Andrew Leung International Consultants Ltd

Securing renminbi via the private sector

Renminbi Internationalization:

Opportunities and Policy Implications for Central Banks

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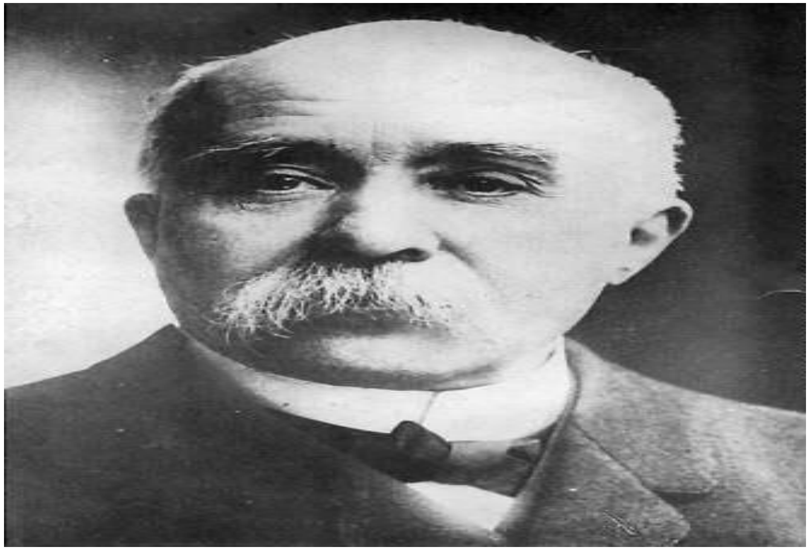
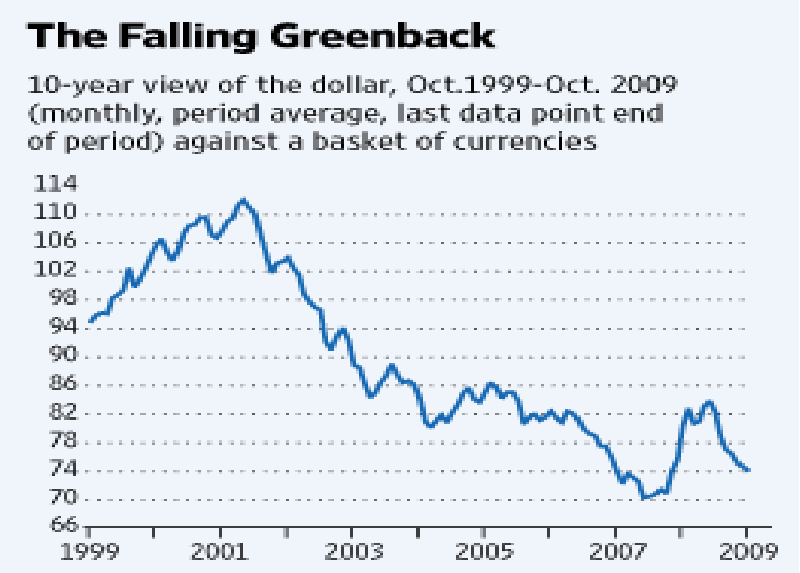
Imperatives behind internationalization

(*Redbacks for Greenbacks: The Internationalization of the Renminbi,* Francois Godement et al., China Analysis, European Council on Foreign Relations and Asia Centre, November 2010)

- Classical consensus – for market economy to mature, necessary to achieve full convertibility in capital account to enable currency to become international. Tendency to equate ***currency internationalization*** with ***currency convertibility*****.** For Rising China with challenges on all fronts, '***Economy too serious to be left entirely to economists'*** – *Clemenceau*
- ***Our Currency, Your Problem*** – published April 2005 by Hoover Institution by Niall Ferguson – 'Bush administration's tax cuts and a global war on terror financed with a multibillion-dollar PBOC overdraft (through China's huge purchase of Treasury bills), a '***Chinese tribute 'to the American Empire***', April, 2009, Paul Krugman, New York Times Op-ed columnist and Novel laureate, calls this ***China's 'Dollar Trap.'***
- Since 1944, the dollar has lost 97% of value against gold. Following continuing bouts of QEs, 13 March, 2009, Premier Wen Jiabao openly worried about China's $1 trillion in US Treasuries. To some in China, US monetary policy a central pillar of US 'economic hegemony' and ***floating rate as 'a mechanism for plunder.'***
- Exchange rate very heart of China's economy, which underpins political survival. Hence ***suspicion that it is a myth of quantitative economics*** that exchange rates are beyond country's control, to be fixed through the market in response to some rational criteria.





Currency Security

Capital Account Convertibility

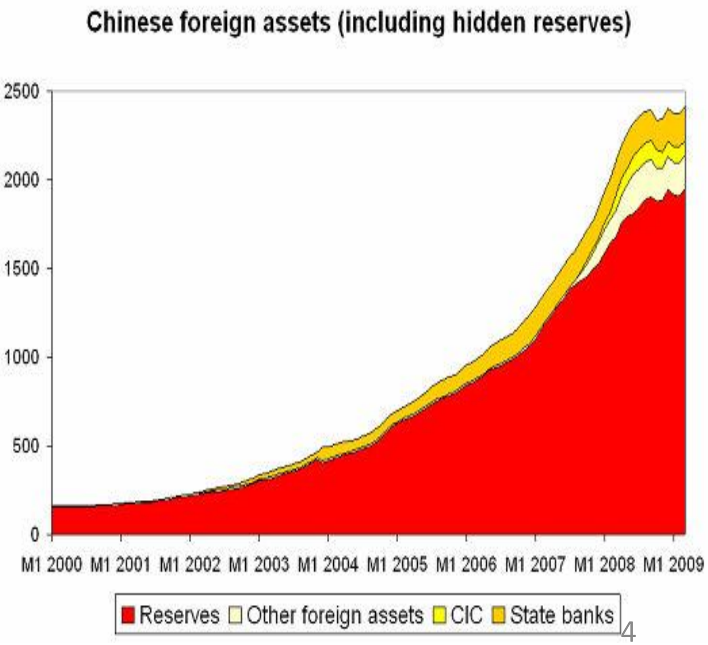
- ***Global Financial Crisi***s Non-convertibility helped ***insulation***
- ***Asian Financial Crisis*** Steadfast non-devaluation helped stabilization.
- ***Stability and independent control - key imperatives*** against growing ***global uncertainties*** – European sovereign debt crisis, fragile Western economies, currency insecurity, ME turmoil, energy and resources scarcity, climate change, rising middle-class aspirations, China at critical stage of growth towards a more equitable society and a Low Carbon Future.
- Before euro, ***Germany able to internationalize deutschmark without entirely giving up exchange control*** or switching to a floating exchange rate.
- So China likely to move with measured pace ***('feeling the stones'***)

World Reserve Currency System

- IMF SDR - ***Zhou Xiaochuan***, PBOC Governor, 23 March, 2009
- ***'Triffin Dilemma'*** – 1960s Belgian-American economist Robert Triffin - Reserve currency-issuing countries suffer large trade deficits to supply enough currency for foreign exchange reserves. ***Conflict of interest*** plus ***tension*** between national monetary policy imperatives of reserve currency issuer and what is best for global currency stability.
- ***No substitute yet for dollar.*** SDR idea lacks traction post-Nanjing G20.
- Dollar ***as long term storage of value increasingly called into question*** by surplus and energy-rich countries after financial crisis and QEs.
- ***RMB international acceptability gathering*** pace, supported by gigantic currency reserve (now $3.2 T) and status as 2nd largest economy
- *Ding Zhijie*, Co-director, College of Finance, Chinese U of Economics and Foreign Trade, - ***Article 8 of IMF to be amended*** for membership on condition of current, and not capital accounts, convertibility.

Currency War?

- ***RMB blamed*** for US record-high unemployment rate, depressed wages, struggling exports, and declining economic performance.
- ***US, ECB, IMF, Brazil and India*** all call for a stronger RMB.
- ***Currency Manipulation Bill*** Sept 2010 majority 348-79; difficult to prove in WTO (2007 Swiss surplus with depreciating currency – Ireland opposite); copy-cat legislation in other countries; and full-scale global trade war?
- QEs depress greenback and RMB (indirect link) – other exporting countries ***beggar-thy-neighbour interventions*** to avoid own currencies' relative appreciation (Japan, Brazil, Korea etc).
- ***China's riposte*** –
  - Unfair for RMB to appreciate while ***QEs*** depress value of reserve currencies.
  - No solution for ***exports and jobs*** as cheap goods from other EMs handy substitute .
  - RMB already ***appreciated 55%*** since last reform ***1994.*** 1985 Plaza Accord yen appreciation ***didn't help*** US exports or reduced US imports .
  - ***Net exports only 8%*** of China's GDP – many high-value import components – so much higher appreciation required.
  - ***Geithner*** - inflation-adjusted RMB ***appreciated by 10% a year.***
  - 'China Price' profit margins - ***catastrophic job losses***, factory closures and social instability.
- Real issues: (a) global and domestic economic ***imbalance*** (b) ***global reserve currency stability*** (c) ***trade to be free and fair.***



International Chess

IMF *2010 Article IV Consultation Report on China 9 July 2010*

• Past two years, China's ***current account surplus*** halved as global demand collapsed. As external demand recovers, larger current account surpluses likely to recur.

• RMB real exchange rate ***back to the late 1990s level*** despite significantly higher productivity gains. RMB remained substantially undervalued in line with long-term fundamentals.

• China reckoned that the current account surplus ***would settle at about 4 % of GDP as structural reforms***, rising wages, and gradual RMB appreciation combine to boost consumption.

• It's arbitrary to judge exchange rate by referencing a particular point when currency may or may not be in equilibrium. RMB ***more than 50 % higher than when unified in 1994 and 22 % higher than low point in 2005***. Real exchange rate very flexible over past decade, moving significantly in both directions.

• However, RMB real exchange rate was back to level in 1999–2003, with no decisive imbalance in the external accounts. In the interim, ***cumulative productivity differentials had been substantial.***

•***U.S. Treasury Report to Congress on 5 February 2011*** In line with Capitol Hill sentiments, recent remarks by Obama and Hilary Clinton increasingly strident accusing China of currency manipulation

•***G20*** – EU echoing US pressure.

RMB exchange rate in a historical perspective

- ***Pre-1978 hermetic exchange control;*** RMB 1.86 @dollar for import-substitution.
- After ***Open Door Policy***, market-oriented series of devaluations reaching RMB 5.8 @dollar 5 July 1986.
- ***Unification on 1.1.1994 of official exchange rate*** and an internal settlement/swap market rate - RMB8.28 @dollar**.**
- ***1994 to 2001***, RMB ***appreciated @dollar by a total of 18%***, 3 % p.a., without affecting export.
- ***21 July, 2005,*** fixed RMB-dollar peg switched to ***peg to basket of currencies***, mainly dollar, Euro, yen, and won.
- ***July 2005 to end 2008***, RMB ***appreciated by 21%,*** while China's current account surplus continued to expand rapidly.
- ***June 19, 2010, RMB returned to 'managed float'*** to a basket of currencies with spot exchange rate moving intra-day +/- 0.5 % from a central parity.

The Petersen Institute diagnosis and recommendations

(**Morris Goldstein and Nicholas Lardy**, *The Future of China's Exchange Rate Policy, Petersen Institute for International Economics, July 2009)*

- ***2003*** China's current account surplus at ***3% GDP,*** RMB undervaluation estimated at ***15-20%***.
- ***2007*** China's current account surplus reached ***11% GDP,*** undervaluation 'conservatively' estimated at ***30-40%.***

Undervaluation -

- Inhibits ***interest rate*** policy.
- ***Under-priced credit bias*** *for 'tradables' and manufacturing* + hampers commercial banking efficiency.
- ***Suppressed deposit rate*** hinders consumption-orientation.
- Perpetuating monetary ***disequilibrium and external imbalance***.

Three –stage approach – to work more closely ***with IMF*** –

- ***During global recession***, avoid competitive devaluation; scrap tax rebates for 'dirty' exports; expand transport and utility infrastructure and social provision; allow RMB to appreciate .gradually 4-5% p.a.; widen daily fluctuation limits to 1 to 1.5%
- ***With global recovery,*** RMB to appreciate sufficiently rapidly to eliminate large current account surplus in 3-4 years; reduce exchange intervention and sterilization; dual capital flows to be gradually liberalized; resume interest rate liberalization; explore central bank independence and inflation targeting mandate.
- ***When China's current account surplus has drastically shrunk***, further curtail exchange rate intervention and sterilization ; abolish daily exchange fluctuation limits; gear monetary policy towards inflation targeting ; substantially liberalize capital flows.

Myths of exchange rate equilibrium

(*Debating China's Exchange Rate Poli*cy, Morris Goldstein and Nicolas Lardy, ed., Petersen Institute for International Economics, 4.2008)

- ***Appreciation not necessarily reduce surplus*** (deuche mark (since 1971) and Japanese yen (since 1977) (*Wu Xialing*, Deputy Governor, PBOC).
- Trade surplus due less to export than to ***falling imports*** (*Jonathan Anderson*, MD UBS Investment Bank); growing ***import substitution (rising productivity)*** (Fang Gang, Director NERI, China Reform Foundation).
- High savings due more to ***corporate savings*** (household savings ratio fairly constant); so low deposit rate not main reason for ***depressed consumption.***
- Bias towards '***tradables' and heavy industrial sector*** -'steel, machinery, chemicals'(Productivity rise concentration in tradables - *Belassa & Samuelson* (1964) Not outcome of under-priced credit but natural course of ***industrialization and urbanization*** (MGI – *Preparing for China Urban Billion*, Feb 2009)? ***Financial repression*** needed for cheap labour, land, credit?
- Need to revalue in line with ***productivity*** but ***equilibrium a myth*** in changing world economy + QEs (*Fang Gang*) .
- Need to focus not on just single exchange rate but a ***multilateral system of exchange rates*** (*Simon Johnson*, Diretor, Research Department, IMF) EU now replaced US as China's largest trading partner.
- Exchange rate flexibility not the same as adjustment of ***real exchange rate*** or ***capital account***. Some evidence that ***less flexibility*** may lead to faster real exchange rate adjustment (stability + productivity?). De facto ***$ peg not bad*** for ***price stability***. (*Shang-jin Wei*, N.T.Wang Professor of Chinese Business and Economy at Columbia University's Graduate School of Business).
- Capital inflow promotion may have exaggerated ***appreciation pressure.*** Now ***outflow*** (ODI) – ***promoting*** structural reform package will make exchange rate adjustment more effective ('*Open Economy Trilemma*' - Exchange Rate, Monetary Policy and Capital Mobility, *Jin Zhongxia*, Chief Rep of the PBoC for the Americas) .
- No real consensus on ***degree of RMB undervaluation***. 'Crossing the river by feeling the stones'. (Andrew Crockett, President, JP Morgan Chase).
- ***Nobel laureates*** *R Mundell* + *J Stiglitz* skeptical about desirability of RMB revaluation.
- ***Monetary policy*** (or central bank) ***total independence unrealistic*** in state-capitalism?
- IMF ***primary focus is rebalancing China's economy***, though exchange rate appreciation important (*Steven Dunaway*, Deputy Director, IMF Asia Pacific Department)

Moving signposts of RMB exchange rate

- *IMF* record of estimates of currency account surplus not convincing
- RMB exchange rate cannot be judged in isolation.

(Dr Xiuping Hua, Assistant Professor in Finance, University of Nottingham Ningbo China (UNNC), in China Daily, 4 December 2011)

- ***No convincing formula*** to judge undervaluation
- ***US deficit problem cannot be solved*** by RMB exchange rate
- Sharp RMB appreciation would trigger ***economic and social chaos*** in China
- Speculation on RMB appreciation leads to ***disruptive disguised capital flows***, exchange control notwithstanding
- Decades of adverse effects of Japan's 1985 ***Plaza Accord*** still remain
- But ***pegging to the dollar*** depresses consumption, causes inflation and sacrifices monetary independence
- Need for a ***more independent, stable yet flexible exchange rate***
- ***Narrow daily fluctuations to be widened*** if not a free float
- ***Long term US /China economic imbalance*** to be addressed - increasing US savings and China consumption

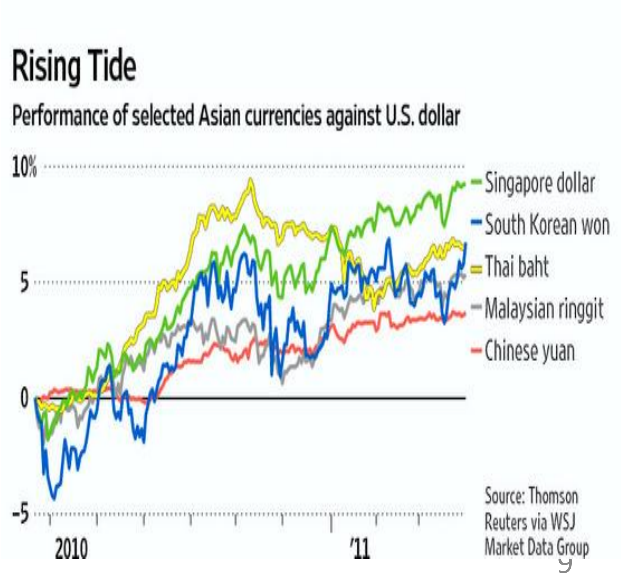
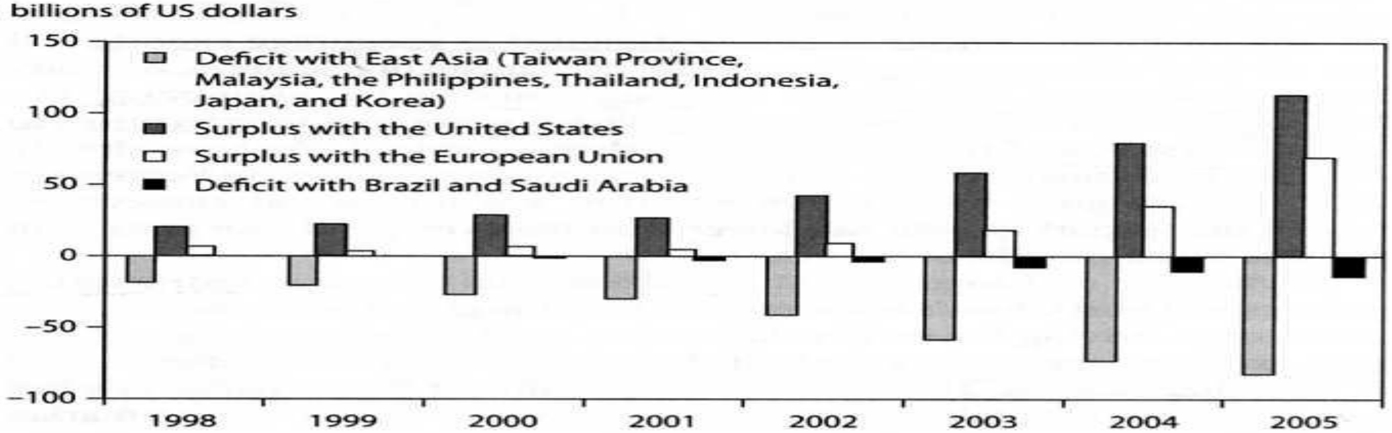
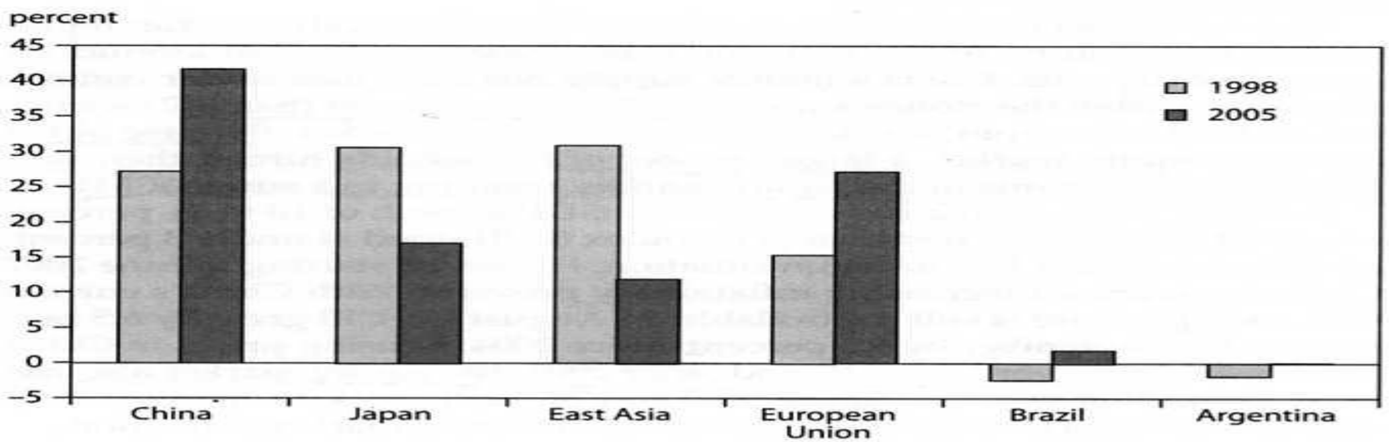


Figure 1 China's trade balance with East Asia, the United States, and the European Union, 1998–2005



Sources: CEIC data; International Monetary Fund, *Direction of Trade Statistics;* Chinese Ministry of Commerce website, http://english.mofcom.gov.cn.

Figure 2 Breakdown of US trade balance (US statistics), 1998 and 2005



Note: East Asia includes Malaysia, the Philippines, Indonesia, Korea, and Singapore.

Source: People's Bank of China.

Addressing Imbalances

Systemic imbalances

- ***Asian surpluses*** feeding ***West's unbridled consumption***.
- ***West over-consuming while China and other surplus countries over-saving***.
- Against financial crisis, x curbing consumption (which would have worsened the economic downturn), QEs ***to jump-start economy*** not very successful.
- The West wants China to import more, but ***what China wants (technologies)*** the West not always wants to sell and what the West can sell not always competitive.

China re-balancing

- ***Last Five Year Plan (2005-2010) most impressive gain' in rural areas*** (*The Future of China's Exchange Rate Policy*, Petersen Institute, Washington D.C.July 2009, pp.36-37) :

  - ***Partial reimbursement (about 30%) of healthcare*** costs registered 20-fold increase by 2007, covering 730 million people, quadruple 2005;

  - ***Health insurance extended the coverage to 90% of population by 2011.*** (Government pays half or more costs, up from 16% in 2001)

  - ***Old Age Pensions for retirees averaged RMB 1,173 January 2009 (> national average wage*** but well below urban wage)

  - ***Minimum living standard guarantee program*** – boosting monthly payments RMB50 in 2002 to RMB140 by 2008.

- ***12th FYP (2011-15) geared to grow the Middle Class*** set ***to diminish current account surplus, moderate foreign currency reserve, and permit gradual RMB appreciation.***
- China's ***financial system expected to open further, as will interest rate regime.***
- ***ODI and FDI further liberalized*** through QDII and QFII schemes
- ***Monetary policy to remain highly flexible*** against inflation, asset bubbles and external shocks.
- ***RMB increasingly accepted for international settlements***, enhancing its status
- ***To promote RMB as international currency***, but to remain ***extremely cautious*** in giving up too soon financial protection of ***non-convertible capital account.***

China's economic and monetary strategy

•***Only partially in line with the Petersen Institute recip***e

•***12th Five Year Plan (2011-15) re-balancing*** - balanced and sustainable development, equality, social justice, social re-distribution including education, healthcare ,welfare and wage increases, technological upgrading, innovation, ecological conservation, renewable energies, agricultural productivity, regional balance, and domestic consumption. GDP target of 7% p.a. (7.5% in the 11th FYP).

•To promote consumption, ***RMB likely to appreciate gradually e.g. a few percentage points a year***, pace and extent adjusted in the light of changing circumstances

•**Inflation** dropped to 5.5% in October 2011, down from 6.1% in September, and a peak of 6.5% in July while IMF recently estimated economy to grow at 9.5 %, albeit slowing from 10.3% in 2010.

•***No rigid inflation targeting to avoid inflexibility*** for an economy still in transition.

• ***RMB internationalization*** and promoting ***more productive capital outflow through ODI***

Wriggling out of the 'dollar trap'

• ***Internalization without immediate convertibility***

•***'Nature moistens quietly' (****runwu xi wusheng* 润物细无声) , *Chen Daofu*, D of Institute of Financial Studies, Centre for Development Studies, State Council.

•***To create a de facto RMB global -currency space.***

•Increases international ***mobility of RMB capital and investments.***

•***Reduces vulnerability*** of China's reserves.

•Mitigates against ***dollar fluctuations.***

•Counterweight against dominance of ***Western financial centres***

•Creates ***revenue from RMB transactions.***

• Timely for RMB for ***international settlements*** as China becoming largest trading partners worldwide. ASEAN-plus-3, the world's largest trade bloc by population.

• ***RMB-denominated bonds***, using Hong Kong as launching pad.

• ***Exporting capital (ODI)*** acquiring foreign technologies, brands (Commerce Minister Chen Deming, March 2011), assets, resources, and markets, through joint-ventures and partnerships,

China's surging ODI

(Is there a China model of overseas direct investment?, Bijun Wang and Yiping Huang, ANU and Peking University, April 12th, 2011)

•ODI increased ***from $2.85 b in 2003 to $56.53 b in 2009, + 55 % p***.a., expanding global share from 0.45 to 5.1 %.

• In ***2009***, China largest developing country investor + ***5th largest investor*** after US, France, Japan, Germany, up from 12th in 2008.

•In ***2010,*** China's ODI ***surged 36.3 % to $59 b*** v FDI growing only 17.4 % to $105.7 b. ODI in ***US increased by 297 %*** + in ***EU by 81.4 %.*** China ODI ***poised to overtake FDI in coming decade.***

•Most Chinese ODI is ***in service industry, including commercial services, finance, retail and wholesale.***

•***Desirous for advanced technology, brands, management skills and stable supply of resources.*** 2006-8 ODI in primary sector = 18.7 % v 7.84% (developed countries) and 8.83% (developing countries)

•***Manufacturing ODI*** = 4.7% v 24.1% (developed) and 15% (developing) but ***rising wages and economic upgrading*** will see China moving more labour and energy –intensive manufacturing to other lower-cost countries, especially Africa

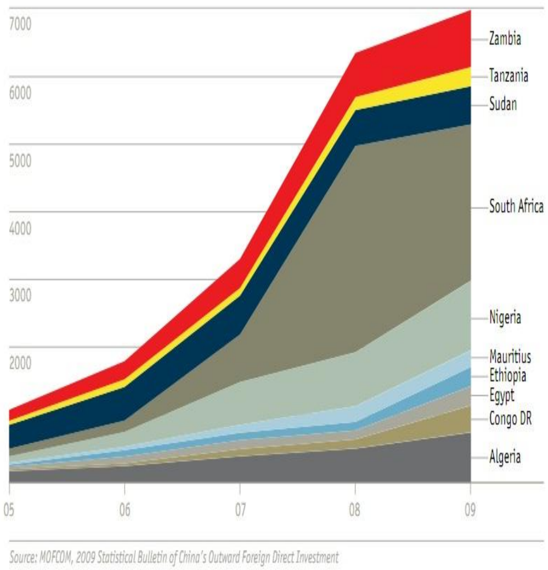
• ***In 2011***, ODI in 680 enterprises first 2 months + ***13.1 %*** to $5.27 b (Yao Jian, Ministry of Commerce spokesman, 23 March)

Dynamics of China's ODI

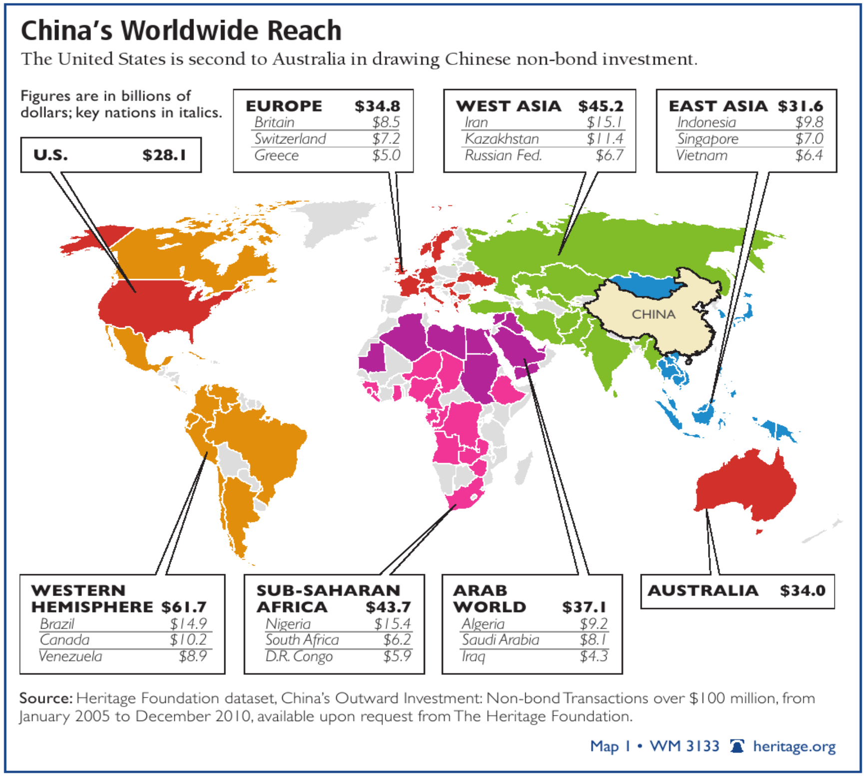
(Going Out: An Overview of China's Outward Foreign Direct Investment , U.S.-China Economic & Security Review Commission Report March 30, 2011)

- China's "***Going Global" strategy established 1999***. World's ***12th largest investor 2008 to 5th largest 2009.***
- Still, China, including Hong Kong and Macau, ***just 6 % of global ODI stock today***. Many less than $10 m @. ***Great deal of upside.***
- Aims (1) ***natural resources;*** (2) ***export*** (3) ***overseas R&D*** for advanced technologies, managerial skills and professionals; and (4) M & As to enhance ***international competitiveness*** (NDRC + China EXIM Bank, ***October 2004)***
- 2003, SAFE and MOFCOM allowed foreign investments of less than $3 m (up from $1m) to be approved at the **provincial level**
- SAFE ***abolished quotas on FX for ODI,*** 1 July, 2006
- Dec 2008, ***commercial bank loans allowed for cross-border M & A.***
- In 2009, ***SOEs = 67.6% of ODI;*** private enterprises = 0.6% (Lenovo, TCL, and Beida Jade Bird (all listed on stock-exchanges) owned by regional governments of BJ, SH, and GD)
- ***Most M&A*** deals in 2007-2009 in **energy and minerals sectors**. In 2009, M & A = 30% ODI, mainly in oil, gas, and mining .
- ***State Organs in ODI*** - State-owned Assets Supervision and Administration Commission (SASAC), created in 2003 to manage and transform large SOEs with a share of resulting profits; SAFE; MOFCOM ; CBRC; State Banks, including China EXIM Bank, China Development Bank and China Export & Credit Insurance Corporation
- ***China Investment Corporation (CIC),*** $332 b sovereign wealth fund

Top 10 destinations in Africa for Chinese outward FDI 2005-2009 (US$m)



China’s worldwide reach in BRIC perspective

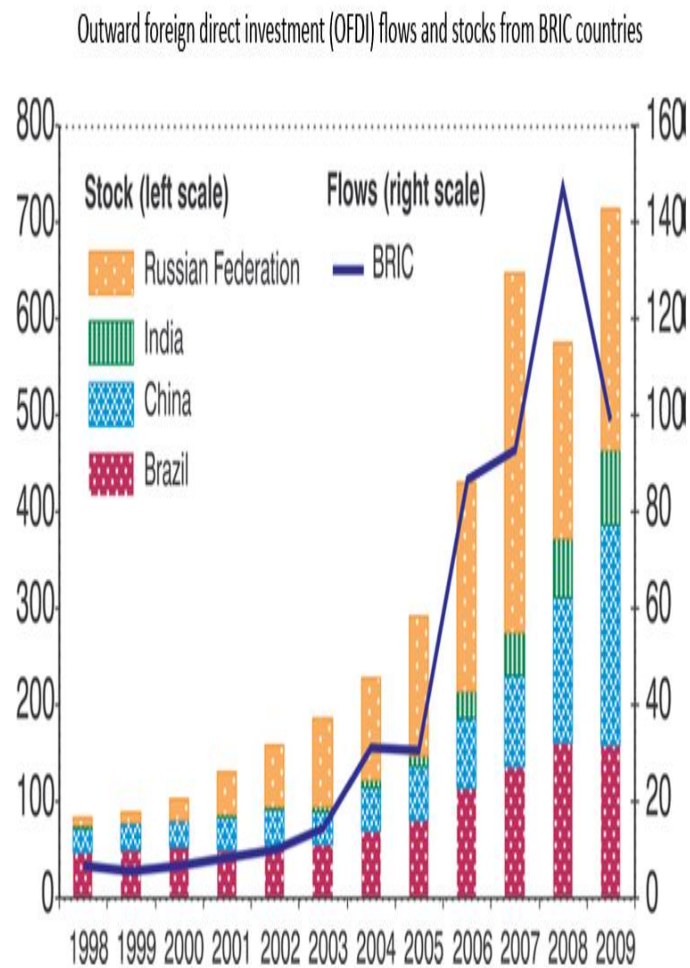


transactions now dominate Chinese spending. A related feature in both Heritage and official Chinese data is the preeminence of large, centrally controlled state entities as investors.

Countries. The Heritage series is far more useful than Chinese data in determining what country destinations are ascendant. The Ministry of Commerce did not publish its breakdown of 2009 investment until November 2010. Even then, Hong Kong accounted for 63 percent of outbound investment because the PRC treats Hong Kong as a separate customs territory. In fact, investment passes through Hong Kong heading elsewhere. The Heritage series tracks spending to its final destination.

The main event in 2010 was a flood of money into the Western Hemisphere outside the U.S., led by Brazil but also featuring Canada, Argentina, and Ecuador. Almost an afterthought in 2008, this is

The Heritage Foundation LEADERSHIP FOR AMERICA



United Nations Conference on Trade and Development (UNCTAD), World Investment Report 2010.

China's ODI objectives and obstacles

(*Going Out: An Overview of China's Outward Foreign Direct Investment* , U.S.-China Economic & Security Review Commission Staff Research Report March 30, 2011)

Energy and Minerals

- In 2002, ***CNOOC*** bought Indonesian assets of Spain's Repsol YPF for $593 m, followed by purchase in March of 5 % stake in Northwest Shelf natural gas field off the coast of Australia for $320 m; and 12.5 % stake in the Indonesian offshore Tangguh Gas field from BP in October for $275 m.
- In 2009, ***Shanghai Baosteel*** acquired 15 % ($240.5 m) stake in Aquila Resources in Australia; ***Yanzhou Coal Mining***, China's 4th largest coal producer, bought Australia's Felix Resources Ltd. for $2.9 b; while ***SINOPEC*** acquired Swiss oil explorer Addax for $7.24 b for high-potential oil blocks in West Africa and Iraq.

Technologies

- In 1988, ***Shougang*** purchased 70 % of California-based Mesta Engineering and Design Inc. with access to high-tech design capability in steel-rolling and casting.
- In 2001, ***Holley Group,*** a Hangzhou maker of electricity meters, bought mobile-phone design and software operations of Philips Semiconductor .
- 2002, ***Huayi Group*** of Shanghai paid $20 m for the battery-making assets of Moltech Power Systems, a bankrupt outfit in Gainesville, Florida

Global Brands (to grow "***National Champions***")

- In 2005, ***Lenovo*** acquired IBM's personal computer division.
- In 2005, ***Nanjing Automotive*** acquired British MG Rover.
- In 2010, ***Geely Automotive***, one of China's biggest, acquired Ford Motor's Volvo for $1.8 b.

Concerns of national security

- Have blocked a number of Chinese ODIs e.g. ***CNOOC for UNOCAL (2005); Chinalco bid to double stake in Rio Tinto (2009)***; Chinese telecom-equipment makers ***Huawei and ZTE bid for US Sprint Nextel Corp (2010).***
- China ***has become more adverse to high-profile deals***

Other less apparent objectives

Investment in "tax havens"

- In 2009, Hong Kong, Cayman Islands, and British Virgin Islands collectively received ***79% China's net, nonfinancial FDI*** outflows.
- Most for ***"round-tripping"*** According U.S. Department of State's China Investment Climate survey, - includes investments from corporate HQs in OECD economies, Taiwan, and, largely, China itself.

Political hedge for property rights protection

Neutralizing trade barriers

- (BBC ,2002) Cotton spinning mill in Mauritius for ***African Growth and Opportunities Act*** duty-free access to U.S. market.
- In 2002, TCL bought Schneider but kept production in Europe to avoid ***European quotas on Chinese TV imports***

Foreign relations especially Africa

- ***(a) UN (b) One China Policy (c) Resources (d) Profits*** (*China's Post-Cold War Strategy in Africa* , Joshua Eisenman, 2007)
- ***Resources, Infrastructure, Agri-business, Consumer, SEZs***
- ***FOCAC*** formed 2003 after 1st Head of State summit 2000
- China and Africa trade grew ***from $18.6 b in 2003 to $106.8 b in 2008.*** Expected by 2013 to equal 50% of $1 trillion African aid over past 60 years.. $300 b by 2015 (Bloomberg, 22 Feb, 2011)
- ***Packaged finance***: concessional loans, sellers + buyer's credits + bank guarantees by MOFCOM and EximBank (1/2 seller's credit 1/3 guarantees) v World Bank almost 100% loans only

New Pilot Scheme to allow RMB for international settlements

Series of MOFCOM, SAFE, and PBoC circulars since January 2011 (*Mayer Brown JSM, 21.07.2011*)

(***Caution: Professional legal advice should be sought in all circumstances***).

- ***July 2009 Circular No. 10***, issued by six PRC ministries and commissions; ***June 2010 Circular No. 186*** issued by Ministry of Finance; ***6 January 2011 Circular No. 1*** issued by PBoC ; 25 ***February 2011 Circular No. 72*** issued by MOFCOM; ***7 April 2011 Circular No. 38*** issued by SAFE; ***3 June 2011 Circular No 145*** issued by PBoC.
- ***Subject to the provisions of these circulars***, including ***approval by NDRC, MOFCOM, or PBoC on a case by case basis.*** cross- border RMB funds may now be used for (a) payments by foreign investors for new or additional ***capital contributions of FIEs***; (b) acquisitions by foreign investors of ***shares/equity interests or assets of existing companies in the PRC;*** (c) inbound ***shareholder loans by foreign investors to their FIE subsidiaries;*** (d) outbound ***shareholder loans by PRC domestic investors to their offshore subsidiaries;*** and (e) ***payments by PRC domestic investors for their ODI project expenses.***
- Circular 145 states that only RMB proceeds ***"legitimately raised"*** by foreign investors may be used for capital account transactions. The following are likely to meet the legitimacy test as prior PRC governmental approvals would normally be required for raising or obtaining such RMB funds:

  • ***Onshore RMB funds deposited by foreign individuals and institutions in RMB settlement accounts*** of a PRC bank for settlement of cross-border trade and service payments;

  • ***Proceeds from offshore RMB-denominated bond issuances, such as "Dim Sum Bonds" and Synthetic Bonds issued in Hong Kong;***

  • ***RMB-denominated dividends distributed by H share companies in Hong Kong***;

  • ***RMB-denominated A share liquidation proceeds and dividends*** repatriated to foreign shareholders;

  • ***RMB-denominated shareholder loans by PRC domestic investors to their offshore subsidiaries***;

  • ***RMB-denominated proceeds received by foreign governments or foreign companies from ODI projects undertaken by PRC domestic investors;*** and

  • ***RMB-denominated IPO proceeds raised in Hong Kong.***

Channels for inflow and outflow of Cross-border RMB funds

(*Mayer Brown JSM, 21.07.2011*)

(***Caution: Professional legal advice should be sought in all circumstances***)

Channels for inflows for an FDI transaction

- ***Onshore agent bank of an overseas bank participating in the cross-border RMB pilot scheme;***
- Overseas clearing bank designated for the pilot scheme e.g. ***Bank of China (Hong Kong);*** or
- ***Settlement account opened by the foreign investor with a PRC domestic bank*** where the balance of such settlement account is ***"ring-fenced" exclusively*** for settlement of cross-border transactions.

Channels for outflows

- ***A PRC domestic investor undertaking an ODI project or providing shareholder loans to its offshore subsidiaries*** may only remit RMB funds required for such transactions ***through its onshore RMB bank account.***
- ***Profits from an ODI project and repayment of principals and interest on any RMB denominated shareholder loans*** must be ***registered with SAFE*** .
- ***Such retained RMB may serve as channel for outflow*** of RMB funds ***for ODI projects with approval of SAFE.***

Ideas for RMB-linked investments through the private sector

(Central banks may consider using investment vehicles similarly to SAFE using CIC as a Sovereign Wealth Fund)

- Purchase of ***'dim sum bonds'*** denominated in Chinese yuan and issued in Hong Kong
- Purchase of ***shares listed overseas by China's main enterprises, including H Shares*** in Hong Kong
- ***QFII*** -for investing ***in selected "A Shares"*** in China
- Purchase of ***RMB through the China Foreign Exchange Trade System (CFETS) for FIEs*** in China
- ***Currency swaps***
- ***M & A of China enterprises*** in China
- ***Joint M & A with Chinese ODI*** (under pilot scheme allowing RMB for international settlements)
- ***Investment in suppliers /exporters to China***
- ***Investment in home/foreign leading brands/technologies/ financial institutions/ resource enterprises/retailers*** (what China needs) and ***selling an equity stake to Chinese ODI***
- Forming ***partnership (joint investment vehicles) with CIC*** for China's *"Going Out"* strategy, using the reimbursement/fee receipt route to receive RMB for settlements
- Helping China to issue ***RMB-denominated bonds in overseas markets*** (e.g. London and New York)
- ***FDIs in Five Year Plan 2011-15 priority-areas*** e.g. new technologies, high-end manufacturing, life sciences, bio-technology, nano-technology, aircraft production, R & D, financial services, green energies, new materials, conservation, deep-water drilling technologies, eco-business, green cars, agriculture, healthcare, education, creative industries, retail chains, famous Chinese brands, tourism and hospitality, shipping and transportation
- ***Joint investments with China in Africa*** e.g. resources, infrastructure projects, agriculture and food processing, labour-intensive production and distribution, mobile banking, telecommunications, China's African SEZs
- ***Joint investments with China in home/overseas infrastructure*** including regional high-speed rail, port facilities, utilities, smart grids, etc.
- ***Special "Swap Fund" with China for joint bilateral investments in each other's country and overseas***

Thank you

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