Citi OpenInvestor℠

Opportunities to support growing relationships with China

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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 and country by trade value by 2015. We have already observed our financial institution and corporate clients turn to solutions to embrace the Renminbi or RMB (the offshore currency is denoted as CNH to distinguish it from its domestic equivalent, the yuan or CNY) in their trade and cash management practices.

The arrival of the then Vice President of China Xi Jinping (and now President) in Ireland in February 2012, the subsequent trade mission to China led by An Taoiseach Enda Kenny and the announcement of some notable specific trade arrangements have kept China very much on the radar for Irish businesses seeking financial services, export and trade opportunities.

Some background

The internationalisation of the RMB has seen a thriving market in offshore RMB deposits, bonds and bond funds develop in Hong Kong, while the currency's role in cross-border trade has expanded notably. We at Citi have observed an exponential growth in the past six months with nearly two billion RMB payments settled in China and Hong Kong, highlighting a significant change in western buyer behaviour. Now, London is picking up the baton, and more is expected in the future.

According to the Hong Kong Monetary Authority (HKMA), offshore RMB deposits of grew 87% last year to CNH588.5 billion, 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:

- The wider circulation of the RMB, particularly through the development of a deeper market in London.
- The 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, The Philippines, Belorussia, Malaysia, Korea and Cambodia have all adopted the RMB as a reserve currency).
- The redenomination of an increasing percentage of China's imports and exports into the RMB.

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

Why the RMB is important

The RMB offers a new perspective for companies who want to reshape 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, among them:

- Receiving more favourable trade terms from suppliers in China when pricing in RMB;
- Improving relationships with Chinese suppliers as RMB usage helps to simplify the export-verification and financial-reporting processes 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 Chinese 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 2012 there was a five-hour extension to the HK RMB RTGS settlement system to accommodate longer trading in London. 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 an 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 the global financial services centre that is London, international banks in Ireland and domestic Irish banks with a banking partner in UK should be able to offer their clients a European-based RMB account. This, in turn, would bring significant benefits to our underlying client base, including:

- 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, allowing existing liquidity structures in the same jurisdiction to 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 the RMB, Singapore and Taiwan recently received approval by China's government to develop offshore RMB business.

Partnership is also prudent

Notwithstanding the opportunities, there are also a number of factors that need to be considered. The most obvious is regulatory.

Clearly, China has undergone a significant transformation to liberalise the RMB. Yet the regulatory environment for cross-border RMB transactions is continuously evolving.

Understanding its regulations is, and will be, the key to executing transactions and identifying opportunities.

This means that having a strong partnership with a banking partner who can help manage RMB FX exposure effectively can work to mitigate any adverse effects of a potential sudden exchange-rate movement.

In terms of growing 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% market share.

Surprisingly, perhaps, the biggest contribution to RMB payments now comes from Europe. According to SWIFT, Europe's share of international RMB payments grew from 36% in the first quarter of 2011 to 47% in the first quarter of 2012.

An expanding dim sum bond market

Dim sum bonds issuance (bonds issued outside mainland China and issued in RMB) has amounted to RMB46.5 billion in the year to date, up about 30% from the same period last year, according to Thomson Reuters. The dim sum bond market in Hong Kong remains a venue where issuers enjoy lower fund-raising costs than in China's onshore market.

In March 2013, China Minmetals Corporation, a state-owned enterprise, completed its sale of a RMB2.5-billion (USD402.3 million) three-year dim sum bond, which attracted more than RMB12 billion in orders and saw strong interest from central banks. It was the fourth company to tap the RMB25-billion quota granted by China's National Development and Reform Commission (NDRC) to five mainland companies last year to issue the bonds offshore.

The total order book for China Minmetals' dim sum bond was more than RMB12 billion from 106 accounts, including central banks, which took 16% of the deal. Fund managers made up 48%, while banks and private banks accounted for 26% and 10%, respectively. Investors are clearly flocking to the offshore 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 RMB currency. The RMB hit a record high against the US 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. In the past number of years, around 10% of China's imports and exports have been redenominated into RMB. That compares with as little as 2% only a short while before that.

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 clients, who are looking to navigate a dynamic offshore 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 client/vendor relationships 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 the importance of growing trade relationships with China (be it from a trade securities, funds or bank perspective), require significant support from a banking alliance that is conducive to navigating and developing new relationships in the Far East. Ireland is expected to see further growth in its trade relationships with China. And this is bound present an even greater opportunity for the Irish banking sector to support the resulting and important emerging relationships.

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