

Introducing the CNH Bond Market

The CNH bond market refers to the offshore Renminbi bond market in Hong Kong.

Also known as the “dim sum” bond market, this nascent but rapidly developing market has caught the attention of many issuers interested in issuing offshore Renminbi (“RMB”) debt and investors, both institutional and retail, wanting to get exposure to RMB.

In this article, we will examine the reasons behind the development and growth potential of the CNH bond market.

Factors behind the development of the CNH market

China’s total trade at USD 2.97 trillion in 2010 is almost as big as the US (USD 3.2 trillion) and bigger than Germany (USD 1.3 trillion) or Japan (USD 1.47 trillion). However, only 0.6% (RMB120 billion or USD 0.018 trillion) of its trade was settled in its own currency in 2010. It is the only major trading country in the world to have so little of its trade settled in its own currency

China also faces a pressing problem – the surge in export growth and the fact that its capital account is not convertible (and hence limiting the amount of overseas investments which domestic corporates and households can make) has caused its foreign exchange reserves to increase to a level that is both politically and economically unsustainable. China foreign exchange reserves have increased 3.4 times to a massive USD 2.85 trillion since end-2005.

To find a solution to this problem, the Chinese government realizes that there is a need to internationalise the RMB (i.e. allow RMB to be readily traded outside China).

However, for RMB to be internationalized, a liquid and open capital market needs to exist in order for holders of RMB to be able to invest in financial assets to receive a decent return.

Hence, the CNH bond market was allowed to be developed. The CNH bond market allows the RMB to be gradually liberalized without opening up China’s capital account as CNH is not fungible into the mainland (i.e. RMB deposits in HK cannot be repatriated back into the mainland without the approval of the mainland authorities).

Tracing the early development

The CNH market was started in June 2007 when the People’s Bank of China (“PBoC”) and the National Development & Reform Commission gave the approval for Chinese financial institutions to issue RMB-denominated bonds in Hong Kong. China Development Bank was the inaugural issuer in June 2007.

The second major development of the CNH market occurred in December 2008 when corporates with substantial business in China were allowed to issue CNH bonds.

The third and most important development occurred in July 2010 when the PBoC and Hong Kong Monetary Authority signed a memorandum of agreement to expand the scope of RMB trading from previously trade-related to “general purposes”.

Following this development, CNH bond issuances surged in the second half of 2010.

Reasons for the potential rapid growth of the CNH bond market

The key driver of the CNH bond market will be the rapid expansion of the RMB cross-border trade settlement.

As at end-2010, RMB trade settlement (the amount of China’s trade settled in RMB) surged 30 times to RMB 120 billion in 2010 from only RMB 4 billion in 2009. Despite the phenomenal surge, RMB 120 billion of RMB trade settlement represents a miniscule 0.6% of China trade in 2010.

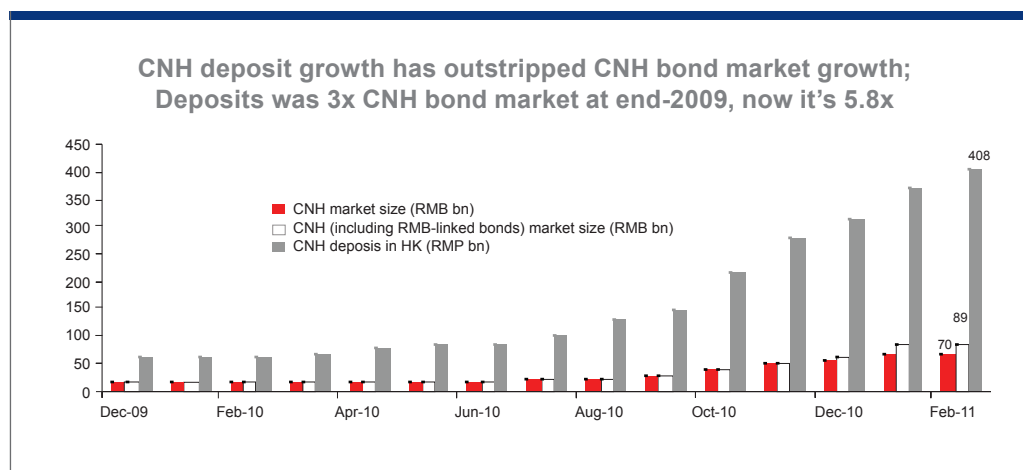
In order to facilitate the expansion of RMB cross border trade settlement, the Chinese authorities in June 2010 expanded the scheme to 20 Chinese cities. The PBoC also increased eligible participating firms from 365 in July 2009 to 67,359 in December 2010.

Given the perceived under-valuation of the RMB as well as the fact that many emerging nations (which also do not price their trade in their own currencies) are eager to bolster trade with China, RMB cross border trade settlement is likely to grow at an exponential rate over the next few years.

We expect RMB cross border trade settlement to increase to RMB 2.8 trillion (USD 430 billion) by 2015. This represents an increase of 23 times from the level at end-2010.

This rapid expansion of cross border trade settlement led to an exponential growth in CNH deposits in Hong Kong. CNH deposits rose 400% in 2010 to RMB 314.9 billion and are likely to double in 2011. CNH deposits rose a further 29% to CNH 407.7 billion in February 2011.

The current pool of CNH deposits is almost 6 times the size of the CNH bond market (or around 4.6 times if we include RMB-linked bonds). Given the rapid expansion of the RMB cross border trade settlement, we believe that CNH deposits growth is likely to outpace the growth of the CNH bond market going forward. This means that the potential pool of funds available to invest in CNH bond market relative to the size of the CNH bond market will continue increase rapidly i.e. the demand for CNH bonds will continue to outstrip supply of CNH bonds.



The under-valuation of the RMB will also ensure that interest in the CNH bond market remains strong. Based on UOBAM's internal models, the RMB is one of the most under-valued Asian currencies. It is estimated that the RMB is around 20% under-valued against the USD, which will place its fair value at 5.45 versus 6.54 currently.

Strong market technicals

The CNH bond market enjoys several unique characteristics that are not found in the Asian USD bond market.

Firstly, the issue size is much smaller at around RMB 300 million to RMB 1,000 million or USD 45-150 million versus an issue size of at least USD 500 million in the Asia USD bond market. The small issue size ensures that demand for CNH bonds will outstrip supply.

Secondly, the CNH bonds are usually placed out to investors such as banks, pension fund, asset management companies i.e. investors who are more likely to hold the bonds to maturity. Hedge funds are largely absent from the CNH market as they usually receive very poor allocations from new bond issues. This means that the CNH bonds tend to be more stable than comparable Asian USD bonds as holders of the CNH bonds are much less likely to sell the bonds in events of spikes in risk aversion.

Thirdly, most of the CNH bonds are issued with maturity of 3-5 years compared to 5-30 years for Asia USD bond market. With a lower duration, this makes the CNH bond market less vulnerable to any rise in interest rate.

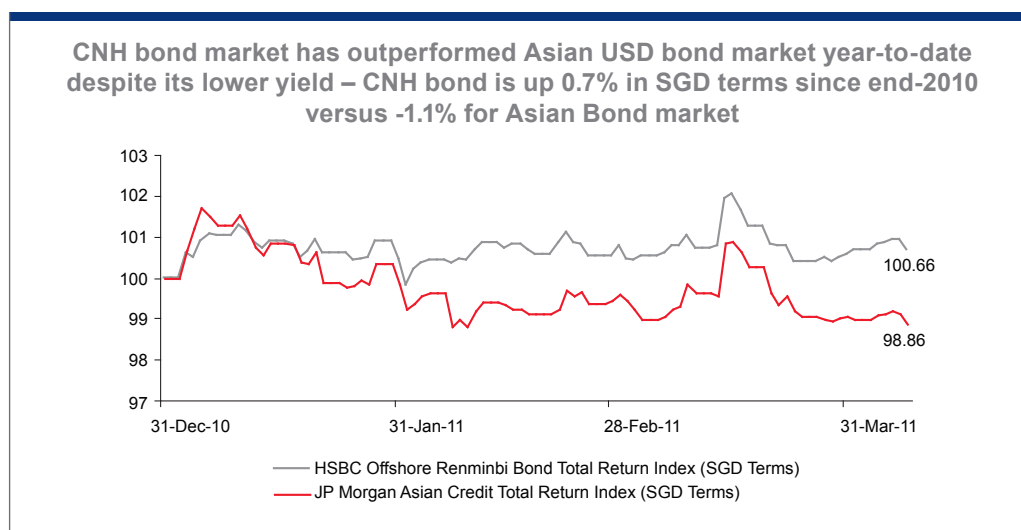
Stellar performance in 2011

The CNH bond market continued its stellar performance in 2011. A total of 16 bonds worth RMB 16 billion were issued since the beginning of the year. 15 out of the 16 are trading above par i.e. 94% of the CNH bonds made money for investors.

They have appreciated 1.03% on average and have almost always traded above par on the first day of trading. This means that investors who subscribed to all new CNH bond issuances since the beginning of the year would have made money on 94% of all CNH bonds issued this year.

Security CNH Bonds	Name of corporate	Maturity	Announcement date	Amt (RMB millions)	Bid Price	Issue price
BCOM 1.4 01/10/13	BK OF COMMUNICATIONS HK	1/10/2013	1/3/2011	500	100.50	100.00
DIALEA 1.65 04/09/13	DALEA MITSUBISHI UFJ LEASE&FIN	4/9/2013	3/31/2011	200	100.50	100.00
SINOCH 1.8 01/18/14	SINOCH SINOCHEM OFFSHORE CAPITA	1/18/2014	1/11/2011	3500	100.60	100.00
PCDHK 5 1/4 02/01/14	PCD STORES GROUP LTD	2/1/2014	1/25/2011	750	101.00	100.00
BJCAPT 4 3/4 02/21/14	BECL INVESTMENT HOLDING	2/21/2014	2/14/2011	1150	102.50	100.00
ROADKG 6 02/25/14	ROAD KING INFRAST (2011)	2/25/2014	2/21/2011	1300	101.30	100.00
TPVTEC 4 1/4 03/21/14	TPV TECHNOLOGY LTD	3/21/2014	3/14/2011	500	101.80	100.00
ORX 2 03/24/14	ORX CORP	3/24/2014	3/15/2011	400	100.30	100.00
OBCBCSP 1.1 03/28/14	OVERSEA-CHINESE BANK/HK	3/28/2014	3/21/2011	200	100.00	100.00
UNANA 1.15 03/31/14	UNILEVER NV	3/31/2014	3/28/2011	300	100.90	100.00
BOOM 1.35 04/01/14	BK OF COMMUNICATIONS HK	4/1/2014	3/25/2011	1100	99.95	100.00
CHWIN 6 3/8 04/04/14	CHINA WINDPOWER GROUP	4/4/2014	3/29/2011	750	101.55	100.00
SINCON 4 3/4 04/14/14	SINGAMAS CONTAINER HLDGS	4/14/2014	4/6/2011	1380	100.45	100.00
IFC 1.8 01/27/16	INTL FINANCE CORP	1/27/2016	1/25/2011	150	102.50	100.00
HKCGAS 1.4 04/11/16	HKCG FINANCE LTD	4/11/2016	3/31/2011	1000	100.10	100.00
ASIA 2.85 10/21/20	ASIAN DEVELOPMENT BANK	10/21/2020	10/18/2010	1200	102.50	100.00

The HSBC Offshore Renminbi Bond Total Return Index (HSBC CNH Index) outperformed the Asian USD Credit Market on a year-to-date basis. The HSBC CNH index is up 0.7% in SGD terms (up 2.8% in USD terms) since the beginning of the year while the JP Morgan Asia Credit Total Return Index is down 1.1%.



Contact Details

Address 80 Raffles Place UOB Plaza 2 Level 3 Singapore 048624

24-hour Hotline 1800 222 2228 (Local) • (65) 6222 2228 (International)

Fax (65) 6532 3868

Email uobam@uobgroup.com

Website uobam.com.sg

Regional Offices

Singapore

Institutional Investments

Dennis Siew

Senior Director

Retail Investments

Norman Wu

Senior Director

Regional Investments

Faizal M. Fazluddin

Senior Director

Structured Investments

Chong Jiun Yeh

Executive Director

International Business (China)

Jasmine Lim

Senior Director

Brunei

Kamal Muhd

General Manager

Japan

Masashi Ohmatsu

Chief Executive Officer

Malaysia

Lim Suet Ling

Chief Executive Officer

Taiwan

Juang San Tay

General Manager

Thailand

Vana Bulbon

Chief Executive Officer

Important Notice & Disclaimers

This publication shall not be copied or disseminated, or relied upon by any person for whatever purpose. The information herein is given on a general basis without obligation and is strictly for information only. This publication is not an offer, solicitation, recommendation or advice to buy or sell any investment product, including any collective investment schemes or shares of companies mentioned within. Although every reasonable care has been taken to ensure the accuracy and objectivity of the information contained in this publication, UOB Asset Management Ltd and its employees shall not be held liable for any error, inaccuracy and/or omission, howsoever caused, or for any decision or action taken based on views expressed or information in this publication. The information contained in this publication, including any data, projections and underlying assumptions are based upon certain assumptions, management forecasts and analysis of information available and reflects prevailing conditions and our views as of the date of this publication, all of which are subject to change at any time without notice. UOB Asset Management Ltd ("UOBAM") does not warrant the accuracy, adequacy, timeliness or completeness of the information herein for any particular purpose, and expressly disclaims liability for any error, inaccuracy or omission. Any opinion, projection and other forward-looking statement regarding future events or performance of, including but not limited to, countries, markets or companies is not necessarily indicative of, and may differ from actual events or results. Nothing in this publication constitutes accounting, legal, regulatory, tax or other advice. The information herein has no regard to the specific objectives, financial situation and particular needs of any specific person. You may wish to seek advice from a professional or an independent financial adviser about the issues discussed herein or before investing in any investment or insurance product. Should you choose not to seek such advice, you should consider carefully whether the investment or insurance product in question is suitable for you.

UOB Asset Management Ltd Co. Reg. No. 198600120Z