Corporate Treasurers Council®

CTC GUIDE TO

The Internationalization of the RMB: A Treasury Perspective

Executive Summary

Underwritten by: Standard Chartered

The Internationalization of the RMB: A Treasury Perspective

A lot has been written about the Chinese government's ongoing effort to reform its economy and internationalize its currency, the renminbi (RMB). Such efforts include the establishment of an offshore market (CNH) in Hong Kong, London, Singapore, Taiwan and elsewhere, and the gradual liberalization of the trade account in addition to promises to reform the capital account over the next few years.

This trend toward the internationalization of the renminbi continues through a series of measured steps, often first piloted on a small-case basis. The most recent advancement was in July 2013 when the Chinese authorities eased several requirements including taking what was a pilot for cross border lending and applying it nationwide, and making it possible to further integrate the RMB into global corporate treasuries.

First, the rules for cross-border trade settlement have been simplified. When exporting to China simplified documentation checking will mean faster invoicing using RMB. If sourcing from China, the regulations now allow for credit remittance first, verification afterwards, which will streamline the payment process. Next, and perhaps most importantly, the government opened up the spigot on lending onshore RMB to offshore affiliates and even third parties, so cash-rich Chinese entities can lend funds via *sweeps*, aka intercompany loans, to affiliates offshore be they the parent or a financing entity, as well as lend to unrelated parties. These new regulations allow treasuries to bring China "into the fold" of global cash and risk management.

The above developments together with the new China (Shanghai) Free Trade Experiment Zone (CSFTEZ) which was officially opened on 27 September 2013 are cause for excitement. The idea behind this zone (and others like it, hopefully, over the next few years) is to create an area for more liberal trade and subject to less financial and business regulation than the rest of China. The Qianhai zone in Shenzhen was opened in August 2010. It is just across the border from Hong Kong and is now under construction. While the CSFTEZ will be a testing ground for China's economic reform, Qianhai will focus more on co-operating with and complementing Hong Kong. These developments will have immediate and long-term ramifications of a strategic nature, which require a new conversation between treasury and senior management about how to treat their companies' growing presence in China.

"This is an exciting time to be in China," said Ryan Hershberger, Ford Motor Company's Asia Pacific regional treasurer, who is based in Shanghai. Witnessing rapid growth in the region for his organization, and watching the ongoing liberalization of the capital markets has put Hershberger at the crossroads of change.

Introduction

The fact that China wants to create a more international market for its currency is not new. The country began its effort with the launch of the offshore RMB market or the CNH market, first with the issuance of RMB denominated bonds in 2007, and then the liberalization of cross-border payment settlement offshore starting in 2009. The Chinese 12th five-year plan and the official statements of the PBOC show that authorities' are in the process of making the RMB a reserve currency. The plan includes the RMB trade settlement program, the establishment of Offshore Centers, Bilateral Swap Lines and other forms of financial agreements.

According to an October announcement by SWIFT the RMB is now the eighth most traded currency in the world, with 1.49% of all currencies confirmations going through SWIFT, up from 0.92% in January of 2012. During the period, RMB trading volume through SWIFT increased 113%, overtaking the Swedish Krona, Korean won and Russian ruble. The figures exclude China and Hong Kong. (See charts to the right)

The Standard Chartered Renminbi Globalisation Index (RGI) climbed to another high of 1,148 in August, rising 61.8% year-on-year attributed to strong growth across the board in deposit growth, dim sum bond issuance, FX turnover and trade payments.

The July announcements are but two more in a series of steps that are part of the broader objective of the Chinese government to make the RMB a world currency by opening the capital account. Ultimately, through a series of measured steps, the

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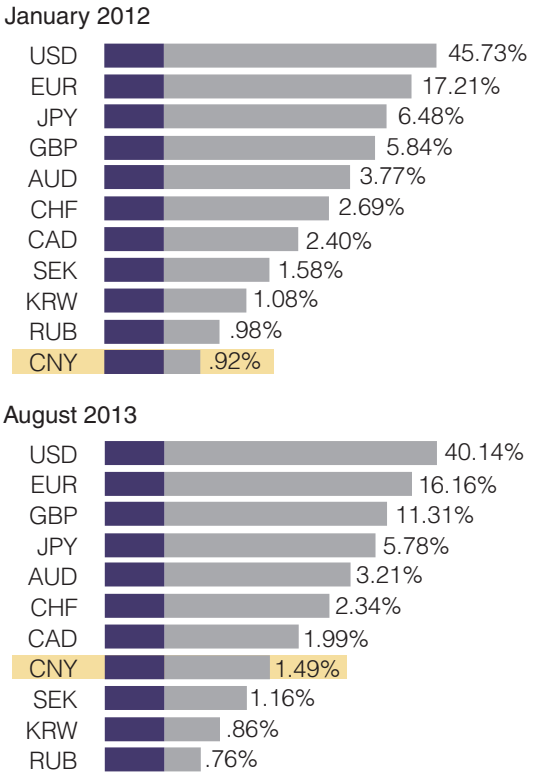
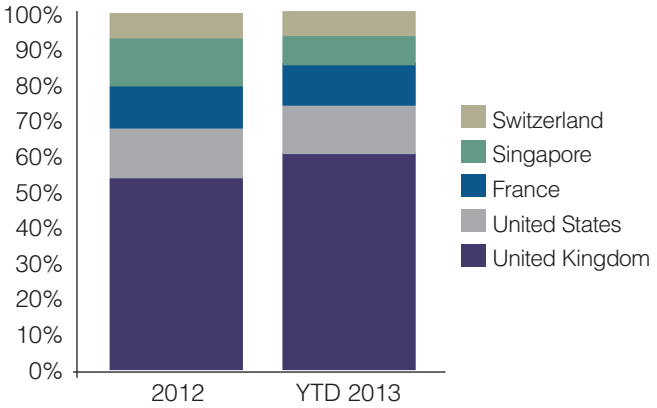


Worldwide CNYFX confirmation in value (MT300)



Top 5 countries excluding China and Hong Kong
CNY FX confirmation weight in value

Source: SWIFT

government intends to bring the CNY and CNH markets together. The steps it took in July are targeted in that direction, although full convertibility and an offshore/onshore union could be years away.

This is not to say that treasurers should hold their breath and wait to take action until some "big bang" event takes place. Rather, it means they should study each new development and begin a series of conversations with management about how cash flows will likely look for China for the next 3-5 years and devise a trade and treasury management strategy that support the business of the company.

> "Over the next 5 to 10 years, we expect our China operations to generate a surplus," said Aled Rees, China treasurer for Cabot Corporation.

Many companies are already doing so. "Over the next 5 to 10 years, we expect our China operations to generate a surplus," said Aled Rees, China treasurer for Cabot Corporation (see Case Study: Cabot on page 22). "We don't want that cash to be stranded on an island." To this end, Cabot is exploring structures that would "allow us to take cash offshore and into the broader pool of accounts and have the potential of more effectively utilizing it for financing or investments across the broader Cabot network. This is work in progress," Rees said. "Recently, we have seen some significant changes in regulation with far more insight being provided into the rules and procedures regarding those [intercompany] loans," said Cabot's assistant treasurer, Tom Whiteley, "and importantly, a better understanding of the risks."

"We spend quite a bit of time talking to our clients' treasury function about the overall developments [in the RMB capital market]," said Andrew Malcolm, who is based in the region as a lawyer with international law firm Linklaters. "What we find is that treasurers are concerned about the macro issues, i.e., should they be looking to start invoicing in RMB and concern around RMB convertibility," explained Malcolm.

"From the perspective of capital raising, the question is whether it's possible to finance their RMB needs offshore to support trade and finance activity and use hedging and investment tools in the offshore market," he said. The recent developments make all that much easier. "What we can say is that it's time to start looking seriously at the issue," Malcolm said.

"There might be a perception among some of a big bang moment that they'll make the RMB convertible and that that would be the time to start engaging in the currency. But that would be a mistake, as the process will be gradual and has already begun. While the onshore currency is still restricted, offshore in the CNH market there's full convertibility, and there is effective full convertibility on the current account already," Malcolm explained.

"It's really early days," said Malcolm. While China still has capital account controls, it's been trying out new approaches through pilots, initially with a quota, and then releasing them more fully. "That's the pace," he said. So even though there's not yet complete capital account liberalization, "this should not be a reason to hold back."

About the Author

Nilly Essaides is Director of Practitioner Content Development at the Association for Financial Professionals. Nilly has over 20 years of experience in research, writing and meeting facilitation in the global treasury arena. She is a thought leader and the author of multiple in-depth AFP Guides on treasury topics as well as monthly articles in AFP Exchange, the AFP's flagship publication. Nilly was managing director at the NeuGroup and co-led the company's successful peer group business. Nilly also co-authored a book about knowledge management and how to transfer best practices with the American Productivity and Quality Center (APQC).

Corporate Treasurers Council

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