Renminbi – why it is time to take the plunge

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Three good reasons why corporates should now consider making the move into renminbi

Despite rapid growth in the offshore renminbi (RMB) since its inception in 2010, many corporates have preferred to wait and see before opting to settle their Chinese trade in the currency.

At Standard Chartered, however, we believe now is the time to come off the fence. We see at least three good reasons why corporates should consider taking the plunge into RMB.

First, settling in RMB would net most international corporates cost savings and an increased control over foreign exchange and interest rate risks. Many companies are wary of invoicing or receiving payment in RMB due to concerns over cost control and foreign exchange risk. However, Chinese firms typically price into their contracts the cost of conversion between US dollars and RMB. This ‘conversion premium’ has been growing since the widening of the RMB trading band last April, which made the currency risk more expensive to manage onshore in China. When transactions are settled in RMB, however – with the non-Chinese counterpart taking on the foreign exchange risk – the premium is eliminated and the underlying price of the goods becomes transparent, ultimately paving the way for negotiating cheaper contracts. We believe that most corporates would gain cost savings in the order of 2-3 per cent. Added to this, would be the competitive advantage of gaining access to a wider range of Chinese customers and suppliers.

Second, the RMB will continue to rise in importance as a trade currency. In the last two years, the speed of growth in the offshore market has exceeded all expectations, as has the rate at which China has liberalised the currency. Currently, around 10 per cent of China’s trade with the world is settled in RMB. In the past six to nine months growth has paused, but we believe this is temporary, and remain confident in our prediction that as much as 20 per cent of China’s cross-border trade will be denominated in RMB by 2015. Driving this will be strong underlying growth in China’s trade with the world, supported by continued liberalisation.

Recently, the Hong Kong Monetary Authority launched a pilot scheme whereby banks can exercise due diligence assessment and waive documentation checking for trade by eligible firms. A similar scheme has been launched onshore, by the People’s Bank of China in Shanghai. Both should encourage corporates that may previously have been put off settling in RMB because of the large amounts of paperwork involved.

Meanwhile Beijing has announced a USD45 billion test scheme in the Qianhai region of Shenzhen to allow the RMB to be used more freely. Dubbed ‘mini-Hong Kong’, this will encourage the repatriation of RMB into Qianhai and in turn create opportunities for banks to provide RMB financing to corporates and projects in the area. The scheme will also enable banks to help corporates and financial institutions to issue so-called dim sum bonds, and foreign investment funds to invest in Qianhai. It demonstrates the accelerating liberalisation by China, and should be viewed as a positive by companies now considering the RMB.

Third, doubts about the true nature of RMB flows should now be receding. For a while now, there has been some concern among corporates trading with China that the volumes of RMB redenomination are being exaggerated by arbitrage, as opposed to reflecting ‘real’ cross-border trade flows. However, as arbitrage opportunities have faded away, the genuine, underlying volumes of RMB trade have become apparent, and this should encourage corporates looking to make the switch.
In the early stages of the RMB internationalisation, the RMB was expected to appreciate gradually against the US dollar, at very low volatility. With onshore forward exchange rate in China being much higher than offshore rates, corporates with cross-border trade flows were able to reduce their cost of funding by leveraging the difference in forward exchange rates in what could be described as a one-way bet.

While the early arbitrage opportunity encouraged a number of companies to switch their invoicing to RMB, it left many others less confident in the currency, because of concern that RMB trade flows were based on arbitrage rather than genuine demand. Since then, however, circumstances have changed. The opportunity to benefit from currency appreciation has receded, while the onshore and offshore RMB exchange rates have converged, making arbitrage based on underlying trade flows non-viable. However, against the expectation of some corporates, this has not resulted in a sharp fall in the proportion of Chinese trade settled in RMB. There was an immediate drop of one basis point to 9 per cent, but the fact that the rate has since rebounded to 11 per cent shows that RMB settlement continues unaffected and that underlying trade flows are indeed ‘real’.

The strong reasons for settling in RMB notwithstanding, it is clear that making the switch comes with significant challenges. The Chinese market remains highly complex and fast-changing. For most international corporates, making the move would entail an extensive internal change process. It would involve the setting up of procurement and sales teams to renegotiate prices and mitigate the impact of adding the currency to the firm’s accounting systems, not to mention that the treasury team would have a new foreign exchange risk to contend with. It would also impact on operational processes, which would need to be adapted to meet the evolving documentation requirements from Chinese regulators.

A company setting up a regional treasury centre to enable invoicing in RMB, sourcing of RMB funding, the issuance of dim sum bonds and the management of foreign exchange hedging would need to consider the potential tax impact of various jurisdictions. In addition, the company would have to keep an eye on external factors, such as changing legal requirements and movements in the different onshore and offshore prices for RMB.

One of the main problems still facing the development of the offshore RMB is a lack of awareness around what can and can’t be done in China by overseas corporates. The rules in China are changing rapidly, and this is compounded by the fact that many of China’s regulations are available in Chinese only. It is no surprise that the majority of the early movers on RMB are Chinese companies with overseas subsidiaries, or foreign companies with subsidiaries in China. These companies are more capable of overcoming the language and awareness issues still surrounding the currency.

Today, the firms considering whether or not to settle in RMB would typically be those without the benefit of an on-the-ground presence in China, and those that trade directly with third-party suppliers or buyers in the country.

However, we believe that an increasing number of these corporates will be persuaded to make the move within the next three years.

The recent UK-Hong Kong forum to develop London as an offshore RMB centre will support this trend, as it will generate greater awareness of the implications involved in managing the RMB globally. This in turn will encourage more companies to take the leap.
While the US dollar remains by far the most commonly used currency for trade with China – and is likely to remain so for a while to come – we believe that the RMB has potential for substantial growth to develop towards a global currency.

Despite the challenges, firms should not be put off by using the RMB. For most companies, the benefits of settling trade with China in RMB will far outweigh the drawbacks.

As we can see, the overall theme in the market is one of support – with encouragement from regulators, domestic banks and local corporates coming together – to make invoicing in RMB to China gradually simpler than in other currencies. With complexities fast receding and RMB-denominated trade expected to grow rapidly in the next few years, now would be a good time to consider making the move.

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