Renminbi-Hub Switzerland: Dashed Hopes?

Swiss companies lack trust in the renminbi. Most daunting are the restrictions on capital movements by the Chinese central bank.

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Abstract

Since 2016, Switzerland has been a renminbi hub. That means: Since 2016, the Chinese currency can be traded across borders. There were high hopes linked to the establishment of the hub, as the Chinese currency renminbi was supposed to become a global currency in the foreseeable future. The gradual market opening of China, increasing freedoms for the renminbi exchange rate and the inclusion of the renminbi in the International Monetary Fund's (IMF's) basket of currencies were signs of this development. These hopes were curbed, however, in the recent past. On the one hand, current economic and geopolitical developments reveal the fragility of the Chinese course in monetary and currency policy. On the other, a study by the ZHAW School of Management and Law shows that Swiss companies with involvement in China have little faith in the renminbi and therefore hardly use it. It thus might take a while longer before the renminbi becomes a global currency.

The Swiss financial community invested a lot of energy in the past years so that the renminbi could be traded in Switzerland. Given the increase in trade between Switzerland and China, the Swiss Bankers Association considered the development in Switzerland of a so-called renminbi hub, a financial centre outside of China in which the renminbi can be traded across borders, to be a priority.

The efforts expended for a renminbi Hub were crowned by success in 2014, the same year in which the free trade agreement between Switzerland and China entered into force. The central banks of these two countries concluded a Swap agreement which enabled the creation of a liquid renminbi-franc market. Also in 2014, the Swiss National Bank (SNB) added the renminbi as a reserve currency in its growing Asian foreign currency portfolio.

In 2016, the Chinese Construction Bank (CCB) was the first Chinese bank to open a branch in Zurich. Since then, CCB has operated as a clearing bank for transactions in renminbi in Switzerland. This year, the Industrial and Commercial Bank of China (JCBC) followed suit. Swiss companies can now hold renminbi accounts and conduct cross-border transactions directly from Switzerland with their Chinese counterparties, without making detours via the dollar or via other financial centres such as Hong Kong or Singapore. This ensures that the Swiss financial centre does not get left behind other centres such as London, Frankfurt, Paris and Luxembourg.

Gradual Opening

As an export and import country, China generally strives to make payments with foreign countries in renminbi. This eliminates exchange rate risks and dependence on foreign currency reserves. The renminbi has however only been approved as a means of payment in international trade since mid-2009. Since the internal stability of the financial system is an absolute priority for Peking, China's monetary policy opening is being pursued gradually[1]: Initially, renminbi hubs are being established in the world's most important financial centres, resulting in liquidity holdings of renminbi. There are already around two dozen such hubs. The Chinese government's intention is clear: They intend for the renminbi to become established as a global trading currency and, through attractive investment opportunities outside China, as a global investment currency. Internationalisation of the renminbi is not only advantageous for China's cross-border trade, but also for Chinese infrastructure projects abroad – with the "New Silk Road" (Belt and Road Initiative) being the most prominent example. From the Chinese view, it is self-evident: If these projects are carried out in renminbi, Chinese banks have an advantage over their foreign competition.

Long-term, the aim is for the renminbi to become established as a world currency with reserve status, which makes China more independent of monetary and interest rate decisions in other countries. With the addition of the renminbi to the currency basket of the International Monetary Fund (IMF) and the increasing freedoms for the renminbi exchange rate, Peking has already achieved significant milestones.

China's Dilemma

China being an export and import country, the Chinese central bank has however never completely left the renminbi's exchange rate versus the dollar to the market. Accordingly, the exchange rate always varies within a certain range. There are two reasons for this: On the one hand, Chinese companies are highly exposed in dollars due to the large volume of exports to the US. As such, 80 percent of the foreign currency obligations of Chinese companies are conducted in dollars or Hong Kong dollars (the rate of which is loosely tied to the USD rate). Secondly, the stable exchange rate is intended to contribute to gaining the trust of the global economy, thus supporting the path of renminbi to become a global currency.

Despite these measures, US tariff increases on Chinese exports and domestic debt problems have significantly impacted the external value of the renminbi. Currently the rate is hovering close to the long-standing upper limit of 7 renminbi to 1 dollar. This means that further interventions by the central bank might carry a high price.

In addition, for the confidence of economic stakeholders in a currency, not only a stable exchange rate is of central importance, but also free, international capital movement and autonomous monetary policy decisions which are made mainly based on inflation, employment and economic growth. In practice, there is however a conflict of objectives, since only two of these three monetary policy ideal situations can be achieved. In this context, we refer to a "trilemma of the exchange rate scheme".

Currently, for China's central bank, the exchange rate relationship with the dollar and the autonomous monetary policy with low interests and a generously assessed quantity of funds is a priority to support the dwindling domestic economy. Consequently, the central bank must abandon the objective of free international movement of capital, which we currently see in the massively heightened restrictions and controls in international movement of capital. Thus, a Swiss company can only repatriate the earnings of a subsidiary in China to Switzerland to a limited extent. These restrictions on free movement of capital are detrimental to the confidence in the renminbi as an international currency and to the success of the renminbi hub.

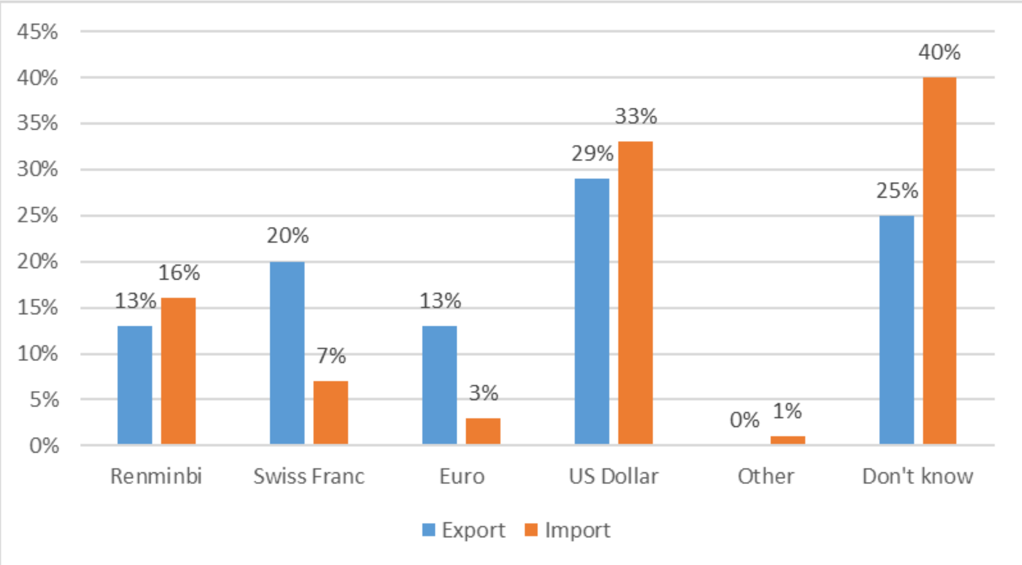
[1] Rudolf Joachim, Tester Elisabeth: China – Der nächste Horizont. Ein Kompass für Anleger und Unternehmer (The Next Horizon A Compass for Investors and Entrepreneurs), NZZ Libro, 2016

Swiss Companies Reticent

A survey by the ZHAW School of Management and Law confirms that Swiss companies lack confidence in the renminbi. In collaboration with the Swiss-Chinese Chamber of Commerce, in May 2018, we surveyed a total of 35 companies operating in China. The companies come from the following sectors: machinery, electrical and metal industry, textile, trade, chemicals and pharmaceuticals as well as ICT.

Among the companies surveyed, 24 export directly to China. Only 5, of which 3 large companies with an annual turnover of more than 50 million francs and with many years' experience in business with China, invoice in renminbi. Overall, 13 percent of the total export volume to China covered in the study is invoiced in renminbi, while the dollar, as the most used currency, has a share of 29 percent (see *Figure 1*). The dollar is clearly the dominant currency for cross-border import from China to Switzerland. In contrast, the renminbi is only used by 8 of the 30 companies that import from China.

Fig. 1: Currency used by Swiss companies for trade with China (2018)



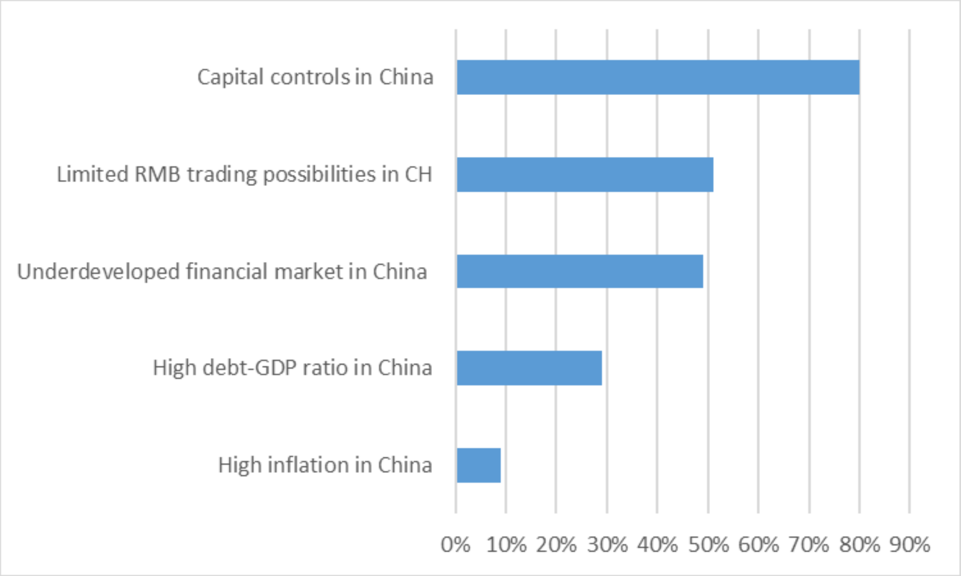
Comment: Survey of Companies (N=35); Source: ZHAW (2018)

Around half of the companies surveyed purchase renminbi from established banks in Hong Kong and Singapore. Just under 40 percent check the offers of the Zurich Renminbi Hub; 17 percent of those surveyed prefer other options, e.g. a subsidiary in China.

Overall, 1/5 of the companies plan to use the renminbi in their business to a greater extent in the future. The Chinese national currency is also hardly used to manage liquidity reserves of the companies: Only 17 percent of the companies would like to use the renminbi in the future for this purpose. The reticence is all the more noteworthy as, since the entry into force of the free trade agreement in July 2014, Swiss exports to China have increased by around one-third.

In performing the evaluation of the limiting factors for further internationalisation of the renminbi, the significance of the aforementioned trilemma was confirmed. Here, for 80 percent of the companies, capital movement controls are the largest obstacle (see *Figure* 2). Around half each of those surveyed refer to the "rather underdeveloped financial market in China" and the limited trade opportunities for the renminbi in Switzerland as obstacles.

Fig. 2: Limiting factors on the path to internationalisation of the renminbi from the perspective of Swiss companies



Comment: Multiple mentions possible; Source: ZHAW (2018)

In sum, we can say: The renminbi is struggling to become a global currency. While China's national bank is making targeted efforts to promote an international network of renminbi hubs outside China, the international acceptance of the renminbi as a means of payment and reserve currency requires more time and is more fragile than we thought. As the company survey clearly shows, building confidence is the biggest challenge to operating a successful renminbi hub. This confidence must, first and foremost, be promoted by the Chinese government and is a long-term endeavour. Further market opening with free movement of capital and a flexible exchange rate scheme seem to be of central importance in this.

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