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Briefing

The Chinese currency in the international financial markets

The rise of Chinese trade in Africa generally and Tanzania specifically is well known. China – Tanzania trade reached USD 2.5 billion in 2012 (up around 15% on the previous year), and in the last week alone, during Prime Minister Mizengo Pinda's Chinese tour, Tanzania and China are reported to have signed seven contracts totaling USD 1.7 billion, for investments in electricity, property construction and research.

However, the last month has seen particular focus on the expanding role of the Chinese currency, the Renminbi (RMB) across the international financial markets. This article reviews the recent relaxations in Chinese currency policy internationally and the growth of new RMB finance products in Tanzania.

Liberalisation of the RMB

The use of the RMB as an international trading and reserve currency, while rapidly growing, is still underrepresented compared to the scale of Chinese export trade worldwide. This is due to the fact that, until recently, the RMB was a closed currency, effectively unavailable for use by foreigners. The last few years have seen a gradual, but accelerating, relaxation of currency restrictions, beginning from a pilot scheme for cross-border trade settlement in RMB launched in 2009. This initially allowed limited trade between certain companies in Hong Kong, Macau and some Asian countries with Chinese companies in certain areas of the country. This was gradually expanded worldwide, and by 2010 all corporates worldwide were able to settle in RMB. A similar pilot programme for individuals and small businesses has now been implemented (although various restrictions and procedural requirements remain across all sectors).

There has been (for reasons considered below) a fairly strong uptake on these newly available products and flexibility. In particular, 10% of China's international trade is already denominated in RMB, and a recent survey released by HSBC predicted that by 2015 this figure could increase to 30%. However, in recent SWIFT statistics, while the RMB was the eighth most popular trading currency, it was only the 12th most used payments currency.

In addition to use as a trading currency, a number of nations are now moving to holding a portion of their reserves in RMB. The HSBC report mentioned above put offshore investments in the currency, almost nonexistent three years ago, at over USD 143 billion this year. Notably, in 2012, Tanzania and Nigeria together acquired RMB 500,000,000 of 3 year bonds from China Development Bank. The RMB has appreciated over

20% in the last 6 years, making it an attractive investment particularly given the challenges currently facing both the US Dollar and the Euro. The use of RMB hedging products (now permitted) is also expanding.

Recent developments

In October, China made two significant international deals to further expand the international use of its currency.

First, an agreement was struck with Britain, giving London-based investors the right to buy up to USD 13 billion of RMB denominated stocks, bonds and money market instruments, while Britain agreed to allow Chinese banks to set up wholesale banking branches in London (catering to other financial institutions and large corporations), and provisions were made allowing the RMB to be traded directly against sterling.

This deal was very significant, as it marked the first such move allowing direct foreign investment in Chinese assets from outside of China or Hong Kong. However, it was quickly followed by a similar deal with Singapore, allowing Singapore-based investors to buy RMB denominated securities, with a quota of USD 8 billion to be invested.

Both deals are expected to further internationalise the use of the RMB and promote increased direct trading in the Chinese currency.

The Tanzanian perspective

For a country such as Tanzania, where international trading is likely to be denominated in a foreign currency in any case, use of RMB for Chinese trade makes even more sense. This is reflected by the fact that a number of commercial banks are already offering RMB denominated accounts, trade settlements or other products, including Stanbic Bank Tanzania, Ecobank, CRDB Bank, Exim Bank and National Bank of Commerce (NBC). There has been a marked increase in the emergence of such new products in the last few months.

These products enable Tanzanian businesses to pay for goods and services from Chinese businesses (or indeed to sell to Chinese business) directly by using RMB, rather than using the US dollar or another intermediate currency.

Trading in RMB will clearly mitigate exchange risk and remove exchange losses for the Chinese counterpart and, potentially may also reduce such losses for the local counterpart (depending on the pricing of the local bank's products). Even if there are not direct exchange savings for the Tanzanian counterpart, the savings on the Chinese side should translate into reduced prices under the contract. Historically, Chinese suppliers have typically needed to add a buffer of up to 5% on their prices to hedge against unfavourable foreign exchange movements. This should now be able to be removed. This is confirmed by statements from Chinese business leaders, who have pledged to offer 3-5% discounts to trading partners who settle their transactions in RMB.

In addition to pricing, RMB settlement should in theory also allow increased efficiency and time savings when conducting Chinese trade.

Nevertheless, there has been some suggestion that many Tanzanian businesses have been reluctant to make the switch to trading in RMB. This may be due to a number of factors, including lack of awareness of the available products or lack of familiarity with the currency in general.

In some respects, this also reflects the position globally, where, although the opportunities for accessing RMB products are expanding rapidly, actual volumes of trading and particularly deposits may be lagging somewhat behind. Of course, as commentators have flagged, the growth of the currency is starting from a very small base internationally. As yet, RMB holdings account for only about 5% of banking deposits in Singapore, and 0.4 % in London (both of which, as discussed above, are key international hubs for RMB trading). However, with more than 10,000 financial institutions globally reportedly now doing business in the RMB (up from 900 in June 2011), increased volumes will surely follow.

Contact us

This monthly briefing is prepared for clients and contacts of Clyde & Co operating in the banking sector in Tanzania. We aim to keep our clients abreast of developments in the sector as they happen and if you have any questions on the issues raised above please contact us using the details provided:

Peter Kasanda
Legal Director, Dar es Salaam
E: peter.kasanda@clydeco.com
T: +255 767 850 056

Teresa Hettich
Senior Associate, Dar es Salaam
E: teresa.hettich@clydeco.com
T: +255 767 850 052

Clyde & Co Tanzania
11th Floor, Golden Jubilee Towers
Ohio Street
PO Box 80512
Dar es Salaam, Tanzania

T: +255 (0) 767 302 200
F: +255 (0) 222 103 004