks. And in February, new regulations opened up the domestic bond market to foreign investors with a medium or long-term investment horizon, replacing a system of quotas and licenses with a relatively simple application process.

With both foreign access to the market and interest from international investors, inclusion of Chinese bonds into the benchmarks could be event that sparks a surge of investment. We estimate that inclusion in all the candidate bond indexes could bump overseas participation up to 10%, which would result in a staggering US$500 billion of new investment over a multiyear horizon[5].

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[3] MSCI statement https://www.msci.com/documents/10199/4b1ba122-5f18-4a36-91c0-41a9b358c2ff

[4] China Equity Insights Equity dated 8 June 2016

[5] HSBC China's potential inclusion in the global indices, April 2016, P3&4

Another channel for access to the domestic stock market, when opened, is the Shenzhen-Hong Kong Stock Connect, an extension of the Shanghai-Hong Kong Stock Connect programme launched in late 2014. Despite the unidentified launch date, the new programme is expected to further fuel investors' appetites for Chinese stocks since there are some unique opportunities in the Shenzhen stock market such as the technology sector.

It is simply more evidence that the Renminbi is evolving into a currency that can fulfil the wide range of roles expected of a major global currency. Well-established as a trade currency, it is rapidly adopting the functions of investment currency and reserve currency.

Malaysia was one of the earliest countries to recognise the potential of Renminbi's growth[6]. The Central Bank of Malaysia, Bank Negara Malaysia (BNM), was the first ASEAN central bank to sign a currency swap agreement with the People's Bank of China (PBC) in February 2009. Since then a number of initiatives and policies have spurred trade and investment opportunities between the two countries. It is only a matter of time before China's domestic stocks and bonds become part of the global investment universe, as China continues to step up its efforts in liberalising the domestic capital markers. It therefore makes sense to become familiar with this exciting asset class sooner rather than later.

"More broadly, the process of internationalizing the Renminbi is firmly on track in a way that allows investors – both big and small – to continue to take advantage of the ongoing Chinese growth story. Diversification is a must for all investors, and Chinese securities are already a viable option for individual investors, and their importance can only increase." concluded Mukhtar Hussain, CEO of HSBC Malaysia.

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[6] BNM

(31% shareholding) and Employees Provident Fund Board of Malaysia (20% shareholding) commenced operations in August 2006.

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