Offshore markets are necessary for RMB internationalization

- Major global currency must trade 24 hours a day
- Major international currencies are used in third-party transactions
- Non-residents’ demand is largely met by offshore market
- “External circulation” reduces impact on monetary policy
- Offshore market speeds up internationalization

Projection of HK’s offshore market

<table>
<thead>
<tr>
<th>2010</th>
<th>2011</th>
<th>2012F</th>
<th>2015F</th>
<th>2015 level as % of 2011 domestic level</th>
</tr>
</thead>
<tbody>
<tr>
<td>RMB deposits</td>
<td>300</td>
<td>589</td>
<td>1,000</td>
<td>2,500</td>
</tr>
<tr>
<td>Outstanding bonds</td>
<td>68</td>
<td>200</td>
<td>500</td>
<td>1,300</td>
</tr>
<tr>
<td>Stock market cap</td>
<td>-</td>
<td>26</td>
<td>30</td>
<td>75</td>
</tr>
<tr>
<td>CNH daily volume</td>
<td>2</td>
<td>15</td>
<td>40</td>
<td>80</td>
</tr>
<tr>
<td>Outstanding loans</td>
<td>-</td>
<td>30</td>
<td>60</td>
<td>500</td>
</tr>
<tr>
<td>Assets/deposit ratio</td>
<td>3%</td>
<td>44%</td>
<td>59%</td>
<td>75%</td>
</tr>
</tbody>
</table>

Source: authors’ projections.

Policies to promote the development of offshore markets

1. Simplify the documentation requirement for RMB trade settlement;
2. Enhance the transparency and consistency of RMB trade settlement policy;
3. Promote the use of the RMB as a pricing currency for commodities.
4. Encourage the entry of banks from South East Asian countries in China, so that they can help promote the use of RMB for trade and investment activities.
5. Remove the remaining bottlenecks for RMB FDI and RMB OIs.
Policies to promote the development of offshore markets (II)

6. Ensure RMB liquidity provision in the offshore market;
7. Encourage the listing and trading of RMB bonds, equities and other financial products in the offshore market;
8. Promote the 3rd party usage of the RMB in the offshore market;
9. Relax the NOP restrictions by HKMA on banks’ RMB businesses;
10. Establish CNH interest and FX fixings and develop CNH repo and future markets.

RMB internationalization and capital account liberalization

Without capital account liberalization, RMB internationalization can only materialize <10% of its potential

Coordination between cross-border RMB capital flows and RMB convertibility

Essentially, lifting restrictions on cross-border RMB flows for capital account purposes and capital account liberalization (or convertibility between the RMB and other currencies) are two reforms that are mutually substitutable. Lifting restrictions on one of these (restrictions on cross-border RMB flows for capital account purposes, or restrictions on currency convertibility) will make restrictions on another invalid. Therefore these two reforms should go hand in hand.

Example 1: QFII vs 3 types of Institutions
Example 2: Permission for RMB remittance vs FX conversion

Macro conditions permit faster capital account liberalization

The rapid decline in China’s trade balance, the increase in ODI, and the reduced RMB appreciation expectations permit a faster opening of China’s capital accounts and its domestic capital markets.

Exchange rate, interest rates, and pace of capital account liberalization

As the exchange rate approaches its equilibrium, and cross-border RMB interest rate differentials narrow, the capital account should be more open

Specific recommendations on capital account liberalization

• Increase the annual limits on FX conversion by individuals and corporates;
• Increase the QFII quota and the quota for foreign institutional investors invest in China’s interbank bond market;
• Permit RMB fund raisings by non-resident corporates on the Panda bond market/ the international board and from banks;
• Open the domestic RMB products market to NRA accounts, at a pace consistent with the development of offshore markets;
• Increase the volatility of the RMB exchange rate (vs the USD) by 3-5 fold;
• Introduce prudential measures to replace administrative controls on FX conversion;
• Introduce a CHIPS-like RMB cross-border payments system.
Impact of financial liberalization on the financial sector

- Slower RMB appreciation but significantly higher volatility;
- Reduction in net interest margin for Chinese banks;
- Greater global expansion for Chinese financials;
- Higher fee incomes including a surge in FX trading commission and income from derivative transactions;
- Ability to offer a wider range of global financial products to China’s domestic investors;
- Negative for insurance in the short term but positive in the longer term;
- Significantly larger two-way capital flows (especially portfolio flows) via Hong Kong to and from Mainland China, benefiting Hong Kong-based financial institutions.

Appendix 1
Important Disclosures
Additional Information Available upon Request

For disclosures relating to recommendations or estimates made or opinions given that the security analyst withhold on any page of this report, please visit our website at http://gm.db.com/ger/disclosure/DisclosureDirectory.eqsr

Analyst Certification:

We have required each member of our investment banking department to complete our mandatory training on ethics and to certify to our code of business conduct. The purpose of this training is to ensure that our investment banking professionals understand the expectations of our clients and the regulators and to provide our employees with guidance on how to deal with ethical and legal issues in the course of their work.

Equity Bond

Financial Instruments

Deutsche Bank equity research analysts sometimes have shorter-term trade ideas (known as SOLAR ideas) that are

Country-Specific Disclosures

Russia: This information, interpretation and opinions submitted herein are not in the context of, and do not constitute, any

25.9% 13.1%
13 EM markets (excl China) average

UK

US

Japan

Germany

Thailand

52% 8%

9% 14%

Argentina

South Africa

Vietnam

8% 3%

25% 28%

27% 9%

Brazil

China (excl overseas listed securities)

53% 12%

11% 13%

62% 9%

10%

41% 8%

24% 11%

18%

12% 6%

15% 10%

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