Internationalisation of the Renminbi an opportunity for IFSC banks to develop services supporting greater trade relationships with China

Citi's CATHAL O'DALY looks at the internationalisation of the Chinese currency and its increasingly important role in international trade and the opportunities for international banks in the IFSC to develop products and services that can aid stronger trade relationships with China.

Few can dispute China's growing influence as a trade partner to the world. Citi's own economists expect China to become the world's biggest importer as well as the biggest country by trade value by 2015. We have already observed our financial institution and corporate clients seek solutions in helping them embrace the Renminbi ('RMB' - when offshore, the currency is denoted as CNH to distinguish it from the general, domestic term, Yuan 'CNY') in their trade and cash management practices.

From an Irish perspective, the arrival of the then Vice President of China Xi Jinping (and now President) in Ireland in February of last year and subsequent trade mission to China led by An Taoiseach, Enda Kenny as well as the announcement of some notable specific trade arrangements has kept China very much on the radar of Irish business seeking financial services, export and trade opportunity.

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Some background

The internationalisation of the RMB has seen a thriving market in offshore RMB deposits, bonds and funds develop in Hong Kong while the currency's role in cross-border trade has expanded sharply. Citi have observed exponential growth in the past year - with over three trillion RMB payments settled in China and Hong Kong - a significant change in western buyer behaviour. Now London is picking up the baton and more is expected into the future.

According to the Hong Kong Monetary Authority (HKMA), offshore deposits of RMB saw record amount of RMB 651.7 billion in Feb 2013, and the volume of Dim Sum bond issuance trebled. Several factors are expected to give the market a continued boost in the coming year or two including:


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- Wider circulation of RMB, particularly through the development of a deeper market in London
- Expansion of the Dim Sum bond and RMB loan markets
- Moves by central banks and sovereign wealth funds to shift a portion of their reserves into RMB (Japan, Nigeria, Philippines, Belorussia, Malaysia, Korea, and Cambodia have adopted RMB as a reserve currency)
- Redenomination of an increasing percentage of China's imports and exports into RMB

Irish and European clients, both financial institution and corporate clients, will seek greater support from their banking partners to ensure that they can receive the necessary support to transact in the RMB.

Why is the RMB important?

The RMB offers a new perspective for companies who want to re-shape their supplier relationship management and treasury management framework, which can improve supply chain management and bring about greater treasury efficiency. There are many benefits of operating an RMB account which include:

- Receiving more favourable trade terms from suppliers in China when pricing in RMB.
- Improving relationships with Chinese suppliers as RMB usage helps simplify the export verification and financial reporting process in mainland China.
- Reaching more clients and creating more business opportunities via RMB payment capabilities.
- Achieving a natural hedge for RMB payments and collections.
- Centralising FX into the treasury function and taking FX management out of China subsidiaries to enhance controls and achieve efficiency.

Hong Kong has traditionally been considered the first choice in terms of 'offshore' markets for the RMB. Nonetheless, London is quickly becoming a strong contender for that honour in Europe.

The HKMA and the UK Treasury announced a joint private sector forum to increase cooperation in promoting the offshore RMB market. As a result, in June of last year there was a five-hour extension to the HK RMB RTGS settlement system to accommodate longer trading in London.

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The extension widened the circulation of RMB in the western hemisphere. The cooperation agreement also improved CNH liquidity and the development of more CNH products.

Those products are fast arriving and European based banks have had to react. For example, Citi in Europe launched a RMB-denominated bank account service, together with a range of related services to support payments, trade, FX and hedging. Further development of liquidity structures are envisaged as the Chinese continue to relax their cross-border concentration regulations. Furthermore there have been a series of RMB-denominated commercial paper issues out of Europe, while last year an RMB bond made its debut on the London Stock

Exchange's order book for retail bonds.

Given our very close proximity and traditional ties to London as a global financial services centre, international banks in Ireland or domestic Irish banks with banking partners in UK therefore should be able to offer their clients a European based RMB account. This in turn will bring significant benefits to our underlying client base. These benefits include:

- RMB account services and FX transactions (spot, forwards and non-deliverable forwards).
- Cash and liquidity management services.
- An efficient integration into London-based liquidity structures means existing liquidity structures in the same jurisdiction can be quickly incorporated into Citi London accounts (including netting solutions)
- Time zone advantages (which clearly means there is no need to worry about significant time zone differences between Europe and Asia).

It should also be noted that in addition to Hong Kong as the main offshore Asian centre for RMB, Singapore and Taiwan recently received approval by the China Mainland government to develop offshore RMB business.

Caution

Notwithstanding the opportunities, there are a number of factors which need to be considered. Most obvious is regulatory. Clearly, China has undergone a significant transformation in order to liberalise the RMB yet the regulatory environment for cross-border RMB transactions is continuously evolving. Understanding its regulations is and will be key to both executing transactions and identifying opportunities. For example, a banking partner who can help manage RMB FX exposure effectively can help mitigate the adverse effects of a potential sudden exchange-rate movement.

RMB its growing role in trade

Both Japan and Russia have signed bilateral agreements to use their national currencies for cross-border trade settlement with China, while the Australian and Chinese central banks have signed a currency swap agreement that will allow RMB200 billion (USD32 billion) of local currencies to be exchanged between the two countries over three years. Data from SWIFT show the RMB now ranks as the number three currency - after the dollar and euro - for global issuance of letters of credit, with a 4 per cent market share.

Europe is contributing significantly to RMB denominated trade and payments. According to SWIFT, Europe's share of international RMB payments (excluding China/HK) grew from 36 per cent in the first quarter of 2011 to 47 per cent in the first quarter of 2012.

Expansion of the Dim Sum bond market

As noted above, the Dim sum bonds (which are bonds issued outside of mainland China and issued in Yuan) issuance has amounted to over 88 billion yuan in first quarter of 2013, up from about 38 billion in previous two quarters, according to Bloomberg. The dim sum bond market in Hong Kong remains a venue where issuers enjoy lower fund-raising cost than in China's onshore market.

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In March of this year China Minmetals Corporation, a state-owned enterprise, completed its sale of a 2.5 billion yuan ($402.3 million) three-year dim sum bond, which attracted more than 12 billion yuan in orders and saw strong interest from central banks.

It was the fourth company to tap the 25 billion yuan quota granted by China's National Development and Reform Commission (NDRC) to five mainland companies last year to issue yuan bonds offshore.

The total order book for China Minmetals' dim sum bond was more than 12 billion yuan from 106 accounts, including central banks, which took 16 percent of the deal. Fund managers comprised 48 percent, while banks and private banks accounted for 26 percent and 10 percent, respectively. Investors are clearly flocking to the offshore yuan bond market.

Analysts say lack of supply and relatively higher yields in the dim sum bond market will continue to attract more investors, especially as confidence in China's economy has improved, supporting the yuan currency. The yuan hit a record high against the U.S. dollar in early April.

Import and export trade flows in RMB

Import and export trade flows with China play the most important role in driving the CNH liquidity pool. Since the latter part of 2012, more than 10 per cent of China's imports and exports have been redenominated into RMB. That compares with as little as 2 per cent only a couple of years ago.

At Citi, we have been leading the way in helping our clients seize the opportunities presented by the development of the offshore market in RMB.

With a significant presence in China and Hong Kong, together with a depth of expertise in London and Dublin, we have seen many enquiries from our client base navigating the dynamic RMB regulatory environment.

As a partner in the internationalisation of the RMB, we have been using our global footprint to facilitate trade flows. Our RMB re-invoicing centre solution, combined with a range of trade, FX and cash management products, delivers flexibility and control, and improves the client/vendor relationship for our client base.

For institutional investors, we offer an end-to-end range of offshore RMB services spanning cash management, custody and funds.

For issuers, our Agency and Trust business offers a full suite of products and services to support offshore RMB transactions – both in Hong Kong and internationally.

Ireland

The importance and growth of the RMB as an international currency together with growing trade relationship with China (be it from a trade securities, funds and bank perspective) requires significant support from a banking relationship to navigate and develop new relationships in the far east. Ireland will see further growth in China trade relationships which in turn represents an opportunity for the Irish banking sector to support these important emerging relationships.

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