

Markets & Investing



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INSIGHT

When 'Made in China' becomes 'Paid in renminbi'

There is a ticking time bomb under the dollar. When it explodes depends not just on the US economy but also on policy actions in Beijing and Washington. Over the past year the Chinese have undermined the dollar by the back-door, questioning it as a store of value and medium of exchange.

Although the Chinese are not advocating the renminbi as the alternative to the dollar this may be only a matter of time. One needs to focus on what the Chinese do, as well as listen to what they say. A key development is China's encouragement of international use of the renminbi, although they prefer to call it invoicing.

This may be from a low starting point but one Chinese saying may be worth bearing in mind: "A march of 10,000 miles begins with one small step". Early signs are promising.

China is encouraging exporters to invoice in the renminbi and is setting up systems to allow trade payments in renminbi. This makes sense. China's trade is soaring. New trade corridors may soon require new means of payment. When the Chinese and Brazilian presidents met last year they agreed to use their own currencies to settle more of their bilateral trade, rather than invoicing in dollars. Although viewed as symbolic, it is a sign of things to come.

The crisis also saw China sign a host of bilateral currency swap agreements with countries ranging from Indonesia to Belarus and Argentina. China's growing trade and financial links with the rest of the world will make the renminbi more acceptable.

Gradualism dictates the Chinese approach to most policy measures. The process is logical. Look at the theory, examine the pros and cons, debate the issue, implement slowly and observe. If the project works, roll it out. On that basis, there is more to come.

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Since a pilot programme started in July 2009, the volume of international trade settled in the Chinese currency has totalled Rmb11.6bn (\$1.7bn). Although only 0.1 per cent of Chinese trade in that time, it has gathered momentum. This has encouraged the authorities to expand the programme.

Renminbi invoicing has been restricted to 400 mainland companies in Shanghai, Shenzhen, Guangzhou, Dongguan and Zhuhai. It will soon widen to cover thousands of mainland companies and more provinces, including Heilongjiang in north-east China which has sought approval to settle trade with Russia in renminbi.

These are still early days and China will need to clear a few technical hurdles to make the renminbi widely acceptable. For instance, guidelines for invoicing and settling trade in renminbi need to be harmonised.

Hong Kong is the main beneficiary as the renminbi gains acceptance abroad. It has the natural advantage of a renminbi deposit base, well-established trade links with China and a head start in

developing renminbi financial products. The city's regulators are ensuring it retains its edge.

Since February, the Hong Kong Monetary Authority has made it easier for its banks to process trade transactions in renminbi, to

develop renminbi-based financial products such as bonds, and to extend loans to and take deposits from local companies in renminbi.

In January, China implemented a free-trade agreement with ASEAN, the south-east Asian grouping of 10 countries. Rising Chinese trade with the rest of Asia will boost renminbi settlement in Hong Kong.

There will be future tipping points. Convertibility of the renminbi on both trade and capital accounts would be the ultimate hurdle to cross for China to make its currency globally acceptable. This will eventually happen. China also needs to develop its capital markets and financial infrastructure.

As international reserves soar I detect among reserve managers a desire to shift away from the dollar. Yet they do not want actively to sell the dollar, lest it triggers the crisis they fear. Instead less of net new reserves are being placed in the dollar. I call this passive diversification but until the renminbi becomes convertible it is unlikely to take its rightful place in reserve holdings.

International use of the renminbi will also rise as Chinese firms invest overseas and its government increases support to other countries. This is already happening: China recently signed a \$20bn financing deal with Venezuela, half to be paid in renminbi.

Furthermore, renminbi use has increased despite the currency's peg to the dollar. Once the renminbi starts to appreciate it may receive an additional boost as a store of value. This de-pegging of the renminbi to the dollar could occur soon, but it is more likely to be a gradual and ongoing shift than a big one-off move. It would signal a trend appreciation of the renminbi. "Made in China", the three most common words of the past decade, may soon be joined by "Paid in renminbi".

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