Reign of the renminbi

China's currency is the new royalty in international treasury circles. Sandip Patil explains why

China's leading position on the world economic stage is now universally acknowledged, and companies of all sizes and industries are positioning the country at the heart of their growth strategies.

Meanwhile, as China becomes increasingly integrated into global networks, the renminbi's role as a world currency – not only for international trade, but also as a treasury, capital and reserve currency – is becoming more strategic.

Some companies are already recognising that the emergence of a new world currency will change the way that they conduct their business in China, and so are embracing new opportunities to use the Chinese currency to support their business strategies there. On the other hand, despite China's pivotal position in international trade, a large proportion of corporations have yet to make the shift and include the renminbi in their currency mix, despite the potential benefits of doing so.

Not 'if', but 'when'

These days, treasurers who do business in China are no longer talking about 'if' they will use the renminbi, but rather 'when'. Companies are also finding that their competitors are increasingly taking advantage of the opportunities that the currency offers, meaning they themselves should act sooner rather than later.
In March 2014, the renminbi became the seventh-ranked global payments currency by volume, according to SWIFT, and it is already the second most popular currency globally for trade finance after the US dollar at 9% of flows, which is an achievement considering its starting point was zero just a few years ago.

For those that have not yet embarked on their renminbi journey, or are at the early stages, how should they go about it? The logical starting point for most corporates is to use the currency to settle cross-border trade, whether that is inbound, outbound or a combination of both, an opportunity that has existed since 2009. The advantages of doing so include better commercial conditions (since counterparties' FX risk is eliminated), greater flexibility in managing cash, liquidity and risk within China, and access to a wider community of buyers and/or sellers. Documentation is less onerous when using renminbi rather than foreign currencies, which speeds up the process of doing business. Payment terms can also be more attractive: suppliers may offer up to 210 days for renminbi, compared with 90 days for foreign currency, resulting in obvious working capital benefits.

Connecting China

Many treasurers are less concerned about settling trade in renminbi than with how they will manage the resulting surplus

ADVICE FOR EMBARKING ON THE RENMINBI JOURNEY

Manage renminbi liquidity in the offshore market – evaluating either investment or funding options.

Ensure that controls encapsulate cross-border sweeping without adversely affecting working capital management in China.

Cross-border controls in China are not yet fully relaxed, so it is important to have controls in place that ensure compliance.

When borrowing, regularly review the risk management of different yield curves. While CNH pricing can be more volatile than CNY, depending on market liquidity, CNH borrowing is becoming increasingly compelling since liquidity in other markets continues to be constrained, while investors have a strong appetite for CNH.

AN EXPERIMENT IN FREE TRADE

The journey towards liberalisation has accelerated recently with the launch of the China (Shanghai) Pilot Free Trade Zone (SFTZ) in September 2013. Although its scope is currently limited, it alludes to expansion beyond Shanghai in the future. The SFTZ covers nearly 29km^2, with the aim of stimulating trade and investment, accelerating functional, administrative and regulatory transformation, and providing experience and insights into the opportunities and challenges of a free economy. As a relatively new venture, some issues require clarification and not every organisation is eligible for, nor would necessarily benefit from, opening an entity in the SFTZ. But, for select companies, the advantages could be material. Significantly, the SFTZ represents a major step towards liberalisation in China and could prove a catalyst for wider renminbi capital account convertibility, interest-rate liberalisation and renminbi internationalisation.

or deficit in the currency, including managing funding gaps across legal entities, both within China and cross-border. This has been a challenging issue in the past, but connecting China within a regional or global liquidity structure can now bring considerable advantages for cash-generative businesses and there are a variety of opportunities to do this. For example, cross-border 'on-behalf' structures, payment netting and lending/sweeping are now feasible, and some well-known banks are experienced in supporting customers in these activities.

One issue that companies operating in China need to consider is the disconnect that exists between the onshore renminbi (CNY) and offshore renminbi (CNH) markets. For companies with surplus cash, the onshore market is more liquid and deposit rates are higher. In contrast, for net borrowers in renminbi, offshore borrowing may be cheaper. Many companies have cash surpluses or deficits at different times, so they should speak to their bank about the most appropriate liquidity solution for them.

In addition to Hong Kong, offshore renminbi centres are developing in London, Singapore and Taipei. As a result, liquidity pools are gradually deepening and the range of available liquidity and risk management instruments is growing. Pretty soon, treasurers should be able to manage CNH in the same way as any other international currency, which will ease the way that business is conducted with China.

Taking a consistent approach

Just as managing renminbi liquidity both domestically and cross-border is becoming easier, opportunities to set up efficient cash management processes are also increasing. Companies can take advantage of this development to centralise payment processing through a shared service centre or a payment factory that uses 'on-behalf' structures and performs payment netting. This enables companies to centralise and streamline payments in a way that is more or less consistent with other regions than in the past. Some challenges remain, however. For example, settling transactions is subject to regulatory restrictions, while processes are less automated than when using established cross-border trading currencies such as the US dollar, but significant progress is being made.

Approaching the final stage

As developments in cross-border trade and liquidity increase, the final step in the renminbi becoming the default currency for multinationals doing business in China is its development as a capital currency. With cross-border controls still in place, onshore and offshore markets cannot converge, and with restrictions on foreign direct investment, the renminbi is still in a nascent stage of becoming a risk and capital currency. While there are changes under way, transfers of renminbi between China and offshore centres are subject to certain conditions. As the obstacles to the renminbi becoming a capital currency reduce, we are likely to see substantial growth in the number of banks, companies and governments that hold the renminbi as a reserve currency. This will cement its importance as a world currency.

Act now, adjust later

Even if economic growth in China experiences periodic slowdowns, which is inevitable as its economy matures, it will undoubtedly continue to strengthen its position as a dominant global trading partner.

Meanwhile, as liberalisation progresses, the renminbi is becoming a strategic global currency, both for doing business in China and more widely. For example, there will increasingly be demand to settle trade transactions in renminbi between counterparties that do not use the US dollar as their base currency. While the benefits will differ by organisation, ultimately, it will be better to learn the game now rather than be beaten later.

Undoubtedly, companies will need to make adjustments and revisions in their renminbi strategies over time, particularly since regulatory revisions offer new opportunities. But adopting the renminbi is critical to a company cementing its competitive position within China and potentially globally.

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