Encik Adnan Zaylani Mohamad Zahid: A way forward for the Malaysian Renminbi market

Speech by Mr Encik Adnan Zaylani Mohamad Zahid, Assistant Governor of the Central Bank of Malaysia (Bank Negara Malaysia), at the RMB Conference, organized by Bank of China "A Way Forward for the Malaysian Renminbi Market", Kuala Lumpur, 1 November 2016.

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It is an honour to be here this morning to speak at the Renminbi Conference organised by Bank of China. Over the last seven years since the internationalisation of renminbi took off in earnest, we have seen the progress and evolution of the currency from its primary use in trade settlement to become a currency of choice for investment and financial instruments, reflecting China's growing presence in global finance as well as various economic initiatives related to its 'One Belt One Road' vision. To this effect, it is important for Malaysia, being a key partner for China in the ASEAN region, to strengthen the renminbi connectivity not only to facilitate our bilateral trade but also to become a launch pad for China's initiatives in this region.

Today also marks one month since the inclusion of the renminbi into the Special Drawing Rights (SDR) currency basket, which is undoubtedly a watershed moment for renminbi given its relatively recent internationalisation over the last seven years. I have no doubt that with the inclusion, more central banks will be adding renminbi into its international reserves. Early last year, renminbi was estimated to represent 1% of the global foreign exchanges reserves, and the share will grow. Recently, we have also started to see interests in SDR bonds, with the inaugural issuance by the World Bank in China's domestic bond market, followed by subsequent interests from commercial entities. Having this seminar thus at this juncture is indeed very timely.

Uneven global growth with gravity shifting to Asia, particularly China

For the past couple of years, the global economy had softened, with a marked slowdown observed throughout both the developed and emerging economies. The International Monetary Fund (IMF) recently revised their global growth forecast to 3.1% for 2016, from 3.2% previously, reflecting softer-than-expected growth in advanced economies and the impact of Brexit. Global trade continued to be subdued, with the World Trade Organization (WTO) expecting only a 1.7% expansion in 2016, marking the slowest pace of global trade growth since the global financial crisis.

While China is also contending with moderation in growth during its economic transition, it continued to become the largest contributor to global growth. The gravity centre of global growth has for now, shifted to emerging economies, particularly Asia. China's slowdown is not all negative – as China's economic transformation, through various efforts to restructure its economy and internationalise its markets, are important towards a more sustainable path of development. Furthermore, a 6.7% growth rate is an economic performance many would aspire to.

Continued RMB developments as part of internationalisation effort

China's progressive liberalisation and opening up of its financial markets as well as the growing offshore renminbi market has led to a rapidly growing share of their global bond and stock markets. The trend behind the internationalisation of renminbi is underpinned by the greater importance of China in international trade, investment and financial linkages and this presents opportunities for China's key partners, including Malaysia. The rise of renminbi since 2009 coincided with China's rise to become the world's largest trading nation since 2013, with total trade of US$3.96 trillion in 2015. The early regulatory and government incentives to promote the use of renminbi proved important towards achieving this. Multinational companies (MNCs), particularly those with significant operations in China, have followed with steps to operationalise the use of renminbi in their invoices and treasury pooling system across subsidiaries. Renminbi has now become the second most used global currency for trade finance, and the latest SWIFT data showed that renminbi is now ranked fifth as payment currency, compared to 17th place five years ago.

In the investment sphere, foreign investors now have multiple channels in investing into China's market. Apart from the Qualified Foreign Institutional Investors (QFII) program, China has granted wider access to the China Interbank Bond Market (CIBM), expanded the renminbi QFII (RQFII) program, and introduced the Hong Kong-Shanghai Stock Connect (as well as the incoming Hong Kong-Shenzhen Stock Connect) and Hong Kong-China mutual fund recognition (MFR) scheme. Since 2015, eight countries including Malaysia had been granted with RQFII quotas; bringing the total available quotas to more than RMB1.4 trillion. In addition, clearing banks across nine countries were introduced since then, adding up to 21 clearing banks worldwide. The increased availability of renminbi globally was evident, with more than sixty central banks and sovereign wealth funds reported to have invested part of their reserves and assets into renminbi, reflecting the broad appeal of the currency: the latest BIS triennial survey in April 2016 showed the renminbi daily turnover reached USD202 billion, almost double the size recorded three years ago, and even more phenomenal when considering it was just around USD34 billion in 2010. The renminbi's market share globally increased from 2% to 4%, still a small percentage, but is now the eighth most actively traded currency in the world. The sizable pool of offshore renminbi deposit of RMB1.8 trillion has also spurred the growth of renminbi-denominated bonds issued outside China, known as dim sum bonds, while steps are taken to develop the panda bond market within China.

Developments of renminbi business in Malaysia

Continued growth and investment from China

In ASEAN, Malaysia continues to be among China's largest trading partners. From Malaysia's perspective, China is our largest trading partner. In 2015, total trade between the two countries expanded by 11.1% to RM230.1 billion, representing 16% of our total trade. More importantly, in recent years, China has become a net exporter of direct investment into Malaysia, contributing to significant source of capital for development in various sectors such as infrastructure construction, power plant and steel manufacturing. Outstanding direct investments from China and Hong Kong SAR had grown significantly, almost reaching USD11.1 billion in first half of 2016, as compared to USD6.5 billion three years ago (end-2013). China's recent One Belt One Road initiative has also added more excitement and opportunities for countries like Malaysia, which is strategically located along the maritime Silk Road. Joint initiatives had been developed to upgrade several ports in Malaysia, with significant investments in the development to come from China. The high-speed rail development between Malaysia and Singapore paired with China's initiative to develop the network within Southeast Asia and Central Asia will further enhance the connectivity within the region. In fact, today's headlines carried more developments on the East Coast Rail project with again, strong participation of China in the financing and construction of the project. As you know, our Prime Minister is leading a delegation to China discussing areas of bilateral cooperation, regional and international issues, as well as investment. Malaysia is also a member of the Asian Infrastructure Investment Bank (AIIB). Recently, the Parliament passed the AIIB Bill 2016, granting approval for Malaysia, a founding member, to contribute capital for the institution. Beyond trade and investment, China- Malaysia bilateral relation expands further with people to people connection, through culture, tourism and education. The opening of the first Chinese overseas university campus in Malaysia, Xiamen University, is a testimony of such close ties.

Market development initiatives to support real economic activities

Financial institutions, being the intermediaries to these trades and investment flows, need to realise there are ample opportunities that lie within these developments. As an early pioneer of renminbi initiatives, Bank Negara has undertaken a number of initiatives to build the renminbi infrastructure, ranging from the currency swap and QFII (2009), direct trading of renminbi-ringgit (2010), Cross-Border Collateral Arrangement (CBCA) (2013), renminbi clearing bank (2014) and more recently RQFII (2015). At the same time, the Bank, through Myclear, had also worked to integrate renminbi into our domestic financial system through renminbi settlement in RENTAS and the RMB Liquidity Facility for our onshore banks to facilitate more effective renminbi liquidity management in Malaysia. To date, 22 banks have embarked on renminbi business, and renminbi trade settlement has gradually gained traction, accounting for 3.2% of total trade with China from 0.4% five years ago. However, the market remains concentrated to only few players with the top three banks representing 80% of the loans and deposits market, and more than 60% of FX market.

Developing the renminbi market – Preparing for the future

That said, with the transformation of RMB to become international reserves currency, coupled with China's strong FDI presence and push for financing infrastructure in Asian countries as part of One Belt One Road plan, it is timely to enhance the strategies moving forward. I would suggest to look at a few key aspects:

1. The first is to increase the stock of renminbi liquidity onshore. With a stable and larger renminbi liquidity pool, banks will be able to offer renminbi loans and financing. Currently, the RMB deposit balance with the banking system is relatively low, hovering around 3% of total foreign currency deposits. Malaysia is a net receiver of FDI from China and with substantial exports to China – banks should be proactive in approaching clients to facilitate these flows in renminbi. Banks with regional presence should also expand its renminbi business through its branches overseas, using Malaysia as a launch pad and leveraging on the renminbi liquidity infrastructure available in Malaysia. The offshore CNH renminbi market is well developed, and the gap between CNH and CNY markets has narrowed significantly. As such, banks should be able to offer competitive pricing for clients to manage and hedge renminbi exposures. With the various liquidity facilities in place, we can expect the renminbi market here to be able to meet their requirements.
2. Second, is to further develop the renminbi foreign exchange onshore market to increase the depth and liquidity. The daily foreign exchange volume in Malaysia is around USD7-8 billion, while the renminbi FX transactions accounts for less than 1% of the daily volume. This certainly does not commensurate with the investment and trade relationship that we have between our two countries. How can we further build on this with the existing infrastructure in place? One area that Bank Negara is looking at is to learn from our baht-ringgit cross currency market framework that we developed with our Thailand counterpart by appointing market makers, which are given certain flexibilities to facilitate doing business. A similar framework could also be considered for the renminbi ringgit cross currency markets. This will enable the market maker banks to play a larger role in enhancing the renminbi FX activities, not only in the spot market, but also in the renminbi forward and swap markets, which will result in lower foreign exchange transaction cost to the real sector. Another area that we are developing is to introduce a flexible hedging framework for residents to hedge their foreign exchange exposures up to a certain limit. This framework is specifically made available for the USD/MYR and the RMB/MYR pair. Under this framework, within a small limit, it suffices for residents to declare their intent and they are free to manage their exposure within this. Last week, Bank Negara had begun engagement with the treasurers on this framework and we hope to finalise this soon for immediate implementation.
3. Third, is to capitalise on the infrastructure financing opportunities. Malaysia has a comparative advantage in this area. The Malaysian bond market is the largest in the ASEAN region, and it is the leading global centre for sukuk issuance. The regulatory framework and supporting infrastructure for bond issuances here is comprehensive. In the past, many

foreign corporations including multinationals have issued bonds and sukuk out of Malaysia. With the increased financing requirement by Chinese companies for infrastructure development throughout the Asian region, estimated to be more than USD1 trillion in the initial stage, investment banks should seize the business opportunities in bonds origination, distribution, investment and trading services. Our markets have already seen issuances of ‘dim sum’ bonds which were highly successful, such as the previous Axiata and Cagamas issuances.

4. Fourth, is to offer competitive trade financing and settlement services. From our industry engagements through Bank Negara Malaysia’s Financial Markets Committee, a key area that we need to strengthen in support of our international and regional trade is trade financing. Given the importance of China to us in this, renminbi trade financing should be given special attention. For corporations which trade predominantly with China, there are many benefits to settle trade in renminbi, in particular, lower foreign exchange conversion costs and greater access to new markets in China. In switching to renminbi, corporations should review on the internal changes required, such as invoicing and trade documentation in renminbi, accounting and any other operational procedures, including engaging banks which are able to provide advice and facilitate trade financing in renminbi. Banks need to be ready in this area, to develop the system to support the trade financing and to be familiar and current with the rules and regulations of the Chinese authorities. Further improvement should be looked into to entice more participation, and efficient ways should be explored to ease trade facilitation in renminbi. In another aspect, this space can also capitalise on another work area of the Financial Market Committee in looking at the introduction of a more standardised documentation requirement across industry. Coupled with the broader and more flexible trade financing facilities and hedging tools, this will create a more business-friendly market which will in turn amplify participation.
5. Last but not least, is to develop investment products in renminbi. In the past, the efforts in promoting the use of renminbi has primarily emphasised transactions or trades in goods and services between the two countries. With the transformation and internationalisation of renminbi, we should accelerate our understanding of the renminbi financial markets and to see the renminbi as a viable choice of currency for financial investments. In November 2015, China granted RQFII country quota of RMB50 billion to Malaysia to enable financial institutions here to invest in China’s onshore financial markets. The renminbi financial market in Malaysia remains incomplete with limited investment avenues. Liquidity needs to be deployed and invested to generate returns. As the liquidity pool increases, financial institutions should capitalise on this and develop the range of renminbi money, bonds and equity products, which can leverage on the RQFII access.

The impact of the Chinese economy on Asia, including Malaysia has been significantly broad-based and encompassing. Financial linkages with China have strengthened. China’s financial markets, already among the world’s largest markets, will be home to a growing number of global Chinese multinational companies with global outreach. The strong interest and commitment to infrastructure building and financing will be a long term theme that will shape Asia and China’s presence in the global markets. There are huge potential that lies ahead and we must be ready to tap the opportunities in all these initiatives. Our financial institutions, corporations and businesses should work together to ensure the readiness of our businesses and economy to keep up with the developments and capture these opportunities. With this, I wish you will have a fruitful discussion and insightful conference today.