CHINA, The Renminbi and The World

Scaling New Heights

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The globalization of China's currency continues at a rapid pace, as regulations ease cash pooling, renminbi trade finance accelerates, and the dim sum bond market goes gangbusters.

Major developments sometimes happen without much fanfare. One such change landed on multinational treasurers' desks in China in November, when the People's Bank of China issued a detailed notice on implementation of cross-border renminbi cash pools for treasury units operating outside the Shanghai Free Trade Zone (SFTZ).

Cash pooling is a technique widely used by treasurers to aggregate surplus cash balances across different accounts in order to optimize interest earned and to better manage liquidity. However, historic restrictions on the free flow of renminbi, particularly for companies operating outside of the SFTZ, have made it difficult for treasurers to incorporate excess renminbi balances across different operating subsidiaries into pooling structures in order to optimize their liquidity and working capital.

Under the new rules it is now possible for multinationals to establish cross-border pools from businesses within and outside of China. There are, however, limitations imposed on corporates. One is a cap on cross-border inflows equaling 10% of the total owners' equity in the cash pool, a sign that the People's Bank of China is cautious about inflows of renminbi while still wanting to encourage outflows.

However, Citibank's head of treasury and trade solutions, China, notes that these are interim restrictions that may be lifted. Overall, he sees the new rules as an exciting development for treasurers. Losing little time, Citi announced in late December that it had initiated a cross-border pooling venture with "one of the world's leading consumer goods companies," without disclosing the company's identity.

Citi was able to develop the solution quickly as an outgrowth of its experience in setting up cross-border pooling for companies within the SFTZ. The fully automatic pooling structure has allowed the company to execute cross-border renminbi sweeping by connecting its onshore and offshore structures. "The expansion of renminbi cross-border solutions to a nationwide level not only signifies the SFTZ's positioning as a test-bed for further financial reform but also brings profound influence to the process of renminbi internationalization,"

SUPPORTING GROWTH

Another component of the currency's growing liberalization was the concurrent lifting of restrictions on pooling foreign currencies in China, known as China FX pooling. The State Administration of Foreign Exchange, or SAFE, issued guidelines in September for foreign-currency pooling. Multinational treasurers are still making their way through the new rules, but the move is expected to accelerate FX pooling on the mainland this year.

The SFTZ has assumed the role that it was designed for when it comes to the internationalization of the renminbi by providing a gateway for eventual nationwide practices. Companies that have been early adopters are reaping the benefits. French electrical equipment maker Sonepar integrated its onshore cash pools from six mainland entities via its subsidiary in the SFTZ into its regional treasury center in Hong Kong last July, RBS describes the move as necessary for the company's China growth plan. The RBS facility means that our regional treasury center in Hong Kong is able to integrate with our China entities' onshore renminbi cash pools. That means we can deploy renminbi liquidity between our onshore and offshore affiliates effectively.

Companies like Sonepar that have established units within the SFTZ have also benefited from easing of restrictions on lending renminbi from onshore to offshore units. Units within the zone can lend up to 50% of their shareholder equity, while those outside the zone are limited to 30%. That means that a wholly owned foreign enterprise established in the zone can deploy its renminbi cash-pooling capabilities to remit undistributed profits to overseas-related companies with which they have an equity relationship. Companies are allowed to negotiate the interest rates on the loans without restriction between themselves, but on arms-length principles demonstrable to regulators.

A NEW TRADE CURRENCY

These developments are providing a mirror to activities offshore, where the use of renminbi as a payment currency is rising rapidly. According to SWIFT and its monthly RMB Tracker, the renminbi as a global payment currency rose recently to seventh position, from 35th in 2010. Although most trade transactions with China from overseas are still denominated in dollars, approximately 25% of all of China's overseas transactions are now conducted in renminbi. An accelerating number of companies that transact directly with clients in China are being asked by counterparties to invoice and pay in renminbi. While international companies are being asked to shoulder the exchange rate risk, they also often gain advantages, such as being able to negotiate better trade terms and gain discounts on goods and services, according to Martin Keller, European head of interest, currency and liquidity management at Germany's Commerzbank. Keller says that a rising number of Mittelsand companies in Germany have been switching over to accepting renminbi as a trade finance currency.

The expansion of renminbi cross-border solutions to a nationwide level brings profound influence to the process of renminbi internationalization. Use of renminbi offshore has now become significant enough that parallel developments can sometimes lead to counterintuitive outcomes. In November 2014, Hong Kong and Shanghai established a program called Stock Connect that linked the cities' two financial markets for the first time. The cross-border investment channel has allowed investors in Hong Kong and the mainland to trade a specified range of listed stocks in each other's markets through their respective local securities companies.

The Hong Kong–Shanghai Stock Connect had a lukewarm start after considerable hype, but then Hong Kong investors in Shanghai stocks began to catch on. In the first two weeks of operation, Shanghai-bound investment from Hong Kong amounted to approximately Rmb50 billion ($8.1 billion), according to Thomson Reuters' CNH Tracker newsletter. However, investments from Shanghai to Hong Kong amounted to only one-tenth of this amount.

The trend has persisted. The introduction of the new pilot, while surely boosting the internationalization of the renminbi, has had the effect of draining offshore renminbi deposits in Hong Kong banks, putting a further damper on offshore renminbi lending from Hong Kong. An interest-rate strategy analyst at DBS Bank in Hong Kong, outstanding renminbi loans of Hong Kong banks totaled only Rmb123 billion as of the middle of last year, about one-sixth of the so-called dim sum bond market, or the market for offshore renminbi bond issuances from Hong Kong.

The attraction of the dim sum bond market has continued to drain renminbi offshore deposits, as the market has had its strongest year yet. As of the third week in December, dim sum bond issuance had grown by 74% over 2013 volumes to reach Rmb324 billion. One reason for the growth is that dim sum bonds began offering higher returns than other competing global credits in 2014. This was a result of volatility in China's markets, prompting issuers to offer higher interest rates to attract investors. The trend is expected to continue this year, with companies offering even higher yields as volatility persists.

But this hardly means that offshore renminbi lending will be on the wane for long. Recent policy changes in China whose intent is to achieve a currency regime "less biased towards one-way appreciation. Banks eventually structuring more products in renminbi, As more global investors use such products to participate in markets and hedge risks, this will be another important step towards internationalizing the renminbi,

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