Swiss Re Institute

Issue 11/2021

Economic Insights
Win-win: China's capital markets are opening up more

Key takeaways

- In value terms, RMB accounts for more than 2% of international financial transactions
- We expect this to grow: China's economy is the largest in the world in purchasing power parity terms.
- China has committed to easing access to its capital markets, and we also expect foreign holdings of RMB assets to rise, from a below 3% share of its bond and less than 2% of the equity markets currently.
- Foreign insurers' interest will rise. RMB assets are an investment diversification opportunity and a source of potentially higher returns
- We also expect foreign insurers to continue to expand their physical footprint in China's market.

About Economic Insights
Analysis of key economic developments and their implications for the global re/insurance industry.

Authors
Xin Dai, Senior Economist
Yaxin Chen, Associate Economist
Li Xing, Deputy Head SRI China Center

Managing editor
Jérôme Haegeli
Swiss Re Group Chief Economist

We welcome your feedback. For any comments or questions, please contact: institute@swissre.com

In a nutshell

The renminbi's profile as a global currency continues to rise. We expect foreign holdings of Chinese financial assets to rise from a low base as the country's capital markets are opened up more. The global and local insurance sectors will benefit.

China's economy and market will become more accessible over the next five years. In its 14th Five Year Plan (FYP) laying out its economic and social development goals for the period 2021-2025, the government has committed to further opening up China's capital markets to two-way foreign traffic, relaxing rules on market access, accelerating renminbi (RMB) internationalization and deepening exchange rate reforms. The moves will present many opportunities for Chinese and global investors. Foreign investors currently own less than 3% of China's bond market, the second largest in the world, and less than 2% of its equity market. We expect the shares of foreign holdings to rise. For instance, with China's higher sovereign rates that other G7 economies, the market is a natural asset allocation path for foreign insurers. We expect foreign insurers will expand their physical footprint in China too, which over time will benefit local market capacity and expertise.

Recent accords such as the *Regional Comprehensive Economic Partnership* among China and other 14 nations in Asia Pacific,[1] and the 25-year *Comprehensive Strategic Partnership* between China and Iran[2] will boost demand for RMB and for wider access to China's financial market. Meanwhile, China has shown strong intention to progress further opening-up through its policy actions. Considering all these factors, we expect the RMB to play an increasing role in international financial transactions. Since the fourth quarter of 2016, the share of RMB in global reserves has nearly doubled, increasing from 1.1% to 2.1% at the end of the third quarter of 2020.[3] In terms of total international transactions value, the RMB share was 2.2% in February 2021, the fifth highest of all currencies, up from 1.9% in February 2019.

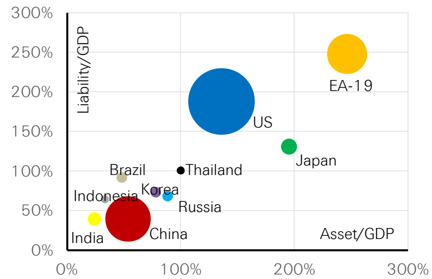
In addition, with the increasing size of China's economy and its growing share of global trade, we expect foreign holdings of Chinese financial assets to grow from what are still low levels. China became the world's largest economy in purchasing power parity (PPP) terms in 2020, surpassing the US. Its bond market is also second largest after the US, with an outstanding balance of USD 18.5 trillion (118% of GDP) at the end of March 2021.[4] The value of its equity market was about USD 12.1 trillion (77% of GDP in 2020).[5] However, China is still less integrated into global financial markets than advanced economies (see Figure 1 (LHS)). Foreign holdings of Chinese assets too, are much lower of other-country assets. For example, despite an eightfold increase since 2014, foreign investors still owned just 2.6% of China's bonds

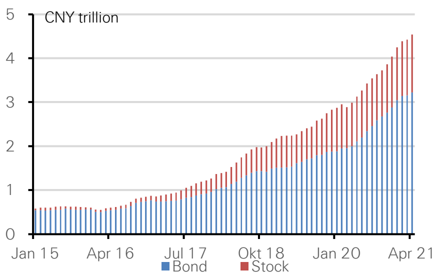
[1] On November 15, 2020, 15 Asia-Pacific nations signed the Regional Comprehensive Economic Partnership (RCEP), the world's largest free-trade agreement (FTA). *About – RCEP (rcepsec.org)*
[2] *Iran and China sign 25-year cooperation agreement, Reuters,* 27 March 2021.
[3] *RMB Tracker document centre*, SWIFT.
[4] *PBoC Financial Market Report*, March 2021
[5] The value of A- and B-shares traded on the Shanghai and Shenzhen exchanges were CNY 78.4 trillion by end March. Source: Wind.

27 May 2021

and 1.6% of its equity assets at the end of March 2021. That compared with 7.3% foreign holding of Korean bonds and 31.5% of stocks (Figure 1 (RHS)). With further opening up, we expect foreign investment to rise over time.

Figure 1
Two-way international investment (LHS), foreign holdings of Chinese financial assets (RHS)





Note: LHS chart: asset means outbound investment while liability means inbound investment. Bubble size refers to GDP.
Source: Wind, CEIC, Swiss Re Institute

With respect to the insurance sector, restrictions on foreign ownership of life insurers in China have been removed;[6] market entry conditions have been eased;[7] the scope of business open to foreign brokers and agents has been expanded;[8] and 14 new regulatory measures for fair competition have been introduced.[9] With easier access, we believe foreign insurers will increase their exposure to China via capital investments. RMB-dominated assets can help diversification of investment portfolios and be a source of higher returns relative to those in the low-for-longer interest rate environment of advanced markets. We also expect foreign insurers continue to expand their physical footprint in China by setting up wholly-owned entities or entering joint ventures with local partners. The market share of foreign insurers has increased rapidly in recent years. In P&C, the share of premiums owned by foreign insurers rose to 2.6% in 2020 from 1.1% in 2010; in L&H, the share increased to 10.3% from 5.6% over the same period. We expect foreign insurers to build coverage for existing and also new risk pools, boosted by the advent of Insurtech and Big Data, as well as knowing more about clients.

For domestic insurers in China, the presence of foreign peers will increase competition pressures but also spur operational and market efficiency improvements. Domestic carriers will benefit from the exchange of insurance expertise with foreign peers, which in turn will help raise standards in local business. The availability of more risk transfer capacity will support development of the local market and, as long-term investors, foreign insurers will also contribute to sustainable growth and economic resilience in China.

[6] All limits on foreign equity ownership in life insurers were lifted from 1 January 2020.
[7] The requirements of 30 years relevant experience and setting-up representative office before applying for a license were removed.
[8] "China further opens up its financial sector to foreign investment", *China Daily*, June 2018.
[9] 'Insurance market in China has entered a new era of opening-up, *sina,com,* December 2020.