



Discussion on “Interest Arbitrage under Capital Controls: Evidence from Reported Entrepot Trades” by Jiafei Hu Haishan Yuan

For ABFER 6th Annual Conference
Singapore, 23 May 2018

Cho-Hoi Hui
Research Department
Hong Kong Monetary Authority

The views and analysis expressed in this presentation are those of the presenter and do not necessarily represent the views of the Hong Kong Monetary Authority



- Onshore-offshore interest differentials drive renminbi inflows from entrepot trades.
- They predict one-year-forward outflows to settle letters of credit.
- Interest differentials have greater impacts on the lower half of the outflow distribution, and induce entry into entrepot trades.
- Renminbi interest arbitrages are feasible but costly under capital controls.

Gap between CNY-CNH interbank interest rates





- Interest rate arbitrage
- Foreign exchange arbitrage – renminbi exchange rate disparity of CNY (onshore) and CNH (offshore)
- Constraint of credit supply – some corporates need to borrow in the offshore market
- “Foreign guaranteed loans” in which offshore loans are guaranteed by onshore collateral (letters of credit)
- Capital controls is a reason for the increase in “foreign guaranteed loans” but not for interest rate arbitrage purposes

Significant increase in Mainland-related trade finance in Hong Kong, but still relatively small in share



Table 5.C
Mainland-related lending

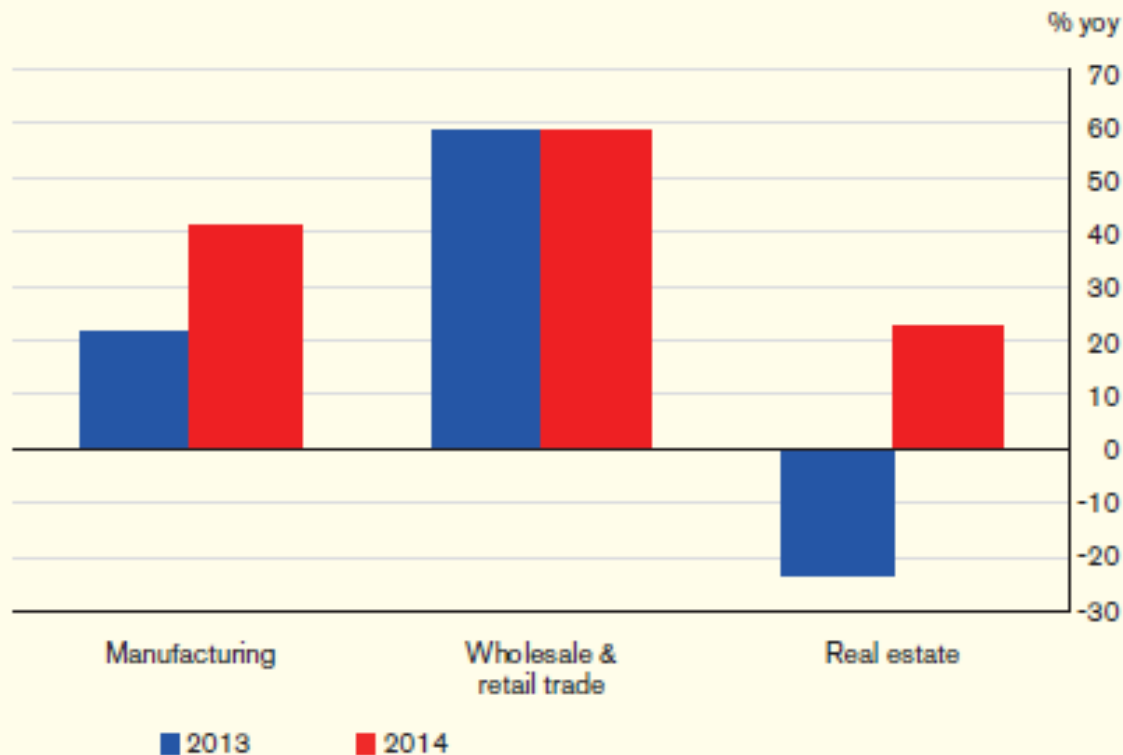
	Dec 2013 HK\$bn	Mar 2014 HK\$bn	Jun 2014 HK\$bn
Mainland-related loans excluding trade finance	2,276	2,461	2,546
Trade finance	312	406	410
Total	2,588	2,867	2,956

Source: HKMA.

Increase in non-performing loans in manufacturing sectors



Chart 2.20
Mainland China: growth of NPLs by sector



Sources: CEIC and CBRC.

Smaller banks faced higher increases in NPL



Chart 2.14
Share of special-mention loans for major listed banks



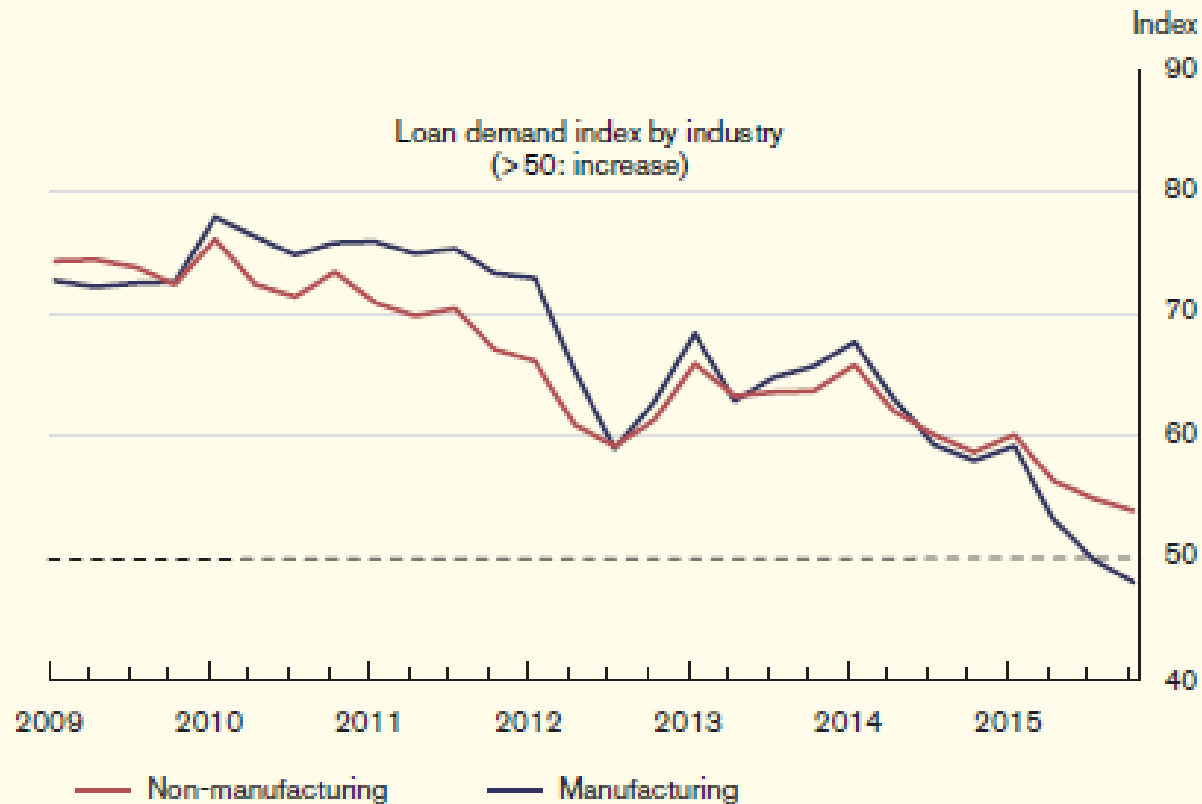
Source: WIND.

Manufacturing sectors' loan demand (supply) declined more



Chart 2.12

Mainland China: Loan demand index by industry

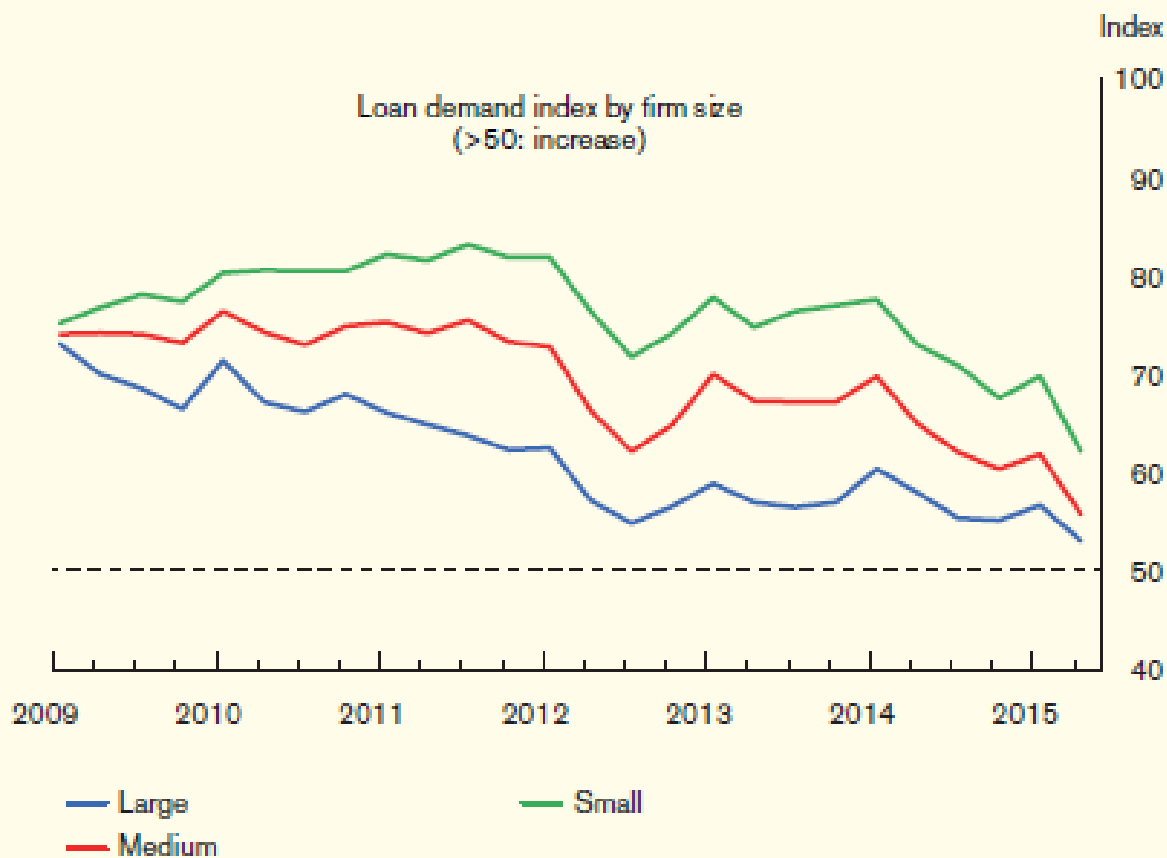


Sources: CEIC and PBoC.

Small firms' loan demand (supply) declined more



Chart 2.19
Mainland China: loan demand by firm size

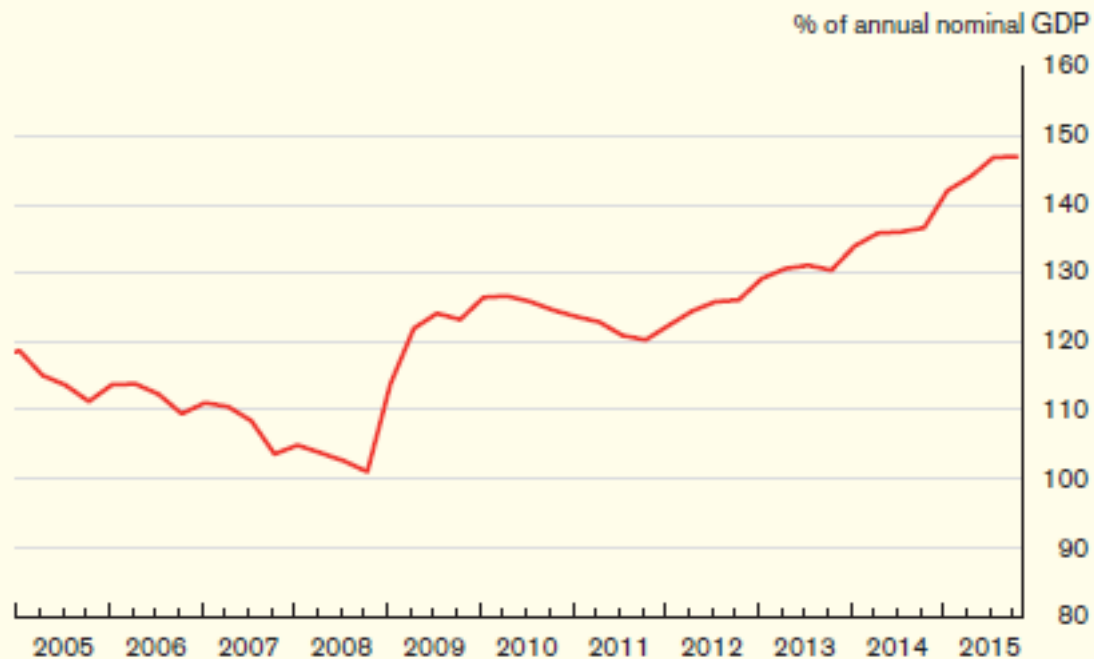


Sources: CEIC and PBoC.

Persistent onshore loan growth probably driven by credits to large firms



Chart 5.20
Credit-to-GDP ratio in Mainland China



Note: Credit-to-GDP ratio is defined as the ratio of total bank loans (all currencies) to the sum of quarterly nominal GDP for the latest four quarters.

Sources: CEIC and HKMA staff estimates.



- Interest rate arbitrage could be a determinant of the increase in letters of credit
- Offshore trade finance increased in 2014
- The increase in Chinese (onshore) banks' NPLs and demand for offshore loans (smaller and manufacturing firms) may cause the increase in "foreign guaranteed loans" in which letters of credit are the onshore collateral
- Therefore, some related control factors should be put into the analysis and estimations to confirm that interest rate arbitrage is a key determinant
- This paper is an interesting study on capital controls