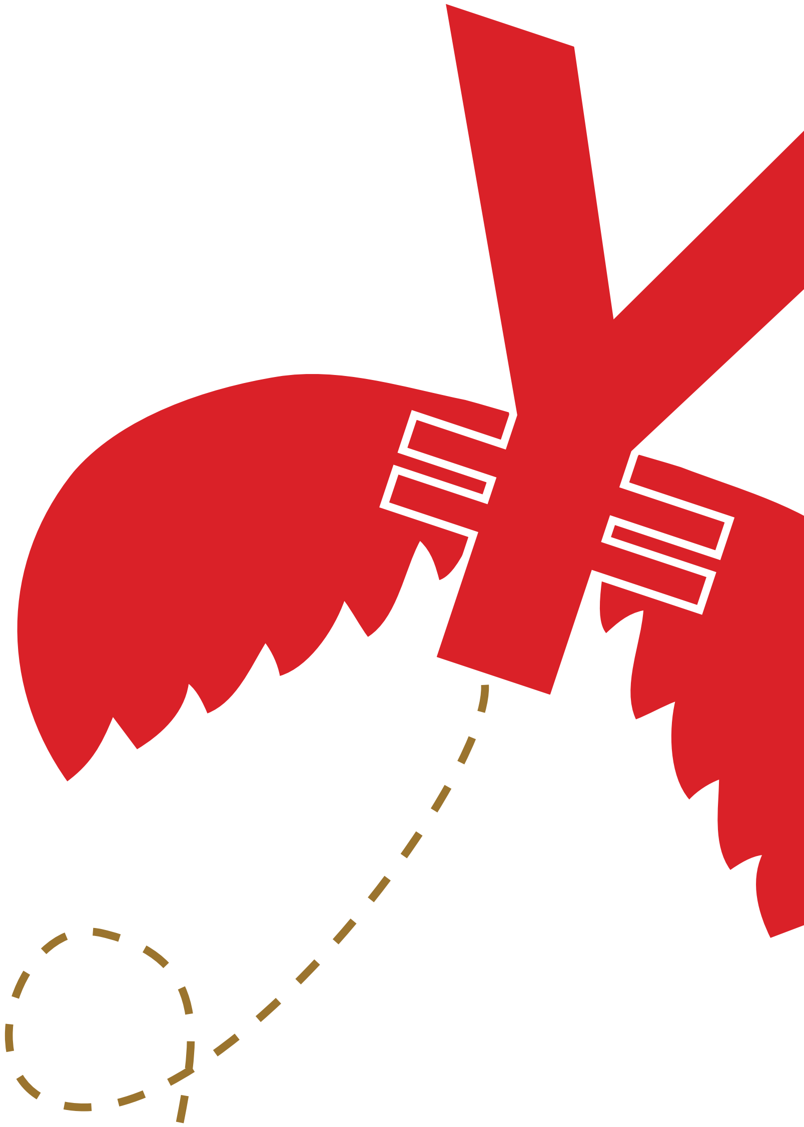

SETTING THE RENMINBI FREE

Chinese authorities are speeding up the pace of currency liberalisation. Rupert Walker explains what this means for treasurers

The internationalisation of the renminbi is a seemingly irreversible trend. Its trajectory is directed by Chinese policy measures and its momentum is fuelled by widespread adoption of the currency throughout the world. The renminbi's role as a means of exchange for trade payments, investment, borrowing and hedging is growing rapidly, and its increasing importance for corporate treasurers and their businesses cannot be exaggerated.

Trade activity in renminbi has surged since China began allowing settlement of international transactions in its currency in the third quarter of 2010. The People's Bank of China (PBOC) reported that renminbi-denominated trade settlement was RMB 2 trillion in the first half of 2013, which was 14%-15%

RENMINBI INTERNATIONALISATION DEVELOPMENTS IN 2013

10 April
Direct trading of the Australian dollar and the renminbi commenced. It was the third currency allowed to directly trade with the renminbi, after the US dollar and Japanese yen.

3 June
Singapore launched CNH clearing services, the third CNH clearing centre after Hong Kong and Taiwan.

24 June
The Bank of England signed a RMB 200bn bilateral currency swap agreement with the PBOC.

10 July
The PBOC announced policies to simplify and facilitate cross-border renminbi transactions, including provisions for onshore companies to provide intercompany loans to their offshore subsidiaries and the streamlining of documentation.

29 September
China launched the Shanghai FTZ, in which the Chinese government intends to implement pilot schemes for the liberalisation of capital account transactions and convertibility of the renminbi.

10 October
The PBOC announced that foreign entities could use their CNH funds to invest in onshore financial institutions, subject to regulatory approval.

10 October
The PBOC and the European Central Bank signed a RMB 350bn bilateral swap agreement.

15 October
The Chinese government granted London-based investors a RMB 80bn quota under the RQFII programme.

SOURCE: MOODY'S INVESTORS SERVICE, REUTERS

of total China trade, compared with 11% in 2012. Standard Chartered Bank reckons it could leap to 28% by 2020, as the country's share of international trade doubles by the end of the decade.

Other indications are the continued surge in offshore renminbi (CNH) deposits held in Hong Kong, Singapore and Taiwan, as well as the large daily turnover in renminbi in the FX market, estimated by HSBC to amount to RMB 5-6bn for spot and more than RMB 10bn in swaps – presumably for hedging.

What treasurers want next

In Standard Chartered's CNH survey of its global corporate customers in June 2013, 92% of respondents said they would increase their use of CNH products as they increase their engagement with China. The attractions of using renminbi as a trade settlement currency include risk mitigation, cost savings and improved access to Chinese buyers and suppliers.

Appreciation of the CNH, regulatory liberalisation, and streamlined processes and procedures for cross-border payments and lending emerged as the top factors that would drive further usage. Many items on their wish list were subsequently realised in the following month when the PBOC lifted a host of restrictions on renminbi cross-border trade settlement.

"The reforms introduced in July in particular addressed many of the requirements of treasurers expressed in Standard Chartered's global survey," says Frankie Au, renminbi product head, transaction banking Asia at Standard Chartered.

"China implemented several measures that facilitate companies' activities in renminbi and that demonstrate that the momentum for liberalisation of the currency remains powerful. These include allowing onshore lending to overseas affiliates, enhancing trade

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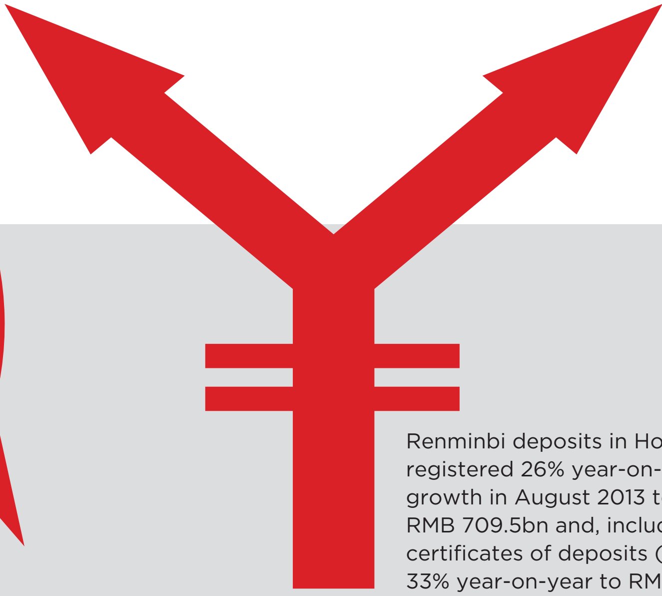

FACTS AND FIGURES

SWIFT calculated that renminbi ranked number 12 in global payments as of October 2013, up from number 20 a year and a half previously. Strong growth of 163% year-on-year in Q3 puts Europe on a path to overtake Asia in renminbi customer payments.

The CNH FX options turnover is now the most actively traded offshore currency options market in Asia, according to the 2013 Bank for International Settlements *Triennial Central Bank Survey*. Deutsche Bank estimates daily turnover averaged about US$7bn, 700 times the 2010 level, and Standard Chartered reckons daily CNH spot turnover of RMB 5-6bn and swaps at twice that level. Data released by SWIFT in October indicated that 62% of renminbi trading outside China and Hong Kong was through London.

By October 2013, the PBOC had signed bilateral swap lines worth a total of RMB 2.2 trillion with 23 countries and regions, including the EU.

Renminbi deposits in Hong Kong registered 26% year-on-year growth in August 2013 to RMB 709.5bn and, including certificates of deposits (CDs), by 33% year-on-year to RMB 904bn (Hong Kong Monetary Authority). Renminbi deposits in Taiwan rose to RMB 98.66bn at the end of September 2013 compared with RMB 17.45bn in 2012 (Central Bank of Taiwan); and increased to more than RMB 140bn in Singapore at the end of July after the Industrial and Commercial Bank of China began offering clearing services in early 2013 (Monetary Authority of Singapore).

The combined amount of RMB 576bn held by foreign investors through quotas exceeds outstanding dim sum bonds/ CDs, at RMB 512bn (Hong Kong Monetary Authority).

16 institutions – including the central banks of Hong Kong, India, Indonesia, Korea, Malaysia, Singapore and Thailand – are operating on the onshore China Foreign Exchange Trading System through quotas granted by the PBOC.

settlement procedures and streamlining documentation," he explains.

Cross-border payments that are capital account-related – such as renminbi qualified foreign institutional investor (RQFII) funds, and overseas and foreign direct investment – are closely controlled either by quotas or specific approvals, but the PBOC Circular 168 issued in July pointed to an easing of restrictions.

Radical July reforms

Onshore companies can apply to conduct cross-border renminbi lending through onshore banks, without needing the approval of the PBOC, and lending is also no longer limited to intercompany transactions. Unrelated entities can also now enter into renminbi cross-border lending agreements through entrustment loans, allowing companies to bring trapped cash out of China to meet overseas working capital needs. In effect, the renminbi can be fully integrated into regional and global cash pools.

"Corporate treasurers are increasingly amalgamating renminbi flows within their global liquidity pools. This heightens visibility, strengthening control by identifying where funding is needed within a company's worldwide operations and optimising yield. Renminbi payments and receivables are now being managed by regional treasury centres, such as Hong Kong, Singapore and London," says Au.

Equally important for efficient cash management and ease of doing business, documentation has been simplified for renminbi cross-border trade settlement of goods and services, based now on normal due diligence processes. This reform should enable companies to achieve real-time collections and payments.

"The easing of the administrative burden and the simple reduction in paperwork is going to incentivise us to do more business in China," says a Hong Kong-based regional CFO of an international conglomerate.

He is encouraged by the other measures implemented and believes that more reforms will be introduced next year to break down barriers on the capital account and extend the internationalisation of the renminbi.

"China's policymakers are receptive to our needs as businessmen, and have also recognised that making things easier for us will help satisfy their own objectives," he says.

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In addition, foreign companies in China can now issue cross-border renminbi guarantees to offshore entities to support their funding needs and optimise their balance sheets; and renminbi funds from bonds issued overseas can be placed in special accounts with onshore banks.

This should lead to a significant change in how companies manage their renminbi cash flows.

"The opening up and liberalisation of the renminbi FX market will continue to go forward. The currency will play an even greater role as commercial trading activity increases and foreign companies invest in China. Overseas firms should look to raise renminbi from dim sum bonds and then invest the proceeds directly in China, where they receive renminbi revenues that can be used to service the interest offshore," says Andreas Weindel, head of group treasury and portfolio management at German confectionery company Haribo, commenting in a personal capacity.

This would be good news for investors. "There is clearly strong investor demand for dim sum bonds now that yields have risen to market-clearing levels, but there is a lack of supply," says Clifford Lee, managing director and head of fixed income, DBS Bank.

Shanghai FTZ will be a test ground

More measures are likely to be introduced to further open up the capital account and are likely to be tried first in the Shanghai free trade zone (FTZ), which opened in September. It will be subject to fewer financial and business regulations than the rest of the country and is likely to allow full foreign ownership in more industry sectors. Also proposed are greater interest rate liberalisation, easier cross-border lending, foreign debt quota reforms and freer renminbi convertibility.

"Medium-size companies are likely to congregate around Shanghai – and in the FTZ – where production costs are lower and they have access to a large, skilful service sector," observes Weindel.

Broadly, the FTZ will be the testing ground for further currency internationalisation.

"Although it is difficult to predict the next stage of the renminbi's liberalisation, the development of the Shanghai FTZ is expected to play a key role as it will be used as a pilot for the rest of the country, both for currency reform and for the incentives it provides for overseas companies to operate in it," says Au.

Irresistible trajectory

Momentum towards full convertibility is clearly under way. Of course, while the offshore renminbi is considered convertible, the onshore renminbi is not. But, already the onshore FX intraday rate has widened to 1%, and analysts expect further widening in phases – perhaps to 2% by the end of 2014, and maybe achieve complete convertibility by 2020, predicts Standard Chartered (or even earlier, according to forecasts from HSBC).

Changes to the domestic interest rate structure are also taking place. China has already removed the lending policy rate, and the next step is likely to be the freeing up of deposit rates, which are subject to an upper limit of 1.1 times the benchmark rate. The extension of deposit insurance, as well as the creation of a more market-driven interest rate benchmark, could follow, according to China economists at HSBC.

These measures reflect an overall strategy of loosening official control over critical levers of the economy, and suggest to analysts that policymakers at the PBOC have the upper hand over more cautious government officials who fear the unintended consequences of market forces.

"The Chinese regulators are continuing to open and expand both the onshore and offshore renminbi markets, notably with recent agreements with the UK, Singapore and other countries, such as implementing direct cross-currency swaps and allowing qualified investment in renminbi financial instruments," says Lee.

Although China is a large, trade-oriented economy, accounting for 10% of global trade, the renminbi makes up only 1% of international payments, so clearly there is plenty of room for its share to grow. More companies want to do business with China, the country's authorities are trying to make it easier for them to do so, and corporate treasury departments are adjusting to a new world order where the renminbi is entering the currency mainstream.

Rupert Walker is a freelance financial journalist based in Hong Kong