

Monthly Highlights

- USD 1.7 billion in contract value of USD/CNH Futures was traded, with an average daily notional value of USD 96 million.
- Non Market Makers contributed 58 per cent of contract volume which at par as January 2015.
- USD/CNH Futures Open Interest increased to 11,677 contracts (USD 1.2 billion notional) as of 27 February 2015.
- The groundwork is in place for further convergence between the on- and offshore rates over the medium term.

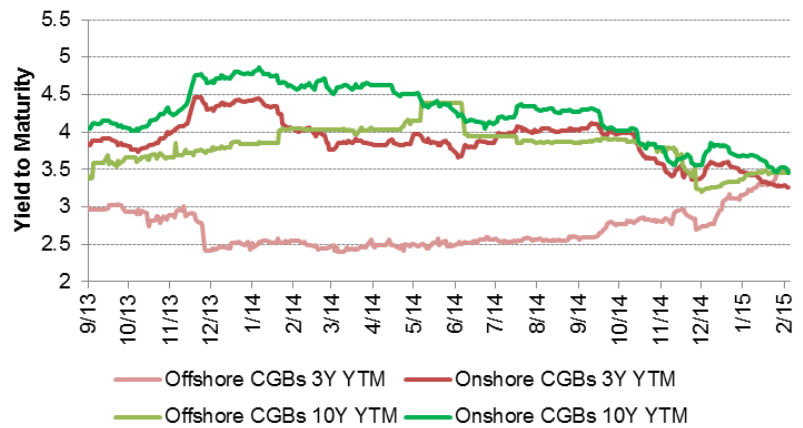
One of the most notable developments in the RMB market in the past two years was the convergence of the on- and offshore interest rate, together with a more synchronous movement in the yield curves of both markets. It was another step towards the internationalisation of the RMB. The effect over time will be to bring valuations in the offshore Ministry of Finance Treasury Bond, or CGB, market, (which have been relatively high because of the market's limited liquidity) more in line with those of the onshore CGB market.

As China's onshore market is now more accessible to foreign investors, CNH interest rates have gradually moved towards their onshore counterparts. Offshore 3Y and 10Y CGBs, which started the year with lower rates than onshore CGBs by 150 bps and 50 bps respectively, now offer similar or even slightly higher rates than comparable onshore bonds. The convergence has come from both sides. CGB yields have been moving up offshore while trending lower onshore. The most notable change occurred in short-dated offshore CGBs. As shown in the chart on the right, the yield of offshore 3Y CGBs increased from 2.5 per cent to 3.5 per cent from January 2014 to February 2015.

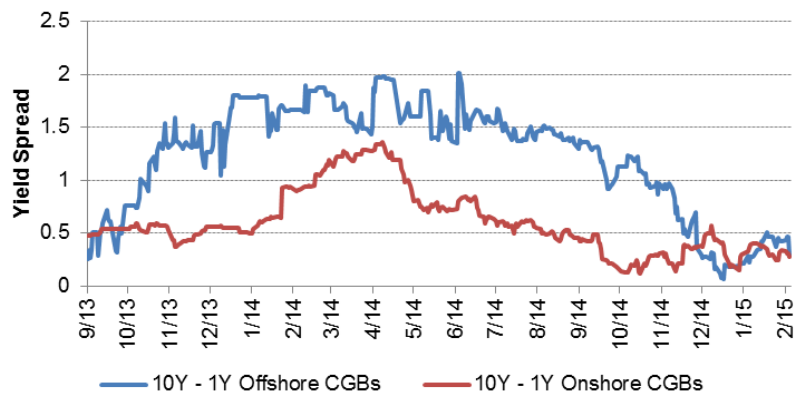
Besides the narrowing offshore/onshore interest rate gap, there is also a more synchronous movement of the yield curves in both markets. The changes in the shape of the offshore yield curve tracked closely with its onshore counterpart in the last 18 months. Both steepened from September 2013 to 2Q 2014, as shown in the middle chart on the right. The yield curves then flattened from 2H 2014 to the end of 2014. Now, the on- and offshore yield spreads are less than 50 bps.

Interest rate convergence picked up pace following the recent start of a series of programmes allowing easier cross-border transmission of RMB. They include the Shanghai-Hong Kong Stock Connect programme, cross-

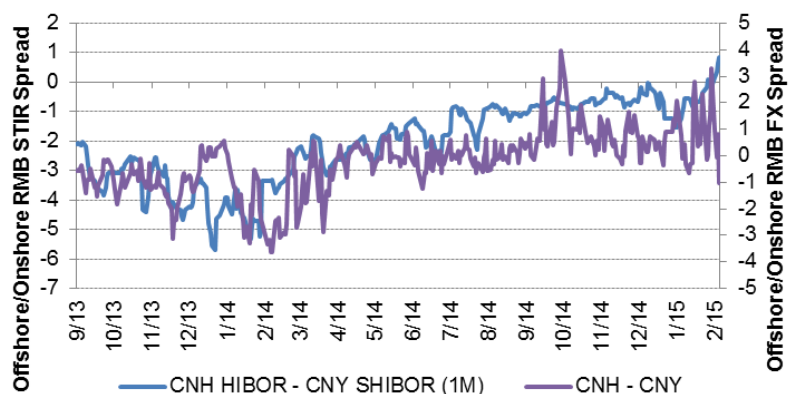
The Convergence of Onshore/Offshore CGB Rate



The Convergence of Onshore/Offshore CGB Yield Curve



Onshore/Offshore RMB STIR Spread and Onshore/Offshore RMB FX Spread



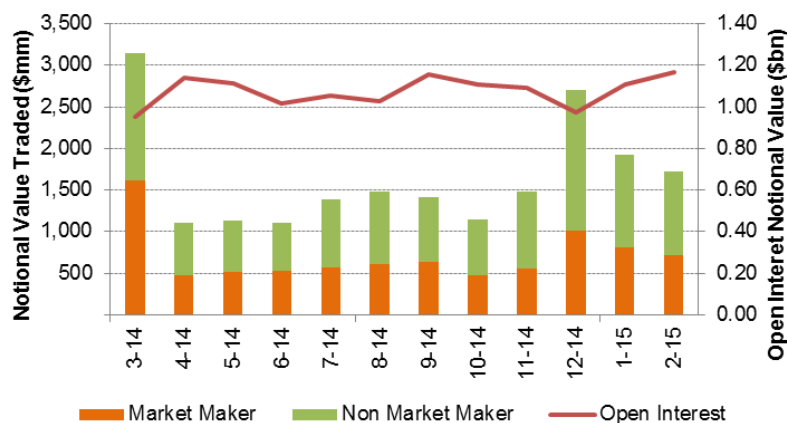
border loan programmes and the expansion of the RQFII programme.

In addition, the gradual convergence of on- and offshore RMB FX rates is driving interest rate convergence, as is the rapid deepening of offshore RMB money markets. The short-term interest rate, or STIR, spread has tracked the RMB FX spread closely in the last 18 months. Both reached the one-year minimum level at the beginning of 2014 and since then increased gradually.

The offshore RMB market is poised to move even more in line with the onshore market, though remaining restriction on capital flows are sufficient to prevent full convergence in the near term. The offshore market can no longer be seen as a standalone market, as onshore conditions must be taken into account. However, for interest rates, the groundwork is in place for further convergence between the on- and offshore rates over the medium term.

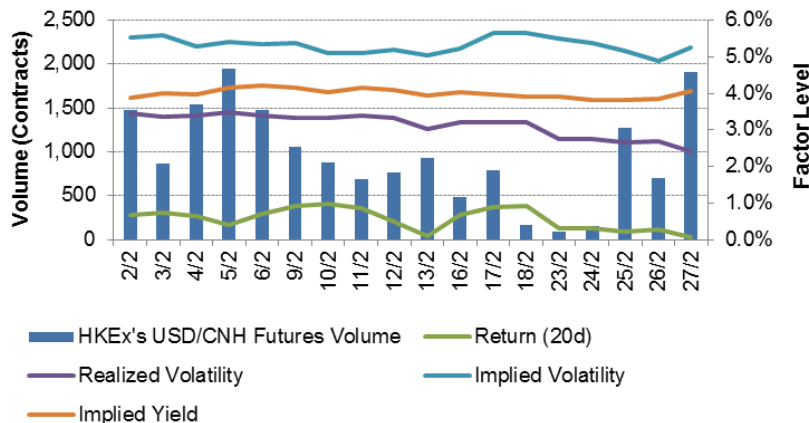
HKEx's USD/CNH Futures Market Statistics

USD/CNH Futures Turnover and OI



- In February 2015, a total of USD1.7 billion in contract value was traded, with an average daily notional value of USD96 million.
- Non Market Makers contributed 58 per cent of contract volume which at par as January 2015.

Key Driving Factors of USD/CNH Futures Volume



The following have been identified as the key driving factors behind the CNH futures volume:

- Cumulative return of CNH/USD,
- Realised volatility (20d),
- Implied volatility (USD/CNH 1Y ATM Implied Volatility from Bloomberg)
- 12 month forward implied yield

USD/CNH Futures Prices and Average Bid-Ask Spread

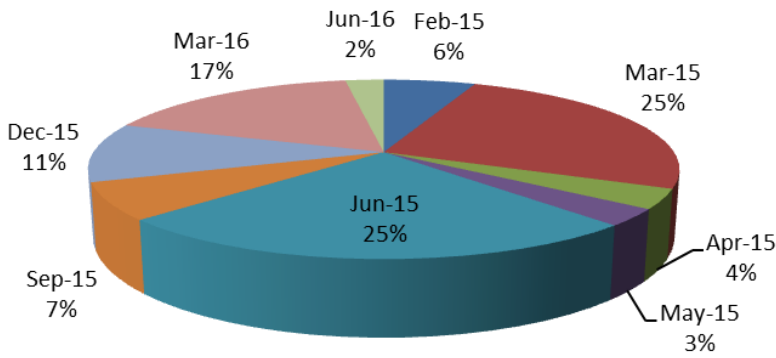
| Contract Month | 27 February Closing | Average Bid/Ask Spread* |
|----------------|---------------------|-------------------------|
| Feb-15 | - | 0.0018 |
| Mar-15 | 6.2983 | 0.0017 |
| Apr-15 | 6.3185 | 0.0023 |
| May-15 | 6.3418 | 0.0023 |
| Jun-15 | 6.3598 | 0.0021 |
| Sep-15 | 6.4179 | 0.0023 |
| Dec-15 | 6.4709 | 0.0021 |
| Mar-16 | 6.5223 | 0.0020 |
| Jun-16 | 6.5707 | 0.0022 |

- During the day session, the average bid-ask spread of the March 2015 contract was 0.0017.

*Average Bid/Ask Spread between 9:30 am and 4:00 pm during the month

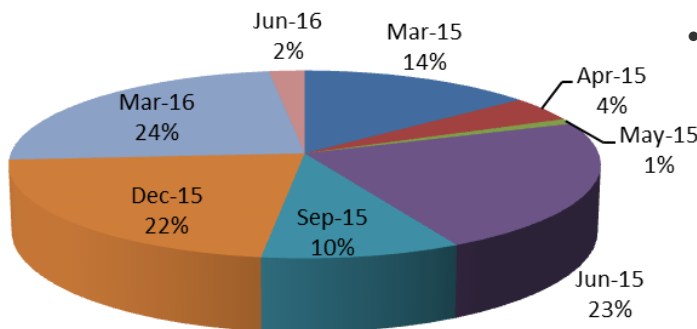
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Breakdown of Volume by Contract Months (2/2015)



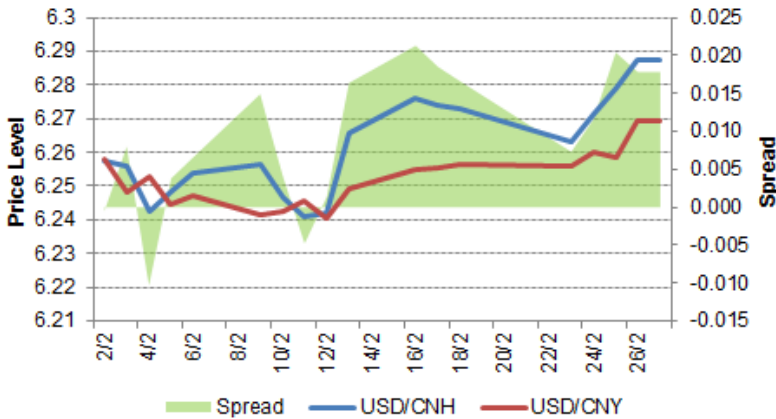
- Trading volume was high in the March 2015 and June 2015 contracts, which accounted for 50 per cent of total volume at the end of February.

Breakdown of OI by Contract Months (27/2/2015)



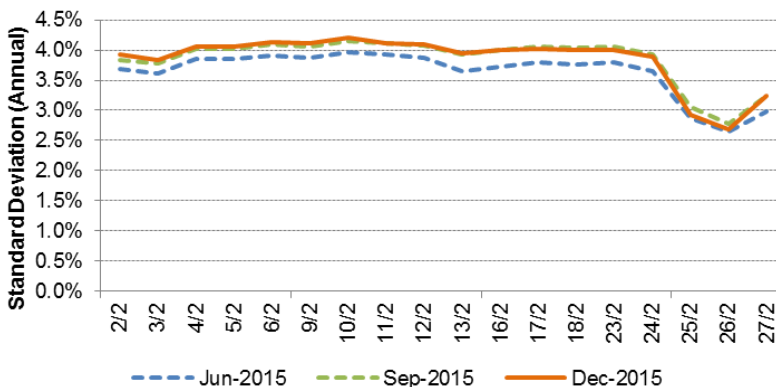
- Open interest was high in the March 2015 and June 2015 contracts, which accounted for 47 per cent of total open interest at the end of February.

USD/CNH and USD/CNY Spot Prices Trend*



- The spread between the USD/CNH and the USD/CNY widened towards the end of February to more than 0.015. The CNH was trading at a discount to the CNY against the USD.

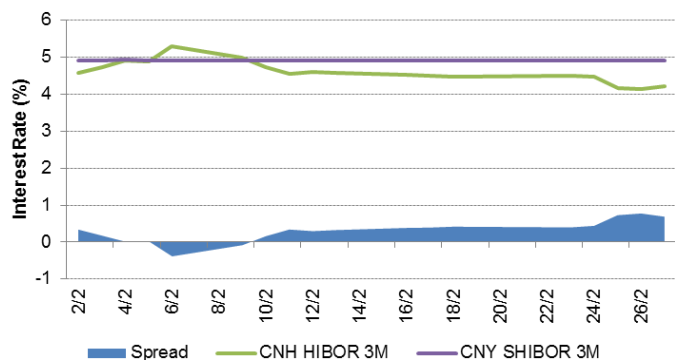
USD/CNH Futures Historical Volatility (20d Rolling)



- Volatility in USD/CNH Futures ranged between 2.5 per cent to 4 per cent in February 2015.
- The volatility spreads across far month contracts and front month contracts were narrower through February 2015 compared to January 2015.

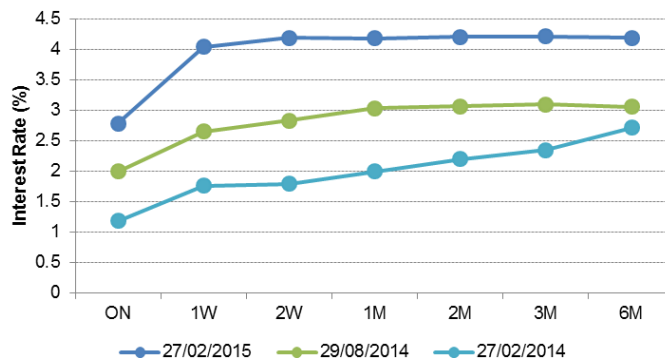
RMB FIC Market Review - Short-Term Interest Rates and Fixed Income

CNY SHIBOR vs. CNH HIBOR



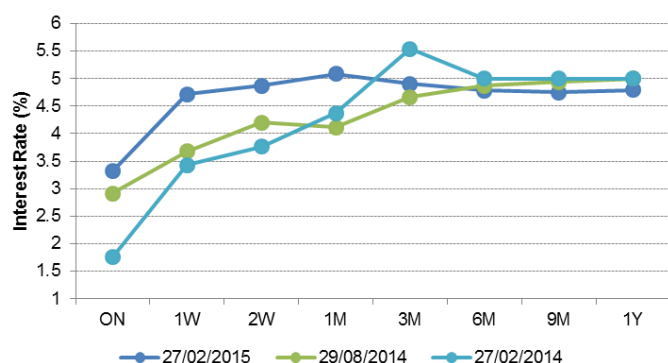
Onshore rates (CNY SHIBOR) remain higher than offshore rates (CNH HIBOR). However, the spread between them was wider towards the end of February 2015.

CNH HIBOR Yield Curves



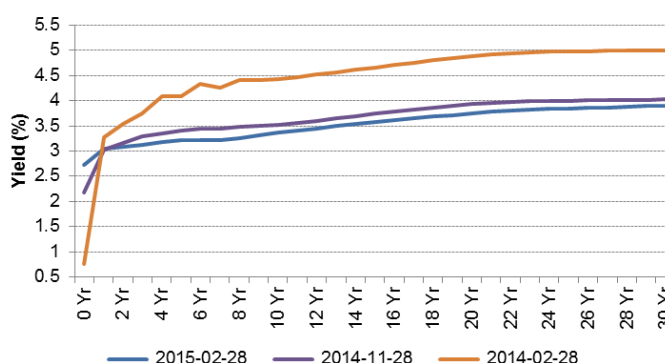
The CNH HIBOR yield curve was flatter in February 2015 than in February 2014.

CNY SHIBOR Yield Curves



The short end of the CNY SHIBOR yield curve steepened in February 2015 while the long end remained relatively stable.

MoF T-Bond Yield Curve



The MoF T-Bond yield curve was gradually moving down through 2014. Compared to the short end of the yield curve, the long end dropped more during that period.

For more information about the USD/CNH Futures Contract Specifications, please visit: <http://www.hkex.com.hk/eng/prod/drprod/rmb/cnhspecs.htm>

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