

The latest developments in the Chinese market reforms

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In recent months, China has taken several steps in order to reform and open up its bond and foreign exchange markets, basically in preparation for the inclusion of the renminbi in the SDR basket, which was accepted at the end of November 2015. Since July 2015, central banks and similar institutions have had easier access to the Chinese interbank bond market. This was followed by the shift to a new renminbi fixing methodology, which provided greater leeway for market mechanisms, as well as the opening up of the Chinese foreign exchange market to the aforementioned group of investors in September. At the end of November, three central banks, including the Magyar Nemzeti Bank, were the first to register in the Chinese foreign exchange trading system.

On 30 November 2015, the IMF decided to include the Chinese renminbi in the so-called SDR basket used as an international settlement currency, which already contains the US dollar, the euro, the Japanese yen and the British pound, effective 1 October 2016, with a weight of 10.92 per cent. The Chinese central bank undertook several reform measures and steps to open up the markets in the second half of 2015 in order to lay the groundwork for the inclusion of the renminbi in the SDR basket. Below we will give an overview of these steps.

During the evaluation of the Chinese currency's "eligibility" in August, the IMF pointed out, inter alia, that the exchange rate of the renminbi was not flexible enough and that it did not sufficiently reflect market developments. This was followed by an overhaul of the methodology used for setting the central parity of the renminbi. The exchange rate of the Chinese currency had been allowed to float in a 2-per cent band around the central parity set at the beginning of the day, however, since 11 August the closing rate at the end of the previous day is taken into account when determining the central parity at the beginning of the day. Even in the communication about the exchange rate measure, the central bank indicated that it would continue the opening up of the foreign exchange market, extend daily trading times and harmonise the onshore (CNY) and offshore (CNH) foreign exchange markets. In addition, since 24 August 2015, the central bank has been setting reference exchange rates five times a day (at 10:00, 11:00, 14:00, 15:00 and 16:00). The published rates are determined as the weighted average of the transactions on the market in the 30 seconds prior to each time. These rates accurately reflect the supply and demand conditions on the market.

Another important requirement of the IMF during the preparation for the inclusion of the renminbi in the SDR basket was the availability of a 3-month risk-free bond-type instrument for bond market investors. In 2015 Q4, the Chinese Ministry of Finance started to auction discount treasury bills with a maturity of 3 months on a weekly basis.

In addition to reforming the operational framework of the financial markets, several measures were taken aimed at opening up the market, which resulted in easier access to the Chinese bond and foreign exchange markets mainly for the sovereign investors of other countries and for supranational institutions.

In July 2015, the Chinese central bank announced that foreign central banks and monetary authorities, international financial institutions and sovereign wealth funds would have a more direct access to the Chinese domestic interbank bond market. The former quota-based, tedious licensing procedure was replaced by a simplified registration. The scope of instruments approved for investment was also widened: in addition to government securities, central bank discount securities and bank bonds, corporate and other bonds were also included in this category. Furthermore, repos, bond lending, bond futures, forward rate agreements and interest rate swaps also became tradable for sovereign investors.

The clearing technique of bond trading is different from the standards used in developed countries, since the Chinese central bank operates as a clearing agent for central banks and similar institutions, and carries out the settlements acting on behalf of its partner central banks. This technique has been preserved in the new system, however, in addition to the Chinese central bank, Chinese commercial banks can also offer such services. The emergence of commercial banks may indicate progress compared to the old system in terms of the qualitative parameters and technical implementation of the clearing services as well as the provision of information on the market.

The precondition for making investments on the Chinese domestic interbank bond market is carrying out the necessary foreign exchange market transactions (the conversion of renminbi from foreign currencies), which in the previous system was based on an agreement with the Chinese central bank. However, as of September 2015, the central bank enabled foreign central banks and similar institutions to access the domestic interbank foreign exchange market with a simple registration. There are three ways to do this, which may even be employed concurrently: i) using the Chinese central bank as an agent, ii) using another domestic market participant as an agent or iii) directly joining the trading system. The available transaction types are spot and forward conversion, FX swap and foreign exchange option transactions. For carrying out derivative transactions through an agent, an ISDA or NAFMII (the Chinese equivalent of the ISDA) contract has to be signed with the potential partner banks. Each domestic market participant that is a player on the domestic foreign exchange market is entitled to offer agency services to foreign central banks. These include not only the Chinese commercial banks but also the Chinese subsidiaries of large international banking houses. Central banks are required to sign a so-called Agency Agreement with these institutions, which has to be submitted to the Chinese central bank. Central banks may use several commercial banks as agents at the same time. The third option is to directly join the trading system (CFETS – Chinese Foreign Exchange Trading System), where registered market participants may carry out transactions as market makers.

The Chinese central bank announced on 25 November 2015 that the Magyar Nemzeti Bank was among the institutions first to register, along with the Hong Kong Monetary Authority, the Australian central bank (RBA), the International Bank for Reconstruction and Development, the International Development Association (IDA – the asset management fund of the World Bank Group) and Singapore's sovereign wealth fund (GIC Private Ltd). This measure simplifies foreign exchange market transactions on the domestic market, where this had only been possible linked to yuan-denominated investments, by acquiring investment quotas. Having registered in the new bond trading system, the MNB continues to prepare for investing a portion of the foreign exchange reserves in Chinese government securities.

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