

# **Interactions between CNY and CNH Money and Forward Exchange Markets**

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## **Summary**

The rapid development of Hong Kong's offshore renminbi (RMB) market (also known as CNH market) has aroused growing interest in its interaction with the Mainland China market (also known as CNY market). Against this backdrop, we conduct a quantitative analysis on the onshore and offshore RMB deliverable forward markets. In order to broaden our perspective, we draw comparisons with the development of the Eurodollar market between the late 1950s and early 1980s, and in particular analyse the effect of onshore regulations on market development.

Our findings suggest that onshore regulations, notably the Regulation Q interest rate ceiling, were effective in containing spillovers between the Eurodollar market and the US domestic market. For the CNH market, we found evidence that cross-market spillovers between the Mainland and CNH markets became two-way in 2013, but were more limited and mostly not significant in earlier years. In addition, onshore-to-offshore spillovers were larger than spillovers in the opposite direction in most cases. This probably reflects the fact that the CNH market, though rapidly growing, is small compared to the Mainland market, and possibly more subject to onshore influences.

Cross-market arbitrage is unlikely to be a major channel for the CNY-CNH spillovers due to the effectiveness of Mainland capital controls. Instead, a more likely channel is based on information differentials between the two markets, i.e. price movements in one market serving as an indicator of certain types of information, prompting the other market to follow suit. Looking ahead, the Mainland market is expected to continue to play a leading role in interactions between the onshore-offshore money and foreign exchange markets since these markets will be ultimately dominated by the monetary policy stance of the onshore authorities.