INTERNATIONAL SERVICES

CHINESE RENMINBI INTERNATIONALIZATION
GUIDE TO RECENT DEVELOPMENTS

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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 sixth most common currency in world trade and is used in almost a quarter of all transactions across China’s borders.

Over the last few years, the Chinese government has undertaken an extensive process to liberalize and internationalize its currency, slowly relaxing rules to become more equal trading partners with other developed countries. This includes expanding the use of the Chinese Renminbi (RMB) for global trade settlement, encouraging a robust offshore renminbi environment and, more recently, liberalizing access to onshore RMB accounts. The People’s Bank of China (PBOC) is laying the groundwork to have the RMB become a fully convertible currency in a three-step process:

1. **RMB as a global trade currency**
   As the RMB develops as a trade currency, businesses outside China 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 the RMB to be invested more freely. Investors are now able to move their RMB-based holdings cross-border. Global companies want their China-based earnings to be convertible into other currencies.

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 challenge the USD as a reserve currency.

**RMB INTERNATIONALIZATION**

In the past, RMB could only be held inside China, and while China’s internal trade was settled in RMB, cross-border trade was conducted in foreign currency, such as the USD. Now, trade of goods and services in and out of China can also be settled in RMB. Trade finance methods are available in both onshore and offshore markets. In addition, China’s currency can now be held and invested overseas.

Among the 101 countries using RMB for trade settlement with China, 57 countries now use the RMB for at least 10% of their trade with China, according to SWIFT, the global financial messaging service provider. We expect the trend to grow, as the government continues to relax currency restrictions, and as companies across the globe continue to adopt usage of RMB.

To facilitate this cross-border flow, companies domiciled outside China can now open RMB accounts both in mainland China and offshore, primarily in Hong Kong, but also in other jurisdictions. Foreign companies need not have a legal entity established in China (or Hong Kong) in order to open an RMB account. The RMB now also trades directly against most major currencies, adding depth to the RMB market.
To help further its goal of internationalization, the PBOC continues to develop Shanghai as a global financial hub and added new offshore clearing centers in Switzerland, Australia, Canada and, notably for the U.S. market, a RMB clearing bank was designated in the U.S. in September 2016. These developments show a commitment by a growing number of countries and regions to increase RMB utilization.

The RMB is also moving toward becoming a 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. In February 2016, the China Interbank Bond Market was liberalized to allow for foreign institutional investors to access the bonds traded onshore in China, bolstering RMB’s depth as an investment currency.

On November 30, 2015, the International Monetary Fund (IMF) approved the inclusion of the RMB in its Special Drawing Rights (SDR) basket of currencies to take place on October 1, 2016, positioning the RMB with the elite global currencies, including the U.S. Dollar, British Pound, Euro and Japanese Yen. With the inclusion of RMB in the SDR basket of currencies, it’s a strong recognition of the development and internationalization of the currency, as well as its attractiveness as an international reserve asset.

While there is more progress to be made in RMB’s internationalization quest, the inclusion is a significant milestone, and may serve as a catalyst for further reform.

**RMB Exchange Rate Trends**

Well before the internationalization initiative, China had been gradually liberalizing its currency and capital markets, partly due to pressure from its trading partners.

From 1994 to 2005, the Chinese currency was pegged RMB 8.28 to USD 1. In July 2005, Chinese officials implemented policies basing the RMB value on a daily trading band and basket of currencies but in a strictly controlled range of +/- 0.3%. Tight capital controls on both incoming and outgoing capital were retained. From July 2005 to July 2008, even with these controls in place, the RMB appreciated by 21%. In 2007, the trading band increased to 0.5%. Due to the global financial crisis, China’s central bank maintained a virtual peg to the USD from July 2008 through July 2010. The trading band was increased to 1% in 2012 and then to 2% in 2014. The RMB has appreciated more than 25% against the USD since July 2005.

While the RMB has steadily appreciated since 2005, the currency started experiencing two-way volatility in 2014. In August 2015, the PBOC announced a surprise devaluation, depreciating the RMB 3% against the USD overnight. Since the August 2015 announcement, the RMB has depreciated further, though measures have been taken by the PBOC to stabilize the RMB exchange rate with some success. The RMB will likely continue to encounter depreciation pressure against the USD, especially as the Federal Reserve raises its target interest rate, strengthening the USD relative to other global currencies including 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 2–3% 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 currency.

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. PNC can assist you in reviewing your processes and implementing practices to capture the advantages of using RMB in your business dealings in China.
ABOUT THE AUTHORS

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Hilary Love specializes in providing advisory and execution services in foreign currency risk management and international treasury management. She has worked extensively with a range of risk management instruments. Before she joined PNC, Hilary was with the capital markets group at CoreStates (now Wells Fargo Bank). Prior to that, she was with Bankers Trust, New York (now Deutsche Bank) in their capital markets area, trading and marketing fixed income securities.

Hilary has a bachelor’s degree in international economics from The Johns Hopkins University, Baltimore, Maryland, and a master’s degree in business administration from The Wharton School, The University of Pennsylvania.

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Based in Shanghai, Chris Chen provides clients with advisory services and guidance on Chinese banking, trade and payments services and assistance with establishing local accounts and credit across Mainland China.

Chris has extensive domestic and international payments experience working with PNC’s Treasury Management group. Prior to joining the China office, he managed PNC’s Automated Clearinghouse (ACH) services and product development for International Cash Management services, including European and RMB offerings.

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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.