

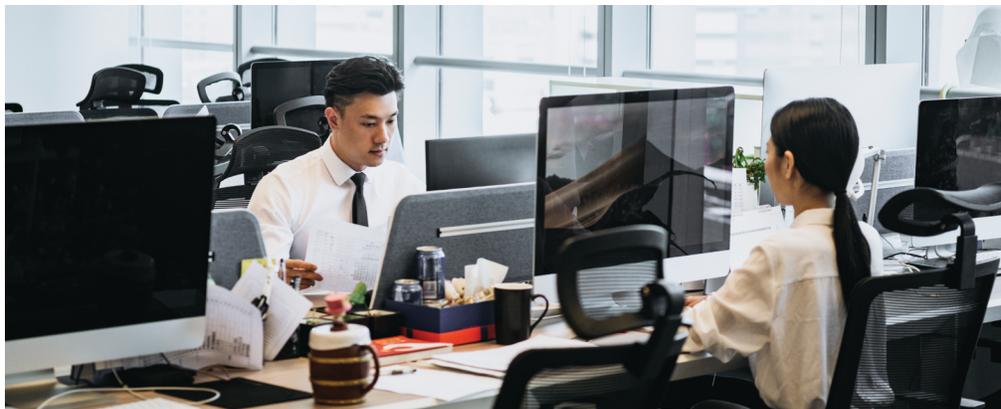
INTERNATIONAL SERVICES

CHINESE RENMINBI INTERNATIONALIZATION GUIDE TO RECENT DEVELOPMENTS

Chris Chen, Representative, PNC's Shanghai Representative Office, China
Seth Peterman, Analyst, PNC's Foreign Exchange Group



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China's dramatic growth in international trade has made it the second largest economy in the world, as well as the largest exporter. The Chinese renminbi (RMB) is currently the fifth most common currency in global usage, according to SWIFT, with the growth of usage expected to continue.

Over the last few years, the Chinese government has undertaken a process to liberalize and internationalize its currency, the Chinese renminbi (RMB), relaxing some rules to move in the direction of allowing its currency to become more freely usable and tradable. This includes expanding the use of the RMB for global trade settlement, encouraging a robust offshore renminbi environment, and deepening markets for RMB to be utilized as an investment currency.

The People's Bank of China (PBOC) is laying the groundwork to have the RMB become a global currency in a three-step process:

1 RMB as a global trade currency

As the RMB develops as a trade currency, businesses are becoming accustomed to using it for payments and receipts for goods and services.

2 RMB as a global investment currency

The goal is to allow global investors to invest using the RMB by providing robust channels and investment options to RMB assets on par with other currencies and global markets.

3 RMB as a global reserve currency

The government wants its currency status to match its position as an economic leader. China would like to see RMB adopted as a reserve currency by central banks around the world.

FIRST STEPS IN RMB INTERNATIONALIZATION

In the past, international use of the RMB was minimal. While China's domestic trade and business activities were settled in RMB, cross-border trade in RMB was not allowed and needed to be in foreign currency, such as the USD. With China undertaking the internationalization of the currency, liberalizing cross-border trade settlement was the natural first step, given the significant international trade activities in China. As a result, trade of goods and services in and out of China can now settle in RMB. The RMB now trades directly against most major currencies, adding depth to the RMB foreign exchange market.

To facilitate this cross-border flow, companies domiciled outside China can use RMB freely for cross-border trade settlement with their trading partners and can open RMB accounts both in mainland China and offshore, including in the United States. Capital transactions, including registered capital for companies setting up in China, can also now be settled in RMB. There are also plans in place to eventually expand cross-border RMB settlement to individuals in China, albeit gradually.

To further the goal of RMB internationalization, the PBOC, China's central bank, continues to develop Shanghai as a global financial center. In addition, new offshore clearing centers have recently been added in Switzerland,

Australia, Canada and in the United States, where an RMB clearing bank has been established in New York. These developments show a commitment by a growing number of countries and regions to further utilize the currency.

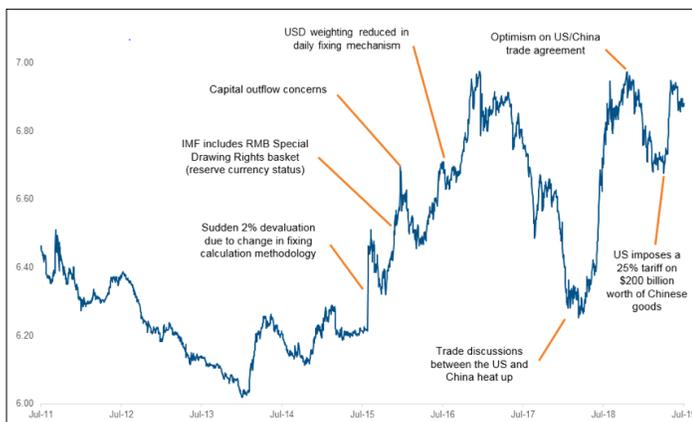
MOVEMENT TOWARD INVESTMENT CURRENCY STATUS

In addition to becoming a global trade currency, the RMB is also moving toward being an accepted global investment currency, as offshore RMB may now be used for capital investment. The RMB is viewed as an asset class, with market participants using the currency as an investment vehicle both onshore and offshore.

RMB can now be held and invested offshore in various RMB centers, such as Hong Kong, Singapore, London and Frankfurt. In February 2016, the China Interbank Bond Market was created to allow foreign institutional investors access to bonds traded onshore in China, bolstering RMB's depth as an investment currency. Programs such as Shanghai-Hong Kong Stock Connect, Bond Connect and, most recently, Shanghai-London Stock Connect (launched in June 2019) provide additional access and depth to the market.

BECOMING A RESERVE CURRENCY

On the reserve currency front, the International Monetary Fund (IMF) has included the RMB in its Special Drawing Rights (SDR) basket of currencies as of October 2016, positioning the RMB as a global currency, in the same IMF category as the U.S. dollar, British pound sterling, euro and Japanese yen. Since the SDR inclusion, central banks around the world have been adding RMB to their portfolio, reaching 1.84% of total global currency reserves, according to 1Q 2019 IMF Data. While there is more progress to be made toward the RMB's internationalization, the SDR inclusion is a significant milestone and may serve as a catalyst for further reform.



A HISTORY OF VOLATILITY

The RMB has experienced greater volatility in the past 3 years driven mainly by PBOC intervention and U.S.–China trade disputes. Shortly after President Trump took office in 2017, the PBOC began to intervene in the market to discourage speculators from betting against the RMB. Throughout 2017, the RMB appreciated from PBOC actions, stronger Chinese economic data and a broadly weaker U.S. dollar.

The RMB appreciation came to a quick halt at the end of 1Q18 as trade discussions between the United States and China intensified. President Trump was accused by China of igniting a trade war, while China was accused of being a currency manipulator by President Trump. The PBOC, in response, signaled its desire to weaken the RMB. The PBOC then spent the second half of 2018 adjusting its daily fixings for the currency (lower RMB) to spur exports as a method of reducing the negative impact of U.S. tariffs.

After topping out just short of 7.0 USD/CNH in October 2018, the RMB appreciated for about 6 months on widespread optimism that the world's two largest economies would come to an agreement on trade. In May 2019, the U.S. imposed 25% tariffs on \$200 billion USD worth of Chinese goods (up from 10% previously), which drove the RMB back to 2018 lows near 7.0. The latest developments came into play at the G-20 summit where Trump and Xi were again unable to come to an agreement on trade, though Trump announced that the new tariffs would be suspended for the time being while trade talks restart.

Only weeks after this announcement was made, Trump decided to impose another 10% tariff on \$300 billion USD worth of Chinese goods by September 2019 (though some tariffs will be delayed until December). This action sent the RMB tumbling past the psychologically important level of 7.0 RMB per USD for the first time since 2008. In a statement, Trump said he believes this move was the result of currency manipulation from China in order to gain an unfair trade advantage. The IMF has not supported that statement.* The new round of tariffs and the currency manipulation accusations have only further increased the tensions between the two nations.

After a long stalemate, the United States and China resumed negotiations at the beginning of October 2019. Negotiations thus far have been encouraging as officials from both nations have shown a willingness to come to an agreement. A partial agreement was announced earlier in October and is being considered “phase one” of a larger agreement. Part of the agreement includes a suspension of tariff increases that were scheduled to take effect in October, purchases of U.S. agricultural products by China, and policies addressing intellectual property rights and financial services concerns. Phase one could be signed by mid-November, according to President Trump.

Going forward, it is still uncertain that a trade deal will be struck between the United States and China, due to the back and forth of tariffs and retaliatory measures by both sides, which may bring further volatility to the RMB.

TRANSACTING IN RMB VS. USD

U.S. companies have historically believed that negotiating international agreements in USD insulates them from exposure to currency volatility. However, this practice often puts them at a competitive disadvantage compared to companies that transact in local currency since there are hidden costs in USD pricing.

With China's changing currency regulations, U.S. companies are learning that conducting business in the RMB instead of the USD could be beneficial. The PBOC has estimated that, due to embedded premiums and transactional charges, the administrative cost alone of transacting in USD is 2% to 3% higher than dealing in local currency. Hedging tools and RMB multicurrency accounts are now readily available to actively manage currency risk when transacting in the RMB.

The acceptance of the RMB as a trading currency and the growth of the offshore market provide opportunities for U.S. importers, exporters and investors to benefit from these developments.

ABOUT THE AUTHORS

Chris Chen, based in Shanghai, provides clients with advisory services and guidance on the Chinese market and banking environment, as well as assistance with establishing local accounts across Mainland China. Chen has extensive domestic and international payment experience working with PNC's Treasury Management group. Prior to joining the Shanghai Representative Office, Chen managed PNC's Automated Clearinghouse (ACH) services and product development for International Cash Management services, including European and RMB offerings. Chen holds a bachelor's degree in economics and music from the Schreyer Honors College, Pennsylvania State University. Chen is originally from Taiwan and is fluent in Mandarin.

Seth Peterman joined PNC in early 2019 and assists the Foreign Exchange Group with providing risk management solutions and currency market insight to clients. Before joining PNC, Seth attended the Indiana University of Pennsylvania where he obtained his bachelor's degree in finance and economics.

*<https://www.imf.org/external/index.htm>



READY TO HELP

The RMB market has experienced exponential change over the last few years, and we expect the trend to continue. PNC's dedicated team of senior foreign exchange consultants and PNC's Shanghai Representative Office can help you understand the implications of conducting business in the RMB and provide overall guidance.

For more information, please contact your PNC Relationship Manager or PNC's Foreign Exchange group at 800-723-9106.

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