# DBS RMB Index for VVinning Enterprises (DRIVE) - 1Q15

**DBS Group Research** 

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### 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 RMD/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) =

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**

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#### **Key charts**

Chart 1: DRIVE index

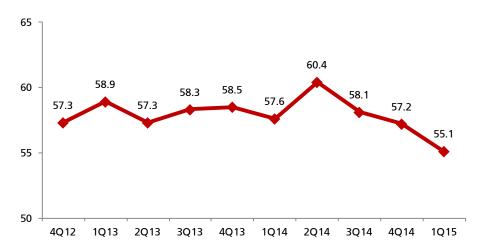
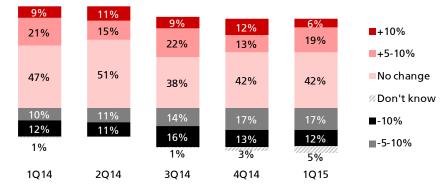
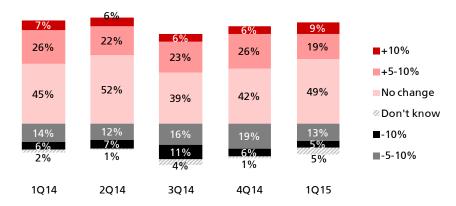


Chart 2a: Business performance in the past 12 months (sales turnover)



Base: All companies

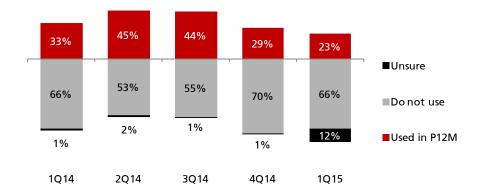
Chart 2b: Business performance outlook in the next 12 months (sales turnover)



Base: All companies

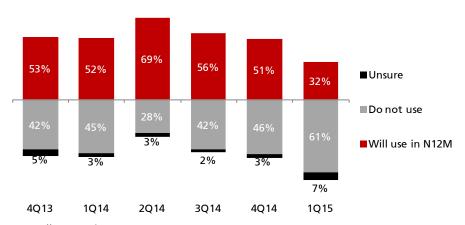


Chart 3a: Change in RMB customer order/invoices and trade settlement in P12M



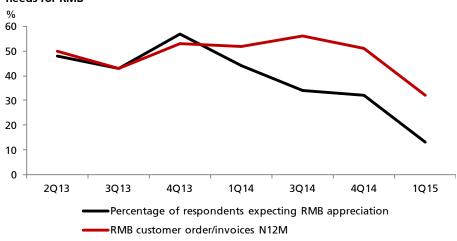
Base: All companies

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



0

2Q13

3Q13



0

1Q15

% 40 60 50 30 40 20 30 20 10 10

1Q14

Percentage of respondents expecting RMB appreciation

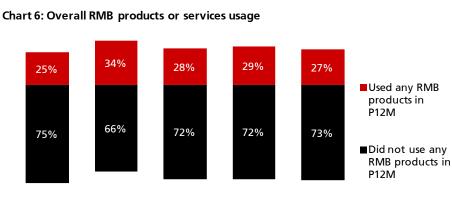
3Q14

4Q14

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

4Q13

RMB product usage (RHS)



4Q14

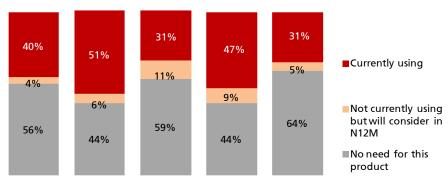
1Q15

1Q14 Base: All companies

Chart 7: Usage and needs for RMB payment and receivable

3Q14

2Q14

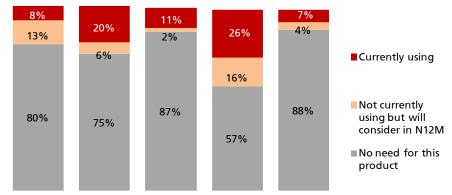


1Q14(n=57) 2Q14(n=70) 3Q14(n=59) 4Q14(n=51) 1Q15(n=65)

Base: Companies using trade services



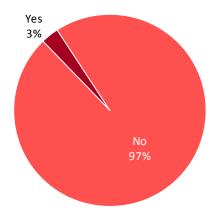
Chart 8: Usage and needs for RMB trade services



1Q14 (n=56) 2Q14 (n=67) 3Q14 (n=54) 4Q14 (n=51) 1Q15 (n=66)

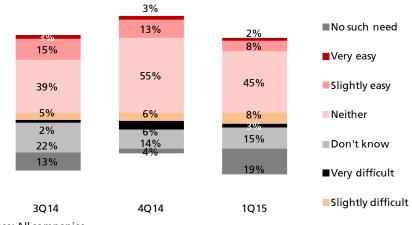
Base: Companies using trade services

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



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