INSIGHT

MARCH 2015

DEVELOPMENT OF OFFSHORE RMB BUSINESS

1. Context

The world has been eyeing the continuous development of the Chinese reminbi and the ongoing efforts of the PBOC to drive further the internalization of its currency, capturing the headlines of major financial publications as it boldly moves towards an opening of the Chinese currency.

Hong Kong and Singapore have traditionally been the major established offshore centres for RMB trade and deposits, and this analysis looks into what is in store for them in the coming years.

Forecasting the evolution of this currency until 2020, we lift the veil on the opportunity that RMB deposits will constitute, who are the players that can reap the biggest benefits and what strategies can be used by financial institutions who wish to be strong contenders in this field.

2. RMB market analysis and forecast

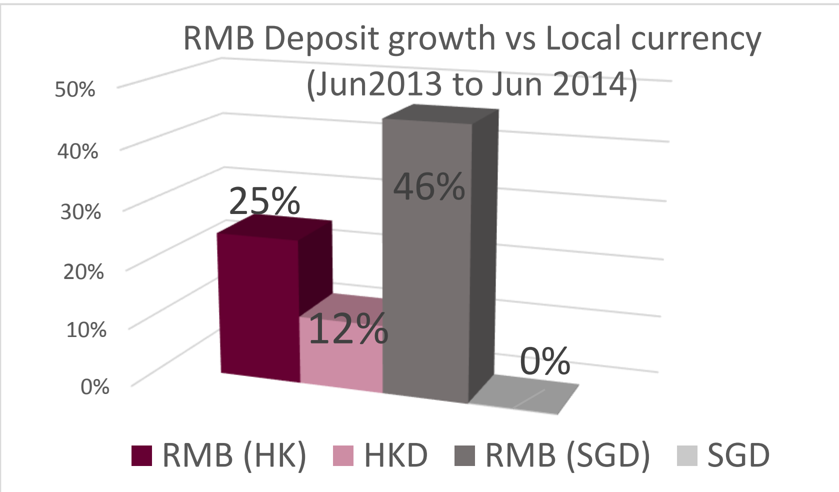
In order to gage the deposit market growth of the offshore RMB for Singapore and Hong Kong, Sia Partners has developed an approach that is based in several macro-economic indicators:

I. Past year-on-year growth of offshore RMB deposits in Hong Kong and Singapore Forecast of RMB trade settlement data up to 2020
II. Past correlation between RMB cross-border trade settlement (growth) and RMB offshore deposit ratio to local currency ratio (growth)

The underlying assumption is that we are forecasting a similar trend for the historic development of the above mentioned indicators.

In addition to macro-economic indicators, political and economic factors like the recent Stock-connect opening, the further opening up of capital accounts by the PRC and more bilateral trade agreements (direct trading of RMB) will further contribute and substantiate the strong growth figures as outlined in our analysis. Additionally, we are expecting the Offshore Bond markets to further develop which will lead to an increase in RMB liquidity held offshore.

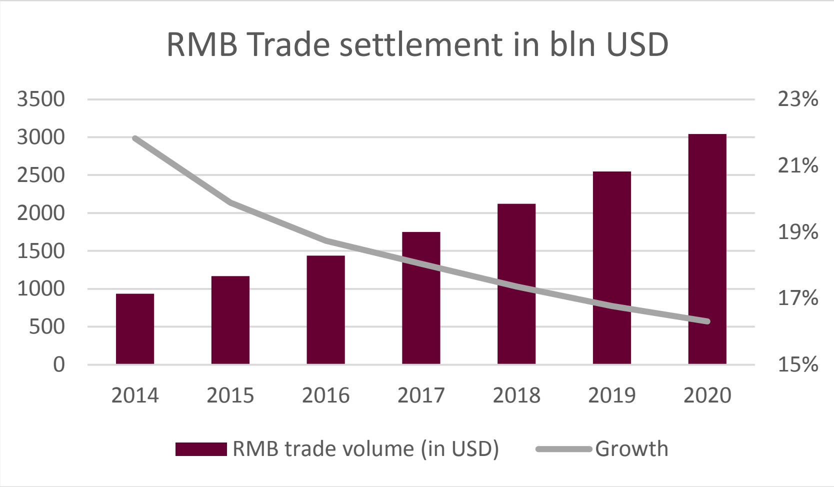
I. <u>Past Year-on-Year growth of offshore RMB deposits in Hong Kong and Singapore</u>



Source: HKMA, MAS

In the recent years, the deposits in RMB have seen a huge growth in both Hong Kong and Singapore, at least compared to the local currencies. Some important factors have been the liberalization of the RMB, its increasing use as a major world currency, alongside the USD and the Euro and a continued growth of the Chinese economy and its place in global trade. This year-on-year growth of RMB deposits gives an indication on the short term growth rates to be expected for both Singapore and Hong Kong for the relevant deposit base, and we project a similar growth rate for YOY 2014 to 2015.

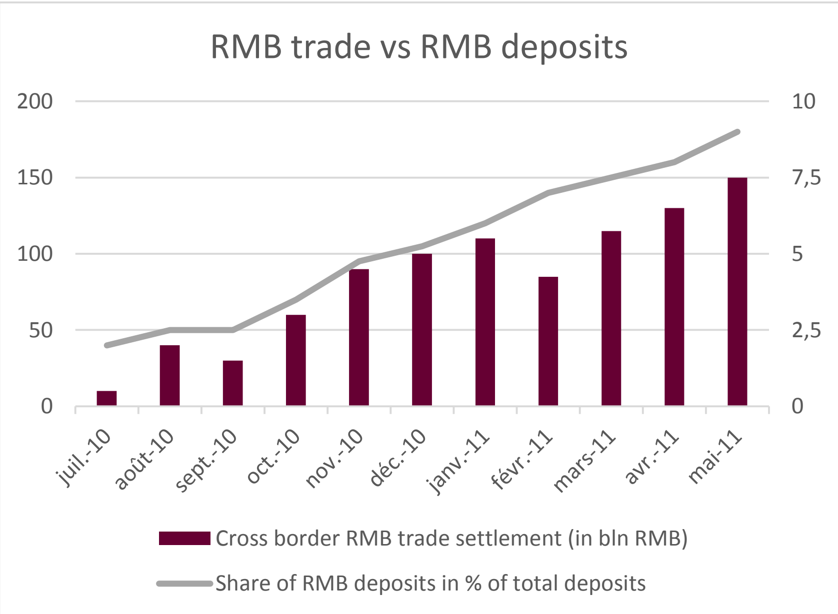
II. RMB trade settlement forecast



Source: Standard Chartered, ASIFMA

In parallel, several sources indicate an increase of the total RMB settlement volume over the next five years, arriving to an equivalent of USD 3000 billion by 2020. Over the years, the expected growth rate will slow down from 22% in 2014 to 16% in 2020.

III. Past Correlation RMB trade settlement vs. offshore deposit ratio



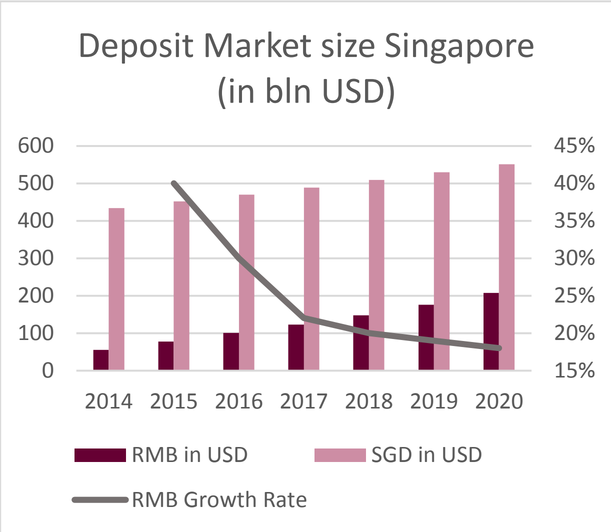
Source: Reuters

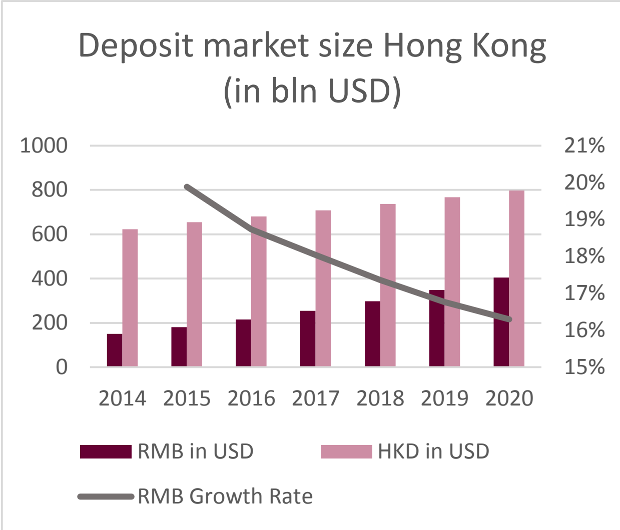
When we look at the history of RMB cross border trade settlement and RMB deposits (in % of deposits), we can identify a correlation where the growth rates of the deposit base are closely linked to the growth rates of cross border RMB settlements. Looking forward, we can use the same logic to project a mid-term/long-term estimation of the evolution of deposit volumes based on the underlying forecast of RMB trade.

IV. Deposit market size projection

Based on the trends identified above, we can estimate the deposit market size evolution in both Hong Kong and Singapore. It is clear that the size of RMB deposits in both locations will continue to grow at a fast rate. While it represented a small amount of the total deposits in 2014, by 2020 it will have grown to represent a third or half (respectively for Singapore and Hong Kong) of the deposits in local currencies.

In today's world where regulations force banks to increase their liquidity, this deposit source represents an incredible opportunity for the players who can seize it. One could argue that the institution which manages to attract this money will have a significant competitive advantage in the coming years.





Singapore growth pattern is based on historic growth rates up to the point where the same deposit market size as in HK is reached. From this point onwards we are applying the trade forecast correlation.

In this forecast, Singapore will see a strong growth in the next years to come with ultimately increasing the RMB deposit base to roughly USD 200bln.

Hong Kong growth pattern is based on the trade forecast correlation.

Hong Kong's RMB growth will continue its strong trend and will ultimately grow to USD 400bln by 2020.

It is notable that Singapore is still in a catching up phase compared to Hong Kong which explains why we are expecting stronger growth rates over the next few years compared to a more matured market in Hong Kong.

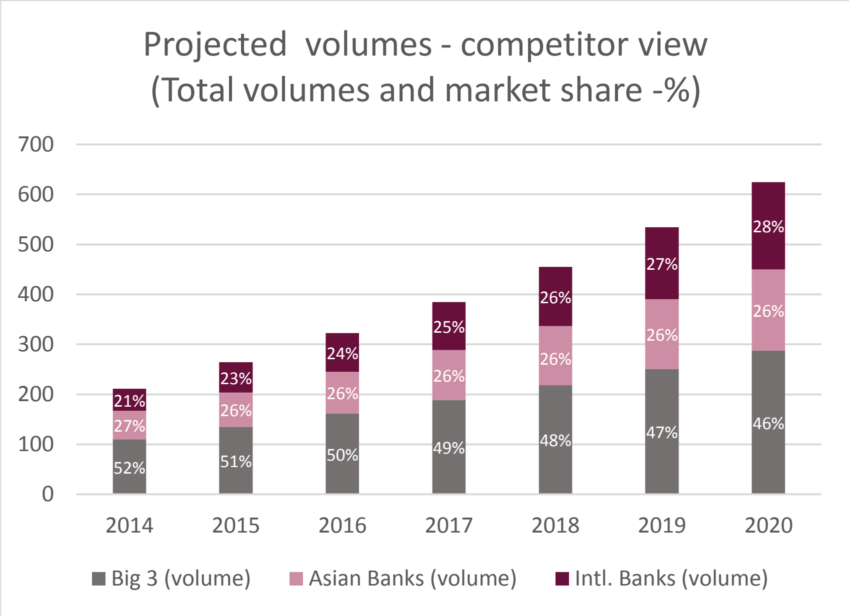
V. Competitive environment and market share by financial institutions

The main remaining question when looking at the total RMB market size in Singapore and Hong Kong by 2020 is how it is divided between the different financial institutions – today and in the future. A recent survey undertaken with CFOs and Treasurers of Asia's top 1000 enterprises splits today's market between 3 distinct categories.

Big 3 banks	Asian Banks	International Banks
▪ Citibank ▪ Standard Chartered ▪ HSBC	▪ Bank of China ▪ DBS ▪ OCBC ▪ UOB	▪ ANZ ▪ Deutsche Bank ▪ BNP Paribas ▪ JP Morgan ▪ Others
52%	27%	21%

Market Share

It is clear that half a dozen banks have the lion's share of RMB deposits. Going forward, there will be little change in the percentage of the market that the 3 biggest banks hold, leaving the international banks to wrestle with the Asian banks for half of the market.



Source: CFO Innovation

Each bank can substantially benefit from RMB growth opportunities if the market share can be maintained.

Nevertheless, it will be increasingly difficult to challenge the market position of the big 3 banks that will still dominate the RMB deposit market. We foresee more intense competition between Asian banks and the remaining international banks.

Banks in those two segments will need to strengthen their efforts in order to maintain or improve their current market share. International banks have the biggest opportunity to develop a strong RMB liquidity strategy in order to cash in on the RMB business opportunities.

3. How can banks take part of the RMB growth story?

We saw that a strong liquidity base is key in the current banking landscape and there is no doubt that it will certainly be even more important in the future. What are the possible approaches to capture a larger piece of the RMB deposit pie and benefit from the strong growth of this deposit pool?

Market positioning & value proposition	Banks can create dedicated corporate advisory teams focusing on deposits and advising clients on products, regulations and financing options to attract more mid-sized companies. Furthermore cash forecasting or RMB FX trading tools can be extended to clients to gain more flow and deposits.
Products	Products centering around liquidity can include structured RMB deposits, trade settlement accounts or cross-border RMB sweeping (target balancing). Furthermore supply chain finance products can lead to an increase in RMB flow.
Pricing	A more client specific deposit pricing model needs to be implemented that take into account re-pricing frequencies and risks (e.g. if rates are increasing). Getting into a price-war with competitors is not sustainable.
Organization	Depending on the client target segment, the transaction banking organization model could take one of the following forms: relationship manager, client service or transaction banker focused. Crucial is to optimize the collaboration between sales, relationship management, product and IT teams.
Sales and Coverage	Banks need to implement appropriate incentive schemes that will allow relationship managers and sales teams to shift their focus on attracting more corporate liquidity and to cross-sell other liquidity products.
Partnerships	For corporate banks that lack the necessary RMB infrastructure, knowledge or client base, it will be advisable to team up with banks that have solid footprint in the RMB segment.

It is clear that all Asian and international banks in Hong Kong and Singapore are gearing up for the fight over RMB deposits, and are starting to implement some or all of the above.

The race is on, who will be the winners and losers over the coming years? Who will emerge as more agile than the competitors and, who knows, disrupt the status quo?

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ABOUT SIA PARTNERS

Founded in 1999, Sia Partners is an independent global management consulting firm with over 580 consultants and an annual turnover of USD 120 million. The Group has 15 offices in 12 countries, including the U.S., its second biggest market. Sia Partners is renowned for its sharp expertise in the Energy, Banking, Insurance, Telecoms and Transportation sectors.

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