HOW FUTURE DIRECTIONS IN U.S.–CHINA TRADE COULD IMPACT YOUR BUSINESS

April 19, 2017 | 2:00 p.m. EDT

Operator: And with that, let's go ahead and begin today's PNC Advisory Series Event. It is my pleasure to turn today's call over to our moderator for today, Mr. George Hoffman, SVP and Manager with International Advisory with PNC Bank. George, with that, I'll turn it over to you.

George Hoffman: Thank you. Hello and welcome, everyone, to our webinar, "How Future Directions in U.S.–China Trade Policy Could Impact Your Business." As noted, I'm George Hoffman from PNC's International Treasury Management Advisory Team, and I will moderate.

Before we get started, I just wanted to highlight some of the PNC resources that are available on PNC.com/ideas. All webinars, including the one that we're doing today as well as past ones are recorded and made available along with other videos, articles and news prints that serve as a one-stop shop for you on the topics that we discuss as well as some of the markets we showcase.

But today we really want to focus on the business climate within China with an eye toward economic and market development. So, obviously, a very interesting time, as everyone is aware. Our goal today will be to break it down after listening to some discussion on the economic aspects into trying to give our listeners some clear guidelines for your business strategies within China.

So without further ado, let's do some intros. First, we have Bill Adams, he's PNC's international economist whose responsibilities, among others, span forecasting economic conditions in Asia. Bill has a lot of experience with China, obviously, from having — if you've read his profile — he was the resident economist for the Conference Board China Center in the past, and he's lived in China for a number of years. Hello, Bill, how are you today?

Bill Adams: Hi, George.

George Hoffman: Great. Also joining us is Chris Chen. Chris is visiting PNC corporate offices today from our Shanghai representative office. Chris is capping off a tour of the United States. He's been visiting with clients, providing insights on what has been developing in China from a financial and banking perspective. Ni hao, Chris.

Chris Chen: Ni hao, George [laughs].

George Hoffman: And last and certainly not least, we have Hilary Love, a managing director with PNC's Foreign Exchange Group, who really specializes in providing advisory and execution services in foreign currency risk management. And she'll give us some color commentary on developments with the renminbi, China's currency. And, Hilary, along with Chris, has co-authored a renminbi internationalization white paper that we'll forward off a link to you when we're done with our discussion today. Welcome, Hilary.

Hilary Love: Thank you. Thanks, George.

George Hoffman: At the end of the presentation, we'll have a Q&A session, so just as the speaker brought up earlier, if you want to start submitting any questions, it seems like we're even starting to get some now, please use the widget, which is found in the lower portion of your screen, and you can submit those questions. We'll tally them up, and we'll try to get to them as soon as we can at the end of the session.

Let's start off our dialog today. We have a polling question for the audience. We really wanted to find out a little bit more about who is attending and what your business is with China. So our first question is, is your organization currently importing from China? That's the first option. Exporting to China is the second option. The third option is you have a local presence, or you're considering a local presence in the market, whether that be a sales office, operations, JV, a WFOE, which is a Wholly Foreign-Owned Enterprise, or, last, all of the above or a combination of above.

So if you would just take a minute and click on which option best describes your organization. We will tally those results in about 10 seconds and let you know what we have. So are you just importing from China? Exporting to China? Local presence or a combination?

Okay, and the results are in, and we have a good number of attendees who are — 45% — who are really a combination of those. Quite a few importing, which traditionally makes sense based upon U.S. trade stats. A smaller number exporting. A local presence, we have about 22%, which is a large number of clients. More and more have that local presence, and we'll be talking about that as we get into the discussion.

But why don't we start looking at China from an economic perspective, and let's start with Bill Adams. Bill, I'm going to turn it over to you to give us some highlights of what's going on with the economy in China.

Bill Adams: Thanks, George. Good afternoon, everybody. So the economic outlook for China is either better or it's worse. It's better in the sense that growth picked up in the first quarter to 6.9% real GDP growth in year-ago terms. That was up from the fourth quarter of last year, which was 6.8%, or the three quarters prior to that, which saw 6.7% growth. So growth has picked up relative to where we were in 2016, and a lot of that are parts of the Chinese economy that are more domestically driven, like the real estate sector, infrastructure investments, the domestic services side of the economy. That's the part of the economy that has been seeing faster growth in the last couple of months.

But that growth, even though it's faster than it was in 2016, we're still near the slowest growth that we've seen since China emerged from the great recession. So it's growth that's in line with China's new trend, and a little better than that new trend, but we're nowhere near the double-digit growth rate that we saw from China in the first three decades after it began a transition toward a market economy.

In terms of what is fueling that growth from the financial side, and how that will pass through to the financial conditions that influence the exchange rate, the interest rates in China were lower in 2016, and in early 2017, and the Chinese financial regulators independently set those interest rates from the quantity of credit that they allow to be distributed in the economy.

It's not like in the United States where the price of credit determines the demand and the supply of it. So in China the interest rates were held low at the end of last year and coming into early this year. But the supply of credit wasn't really growing any faster in late 2016, early 2017. And since the economy, without adjusting for inflation, has been growing faster, nominal GDP growth in the first quarter of this year was the fastest in five years. That credit has not been going as far in quantity terms.

So you read a lot of headlines about how China saw record increases in the quantity of loans distributed in the latest months. That's true because the record, once you're growing off of a peak level, anything on top of that is going to be more than you saw before. But in percentage growth terms, is just how I think of it, the growth rates of credit in China are actually pretty moderate by historical standards.

And, Chris, can you talk about how that feels on the ground in China? The businesses — are those growth rates affecting the availability of credit either to our clients in China or to their business partners there?

Chris Chen: Absolutely. Thank you, Bill. So what we're seeing on the ground in China is, as Bill mentioned, the credit supply certainly has been limiting. And for foreign companies that are based in China, it is relatively difficult enough to obtain financing as it is. And since, really, the end of last year, we're seeing that condition tighten further. So for foreign companies these days to obtain credit, so the companies that really need them, that continues to be quite difficult.

Of course, that's not the case for every company. There are certainly companies that do have the ability to obtain financing and tend to be your larger companies and interest going to those companies are actually in a decent shape financially. They may not need the loan, so you have the condition where loans are going to companies that, quite honestly, don't need them.

Some of that is also a factor of those Chinese banks looking to control the non-performing loans. So you're seeing a factor that also crimping the loan supply over in China. So we're observing similar observations as Bill pointed out.

Bill Adams: Thanks, Chris. So if credit isn't growing fast enough to really be boosting growth now, where is that growth coming from? My view is that it's fiscal stimulus spending, deficit spending that has really supported growth in 2016 and in early 2017.

This is a chart of China's fiscal deficit relative to the size of the economy. A larger fiscal deficit, so a more negative value there indicates larger fiscal stimulus. And from this you can see that China had a more aggressive fiscal stimulus program relative to the size of the economy than they did during the global financial crisis, or the great recession or, during the Asian financial crisis in the late 1990s — anytime going back to the mid-1990s, this is the biggest fiscal expansion from the central government that we've seen out of China.

So it's not that China — the domestic drivers of growth in China weren't so strong that they were able to see faster growth in the latest quarter based on just that. They have been having stimulus, but the composition of that stimulus has changed where a couple of years ago it was stimulus coming from Chinese state-owned and state-controlled banks channeling credit to state-owned companies. Now more of that stimulus is coming from direct spending, from the central government supporting infrastructure construction, a revitalization of older neighborhoods in Chinese cities, as well as funding tax cuts for Chinese businesses and Chinese households.

So that's what's going on domestically. The international dimension of China's growth has changed just as much in the last few years. So from the beginning of the 21st century into mid-2014, China was persistently accumulating foreign reserves. That's the orange line on this chart.

And when a country's central bank is always getting more and more foreign reserves, that means that they're intervening in the foreign exchange market, selling their own currency, and buying foreign currencies, which is what those foreign reserve has made up of it. It's foreign currency that the central bank buys.

So the central bank is always buying that foreign currency and selling its own currency. That means that they're trying to prop up the value of those foreign currency assets and push down the value of their own currency. So that the central bank intervening to make their currency weaker than it would be if its price were just set by supply and demand.

But, as you can see from mid-2014 onward, that trend has changed. The Chinese central bank continues to intervene in the foreign exchange market, and you can see that because if they weren't intervening at all, their foreign reserves would just continue to be the same amount. But now they're spending down those foreign assets, so they're selling foreign assets and buying their own currency. So intervening in the market to push down the value of foreign currencies and prop up the value of the domestic currency.

So this is not what we're used to hearing in the United States, but China's currency, just from what's going on in — just from their central bank's behavior, it looks like China's currency would be weaker under a freely floating exchange rate than it is under its current managed exchange rate regime.

So that put some pressures on the Chinese government because if you're intervening in the foreign exchange market, selling your own currency, you can do that indefinitely. You just print more of it if you're a central bank. And central banks, they have their printing press to do that if they want to.

To sell foreign currency assets, they have a finite stack of them in their foreign reserves, and when they're gone, they're gone. So China has been using other tools to try to slow capital outflows and make the yuan more attractive to hold. Most recently, China has started to time increases in their policy interest rate or the closest thing they have to a single policy interest rate, which is the blue line on this chart, the seven-day reverse repo rate. And timing those increases to kind of match what the U.S. federal reserve is doing with the federal fund's target range here.

So that means that if U.S. interest rates rise, Chinese interest rates also rise, and they're trying to encourage anyone, financial investors or businesses that have a balance that they could have in China in Chinese currency or could move abroad and put it in foreign currency. They're trying to keep those Chinese currency assets attractive as U.S. interest rates rise and holding U.S. dollars becomes more attractive. And those changing interest rates have some implications for what China is going to do with its exchange rate policy, going forward.

Before I talk about that, let me turn it over to Hilary to talk about how China has managed its exchange rate historically.

Hilary Love: Thanks, Bill. The renminbi, which is the renminbi yuan is the currency there on the left-hand side of the graph. It shows the currency exchange rate, which is the number of renminbi that one U.S. dollar will buy. Back before 2006, the renminbi was pegged, and that's why you see the straight line. It was pegged at what is thought to have been an artificially weak or cheap level.

And then over the course of 2006 to 2008, there was a lot of pressure from China's trading partners, including the U.S., to allow the currency to appreciate to make it more of a trending towards where it would be in the free market. Because, of course, a weak currency makes your exports more competitive. So global partners were pressuring China, and China did allow the renminbi to appreciate quite rapidly there.

But then during the financial crisis, the renminbi again became very stable, as you can see, starting in 2008, and it became stable because of the global economic slowdown. The reniminbi became a tool to help the Chinese economy continue to be able to export in the slower-growth global market, the renminbi helped this weak or stable renminbi helped keep Chinese exports up.

And then when the global economy started recovering and growing, then you can see again the renminbi, in 2011, started gradually appreciating at a much slower rate. But that downward movement there is a slow appreciation. And starting in 2014, interestingly, the yuan started depreciating again, and a couple of things are going on in this 2014 onward period.

One is that the bank — People's Bank of China — and the Chinese government, in general, has made it a priority, a long-term goal, to make the renminbi a more internationalized currency to make the financial markets, including the currency markets, more free trading and more closer to a global sort of capitalist country, and they've done several steps. One of them has been to allow the renminbi to float a bit more; allow the renminbi to trade both offshore and onshore; allow banks such as PNC who is not domiciled with a full branch in China to be able to hold renminbi accounts.

So now you can hold a renminbi account by a bank like ourselves, either onshore in China or offshore in Hong Kong and other centers. Companies are able to raise renminbi yuan debt outside of China, so there's a liberalization of some of the global capital markets in renminbi. And also a big goal, and it occurred in October of 2016, was that the IMS granted the Chinese currency, the renminbi, to become a member of the special drawing rights basket, which means that other central banks around the world could then hold renminbi as part of their reserves, and this has occurred that other central banks are diversifying some of their reserve currencies to include the renminbi. And that's a general acceptance into the global financial system.

And, certainly, most recently, as Bill has mentioned, the renminbi has been weakening. There's been a fear of capital flowing out of the country, and that's what that upward movement is. Now, very, very recently in the last couple of months, the renminbi has gained about 1%, and part of this is because of the interest rate policy that Bill was talking about in terms of bringing up interest rates so that it's a more attractive investment climate.

Bill Adams: Thanks, Hilary. So if that's where we've been, let me talk for a moment about where we think we're going next. PNC publishes exchange rate forecasts quarterly, and this is our second quarter of 2017 forecast for the coming year and for next year. And we're expecting in the base case, we think the most likely policy for China to pursue is to continue to, on average, allow their currency to depreciate against the U.S. dollar, a continued managed depreciation of the currency.

Now, I think the tail risk to this forecast, I mean, one would be that the appreciation of the renminbi against the dollar in the last month or two could continue. That doesn't seem terribly likely to me, both because there is such a strong trend of depreciation over the last few years, as well as because part of the reason why the dollar has weakened against China's currency as well as against the yen and the euro and the pound is because of declining interest rates and long-term interest rates in March and April in the United States. And our forecast is that U.S. interest rates are likely to rise in the next couple of quarters.

But also because we don't think that an appreciation of the currency against the dollar is likely on a sustaining basis. In terms of whether the currency could depreciate by significantly more than we forecast, I think that is still unlikely, but it's something to consider what that would mean for your business or for the world.

Again, they've spent almost $1 trillion in foreign reserves managing that exchange rate between mid-2014 and early 2017, and if they were to decide to stop intervening in the foreign exchange market, save those foreign reserves for a rainy day rather than spending them to manage the currency. Then we could see a sudden and perhaps a large depreciation of the renminbi against the dollar.

But in the base case, we expect the currency probably to depreciate by mid-single digits and reach about 7.5 per U.S. dollar by the end of 2018. Now, that is our base case forecast. Let me turn it over to George to take the next polling question.

George Hoffman: Yes, this is — I'm going to step in on here. Thank you, Bill, for all the economic updates and the forecasts. So what we wanted to do, based upon what we've seen in the market, this is a question we wanted to ask our audience. Has the recent economic slowdown in China changed your business outlook? So the first answer is "no change," second answer is "minimal change," third is "noticeable change," and last is "significant change."

So if you would take a moment to pick which option best describes your organization with regard to China, whether it's "no change," "minimal," "noticeable," or "significant." We'll take a few seconds to collect the results and tally them up.

Okay, so it looks like the bulk of the audience is between the "no" to "minimal" change. So, Chris, I'm going to ask you — I know you've been working a lot with American Chamber of Commerce in Shanghai and other organizations. What do you see the business outlook in terms of what's going on with the economy from your perspective and what you've seen on the ground?

Chris Chen: Sure thing, thanks, George. So this is actually pretty consistent with what we're seeing on the ground from speaking with businesses from participating and American Chamber of Commerce events and interacting with other American businesses. So this result is consistent in the sense that businesses are not changing their strategies dramatically, and we'll talk a little bit about that in a couple of minutes as well.

I do want to point to the American Chamber of Commerce China Business Climate Survey done in 2017. The survey there paints a slightly different picture that 44% of the respondents are expecting significant growth. So, therefore, actually, pretty good change for them as far as that's concerned. 56% is expecting less than 5% growth, no change or even a decline. So based on the result here, it looks like companies from the audience is not expecting a significant impact to the business from the negative perspective. So that's certainly good news in that regard.

Bill Adams: Thanks, Chris. So I've talked a lot about PNC's forecasts. I would be remiss in my presentation if I didn't talk about the one thing that we're sure of with forecasts, which is that they are sure to be incorrect. We're just not sure whether we're going to miss by forecasting too much growth or too little growth or the wrong kind of growth. And so these are some of the uncertainties hanging over us that I wanted to mention and that could affect the U.S.–China trade relationship and the Chinese outlook in the year ahead.

The first couple of these are all about changes in U.S. trade policy and changes in U.S.–China trade policy. If the U.S. were to institute a tariff on imports from China or a border adjustment tax or designate China as a currency manipulator, that could obviously make it more expensive to import from China into the United States. I think it could change the sourcing behavior of some American businesses, although those tariffs also could pass through to move exchange rates.

And so it may be that the combination of the tariff and the exchange rate would net out similar to what we saw in Mexico at the turn of the year where the Mexican peso had depreciated by so much in January that even if there had been a 20% tariff on imports from Mexico, the price, in U.S. dollar terms, of an unchanged price in Mexican pesos would have been the same once you got it into the United States.

So it's a big source of uncertainty. I don't think that we really know exactly how it would play out. It seems like a downside risk to the growth outlook. The textbook answer on trade is that trade restrictions, over the long run, tend to reduce growth. So as a textbook-trained economist, you would expect no other from someone like me.

In the short run, the U.S. government has said that they do not plan to designate China as a currency manipulator, and we've seen more conciliatory language between the U.S. and China, but policies can change, and so that's still an issue that we're watching.

Along with those is Chinese ownership of U.S. Treasuries and uncertainty about U.S. monetary policy. If you think back 10 years ago, the big concern about China and the U.S. and our financial relationship is they owned all of this U.S. government debt. They financed a lot of the U.S. government's borrowing in the first decade of the 21st century. If they were to sell it all at once, would that cause a surge in U.S. Treasury interest rates? Would that cause a financial shock to the United States? I think the good news there is that they have sold $1 trillion worth of foreign reserves, and much of those are U.S. government securities. And U.S. interest rates, in the last couple of years, the things moving U.S. interest rates have been the U.S. growth outlook and the outlook for the Federal Reserve and concerns about downside risks from growth in the rest of the world, not what foreign owners of U.S. Treasuries or U.S. agency debt have been doing with their holdings. So I think it's encouraging that the U.S. capital markets have been very resilient to development in what's going on with these foreign holders of debt.

Finally, as China's overhang of debt and these long-standing hard landing risks from China, this seems like the biggest risk that China holds for the U.S. and global growth outlook. China is such a large contributor to global economic growth that if we were to see a recession in China, we would be sure to feel it in the rest of the world.

Now, how likely does that seem in the near run? I mean, in the long run, every economy goes through cycles. They seem inevitable, so I would expect that China will see some volatility at some point in the future, but in the near run, Chinese interest rates, even though they're rising, they're rising from very low levels. So financial conditions are accommodative. The Chinese government is doing a lot with fiscal spending to stimulate growth.

Even though U.S. interest rates are on a path to rise, we don't think they're going to rise by so much to really derail the Chinese outlook in 2017 or 2018. So those Chinese hard landing trail risks continue to be worth monitoring, but we think the probability of any of those big negative events turning into a crisis in the short run seems very small.

So, with that, all of those uncertainties and unknowns noted, and my rear, hopefully, totally covered by now, let me turn it over to Chris to talk about what businesses can do in an environment with so much uncertainty to manage their risks and understand their exposures. Chris?

Chris Chen: Thank you, Bill. Thank you very much. So we'll talk about several things in the next 20 minutes or so yet remaining. So several market observations we're seeing on the ground, being in Shanghai, certainly, a very interesting time to be there. And some of the best practices that we identified now, hopefully, help you manage some of the risks, some uncertainties, certainly, some of the things that we've been advising our customers.

And then also RMB internationalization development — some of that was already covered by Hilary earlier, but we'll also talk a bit further what it means from a corporate perspective.

One of the things that we're absolutely seeing within China and the market is uncertainty and caution amongst the businesses and, really, the uncertainty portion of it. I mean, that has been in place since the economic fall and slowdown in China in the last couple of years, so that's been an adjustment period for businesses on how they should be evaluating their strategy within China. China is not a market where you would enter and automatically grow at 10%, 20%, as it may have been in the past.

And on top of that, the current administration and the tension between U.S. and China certainly is another item that businesses are watching very closely, especially since a lot of the companies are established in China, be it American businesses and certainly Chinese businesses. A lot of them thrive on good trade policies and open trade, so the talks of potentially a more limiting trade environment is certainly giving businesses some pause and some uncertainty.

With that said, businesses are still thriving in China, providing that they have the right strategy, and some industries that we are observing, they're actually doing quite well, particularly in the automotive space. The companies that we stay in contact with, they're still reporting and still very optimistic about double-digit growth in the coming years. So with that said, of course, it's all with a bit of caution that companies tend to be basically cautiously optimistic at this point in time.

And given the last couple of months of development and the Mar-a-Lago Summit that President Trump and President Xi had had, there's been a bit of toned-down as far as potential hostility, if you will, between the trade policies. So that seems to be a positive for businesses. And another thing that we're certainly observing is that businesses are mostly staying the course for the time being. They're not drastically changing their strategy as a result of the geopolitical tension. And with the uncertainty being so policy-driven, now that the companies what they're doing basically is continuing their strategy and observing and staying close to the market involvement, which is what we also advise our customers.

So, furthermore, another interesting development and, really, it's a development that can impact quite a few customers, is the getting money out of China question. This is the question that we get a lot, a question that comes to be as amongst themselves to ask a lot as well. So specifically outbound cross-border payments. So there has been a lot of reports, certainly, since the middle of last year or even early last year about the rights of [inaudible] as getting money out.

And there has been some conflicting information as far as the degree of difficulty in getting money out. We do want to use this opportunity give you an idea of what we're seeing on the market. So when we think about cross-border payments out of China, there are really two main types of cross-border payments. One of which is current-account trade settlement and also capital account transactions.

So spending a minute just on the current account trade settlement, that is your bread and butter, the services rendered were goods imported/exported trade settlement. Basically, transaction involved, that type of activity. And what we're seeing right now is that this is not restricted. There might be more scrutiny in place as far as the completeness of documentation, but we have not heard a case at this point where the trade settlement has been completely, say, shut down and were impacted to the point where companies cannot do business.

So we have not heard that in that regard, whereas, some of the news or information coming out at the end of last year suggests that the trade somewhat will be impacted. So, again, we're not really seeing that.

The capital account transaction is the one that I think a lot of folks do ask questions about — basically, dividend repatriation. Would I be able to repatriate my profit in the current market environment? And we are seeing more scrutiny placed on this particular type of transaction on processing these through the banks and the ability to repatriate these in a timely manner.

So we've seen scenarios where banks are basically asking for multiple rounds of information or documentation before the process even per basically companies asking to justify why this particular year the companies are repatriating profit whereas in the prior years no company had not done so.

So just different information being requested where, perhaps, in a prior environment that was not the case. So, unfortunately, for better or worse, this is the environment that does persist today and, basically, some repatriation is still technically difficult. In fact, the Chinese government came out with the announcement in March to specifically say foreign companies — dividend repatriation will not be impacted under the current capital transaction restrictions, but the jury is out on that one as far as what would really happen in practice. There's something that we do watch closely.

And, additionally, we do see some of the transactions of this type being more impacted due to tax issues, meaning that there are outstanding tax transactions have not been paid; that basically we're holding up the payment, so there's that aspect of the two to keep in mind for these particular types of transactions.

And, also, outbound M&A activities, that's another item that we're seeing being restricted, basically, Chinese companies looking to invest in U.S. companies, or companies in other parts of the world. So we're also seeing that being more scrutinized at this point in time. Just like anything else with policies, policies can change, especially in China they can change fairly quickly, but it is the current environment.

And to tie it all together, the reason really the capital accounts transactions have been more scrutinized is the government's desire to maintain market stability. So while we listened to Bill's economic update in China, in turn, there's a lot of volatility happening in the foreign exchange market, the foreign exchange reserves, the economic numbers and so forth. So in that last two years there's been a lot of measures to create market stability. So be it capital outflow, foreign exchange, and what is called window guidance — basically the regulators with selected local banks know certain policy changes without an official communiqué on websites and so forth. So this does create an environment where it's more difficult for companies to anticipate changes. And, for that matter, for local banks, as well, in China for them to dissipate the policy changes.

So while we do advise customers that are importing from China in this current market environment, when you're the buyer of this — in the leg of this transaction — it's a good practice to have robust documentation on hand to support the settlement of payment.

Now, with that said, if you're paying a company in China, you technically are not required to provide any documentation to your bank, such as PNC, when you process these transactions. However, in order for your vendor, we are a supplier to settle up the payment. They do need documentation on their side. So in the current environment, even though as we covered in a prior slide, pre-settlement is not restricted. The companies in China are still required to have the appropriate documentation to prove the genuineness of the trade transaction as something important to have.

And then ensure accuracy of the payment instructions. That's also very important as well in order for the payment to settle properly. And so support all that, open dialogue with your vendor. You may have sent the transaction properly on your side, but for any number of reasons, especially when it's international payment, the payment can be held up due to any number of reasons. So it's important to keep an open dialogue with your vendor when you're doing trade transactions with your vendor out there.

And then one of the things that we do also talk to our customer about is this paying RMB — in RMB makes sense for you and the vendor in China?

George Hoffman: I think I'm going to step in again with the next polling question as we start to talk a little bit about different payment types and different currencies. The next question is for companies conducting trade with China, is your organization, first of all, paying and/or receiving renminbi? A second choice is not using renminbi today but considering. Or, lastly, 100% U.S. dollar.

So if you would take a moment to choose the option that defines your case, we'll take a look at those in a few seconds. So you're either using renminbi today, not using, or you're 100% U.S. dollar. And, as expected, we — and this plays out with much of our client base, the vast majority are dollar-centric for many reasons, there's a history and whatnot.

But, Hilary, I'm going to turn to you because I think you have some thoughts on use of renminbi and how our clients are looking at that.

Hilary Love: Absolutely, and many of PNC's clients, many of our clients continue to transact in U.S. dollars just as the audience is transacting in U.S. dollars in China for trade and services. However, there is a growing tendency globally to transact into local currency, and there are several advantages. The renminbi is now the sixth most common currency in world trade in a 2017 IMF report, and it's used in almost a quarter of all transactions across China's border.

And I wanted to mention that Chris and his team in China, in PNC's Shanghai office, can help you as well as people like myself here in the U.S. can help you with payment instructions. And that is something we're observing with our clients. There is a growing tendency to pay and receive in renminbi, but the instructions — detailed instructions — are important, and we can handle that process before you're ready to go ahead and make the payment or receive the payment. And we see a growing tendency to have a bank like ourselves to make that payment or that conversion for you.

One of the points I made about liberalization of the currency is that a bank like ourselves can do that conversion for you by accepting renminbi on the inbound side and making payments for you in renminbi on the outbound side. So that is a growing need amongst our clients and amongst U.S. companies, in general.

And if you are an importer from China, which we saw in one of the early slides that the majority of you are, there are advantages to paying in the renminbi, and some of them have to do with the fact that you can take advantage of, right now, the relatively strong U.S. dollar and pay in renminbi and pay a fewer number of U.S. dollars for the same amount of renminbi.

And if you were to continue doing business in U.S. dollars, your vendor, who is accepting your U.S. dollars, they are happy to get U.S. dollars. But even they have some risks involved in accepting, and some cost involved in accepting, U.S. dollars.

As we saw from some of the graphs, the volatility, the two-way movement in the renminbi has really increased over the last several years. So even though the dollar is relatively strong right now against the renminbi, they still have some risks. So if they're accepting U.S. dollars, they won't get paid in 60 or 90 days or 180. They're going to build some buffer in there in the number of U.S. dollars they're going to ask for. And there's just, also, administrative costs that they have in accepting U.S. dollars.

The People's Bank of China has stated that there's at least a 2% or 3% cost or premium on Chinese companies accepting U.S. dollars. So by you paying in the local currency, you can save those costs, and you can manage the exchange rate risk and get visibility into what those costs and those buffers are.

And when I mention managing the exchange rate risk, all the hedging tools that you would find available to you if you're dealing in, say, the euro zone or Canada or Japan, as part of the liberalization of the currency, the markets have been freed up so that companies — any company — can now enter into a deliverable hedge, a deliverable forward currency hedge, either forwards or options. And they're growing in usage here in the U.S. with our clients and with companies across the board.

The other side of the coin, if you were an exporter into China, you may want to price in renminbi and be able to handle, again, the exchange rate risk that introduces you can handle that risk through a variety of hedging techniques. And we can work with you on the payment instructions to be able to accept those renminbi. So it's gotten much more liquid and much more like a dealing in many developed currencies in the world.

Chris Chen: Thank you, Hilary, that's a great segue. So with exporting to China, we do have companies that are invoicing RMB, and that actually helps the companies also increase their market share because export may actually prefer to deal with the RMB currency and the weakening environment and, as Hilary pointed out, there are various hedging techniques developed to help manage that currency from the U.S. side.

And a couple of other things that we do talk to customers about as they export to China. And more and more U.S. companies are selling into China as opposed to traditional importing from China. As a seller, the robust documentation is even more important because you're looking to get paid. And so in that case, then the Chinese company that's paying the U.S. company will need to have the complete set of documentation to get the money out.

So money flowing into China is easier today than money going out, so these types of transactions, these are trade transactions since they are basically leaving China's border, they are being even scrutinized more closely today. So having robust contract, invoice, is very important, shipping documents even, and will support the trade. Again, to receive these payments from China, the U.S. company doesn't need to provide anything to the bank.

But, again, it is the company on the China side that needs to provide all this information, so it's important to have that support for your China client in order for these to access process properly. And then having a letter for credit for new client relationships, that's certain important. As a consideration to help manage the risk of entering any new client relationships.

Some of the best practices that we do talk to companies in China to help manage the risk but also be able to have a successful start and also successful management of the [inaudible] and the initial setup is understanding the basics of doing business in China. And there are a couple of things to consider here. I mean, what will be the most optimal structure for the company if the company goes and sells in China. Would it be a WFOE, a FICE, JV and I've been spilling out different acronyms here, but those who invest in China, these are some of the things they need to understand as far as the best structure to have.

And, also, expectations of timeline as far as if they have a company in China is not the quickest thing to sell the company in China versus the other markets, even the U.S.

Hong Kong, you open relatively quickly but, in China, that's certainly not the case, so it's important to have that expectation. And then just as importantly, profit repatriation. At the end of the day, the profit — isn't — our goal is to make profit, and it's a new market in China, such as China, so how does the profit repatriation mechanism work? What does the timeline look like? These are important things to plan out, so that does not impact your business strategy negatively when the timeline that you may have in mind will be different than the reality.

And then we also talk to companies about banking in China. It is a very different market in China in terms of how banks operate there as we plan to be very decentralized. The account structure has been more complex, there's more specialized accounts for various purposes, such as what's called a "basic account" for payroll and for cash receipts and withdrawal and only that account can do such functions. And only one basic account can be utilized for corporate clients.

So nuances such as that, that's important to grasp as you're exploring the China market. Local payment instructions and also methods, getting comfortable with that, so that would help you basically conduct trade, locally or even cross-border. So cross-border payments, how the differences in China would impact how you manage it from a [inaudible] perspective in the U.S., how to manage it locally, these are important considerations to know.

And just as importantly, the culture of doing business in China. Not everything is going to be the same doing business in China versus the U.S. So it's important to keep an open mind, as well, to adjust for the culture, [inaudible] but also your employees because employees, certainly, is a big factor as far as the culture, and most of you who have businesses will hire a good part of the locals for their operations, and it's important to understand the culture aspect as well.

Lastly, some other considerations we also talk to our customers about, follow the market involvement, the China market does change very quickly, and it can change very suddenly, so [audio break] geopolitical development from a trade policy perspective is important for any businesses operating in China.

Local market development, be it an industry where policy changes, staying on top of that is also very important for your operations. And identify and assess and mitigate various risks that become as a result of having an operation in China is also very important. And remaining nimble — that's, again, the policy can change on a dime like that — so it very much ties into following the market involvement in China and also remaining nimble.

And engage with the market. So just as importantly, you need to be engaged with the market to be familiar with all the changes, and with the time difference, the cultural differences and also the language differences is a very important market to basically be engaged because of all these different challenges that you'll have.

And then, lastly, have the right partners and leverage local resources, and we, at PNC Shanghai office, we are a resource available for our customers if you have any questions of doing business in China.

George Hoffman: Well, with that, I think we're going to open it up for questions. We've had quite a few questions come through, so we'll just take a look at some of those and prioritize the responses. The ones we can't get to, we'll make sure that we get back to you at a later time.

So if you have any more to ask, remember that you can use the widget at the bottom to submit the question. So we do have a question on the Trans-Pacific deal that was reneged on by the — well, it's not reneged on, necessarily, but has not come to fruition in the U.S. as a result of the Trump administration's decision to pull out.

So there's been questions, Bill, on what industries would impact or what does that mean, do you think, economically, for U.S. companies and does that put us at a disadvantage?

Bill Adams: The Trans-Pacific Partnership, the specifics of what the U.S. government has done since the election is the Trump administration has said that we do not want to be a participant in this trade deal. It was never enforced, so there's no change in rules for businesses, it just means that the change that would have happened as a result of the TPP is now not going to happen.

So in terms of the specific — China was never a partner in the Trans-Pacific Partnership. There would have been no direct impact of the TPP on U.S.–China trade relations. TPP would have affected U.S. businesses in life sciences and healthcare and businesses in information technology in terms of market access and how they carry out trade disputes as well as market access for U.S. agricultural exporters and other food products as well as American businesses competing against foreign imports here in the U.S.

But long story short, we're not going to be a member of the TPP. There will be no TPP as it stood during the Obama administration. During the Trump administration is the current policy, and the Under-Commerce Secretary, Wilbur Ross, it looks like the U.S. trade policy is now focused more on primarily enforcing the current existing trade agreements and being aggressive in taking trade cases to the World Trade Organization and other third-party ways to dispute when the American government thinks that foreign trading partners are behaving unfairly.

And then, secondarily, negotiating bilateral trade agreements and the specifics there are kind of to be determined. But long story short, I think the change in policy is that now there is going to be no change in policy. So business as usual, it looks like the near-term outlook.

Hilary Love: Bill, I'm going to follow right up, because we've got a couple of these, too, that are questions on the border tax and what is the current sentiment with regards to the border tax among U.S. political leaders.

Bill Adams: We are following the border tax very closely. It's an issue that not just affects U.S.–China trade relations but U.S. trade relations with Mexico, with Canada, with European Union. There are a couple of different versions of the border tax proposal out there. One of those is the border adjustment tax, which is a way to change corporate income tax in the United States and reduce corporate taxes for American companies by imposing a tax on imported inputs.

We also have heard proposals, mostly during the election last year, of having a targeted tax on imports either from China or in Mexico or, I think Japan was mentioned a couple of times as well, although we haven't heard as much from that lately.

I think they continue to sort of be out there. We're monitoring them. Movement on those taxes has been pretty slow. We're coming up on — I think we're about 10 days away from the end of the first 100 days of the administration, and so far we don't have a border tax imposed on Mexico or China. So it's hard to know if that's going to be trend or — I don't know if that's a predictor of things to come or if it's just been slow to come out.

But my expectation immediately after the inauguration is that if those things were to happen, they would probably happen relatively quickly.

Okay, I was told we only have time for one more question, but I'm going to make it a double question because there's a number of these I'm going to ask of Hilary. Hilary, there's a couple of questions with regard to invoicing and renminbi and the benefits of that. If you could talk about that. And then, also, you mentioned about RMB accounts. So maybe if you could comment a little bit on both of those, I'll try to get two questions in one here.

Hilary Love: And I'll try to speak quickly. The renminbi invoicing, if you're selling into China, makes it easier for local purchasers to pay in their own currency, especially as we were talking about with the U.S. dollar being relatively expensive right now. And also just the mechanics of making — for them to make a payment to you in renminbi is easier because it's local currency to local currency payments.

So, for many reasons, it can help you increase market share, especially if your competitors are on the ground already in China, and you're bumping up against competitors who price in renminbi. And it does relate to the question of an account because for these renminbi invoices, there are certain type of accounts that you can accept those incoming trade settlement payments into, which are domestic type of accounts, and Chris and his team can advise you on which type of accounts are appropriate for which type of payment.

PNC does offer corporate accounts in renminbi, but there's a type of onshore account you'd need if you were invoicing to local customers in renminbi. So we're here as a resource to help you with account structures and what type of account you need to fulfill what purpose.

George Hoffman: And that makes me think, too, as well, and there's a flurry of questions on industries and others that we'll look at these questions and try to get back to you. But I also want to just clearly state that our Shanghai rep office, if you need to get in touch with them, if you have questions about your industry or you need a briefing on the market, if you plan on taking a trip to China, it's a great place to stop off. We can work that out with our relationship teams, so please contact your RM or your Treasury Management Officer, your FX salesperson, to set up time to talk about these more in depth about your business.

I really wanted to thank Bill and Hilary and Chris today for your insights and perspectives. I also wanted to remind the listeners that there is PDF of today's presentation available to download from the green resource list, file folder wedge. It's in the lower portion of your screen. You also see a link to a short survey. Please take a few minutes to respond to that survey. Your feedback is critical to us, and we really appreciate that, and it will help us for future sessions.

And, also, if you need to know more about China, as I said earlier, we have different resources available through your relationship team. But also we have a specific website, PNC.com/gochina — quite a bit of information on renminbi, internationalization, economic developments within the market, a lot of commentary there that is going to help you with your business decisions for the market.

So, with that, this concludes our presentation today, so I wanted to thank everyone for joining, and we'll talk to you next time.

CIB ENT PDF 0417-0135-525201