
Photo by Alain Delorme

CHINA'S BUMPY ROAD TO RENMINBI INTERNATIONALIZATION AND WHY IT MATTERS FOR CANADA

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Canada

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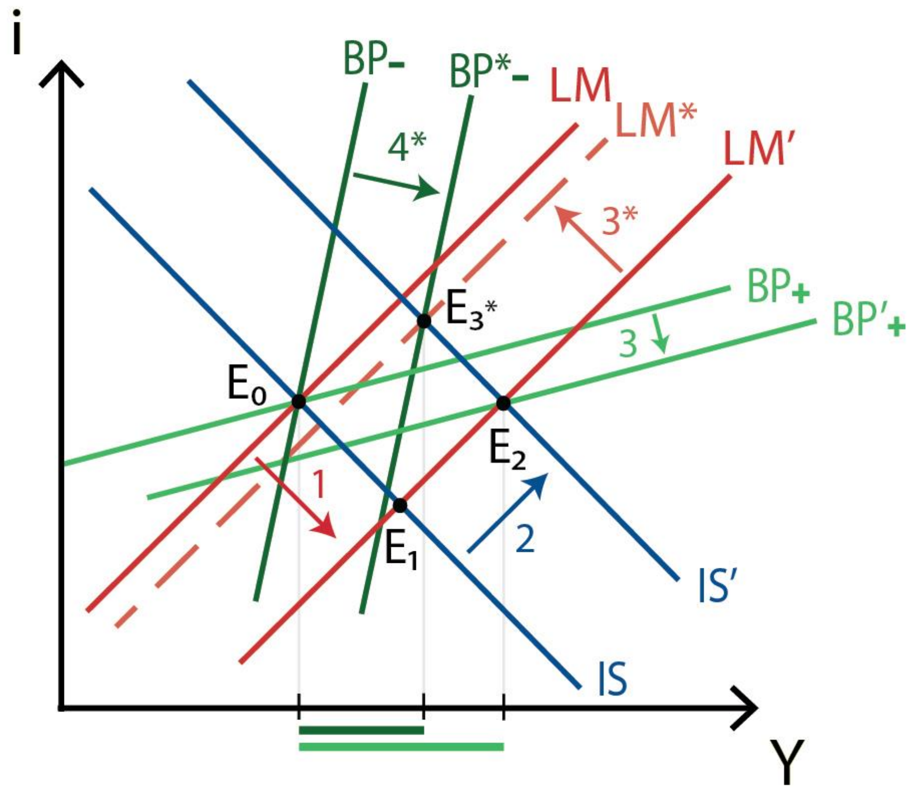
Realize a World of Opportunity

THE IMPOSSIBLE TRINITY ~ THE MUNDELL FLEMING MODEL WITH PERFECT CAPITAL MOBILITY



- Key assumption: small open economy with perfect capital mobility

  r = r*

- Goods market equilibrium – the IS* curve:

  Y = C (Y-T) + I (r*) +G + NX (e)

  where

  e = nominal exchange rate

  = foreign currency per unit of domestic currency

JUST KIDDING!

OUTLINE

- EDC background
- A word on terminology
- Scene setter:
  - 2009-2015: All goes according to The Plan
  - 2015-16: Then all heck breaks loose…
- Four questions:

Question 1: Why is China *trying* to internationalize the renminbi?

- Currency internationalization is a rare and risky endeavour.

Question 2: What are the main drivers behind RMB internationalization?

Question 3: Why must Canada care?

EDC BACKGROUND

- EDC is Canada's official export credit agency
- EDC and the Canadian economy
  - Facilitated $99 billion in business carried out by Canadian companies.
    - This means: EDC contributed more than 4 cents for every $1 of income earned in Canada.
  - Helped sustain 530,839 jobs.
  - Paid close to $5 billion in dividends to the Government of Canada
    - Against the Government's total historical investment of $1.3 billion.
- EDC and China
  - EDC has been on the ground in China since 1979.
  - In 2014, EDC supported $6.6 billion of Canadian business in China.

A WORD ON TERMINOLOGY

- "RMB Internationalization"
  - The transformation of the RMB into a global reserve currency like the US dollar.
  - Could fundamentally change the global economy and commerce by:
    - Re-pricing commodity markets
    - Downward pressure on the value of the US dollar
    - Higher cost of living in the US and other countries pegged to the US dollar
    - More foreign exchange risk and costs for US economy
- There are many different terms for China's currency…
  - Renminbi (RMB—人民币); Yuan (¥, 元); Kuai (块)
- …But there is only one important distinction
  - CNY vs. CNH

THE PLAN

›The rise of the RMB hub: First Asia, then Europe, and now the Americas

› RMB internationalization is a classic example of Chinese policymaking in action

- › **Phase I, 2009 ish:**
  - › Hong Kong (¤)
- › **Phase II, 2013:**
  - › Southeast Asia
- › **Phase III, 2014:**
  - › Europe
- › **Phase IV, 2105:**
  - › Canada and the Americas
- › **Phase V, 2015:**
  - › IMF SDR Basket

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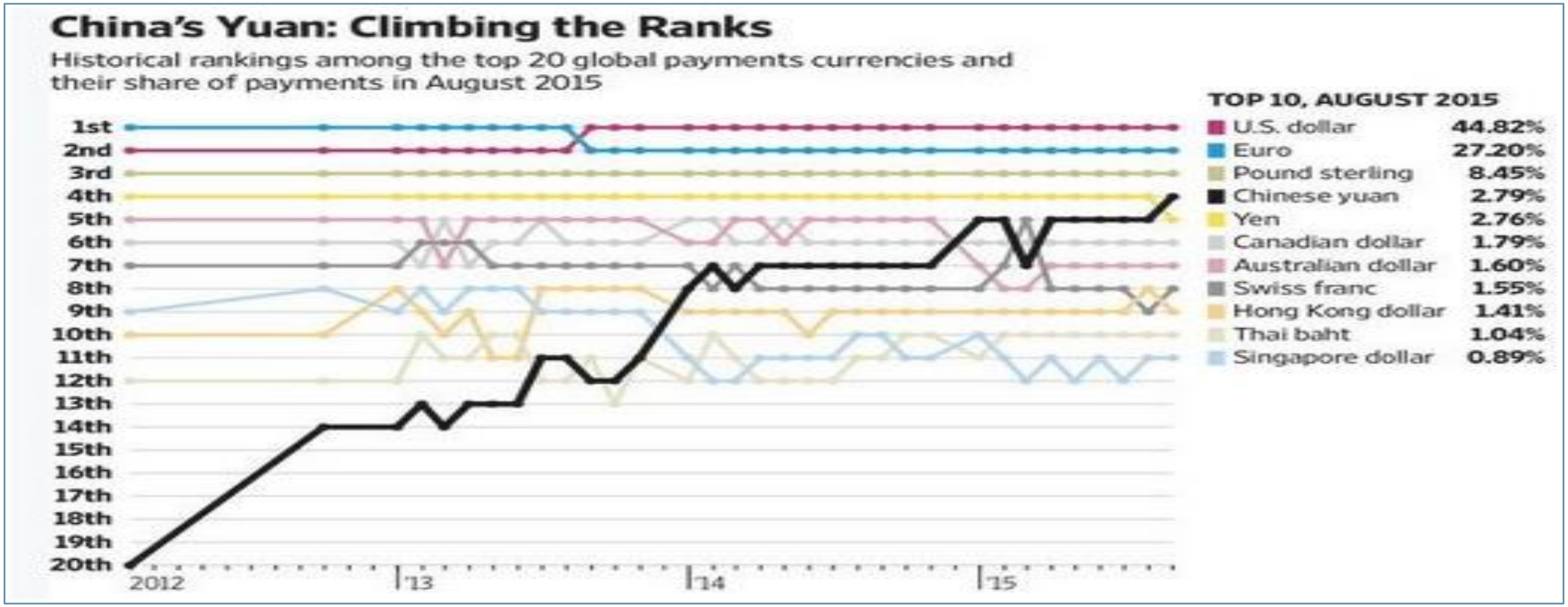
- › **Phase VI (2020):**
  - › Full convertibility?

Source: Bloomberg

THE PLAN IN ACTION — IT'S ALIVE!

› Three realities about RMB internationalization:

1. **Momentum** is key—the pace was glacial at first, but it's heating up fast and it is irreversible



Source: Wall Street Journal

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THE PLAN IN ACTION — IT'S WORKING

› Three realities about RMB internationalization (continued):

2. Asia is leading the charge

Renminbi usage surges in Asia-Pacific		
Currency	Jan-Apr 2012	Jan-Apr 2015
AUD	12%	12.1%
USD	21.7%	12.3%
HKD	21.8%	16%
JPY	28%	23%
RMB	7%	31%

Source: Swift

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THEN COMES THE SURPRISE DOUBLE WHAMMY

- Internal turbulence (5); external froth (1)

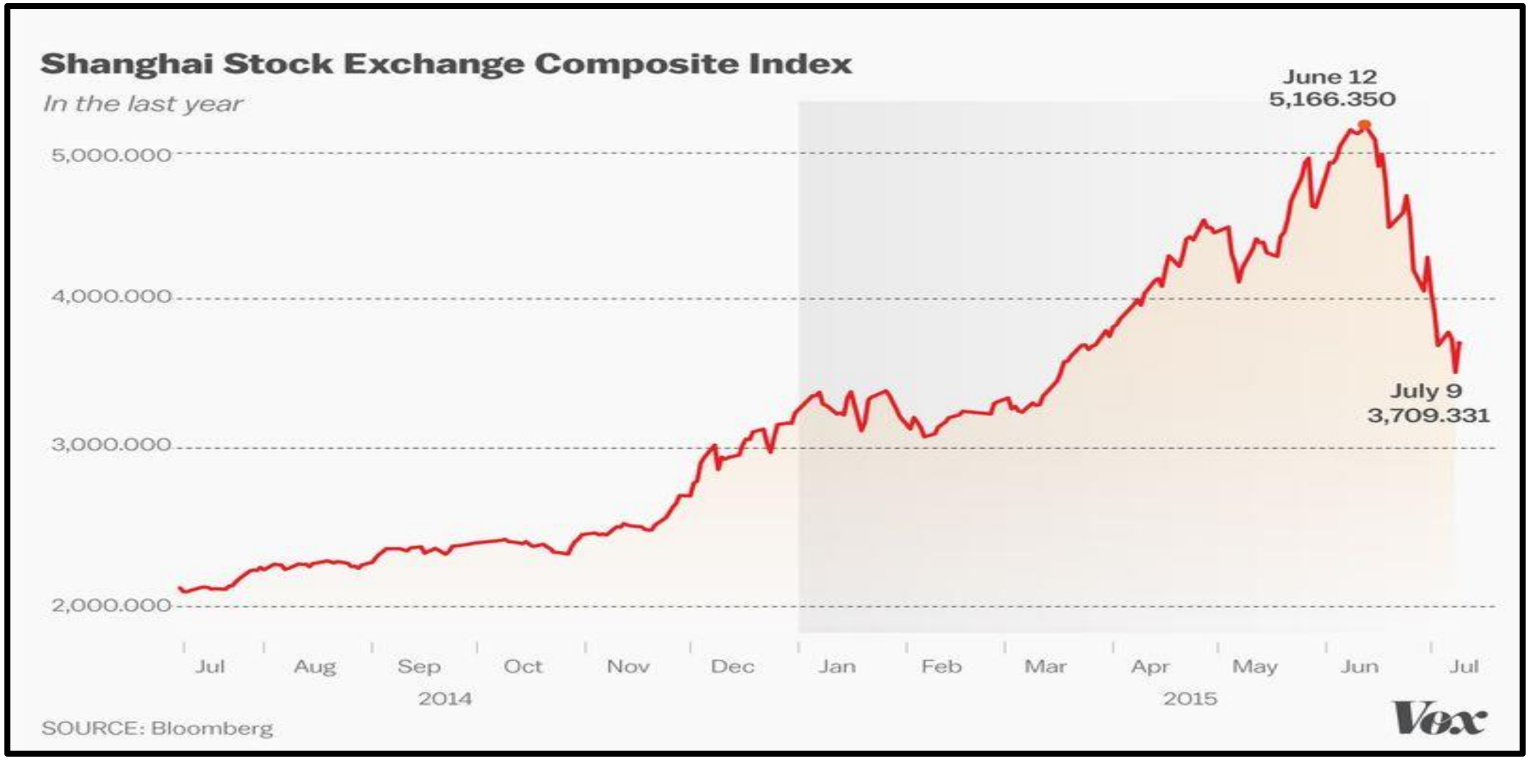
THEN THE SURPRISE DOUBLE WHAMMY —INTERNAL TURBULENCE

1. GDP growth slows faster than expected

Source: FT

THEN THE SURPRISE DOUBLE WHAMMY —INTERNAL TURBULENCE

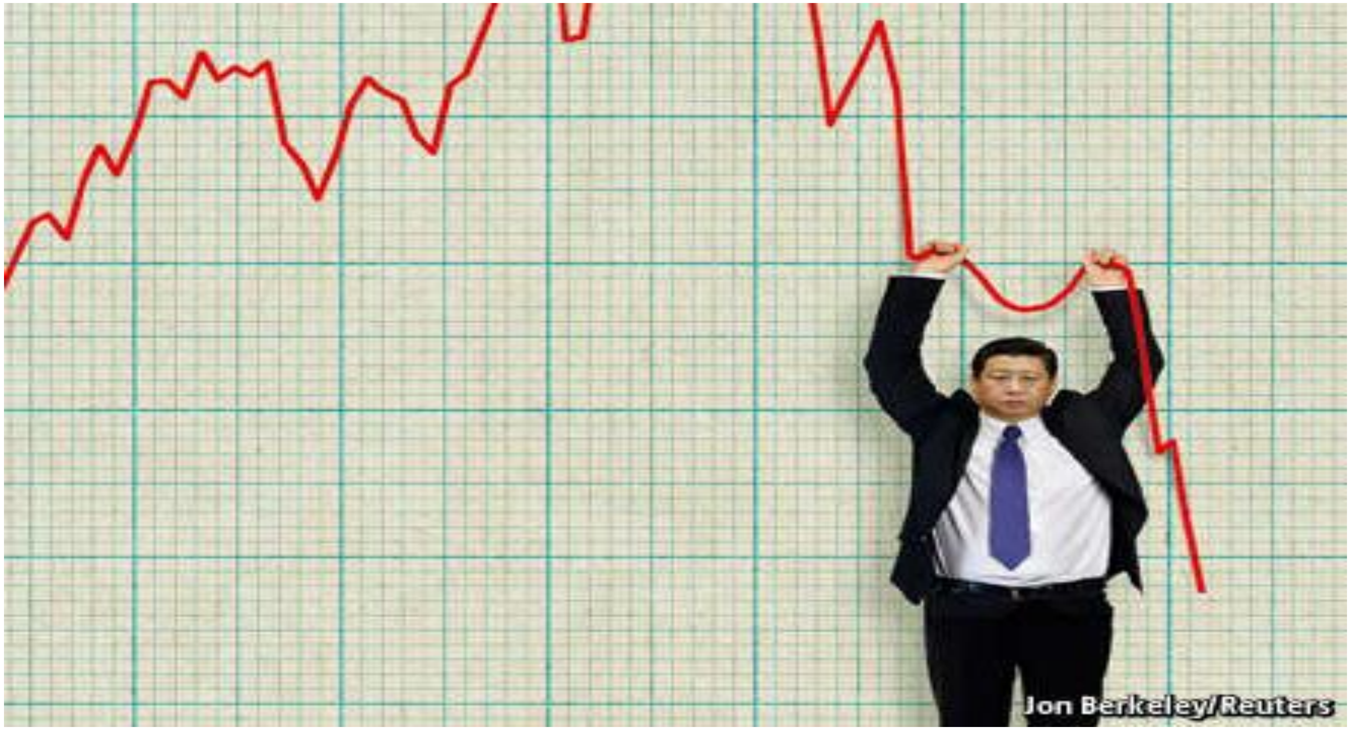
2. Equity markets tank in summer 2015



Source: Bloomberg

THEN THE SURPRISE DOUBLE WHAMMY —INTERNAL TURBULENCE

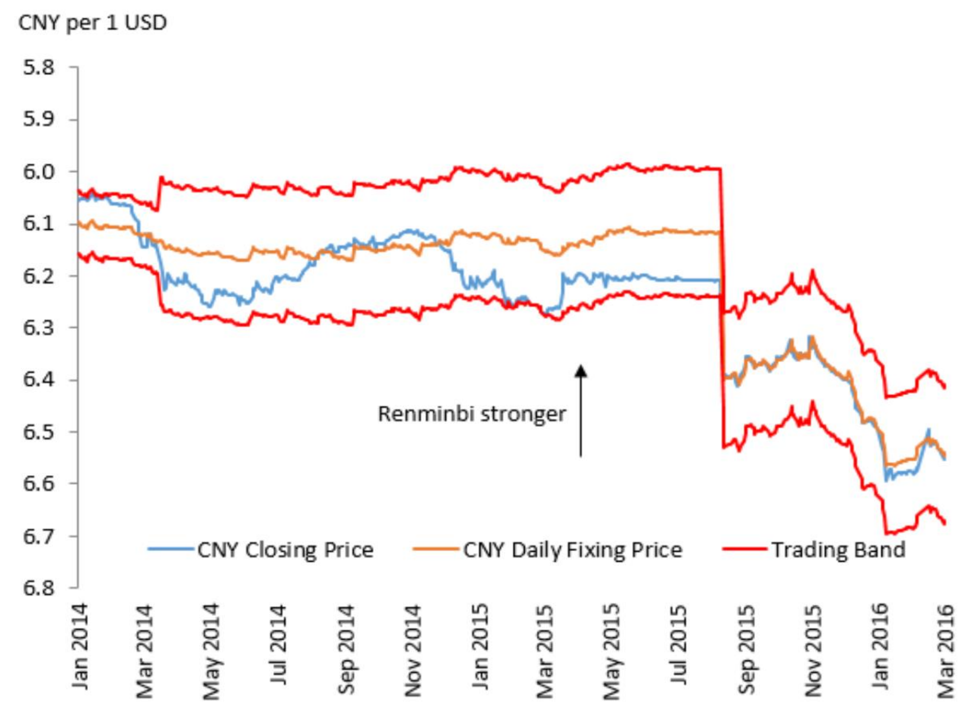
3. Missteps (intervention and circuit breakers)



Source: The Economist

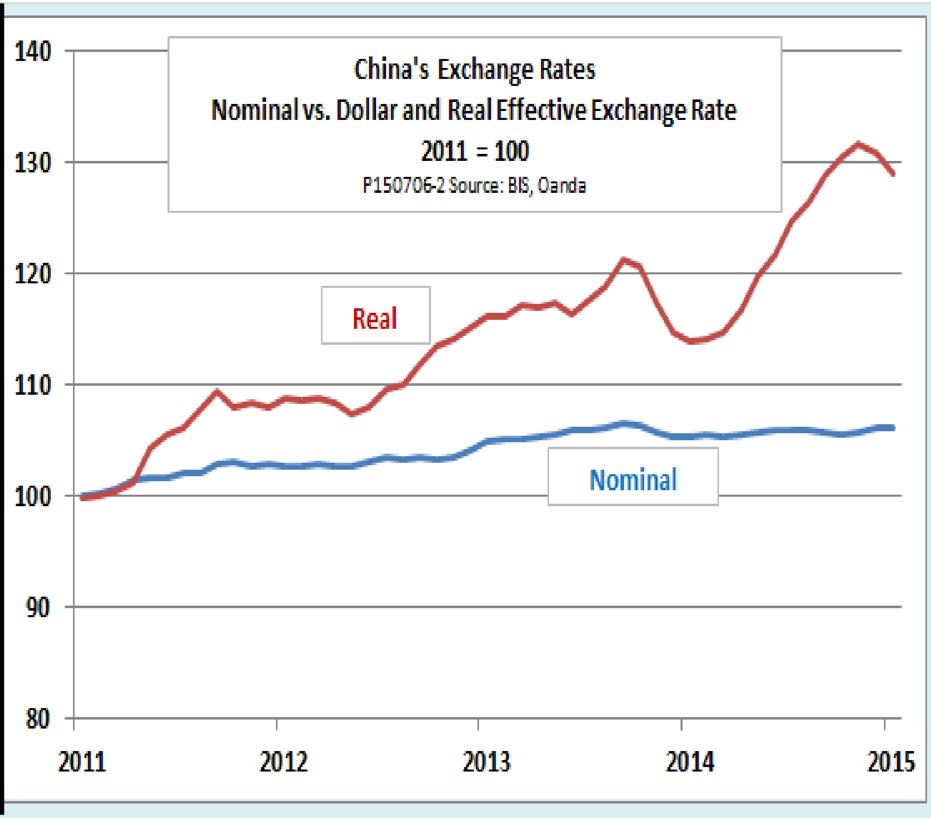
THEN THE SURPRISE DOUBLE WHAMMY —INTERNAL TURBULENCE

4. The PBOC suddenly devalues the RMB in August 2015



CNY = The abbreviation of China's currency, the renminbi

Source: Bloomberg.



Source: Bloomberg

Source: Ed Dolan

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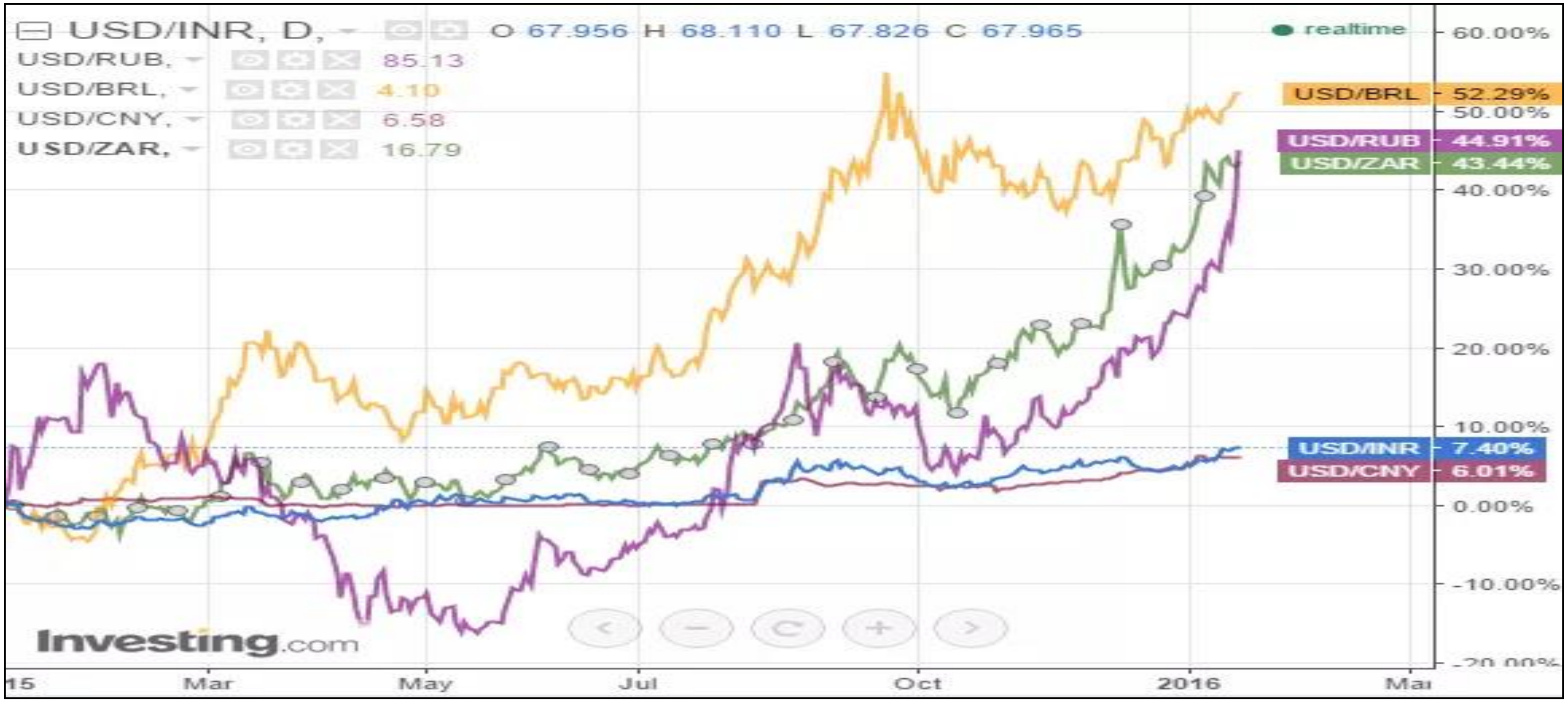
THEN THE SURPRISE DOUBLE WHAMMY —INTERNAL TURBULENCE

5. “Communication breakdown”: Radio silence and then misspeaks…

Source: Rebel Pepper

THEN THE SURPRISE DOUBLE WHAMMY —EXTERNAL FROTH

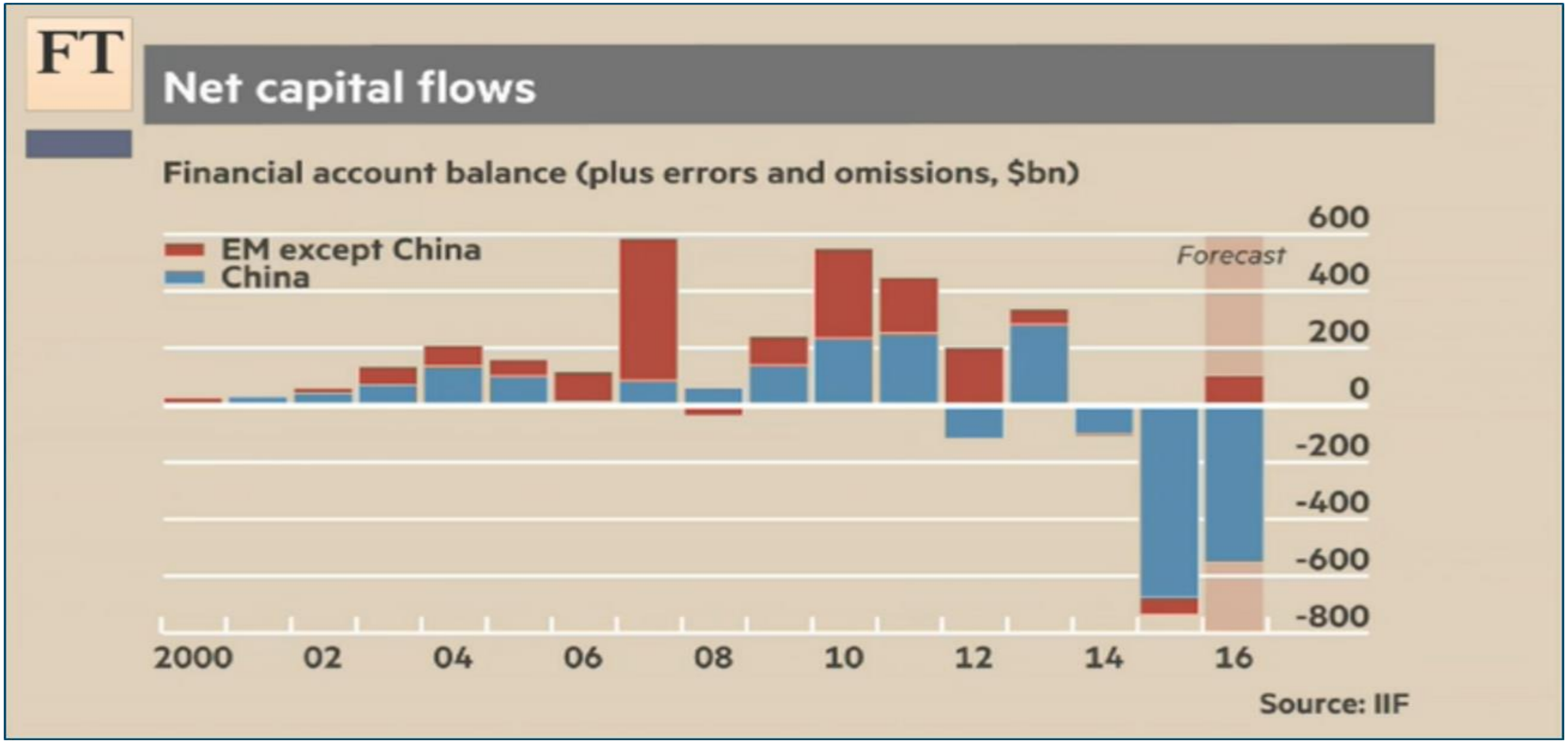
1. The US fed raises the overnight lending rate for the first time in 7 years, and the world's currencies and markets react.



Source: Investing.com

THEN THE SURPRISE DOUBLE WHAMMY —INTERNAL TURBULENCE; EXTERNAL FROTH

- The end result: China’s capital takes flight (but it’s not all bad)



Source: FT

QUESTION 1: SO WHY DOES CHINA WANT TO INTERNATIONALIZE ITS CURRENCY?

- Intangibles:
  - Geopolitical influence
  - Symbolism/prestige—just ask the British
- Tangibles:
  - Integral part of ongoing financial reforms
  - Trade inefficiencies—helps companies ↓ FX risk and ↓ costs
  - Investment and access to cheaper credit
  - Pricing advantages for consumers
- But… disadvantages as well—exports can become more expensive.

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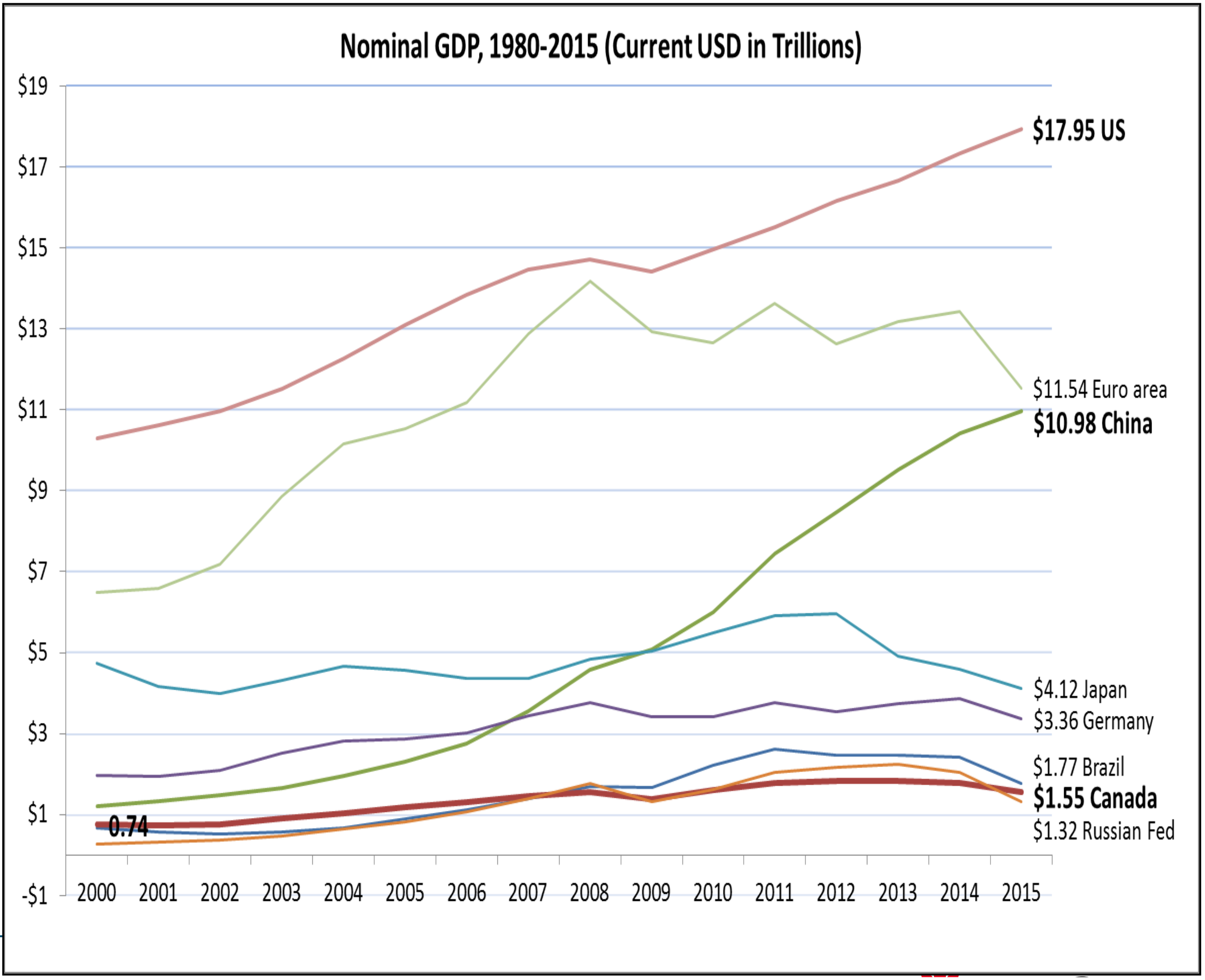
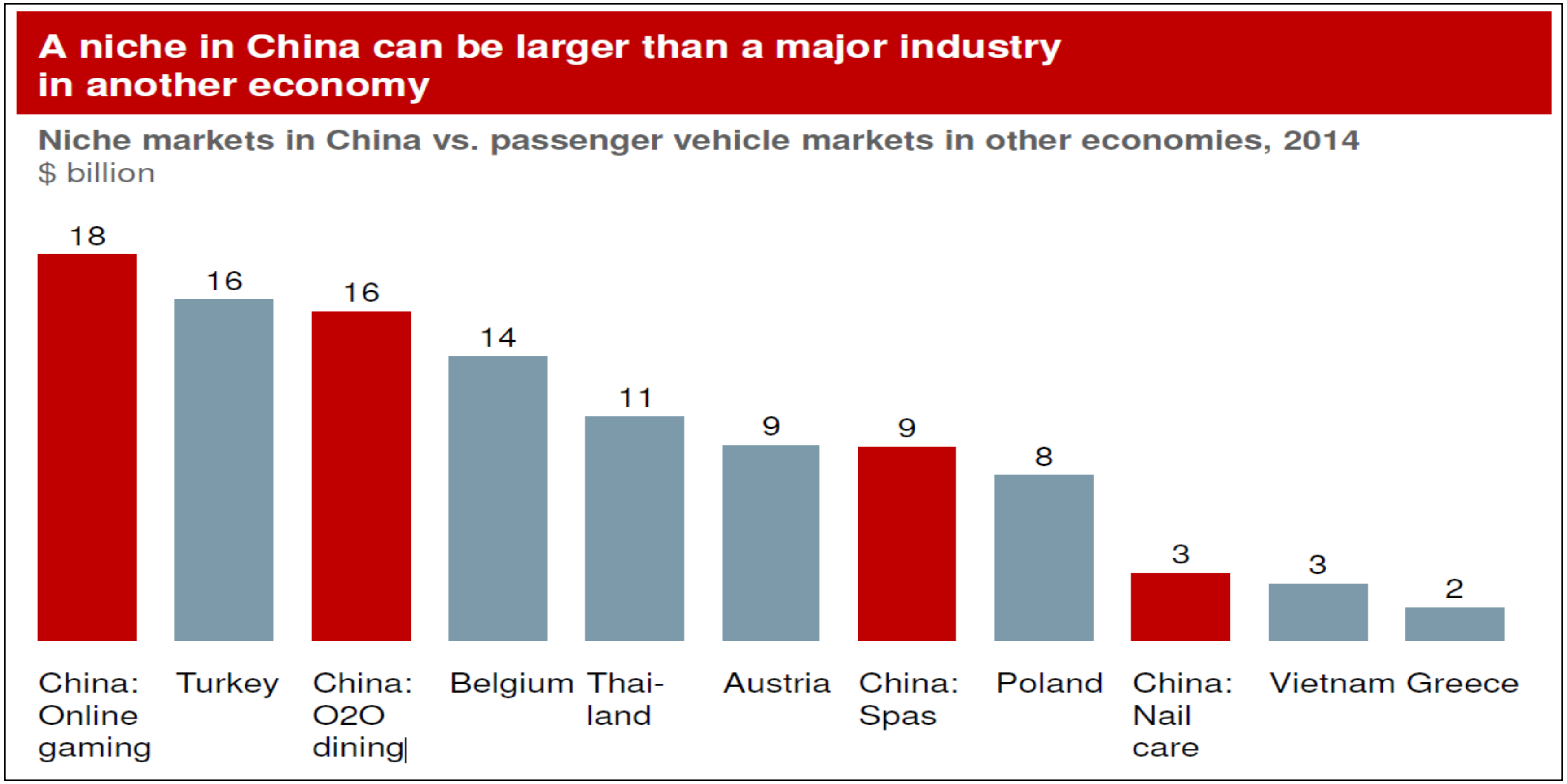
QUESTION 2: WHAT IS DRIVING RMB INTERNATIONALIZATION? — CHINA'S ECONOMIC MASS

- The Chinese economy has achieved liftoff
  - In 2015, China's GDP hit $10.9 trillion
    - An increase of $700 billion
    - Ontario's entire 2014 economy was $721 billion
- In other words, China is adding an Ontario to its economy on an annual basis.



Source: EDC Economics, IMF DataMapper

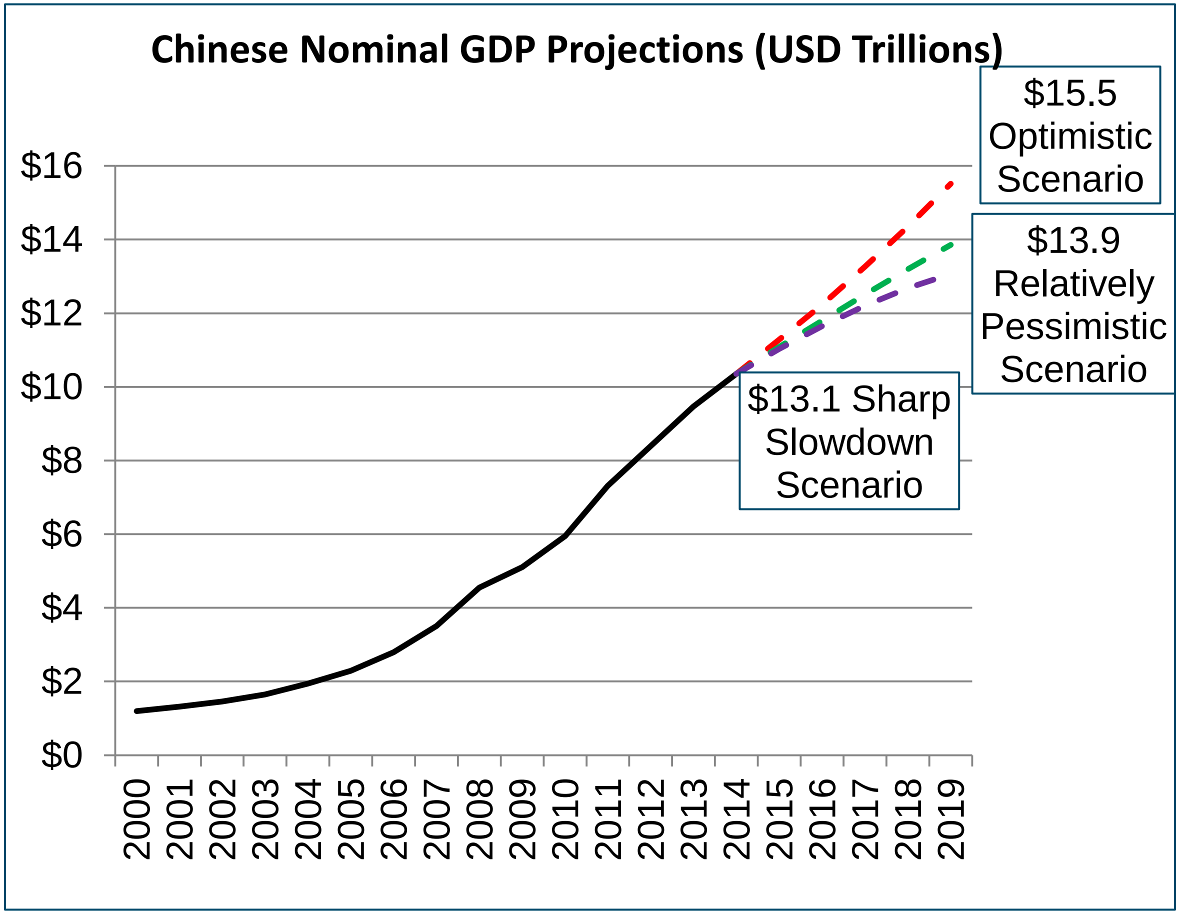
QUESTION 2: WHAT IS DRIVING RMB INTERNATIONALIZATION? — CHINA'S ECONOMIC MASS



Source: McKinsey & Company

QUESTION 2: WHAT IS DRIVING RMB INTERNATIONALIZATION? — CHINA'S ECONOMIC GROWTH

- **Optimistic scenario (8%):**
  - GDP increases by $5.1 trillion
- **Relatively pessimistic scenario (5%):**
  - GDP increases by $3.5 trillion by 2019
- **Sharp slowdown scenario (3%):**
  - GDP increases by $2.7 trillion by 2019

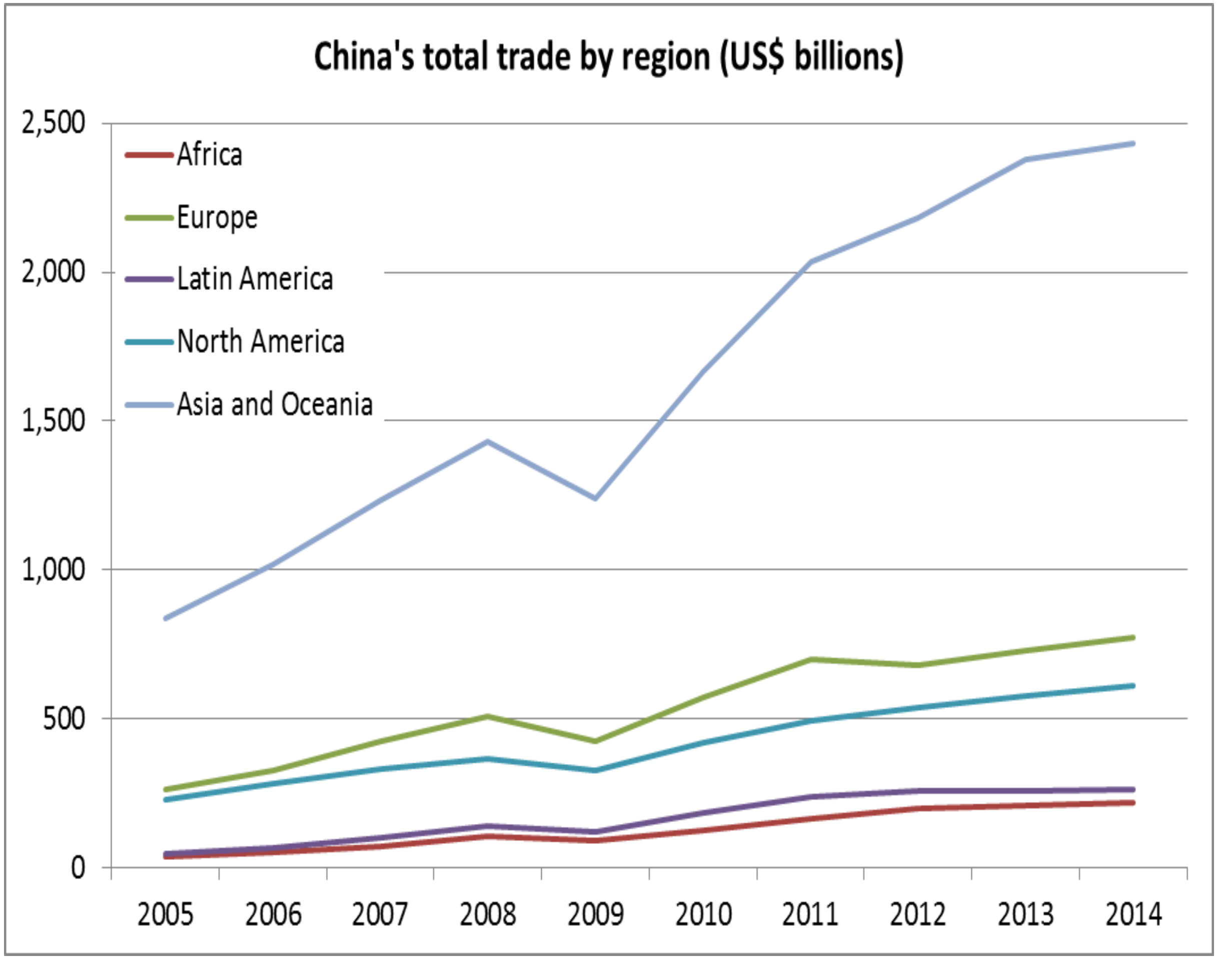


Source: EDC Economics, National Bureau of Statistics

QUESTION 2: WHAT IS DRIVING RMB INTERNATIONALIZATION? — THE RMB DEMAND STRUCTURE IS GLOBAL

- China's is a major trade partner for all regions:
  - #1 in Asia
  - #1 in Africa
  - #2 in Europe
  - #3 in Latin America

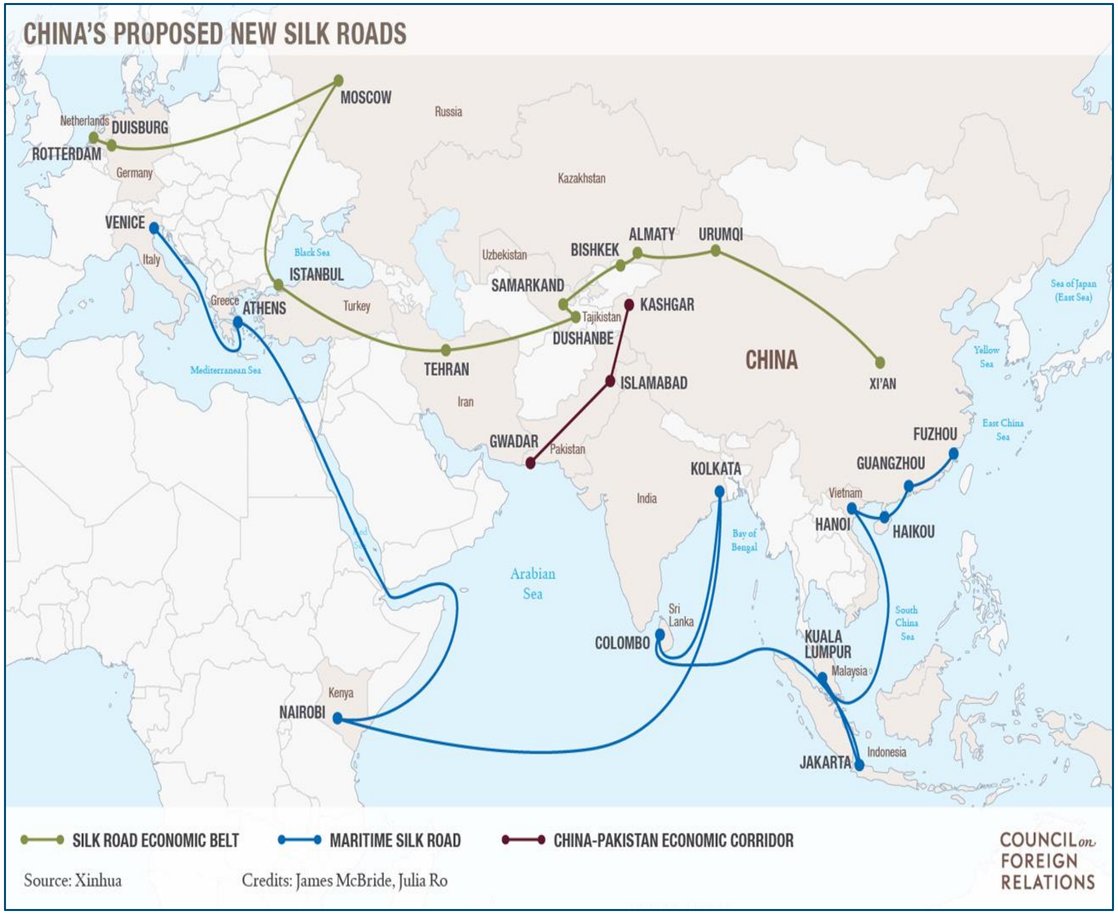
  (and soon to become #2)



Source: EDC Economics, National Bureau of Statistics

QUESTION 2: WHAT IS DRIVING RMB INTERNATIONALIZATION? — SUPPORTIVE POLICY ENVIRONMENT

- Ambitious policies like the “New Silk Road” will further deepen China’s global trade links
- Likely support of AIIB and NDB



Source: Council on Foreign Relations

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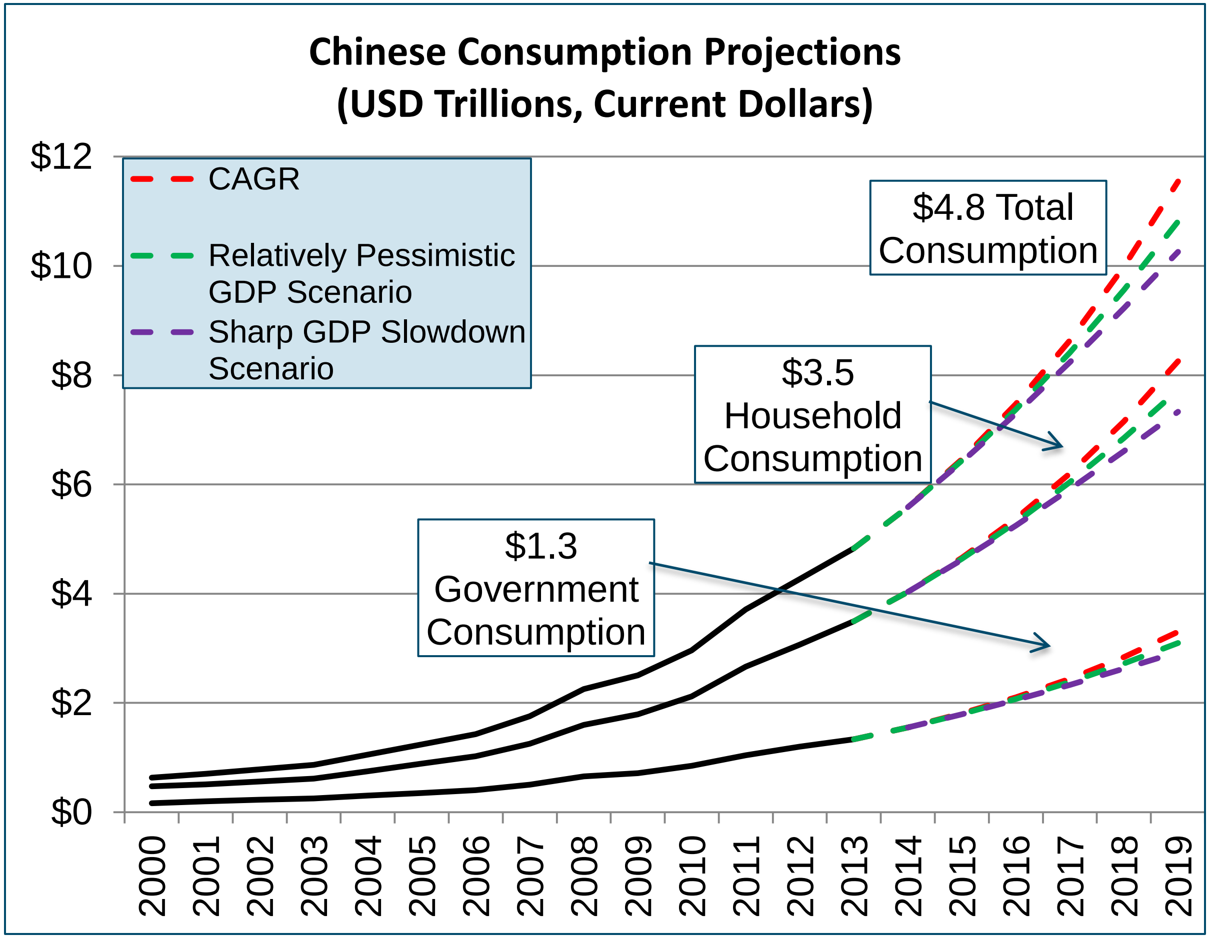
QUESTION 2: WHAT IS DRIVING RMB INTERNATIONALIZATION? — CHINA'S CONSUMPTION GROWTH

- As of 2013, total consumption stood at $4.8 trillion
    - An increase of 470 percent since 2003
    - Still small compared to US



Source: EDC Economics, National Bureau of Statistics

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QUESTION 3: WHY MUST CANADA CARE? — IT'S COMING, SO GET USED TO IT

- Many of the factors that have restrained the RMB's rise are rapidly fading away
  - USD interest rates are rising
  - Awareness is increasing in both Canada and China
  - Offshore RMB derivatives market is growing
  - Chinese FX agents

QUESTION 3: WHY MUST CANADA CARE? — IT'S GOOD FOR THE GLOBAL ECONOMY

- In order for China to internationalize the RMB, it needs to get its own financial system in order.
  - Capital account opening
  - Exchange rate reform
  - Interest rate liberalization
- These reforms will
  - Increase the efficiency of resource allocation within China
  - Help address global imbalances that led to China's accumulation of nearly $4 trillion dollars worth of foreign exchange reserves (early 2015).

QUESTION 3: WHY MUST CANADA CARE?
— IT CAN GIVE OUR COMPANIES A LEG UP

- **The four Cs of RMB business:**
  1. **Competition** for market share in China
     - Canada's international competition is exploring RMB solutions
     - As are Canada's leading exporters
     - Being done quietly to achieve competitive advantage
     - EDC RMB bonds have been snapped up
  2. **Capital** Management
     - Easier to do business with a Chinese small and medium sized client when payment is made in RMB
       - RMB letters of credit and cash financing easier to obtain and more flexible
       - Can bypass China's foreign exchange agents, who impose fees and enforce quotas (¤)

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QUESTION 3: WHY MUST CANADA CARE? — IT CAN GIVE OUR COMPANIES A LEG UP

3. Customers

- Sweetens a company's offering
  - Particularly important when your competition is rooted in price
- Expands the universe of Chinese clients

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QUESTION 3: WHY MUST CANADA CARE?
— IT CAN GIVE OUR COMPANIES A LEG UP

4. **Costs** benefits of 3-8%

Cost Savings	New Benefit/ Cost Transfer	Savings/ Premium
1. Direct conversion savings	New	0.5-1.0%
2. FX transaction fee premium	Transfer	0.5-2.5%
3. Convenience premium	New	1.0-2.0%
4. FX risk premium	Transfer	1.0-2.5%

Source: EDC Economics

BE AHEAD OF THE HERD

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