China

PBoC starts trial for RMB direct investment overseas

This move is an important step towards the internationalization of the RMB. The PBoC has given the official green light for Chinese enterprises to use the RMB in direct overseas investment on a trial basis. This has effectively provided another channel for the supply of RMB in offshore markets, and will encourage the subseqent use of trade-derived RMB offshore funds for investent use outside China.

The PBoC's first announcement of the New Year unsurprisingly revolved around internationalization of renminbi. Chinese enterprises eligible to make overseas direct investment (ODI) can now use renminbi in direct investment (including establishing new companies, M&A and acquiring equity) overseas, according to the announcement. But as a trial program, only non-financial enterprises registered in regions approved under the renminbi cross-border trade settlement scheme are eligible.

This trial programme will likely be small in scale at the early stages, and will likely accelerate the development of two important trends that have increasingly caught the eyes of the investment world in recent months. One is the internationalization of the renminbi, the other is the steepening pace of overseas direct investment.

Since renminbi's cross-border trade settlement kicked off in mid-2009 with its global roll-out, renminbi denominated trade settlement has exploded from several billion renminbi per month in the early days to nearly hundreds of billion per month (as of latest figures available). At the same time, Chinese enterprises have made impressive progress in funneling overseas direct investment. China has become the world's fifth largest source of foreign direct investment and ODI is likely to grow by 40-50% y-o-y.

We still think the renminbi will go global at a faster-than-expected pace with the most potent potential lying in emerging markets. Now the renminbi holds both trade and investment channels to go abroad. These dual channels of renminibi denominated trade and investment promote each other, supporting growing international acceptability of China's currency.

Note that the PBoC's trial on using renminbi in ODI will commence only for players in regions already approved to settle cross-border trade in renminbi, further encouraging the recycling of trade-related renminibi funds for subsequent use in offshore markets. This, plus Beijing's previous encouragement for Chinese enterprises to "go abroad", should expand the overseas circulation of renminbi by a substantial amount. Emerging markets account for nearly 90% in China's ODI, which in turn should help to meet the surging need for renminbi trade settlement in emerging markets.

Ultimately, faster accumulation of renminbi in overseas market and offshore renminbi center should promote the faster opening up of China's own domestic financial market.

Bottom line: Internationalization of the renminbi continues to move briskly, supported by an increasingly varied array of regulatory moves. In the longer term, this will ultimately accelerate the opening up of China's financial market.

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1 This report is dated as at 14 January 2011.

2 All market data included in this report are dated as at close 13 January 2011, unless otherwise indicated in the report.

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