HSBC

New wave of financial reforms set to increase acceleration of Renminbi internationalisation

Continued reforms by The People's Bank of China (PBOC) are set to further accelerate the use of Renminbi (RMB) in international trade and investment and reinforce the move towards full convertibility of the currency. Reforms such as the widening of the RMB daily trading band, recent capital account deregulation and the expansion of the Qualified Institutional Investor Scheme are all signs of a change in focus away from appreciation to flexibility.

With a move away from the crawling dollar peg, HSBC expects the Foreign Exchange regime to offer more two-way volatility and the true flexibility characterised by a traditional free market currency. As such, HSBC has revised down its year-end 2012 forecast of USD-RMB to less than 2% appreciation over the calendar year, down from a previously forecast pace of 3% over a year ago.

In addition, HSBC predicts that by 2016 China will overtake the USA to become the biggest trading nation in the world, accounting for 12% of global trade[1]. As a result, RMB is predicted to become a top three global currency by 2025.

"We continue to encourage exporters and importers to 'test the water' by, at a minimum, receiving or providing quotes in RMB as well as USD. It's important New Zealand exporters and importers are competitive in understanding and using RMB when trading in the global marketplace," says Cath Henry, Head of Global Payments and Cash Management at HSBC New Zealand.

Recent financial reforms and the effect on the movements of the currency

<u>RMB Band Widening</u>

In early April the PBOC widened the USD-CNY daily trading band. As at 16 April 2012, the band is extended from +/- 0.5% to +/- 1%. This is a milestone in currency deregulation, as it means the currency is moving away from an appreciating crawling peg regime to being more market driven. Although the PBOC may not utilise the new fully expanded range, this increased exposure to market forces is expected to be followed by a gradual increase in intra-day volatility.

<u>Capital Account Liberalisation</u>

China continues to liberalise its current account, most recently evidenced by Beijing policymakers further easing restrictions on capital inflow. China's structural current account surplus has also fallen as domestic demand grows relative to exports and RMB appreciation erodes the surplus. This is highlighted by China's current account surplus to GDP ratio which fell to only around 3% of GDP indicating the RMB exchange rate is much closer to its equilibrium level than it has been in previous years.

<u>Qualified Institutional Investor Scheme Expansion</u>

In another move designed to promote inbound foreign investment, China announced in April that it would raise the quotas for both USD and RMB qualified foreign institutional investor schemes (QFII), a main channel for foreign investment into

Chinese Securities. The USD and RMB QFII will be expanded to USD80bn from USD30bn and to RMB70bn from RMB20bn respectively, which is expected to boost foreign investment in domestic markets.

Mainland Designated Enterprise Requirements Abolished

Until now cross-border trade settlement in China has been limited by the Mainland Designated Enterprise (MDE) list system which has required Chinese companies to be pre-approved in order to conduct RMB goods export. This system is now to be abolished and replaced by a blacklist system. Set-up initially in July 2009 with only 365 mainland companies having approval before being expanded to more than 67,000 companies in 20 provinces in 2010, the trade and services settlement programme will now be widened to all payments relating to cross-border trade or service settlements made by companies that are not named on the black list.

“It continues to be an exciting time in China, with constant developments changing the economic and financial landscape. It is a significant challenge to remain aware of the latest movements but each new announcement opens up new opportunities for New Zealand businesses,” continues Henry.

As our second largest export market, we already have strong relationships with China’s traders, and in these uncertain times New Zealanders can increasingly capitalise on the benefits of trading directly using this upcoming global currency with counterparts in China.

1 - HSBC’s Global Connections report issued 22 February 2012

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