Renminbi Liberalization: Evolving Opportunities for Multinationals

The integration of China into the global economy that has been underway for the past quarter of a century took a huge leap forward in July 2009 when the country began to liberalize the use of its currency, the renminbi (RMB). Since then, the pace of reform has surprised even the most optimistic observers: in just a few years, the People's Bank of China (PBoC) has strategically positioned the RMB as a top global trading currency.

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For global corporates, the rapid evolution of RMB offers enormous opportunity to enhance treasury and trade management practices. China is already a critical part of many multinationals' global supply chains. For Citi clients, the impact is obvious as it is now a top-three market and will continue to be an increasingly important driver of consumer demand.

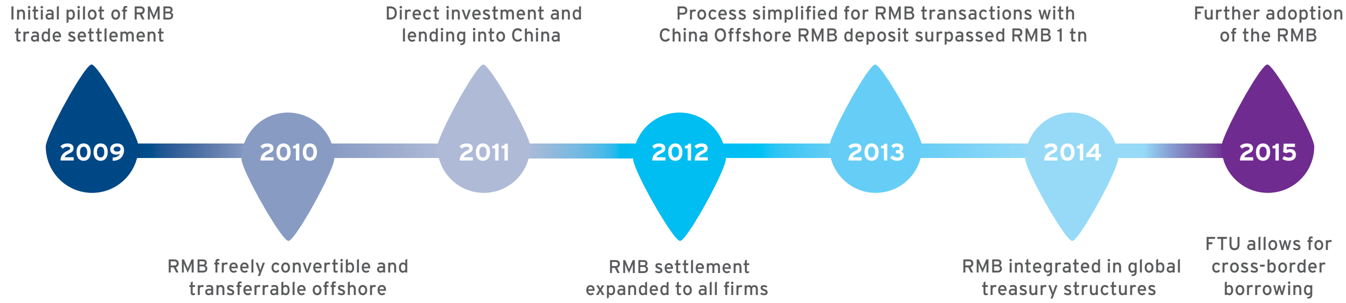
Growth is Accelerating

For companies doing business in Asia or planning to do so, the RMB is impossible to ignore. The currency is globally significant in terms of volumes for payments, trade and foreign direct investment.

In 2010, just 1% of trade flows were denominated in RMB. According to PBoC, by the end of 2013, approximately 20% of trade (RMB 2.94 trillion or USD 485 billion) was RMB-based. According to the SWIFT RMB Tracker, RMB's activity share for documentary credits increased in value to 9.43% in January 2015, strengthening its position as the second most-used currency for this purpose.

According to SWIFT, the RMB became the fifth most-used currency for global payments in 2015 – overtaking both the Canadian dollar and the Australian dollar by value.

RMB Internationalization: Milestones



Understanding One Currency, Two Systems

While China's currency is generically known as the RMB, a distinct difference remains between the onshore and offshore markets. The onshore market is typically denoted by the CNY currency code, and it is largely determined by government policy. In contrast, the offshore CNH market is tradable in key hubs such as Hong Kong, London and Singapore, as well as the Free Trade Unit within the Shanghai Free Trade Zone in China. It is also imperative for multinationals to note that the only ISO currency code used for bank services remains as CNY (regardless for onshore or offshore).

The roles played by CNY and CNH differ, depending on the scale of company activity inside and outside China. The onshore market, as the name suggests, requires companies to have a presence in China, for example. The establishment of the CNH in 2010 has perhaps changed what is achievable for foreign multinationals conducting business in China, by allowing them to open RMB bank accounts outside China so that they can access the foreign exchange markets overseas or utilize funding opportunities in the Dim Sum bond market, as an example. In addition, the establishment of the Shanghai Free Trade Zone in September 2013, where the cross-border controls have been relatively relaxed, indicates a possible future path for onshore liberalization. At the moment, onshore and offshore markets remain separate but regulations are evolving at great speed. Ultimately, it is widely anticipated that the two markets will converge into one.

Why Using RMB Makes Business Sense

For overseas multinational companies with trade flows with China, the use of RMB opens up new business opportunities, largely because it reduces FX risk, and enables access to a wider range of buyers and sellers.

For corporates with Chinese suppliers, paying in RMB could facilitate improved trade terms as FX risk is eliminated for the Chinese exporter. Historically, many Chinese suppliers have included a buffer to accommodate FX fluctuations or have sought to renegotiate terms as the FX rate changed. Paying in RMB can therefore offer the multinationals greater pricing transparency and potentially lower costs.

In addition, by paying in RMB multinationals gain potential access to a much wider range of suppliers and business opportunities in China, since small-and medium-sized companies may prefer to settle in their home currency. Similarly, for companies selling to China, using RMB removes FX risk for importers and could therefore potentially expand the multinationals' customer base.

Opportunities for Treasury

For multinational companies with operations in China, RMB liberalization offers an opportunity to enhance treasury efficiency. Corporates are increasingly creating RMB hubs, often in Hong Kong, to serve as a conduit for transactions between onshore and offshore counterparties, for both trade and financial purposes.

Foreign exchange activity in China can now be managed centrally by a treasury center or RMB hub outside China, thus lowering costs, and making better use of expertise and sophisticated tools that may only be available at the central treasury. Additionally, centralization of treasury activity improves liquidity visibility and control, while enhancing overall risk management. Consolidation of positions also facilitates natural hedges, which reduce transaction volumes and lower costs further.

Multinationals' Chinese subsidiaries can focus on managing cash positions using cross-border liquidity management structures, reducing trapped cash and maximizing efficiency. The currency can also be integrated into global structures, such as multicurrency notional pooling solutions. Further efficiency can also be gained through conducting payments on a netted basis which can improve intercompany settlement efficiency and reduced foreign exchange exposure.

Continuing Evolution

China's liberalization of the RMB over the past several years is a profound historical event. RMB is now a global trade currency: any company can use it to settle trade anywhere in the world. RMB is also on its way to becoming a full-fledged investment currency, with use for a variety of investment options in offshore markets. Inward and outward direct investment in China can be settled in RMB while corporates can conduct cross-border RMB cash sweeping. In the near future, the RMB is expected to become a reserve currency for many central banks worldwide.

Many international corporates have already begun to take advantage of the opportunities available by creating a hub in Hong Kong to manage inter-company flows, FX or other treasury functions such as liquidity management.

However, as liberalization continues, multinationals need to be aware of developments not just in China, but around the world to evaluate all available funding options. With respect to China, corporates should therefore constantly analyze the opportunities and changes in RMB regulations, as they continue to expand the role of RMB in their commercial and financial activities.

The value of global payments made by RMB has increased by 321% over the past two years.[1]

[1] SWIFT RMB Tracker, January 2015