

THE RENMINBI

FROM THE PEOPLE'S MONEY TO A GLOBAL CURRENCY

A practical introduction to conducting cross-border trade and investment with China.

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The Hon. Steven Clobo, MP
Minister for Trade, Tourism
and Investment

Foreword by The Minister for Trade, Tourism and Investment

The rise of China as a global economic powerhouse has been well documented. Perhaps less well known has been the emergence of China's currency, the Renminbi (RMB), as one of the world's truly global currencies.

Use of the Renminbi was limited even ten years ago. In 2009, China launched a pilot program for cross-border settlement and since then, the Renminbi has become one of the world's top five payment currencies and the second most widely used in traditional trade finance.

China's economic rise has also seen rapid growth in demand for Australia's high quality goods and services. China is now Australia's number one trading partner with two-way trade in excess of \$155 billion.

The Turnbull Government is boosting opportunities for Australian exporters by opening up market access and removing barriers to trade and investment.

The China-Australia Free Trade Agreement (ChAFTA), which came into effect in December 2015, is a key enabler for building closer trade ties with China, facilitating our access to China's increasingly wealthy consumer and ensuring that Australian goods and service providers are guaranteed the best market access of any foreign country.

In much the same way that ChAFTA removes barriers, the increasing use of the Renminbi in international trade has the potential to provide businesses with a competitive advantage, including through better pricing and payment terms, access to deeper sources of funding and minimizing transaction costs.

I commend the authors of this report – the Australia China Business Council (ACBC), Commonwealth Bank of Australia, PricewaterhouseCoopers (PwC) and the Australian Trade and Investment Commission (Austrade) – for providing a straightforward guide to transacting in the Renminbi.

The opportunities for Australian business in China are significant, and this report provides a clear pathway for companies seeking to grow our trade and investment relationship.



Foreword by Australia China Business Council

The Hon. John Brumby
National Chairman
Australia China
Business Council

It is with great pleasure that I present to you the report “The Renminbi - From People’s Money to a Global Currency”.

Produced by the Commonwealth Bank of Australia in partnership with the Australian Trade and Investment Commission (Austrade) and the Australia China Business Council (ACBC) with contributions from PricewaterhouseCoopers (PwC), this report provides a practical guide for Australian businesses interested in using the renminbi (RMB) for trade, investment and capital management purposes.

China is the world’s largest exporter, and second largest importer, and every economic decision it makes has far reaching ramifications for its trading partners. The internationalisation of the RMB is an excellent example of this, and it is imperative that Australian businesses fully understand the opportunities presented by the use of RMB in foreign trade.

The report offers practical insights on the benefits of using RMB, including how accessible the RMB is for foreign businesses, and how it is easy to use in cross-border trade, investment and liquidity management.

As China shifts towards a consumption-based economy, the nature of Australia’s trading relationship with China will continue to develop. Australia’s ability to adapt to China’s changing consumer preferences is not just limited to the products and services we offer. As identified in this report, it is increasingly important that Australian organisations can transact with Chinese companies in RMB. Better understanding the opportunities presented by the use of RMB will be a key driver of success for Australian business, and makes this report important reading for government and business leaders.

On behalf of the ACBC Board and our members I would like to sincerely thank our sponsors and partners, the Commonwealth Bank of Australia, Austrade and PwC for making this important report possible.



Foreword by Commonwealth Bank of Australia

Kelly Bayer Rosmarin
Group Executive,
Institutional Banking
& Markets
Commonwealth Bank
of Australia

As Australia’s largest trading partner, China’s global plans for its currency, the renminbi (RMB), have significant relevance to the future economic development of both countries. The China-Australia Free Trade Agreement (ChAFTA) that came into effect at the end of 2015 provides a compelling backdrop for capitalising on a myriad of trade and investment opportunities, including further development of the RMB market.

The ancient Chinese were famous for their inventions, one being the development and use of paper - including paper money - in the 9th century. It is apt then, following China’s long journey of financial and economic liberalisation since the 1970s, that the RMB is now taking its rightful place on the global currency stage. To this end, the International Monetary Fund (IMF) announced that the RMB would become the fifth reserve currency to join the Special Drawing Rights (SDR) basket of currencies in October 2016.

While China has introduced significant regulatory changes to support its pivot from an investment-led economy to one that will rely on consumer demand for future growth, Australia will play an active role in laying the foundations for local companies to tap the many opportunities presented by China. Historically, however, local companies have been cautious to take advantage of our preferential trading and investment relationship with China. Part of their challenge has been demystifying what is sometimes perceived to be a complex business environment.

This is why this report was created by the Commonwealth Bank of Australia (Commonwealth Bank), in partnership with the Australian Trade and Investment Commission and the Australia China Business Council, with contributions from PricewaterhouseCoopers. Providing Australian companies with a concise how-to guide to use RMB as part of their operational and financial strategies will help them overcome some of the perceived obstacles to tap into this significant market.

Commonwealth Bank has had a presence in the Chinese market for over two decades since opening its first China representative office in 1992 in Beijing. The Bank currently has a presence in Shanghai and Beijing. Commonwealth Bank was granted a RMB license for its Shanghai branch in 2015 enabling us to service both the onshore and offshore RMB needs of Australian companies with established operations outside China. It has also enabled us to become more relevant to our Chinese clients in China and the market more broadly.

Commonwealth Bank is proud to demonstrate its expertise in helping clients - some of whom are featured in this report - who have already embarked on this journey. Our dedicated RMB and China Solutions team has a proven track record in structuring and delivering solutions to clients, and assisting them in expanding their trade and investment relationships across the economic corridor between China and Australia. We help clients across the industry spectrum understand the regulatory landscape governing cross-border trade and investment while also providing a one-stop shop experience for clients’ bespoke requirements.

The coming 12 months will be important for Australian companies, particularly those in the services sector. Our economy is reconfiguring, moving from a resources-heavy focus towards promoting our market-leading position in industries such as education, agriculture, tourism, healthcare and others. China’s burgeoning middle class - which is forecast to surge past the 850 million mark in the next 14 years’ - is eager for our quality goods and services, and this growing appetite represents substantial prospects for Australian companies who move now to seize this opportunity.



Executive Summary

Early this year, China's State Council launched a pilot program covering 10 cities and provinces, and five new districts to provide more flexible rules to boost service trade. This two-year program² will further open China's service trade market to foreign companies and encourage domestic service businesses to increase their exports.

This program is just one example of the many initiatives and reforms China has embarked on as the country continues to shift from investment-led to consumption-led growth, supported by the creation of financial infrastructure. A key milestone on this journey has been the internationalisation of the country's currency, the renminbi (RMB), since China started promoting its offshore use in the late 2000s.

As the world's largest exporter – and second-largest importer – any changes China makes to the composition of its economy have far-reaching ramifications for its trading partners.

Complementing China's trade story has been the liberalisation of its regulatory regime to promote foreign direct investment (FDI) in the country, and outward direct investment (ODI) by Chinese companies in preferred industries and sectors abroad. This trend is already making its mark: in 2014, overseas investment by private sector businesses in China overtook that by state-owned enterprises (SOEs) for the first time.³

Fuelling opportunities in both instances has been the growth in China's middle class, a powerhouse that by 2030 will triple in size, and comprise more than 70 per cent of the country's population.⁴ This growing population segment will increasingly demand quality goods and services produced both domestically and internationally.

Running parallel to China's growth, the Chinese government has been keen to promote its currency, the renminbi (RMB), Chinese for 'the people's currency' in line with Chinese naming conventions. The currency is also known as the yuan or 'redback'. China has delivered rapid reforms to transform what was once a restricted and heavily regulated currency into one increasingly used for international trade and investments, as discussed in this report.

In just seven years, since the launch of a pilot program to trial the currency in cross-border settlement, the RMB has become one of the world's top five payment currencies and the second most widely used in traditional trade finance. In October this year, it will achieve one of its most important milestones when it is added to the International Monetary Fund's (IMF's) special drawing rights (SDR) basket of currencies.

This report – brought to you by Commonwealth Bank of Australia, in partnership with Australian Trade and Investment Commission and Australia China Business Council, with contributions from PricewaterhouseCoopers – comes at an opportune time. Despite the decline in commodity prices, China continues to import record volumes of iron ore from Australia. In addition, the China-Australia Free Trade Agreement (ChAFTA) which came into effect in late 2015 after 10 years of negotiations, opens up further opportunities for Australian businesses. The relationship between China and Australia has achieved new significance since the ChAFTA came into force. This has coincided with the China-driven launch of the Asian Infrastructure Investment Bank (AIIB) and unveiling of China's One Belt, One Road (OBOR) strategy aimed to enhance connectivity across the region.

Rounding off a plethora of economic reforms and new financial infrastructure has been the creation of a global network of RMB hubs – including Sydney – to support foreign businesses in adopting the RMB as part of their operational strategies.

This report is aimed at businesses and organisations that have identified the multiple prospects and benefits from doing business in or with China, and has been crafted as a practical guide to capitalise on these opportunities by using the RMB.

The ongoing internationalisation of the RMB has brought many changes. Today, the RMB is easier to use and more accessible to foreign businesses than ten years ago. This report outlines how to use the RMB for cross-border trade, investment and liquidity management.

The information in this report was current and accurate at the time of publication. China's rapidly evolving economy means that regulatory change is happening all the time – and this can be daunting to organisations that need to navigate a complex environment. Australian businesses don't have to go it alone. They can rely on the expert guidance of their banking partners to meet China's regulatory requirements and to implement bespoke solutions specific to their strategic objectives.

CHAPTER 1

RMB INTERNATIONALISATION – THE RISE OF THE REDBACK

“ ... the Executive Board (determined) the RMB to be freely usable and include it in the SDR basket as a fifth currency, along with the British pound, euro, Japanese yen, and the U.S. dollar. ”

Christine Lagarde, Managing Director, IMF.⁵

“ Reform of the RMB exchange rate formation regime will continue in the direction of market operation. China is advancing the convertibility of the RMB under the capital account in a steady and orderly manner. ”

Xi Jinping, President, People's Republic of China.⁶

“ China's plans to liberalise its economy, and more specifically the RMB, has already had a significant impact on the global financial markets, making it important to understand its application in everyday life to ensure our companies are competitive when dealing with or in China. ”

Andrew Hinchliff, Executive General Manager, Global Markets, Commonwealth Bank.



Figure 1: Shenzhen in 1980 (above) and in 2016 (right).

To understand the renminbi's (RMB's) ascension up the ranks to one of the world's most used currencies, and the resulting implications, it is necessary to see the redback in the context of China's gradual transition over the past four decades away from a command economy. Predicting the currency and economy's future path and China's general intentions in this regard can only be achieved by understanding its past trajectory.

For nearly three decades, China's economy was managed according to Marxist-Leninist principles. China's economy was centrally planned and devoid of private ownership, entirely dependent on government intervention to produce growth.

In 1978, the introduction of economic reforms under Deng Xiaoping opened up China's economy, paving the way for the reforms introduced years later to internationalise the RMB.

Change did not happen overnight under Deng, whose market reforms were cautious and tightly managed. Nonetheless, the reshaping of the Chinese economy was profound and its impact ubiquitous: there is scarcely a person alive today who hasn't been touched by it in some way.

In 1953, influenced by the Soviet Union's economic model, China introduced the 'Five-Year Plan' to concentrate state efforts on certain sectors. Initially, these plans introduced social and economic reforms focused on headline growth in gross domestic product (GDP).

The 12th Five-Year Plan, covering 2011 to 2015, shifted the focus towards sustainability, wealth and disparity, and the urbanisation in western China. GDP forecasts were revised down to an annualised figure of seven per cent as China prepared to move to a consumption economy that can deliver sustainable long-term growth that is fuelled by the rising living standards of its population. The latest 13th Five-Year Plan continues to build on this progress. It aims at encouraging domestic innovation and entrepreneurship to maintain sustainability under the 'new normal' pace of economic growth.

Today, China accounts for 12.4 per cent of global merchandise exports.⁷ It is the world's third-largest foreign investor, and in 2014, overtook the US in terms of the value of foreign direct investment.⁸ This does not factor in any contributions from Hong Kong, which has been an economic powerhouse for the mainland since becoming a Special Administrative Region of the People's Republic of China in 1997.

Evidence of Deng's strategy 'to deliver socialism with Chinese characteristics' was first seen in the 1980s when a small number of farmers were permitted to own their produce for the first time. More ambitious schemes soon followed, and as reforms gained momentum, the country's economy expanded dramatically. Over the next 30 years, China stunned the world with GDP growth that was matched only by its insatiable demand for resources.

The impact was felt almost immediately. For example, the small fishing town of Shenzhen was designated China's first special economic zone in 1980, in which China's version of market policies could be tested. By the 1990s, Shenzhen was one of the world's fastest growing cities. In just three decades, Shenzhen's population grew from 30,000 to reach 2015 estimates of nearly 11 million. Today, it is the gateway to China's most important manufacturing regions in the Pearl River Delta megacity, which has a population of 44 million people.⁹

Reform after reform followed the Shenzhen experiment. China opened its first stock exchange in 1990 in Shanghai, and joined the World Trade Organization just over a decade later, after becoming one of the world's largest exporters and importers. Tariffs on foreign goods were reduced or abolished, and foreign companies were permitted to establish ventures on the mainland. Money poured into building ports, railroads, airports, power stations and even whole cities, monopolising the world's construction cranes to keep up with the furious pace of growth.

MANAGED REFORM

The RMB's journey to its current global prominence had a similarly judicious start. As trillions of dollars were pumped into developing China's manufacturing base to create the foundation of its economic transformation, the country's leadership rolled out carefully controlled financial market reforms.

After 1978, China's authorities created a dual-track currency system. The RMB – or yuan, as the individual units are known, similar to the difference between sterling and the pound – could only be traded domestically, and foreigners were restricted to using foreign exchange certificates to settle transactions. The foreign exchange certificate system was abolished in 1995, marking the start of RMB internationalisation journey.

China's decision to separate foreign exchange trading of its currency on the mainland (designated 'CNY') from that traded offshore (designated 'CNH') was motivated by the desire to protect its capital account from any potential outflows that may have constrained the nation's ability to invest in domestic infrastructure.

A major milestone was reached in July 2005 when the RMB's peg to the US dollar was converted into a tightly managed trading range. This was gradually widened in subsequent years in the evolution towards a freely floating currency.

In about 2005, China began promoting the use of RMB beyond its national borders. Multiple initiatives and channels laid the foundation for RMB to become a meaningful player in international trade and investment.

Table 1: The differences between CNY and CNH

	CNY (onshore)	CNH (offshore)
Definition	Denotes the exchange rate available in the onshore (mainland China) market	Denotes the exchange rate available in the offshore market (outside mainland China)
Spot rate	Official mid-point rates are set by the People's Bank of China	Based on supply and demand
Transaction location	Mainland China	Offshore
Eligibility	Subject to eligibility criteria under various schemes	No restriction
Approvals / documents	Evidence of supporting documents required	None
Opening times	CST: Mon to Fri 09:30 to 23:30	24 hours

A DECADE OF FOCUSED EFFORT

As China's currency gained prominence, comparisons were soon made with the US dollar – or 'greenback' – historically the currency of record for global trade and investment. The RMB was soon known as the 'redback', referencing the colour of the note, but also acknowledging its growing role as a global currency.

To challenge the greenback's dominance, China selected four channels to promote its currency, as shown in Figure 2.

Figure 2: Access channels and schemes introduced to encourage RMB internationalisation

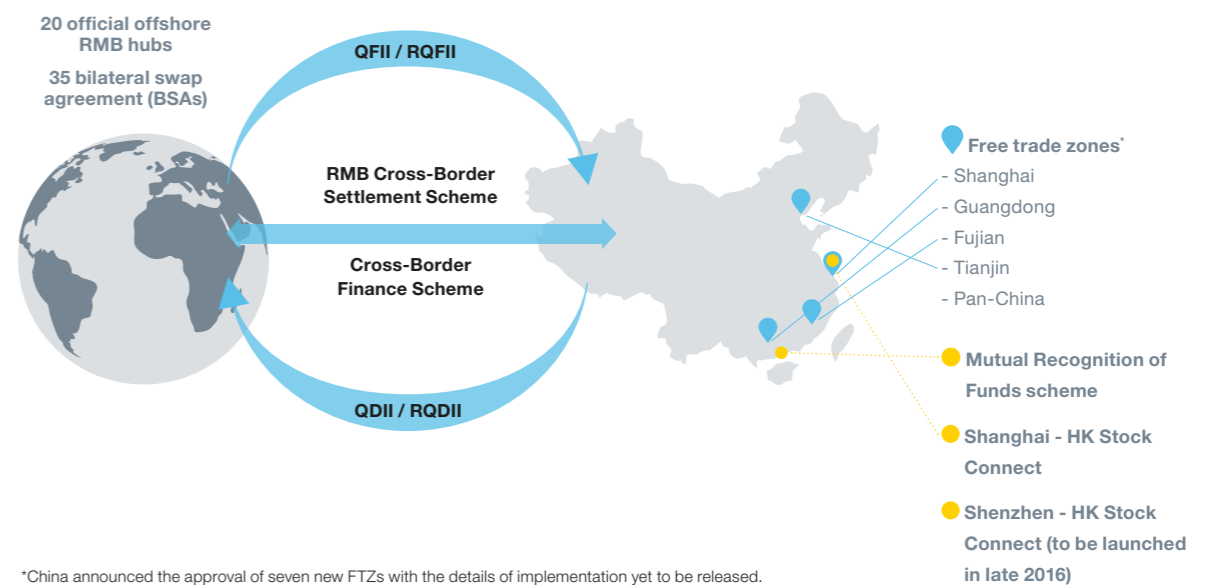
KEY CHANNELS

Use of RMB as a **settlements currency** for cross-border transactions

Creation of an **offshore market**

Promotion of RMB as an **investment and funding currency**

Cross-border solutions for corporates to enhance **connectivity** between mainland China and offshore



*China announced the approval of seven new FTZs with the details of implementation yet to be released.

RMB AS A SETTLEMENT CURRENCY

True internationalisation of the RMB started in 2009 when the People's Bank of China (PBoC) launched the RMB trade settlement pilot scheme. The aim was to test RMB settlement of merchandise trade transactions with counterparties in neighbouring countries. This represented the most significant development in RMB internationalisation up to that point, and should be seen against the backdrop of China becoming the world's largest trading nation.

The impact on the global uptake of the RMB was remarkable – after just three years, it advanced into the top five of the world's leading payment currencies, according to Society for Worldwide Interbank Financial Telecommunication (SWIFT) as illustrated in Figure 3.

While the trade settlement pilot was initially limited to 365 'mainland designated enterprises' in five mainland cities, the formal scheme was progressively rolled out nationally and internationally, eventually allowing all cross-border merchandise and service trades to be settled in RMB in March 2012.

Despite this progress, there were still too few market instruments – especially for mainland CNY transactions – to satisfy the increased demand for currency hedging and liquidity. Consequently, in August 2015, the PBoC allowed participating offshore banks to access CNY-denominated derivatives to support 'genuine hedging requirements' and to convert trade exposures from CNY into foreign currencies or vice versa.

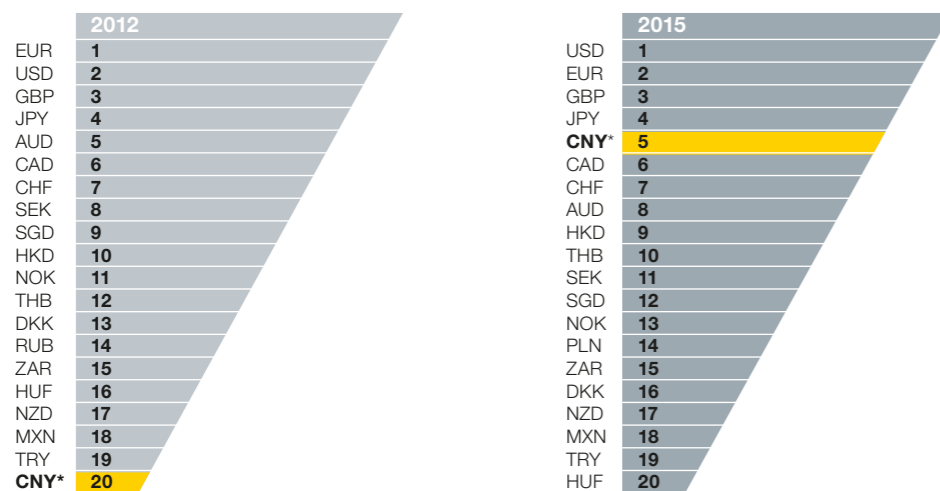
The message was clear: when it came to settling cross-border trade, the RMB was becoming simpler to use and more accessible than ever. To accompany the reforms leading to this achievement, the Chinese government created new financial architecture to facilitate seamless settlement processes. For example, the Cross-Border Inter-Bank Payment System (CIPS) was established to offer clearing and settlement services for cross-border RMB payments and trade. CIPS is compatible with international SWIFT messaging standards, and made settlement more efficient while also reducing the number of failed payments.

The RMB has grown its share of global trade more than fivefold in the past five years as a result of China's currency reforms. Market consensus calculates that 25 per cent of China's trade is denominated in RMB, compared to five per cent in 2011. While this momentum is likely to continue, the RMB's future as a global trade currency will be determined by its acceptance in commodity trading.

Currently, global trade is dominated by the buying and selling of commodities, and in large part remains priced and settled in US dollars due to the abundance of dollar-denominated market instruments, such as futures contracts and indices. Given China's position as one of the world's largest consumers and producers of commodities such as aluminum, copper, iron ore, and gold, it arguably has sufficient market power to influence a switch to RMB.

Figure 3: The rise of the RMB as a world payments currency, 2012–15

RMB as world payments currency in January:



Source: SWIFT
* Includes CNH payments

CCPIT promotes growing China-Australia trade and RMB internationalisation

The China Council for the Promotion of International Trade (CCPIT) says ChAFTA has established a new cooperative platform between China and Australia in various sectors, including trade and investment, tourism, education, agribusiness and financial services.

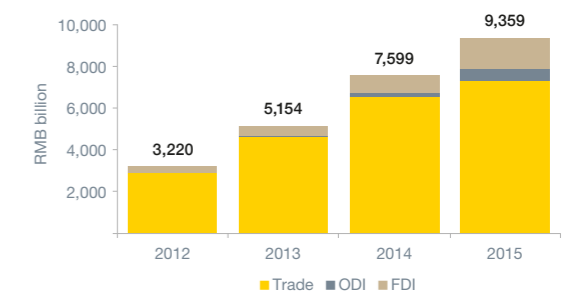
“With the rapid development of cross-border e-commerce, the establishment of overseas warehouses and the implementation of the One Belt, One Road (OBOR) initiative, demand for RMB cross-border settlement by Australian enterprises will keep growing, and the internationalisation of RMB will be further promoted,” CCPIT says.

“As the largest trade and investment promotion organisation in China, CCPIT is ready to be involved in this process and provide better services to bilateral business circles through consultation, exhibition, conciliation, arbitration, certification and intellectual property rights protection.”

ccpit.org/australia
overseas.ccpit.org/au

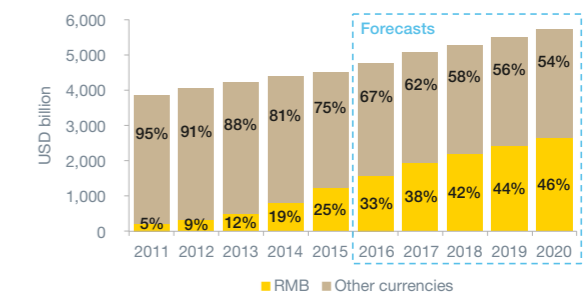


Figure 4: Growth of cross-border settlements in RMB, 2012–15



Source: CEIC, PBoC

Figure 5: Forecast growth in RMB trade settlements to 2020



Source: CEIC, Standard Chartered Research

THE GROWTH OF THE OFFSHORE MARKET

After the RMB trade settlement scheme was introduced in 2009, offshore liquidity grew strongly as more businesses began to price and settle trades with China in RMB. As trade and investment volumes picked up, China recognised the need to ensure sufficient RMB liquidity in global markets to support the internationalisation program.

This gave rise to the creation of offshore RMB hubs around the world. These hubs give mandated clearing banks in each region access to both offshore (CNH) and onshore (CNY) liquidity through quotas from the PBoC. This means financial institutions outside China can clear CNY via their RMB hubs. They also develop new RMB-denominated instruments, and act as ambassadors promoting greater use of the currency in their respective regions.

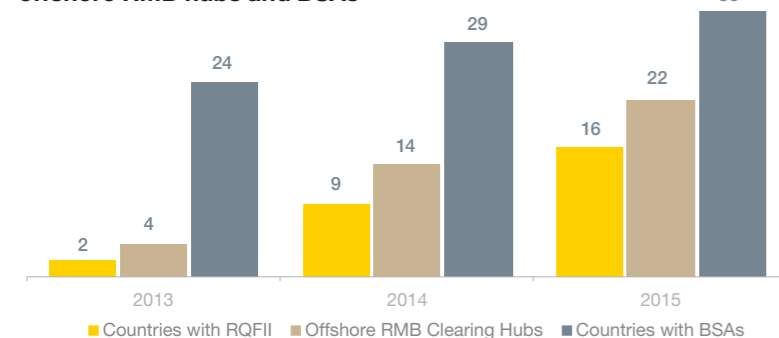
20 official hubs have now been established around the world, including Australia, with each playing a unique role in either a geographical or market context.

For example, Singapore, Australia and Canada all have regional significance due to their close trade ties with China. The United Kingdom and Luxembourg are more focused on facilitating the development of specific financial instruments given that the United Kingdom is home to the world's largest foreign exchange market and Luxembourg boasts a sophisticated funds management industry.

China also signed RMB-denominated Bilateral Swap Agreements (BSAs) with a number of central banks to increase international flows of RMB. As at the end of June 2016, PBoC has secured swap agreements with 35 central banks with a total notional value of over RMB3 trillion. The hubs, the BSAs and the RMB Qualified Foreign Institutional Investor (RQFII) scheme (discussed later in this chapter) have become known as China's 'three gifts' for bolstering bilateral economic cooperation (Figure 6).

The creation of offshore RMB hubs and the support of central banks have made foreign companies more comfortable about settling in RMB, knowing they have the backing of their governments and peers.

Figure 6: Growth in the number of RQFII quota, offshore RMB hubs and BSAs



Source: PBoC, SAFE



China Railway Rolling Stock Corporation sees global role for the RMB

Australia's mining sector is attracting Chinese activity in more ways than one. China Railway Rolling Stock Corporation (CRRC), the world's largest global rolling stock manufacturer, has established an Australian branch to service local customers. The Beijing-based company has 46 subsidiaries and more than 185,000 employees worldwide. CRRC Australia Pty Ltd will function as a 'one-stop solution' for Australian customers, providing rail rolling stock, after-sales services and supplying spare parts from a warehouse in Western Australia. CRRC Australia Pty Ltd will also offer finance, leasing and maintenance.

While most of the payments CRRC receives are denominated in US dollars, it also accepts RMB. A CRRC spokesperson said RMB was widely used for settlement, and predicted the RMB would play a "very important role" in global settlement in the future.

crrcgc.cc

THE SPECIAL DRAWING RIGHTS CLUB

In late 2015, the International Monetary Fund (IMF) formally announced that the RMB would be included in the special drawing rights (SDR) basket of currencies in 2016. Currently, there are only four currencies in the basket: the US dollar, the Japanese yen, the pound sterling and the euro.

Adding to the prestige of this invitation was the IMF's decision to recalculate the percentage of each currency in the basket. From October 2016, 10.9 per cent of the basket will be held in RMB – topping the amounts held in yen and sterling.¹⁰

This is the first time the IMF has revised the SDR basket's currency composition in 15 years, and provides further evidence of the RMB's growing relevance in global financial markets.

Inclusion in the SDR basket was the ultimate acknowledgement that the RMB has become a true global currency. IMF Managing Director Christine Lagarde said it constituted an important step in the integration of the Chinese economy into the global financial system.

“It is also a recognition of the progress that the Chinese authorities have made in the past years in reforming China's monetary and financial systems.”

– Christine Lagarde, Managing Director, IMF¹¹

While highly symbolic for China, it is essential to note that inclusion in the SDR basket is not granted in perpetuity. The IMF has made it clear that China must continue with its financial reforms and liberalisation to maintain its SDR eligibility. Key to these requirements is the continued globalisation of the currency towards full convertibility, as well as greater flexibility around the capital account.

Given the size of China's economy and the complexity of integrating it into the world economy, the task is not simple. Accordingly, China seems to have chosen a more innovative and measured approach: to allow, in theory, maximum flexibility while retaining full control. One of the mechanisms it has employed in this approach is the free trade zone (FTZ).

FREE TRADE ZONES

In 2013, the Pudong district of Shanghai was named China's first FTZ by Premier Li Keqiang. This FTZ was intended as a pilot to test the reaction to and implications of future reforms before being rolled out nationally. Many industries previously prohibited in China slowly set up businesses in the zone, taking advantage of tax concessions and streamlined customs clearing processes.

China's State Council then announced in December 2014 that it would introduce selected reforms into a pan-China FTZ scheme. One of these reforms permits multinationals to use cash-pooling facilities to allow companies to get cash in and out of China on an intraday basis. Currently, multinationals looking to use these schemes must meet certain criteria relating to purpose of remittance, enterprise size, profitability and registered capital.

Three new FTZs were launched in May 2015 in the cities of Guangdong, Tianjin and Fujian. Each plays a strategic role in the Chinese economy and has important trading ties with neighbouring countries, as shown in Table 2.

Table 2: The characteristics of China's free trade zones

Free Trade Zone	Characteristics
Shanghai FTZ	<ul style="list-style-type: none"> focuses strongly on financial services provides pilot ground for new reforms and innovations
Tianjin FTZ	<ul style="list-style-type: none"> focuses on financial services, services, trading, logistics and marine transport encourages close trading ties with Korea
Fujian FTZ	<ul style="list-style-type: none"> focuses on trading, logistics and marine transport specific regional reforms are expected due to its proximity to Taiwan
Guangdong FTZ	<ul style="list-style-type: none"> focuses on financial, legal and professional services, trading, logistics and marine transport specific regional reforms are expected due to its proximity to Hong Kong
Pan-China FTZ	<ul style="list-style-type: none"> takes the lessons learned from the Shanghai FTZ and rolls out selected schemes nationwide

While strategically important, China's capital and liquidity management reforms have not stopped at the creation of the FTZs. For most businesses, both Chinese and foreign, setting up a base in an FTZ can be impractical and expensive. Chapter 4 will review alternative solutions available to treasurers to manage cross-border capital and liquidity.

In May 2016, a key milestone was reached when PBoC announced that a nationwide cross-border finance scheme would be available to both domestic and foreign-invested entities in mainland China to allow them to obtain financing from offshore sources in RMB or foreign currency. While subject to conditions, this will open doors to Chinese and foreign companies to source funds from their parent companies without requiring pre-approvals.

DEVELOPMENTS IN CROSS-BORDER INVESTMENT CHANNELS

The rise of China and the RMB in cross-border investment

In 2015, China overtook the US as the top destination for foreign direct investment (FDI). Its own outbound investment activity is growing so rapidly that China is expected to become the largest foreign investor in the world by 2020.

Outbound direct investment grew so fast that in 2014, it exceeded inbound investment for the first time, making China a net capital exporter. In 2015, non-financial FDI rose for the 13th consecutive year, to US\$118 billion, representing an increase of just over one-third compared to the 2014 figure.¹²

Having established the RMB as an international trade currency, the next step in the internationalisation journey was to promote it as an investment currency.

China introduced access schemes and mechanisms to ensure mainland capital markets could be accessed in a carefully controlled manner.

Apart from these investment schemes, which provide access to China's financial markets, new reforms permit foreign companies to invest in mainland Chinese companies and industries. Such investment not only brings foreign capital into China, but also further strengthens the penetration of the RMB into the global economy.

China's invitation to foreign investors, and its encouragement of domestic enterprises to invest offshore have led more companies to diversify their investment interests. China has smoothed the way by making it relatively easier and simpler for domestic enterprises to invest abroad, and similarly, for foreign companies to invest in China. For example, various reforms have been introduced to move away from an approval to a registration-based process.

Table 3: China's schemes to promote the RMB as an international investment currency

Type	Scheme	Implications
Investment schemes	QFII and RQFII The (RMB) Qualified Foreign Institutional Investor (R/QFII)	<ul style="list-style-type: none"> access to China's debt and equity markets by qualified foreign institutional investors the creation of a quota-based investment scheme
	QDII and RQDII The (RMB) Qualified Domestic Institutional Investor (QDII)	<ul style="list-style-type: none"> access to offshore debt and equity markets by qualified Chinese institutional investors the creation of a quota-based investment scheme
	The Shanghai-Hong Kong Stock Connect	<ul style="list-style-type: none"> the creation of a cross-border investment scheme to connect Shanghai and Hong Kong Stock Exchange. eligible investors can access select equity/shares in respective markets
	Mutual Recognition of Funds	<ul style="list-style-type: none"> eligible asset managers domiciled in Hong Kong and China can distribute selected investment funds in Hong Kong and mainland China's retail markets
	CIBM China Interbank Bond Market	<ul style="list-style-type: none"> eligible foreign commercial banks, insurers, securities companies, asset managers and other institutional investors can invest in the domestic interbank bond market
Announced investment schemes in pipeline	Shenzhen-Hong Kong Stock Connect	<ul style="list-style-type: none"> confirmed by the China Securities Regulatory Commission (CSRC) in March 2016, and to be launched in the second half of 2016
	Shanghai-London Stock Connect	<ul style="list-style-type: none"> research by the CSRC is currently in progress on the feasibility of the international expansion

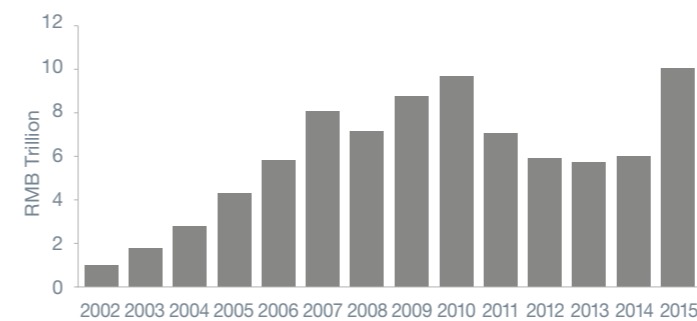
CHINA'S DEBT MARKET

Similar to the way the RMB evolved, China created both onshore (Panda) and offshore (Dim Sum) debt markets. In 2005, it allowed the issuance of the first Panda bonds, which are RMB-denominated debt instruments issued only on the mainland by foreign issuers. Although there were capital repatriation restrictions on the proceeds of these bond issues for five years, the mainland bond market was partially liberalised in 2010, and proceeds could be repatriated abroad.

In July 2015, China's bond market reached a key milestone after previous requirements and quotas were scrapped to allow central banks, sovereign wealth funds and other financial institutions access to the market. It also meant that China would be able to continue funding ambitious domestic and regional economic plans such as its One Belt One Road (OBOR) strategy that will be assisted by its membership to the Asian Infrastructure Investment Bank (AIIB).

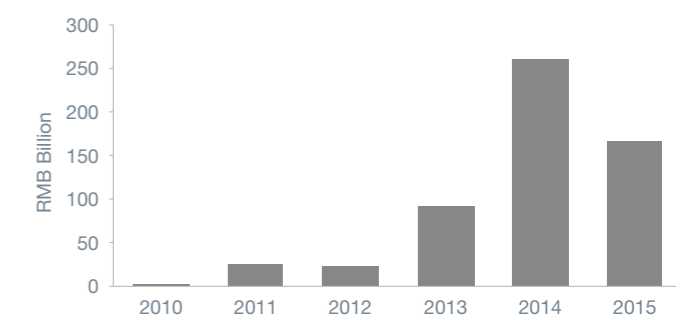
In late 2015, China took a significant step by opening its domestic bond market to foreign issuers, with the Bank of China, Hong Kong and HSBC Hong Kong issuing such bonds of US\$156.86 million and US\$1.57 billion respectively. This decision was driven by the need to broaden RMB-denominated financing channels for international commercial banks and to support continuing efforts to globalise the RMB.

Figure 7: Onshore RMB bond issuance, 2002–15*



Source: CEIC

Figure 8: Offshore (Dim Sum) bond issuance, 2010–15



Source: Bloomberg

*Including Panda Bonds

REGIONAL INITIATIVES

Despite its newly minted status as one of the world's global currencies, the RMB is likely to remain at the centre of China's concerted efforts to drive growth.

The government's focus on sustainable growth is underpinned by a strategy to rebalance the economy. This includes finding new markets as part of the OBOR initiative to absorb excess domestic production.

The other significant development offering new markets for China's capacity surplus is the AIIB. Launched officially in early 2016 following proposals by China in 2013, the AIIB will have paid-in capital of US\$20 billion with total authorised capital of US\$100 billion. These funds will be allocated to infrastructure investment in Asia to foster growth in the region's emerging economies. China having contributed US\$29.78 billion to the bank's capital stock, is the largest shareholder and this gives it significant influence over the new institution's investment strategy. This will also help China secure new markets by co-financing key projects.¹³

Australia is one of the 57 AIIB members, and the sixth largest shareholder, having committed nearly AUD\$1 billion over five years. At the AIIB's launch, the Australian Government said it would create opportunities for Australian businesses to sell more commodities and services.

ONE BELT, ONE ROAD

Adding to the momentum of China's international investment strategy is the colloquially known One Belt, One Road initiative. Officially called the Silk Road Economic Belt and the 21st Century Maritime Silk Road, this plan is premised on China creating a powerful economic land and sea corridor to connect central and western Asia with the Middle East and Europe. An additional 'belt' tying China to South Asia and Southeast Asia has also been proposed, supported by the China-led AIIB, which includes several countries in south and Southeast Asia among its members. OBOR will extend over a population of 4.4 billion people, or 60 per cent of the global population.

OBOR is also being driven by China's international political and economic ambitions. The nation needs deeper economic alliances to create new markets for over-capacity in its domestic production. This will be a mutually beneficial arrangement: many of the countries along the Silk Road corridors that stretch west to Europe and south towards South East Asia need infrastructure investment to drive their economic growth.

Economic ties will also support China's effort to expand its diplomatic and political influence in the wider Asian region as it cements its position as a global superpower.

OBOR has already had an impact, with related investments in 2015 comprising 12.6 per cent of the US\$118 billion allocated to outward direct investments.¹⁴

CONCLUSION

China has embarked on a journey to liberalise its financial markets and internationalise the RMB through various reforms. While it still has a capital control regime in place, it is gradually and selectively relaxing these controls, and the speed of reforms picked up in 2015, as shown in Figure 9.

Australia is well positioned to benefit from China's progress in promoting trade and investment given the close ties between the two nations. This connection will be discussed in Chapter 2, with an analysis of the ChAFTA in Chapter 3.

The practical implications, as well as how to capitalise on recent reforms and trends to secure a competitive advantage when doing business with China, will be explored in Chapter 4.

Figure 9: Overview of key milestones and reforms from 2015

A more open FX and MM	A larger offshore market	Further promotion of cross-border trade	Development of cross-border investment
<ul style="list-style-type: none"> Pricing mechanism CFETS index Extended trading hours Reserve currency status Interest rate liberalisation Forward market reforms Central banks access 	<ul style="list-style-type: none"> Eight new hubs 13 new BSAs Eight new RQFII allocations Three new direct trading currency pairs Special schemes and MOUs 	<ul style="list-style-type: none"> CIPS launch Commodity pricing, trading, collateral and settlement in RMB 	<ul style="list-style-type: none"> More free trade zones (FTZs) Panda bond rules relaxed Mutual Fund Recognition launch QFII quota increased to US\$150billion RQFII quota increased to RMB1,170billion Cross-border finance scheme Access to CIBM

CHAPTER 2

THE AUSTRALIA-CHINA STORY

“ ...The RBA has invested some of its foreign currency reserves in RMB. ... This portfolio shift reflects the growing importance of China in the global economy and the broadening financial relationship between Australia and China. But it has also allowed us to deepen our own understanding of developments in Chinese financial markets and the RMB. ”

Dr Philip Lowe, then Deputy Governor, Reserve Bank of Australia.¹⁵

“ There's no doubt that Barangaroo... will drive financial services and if the RMB opportunity comes to Sydney I see a powerful collision of the two. And that would become a very important financial centre not just in the Asia-Pacific, but globally. ”

The Hon. Mike Baird, New South Wales Premier.¹⁶

“ The signing of the ChAFTA, joining the AIIB and appointment of an RMB hub are all important milestones that strengthen Sino-Australia relations, and as China enhances its focus on services and e-commerce, it will present increasing opportunities for a stronger partnership between the two nations. ”

Michael Eidel, Executive General Manager, Cash Flow and Transaction Services, Commonwealth Bank.

The relationship between Australia and China dates back more than a century. China's first Consul General to Australia landed in Melbourne in 1909.

According to Australia's National Archives, Australia only reciprocated in 1921 when it temporarily posted a trade commissioner to China. It was another two decades before diplomatic relations commenced, but these were also short-lived, terminating in 1949 after the creation of the People's Republic of China.

Finally, in late 1972, Australia and China re-established diplomatic relations, and Australia opened an embassy in Peking (now Beijing). In 1973, Gough Whitlam became the first Australian prime minister to visit China and sign a bilateral trade agreement, establishing the foundations of the present-day relationship that all subsequent governments have supported.

THE TALE OF TWO COUNTRIES

The Australian and Chinese economies are closely entwined. Economists used to say that if the US economy sneezed, Australia's economy caught a cold. Replace the US with China, and the aphorism still holds. In the last decade the correlation between Australian and Chinese growth has increased significantly.

While bilateral trade between Australia and China continues to grow, the underlying composition has fundamentally shifted. China's economy is changing rapidly, shaped by the dramatic expansion of a newly wealthy (in comparative terms) middle class. This population segment has overtaken the middle class in the US to become the largest in the world, and is forecast to grow to 850 million people by 2030.¹

This consumer powerhouse will have increasing influence over China's demand for foreign goods and services.

The most recent data on Australian merchandise exports to China paint an interesting picture. At first glance, it shows a 9.5 per cent decline to AUD\$81 billion in the value of goods sold to China in the 2015 calendar year.¹⁷ The contraction was not unexpected, given the decline in commodity prices. However, once all resources and energy-related exports are stripped out of the data, the resulting number reveals that all other sales actually increased 22.6 per cent, reflecting the diversification in demand for Australian produce. The best performing categories included edible products (up 288 per cent), medical equipment (up 205 per cent), alcoholic beverages (up 71 per cent), and beef (up 53 per cent).¹⁷

Australia's government and corporate sectors are aware of the changing dynamics and increasingly identifying opportunities to meet this demand. This was illustrated earlier this year at the Australia Week in China (AWIC) event where Australia was positioned as a premium destination for trade and investment, with the event including meetings and site visits across numerous strategic industries, including agribusiness and premium food, financial services, health and aged care, urban sustainability and water management, education and tourism.

Australia also used AWIC to promote tourism, one of the country's top five exports, with the official launch of Tourism Australia's coastal and aquatic promotional campaign in China.

Tourists from China are already delivering significant returns for Australia: in 2015, the number of Chinese tourists visiting Australia passed the one million mark for the first time, double the total of just five years ago. According to Trade, Tourism and Investment Minister Steven Ciobo, Chinese tourists are now Australia's biggest-spending visitors and their growing presence in cities and regions is driving a renewal in infrastructure and tourism jobs.

On the other side of the trade equation, Australia's imports from China increased 18.67 per cent in 2015, to AUD\$62 billion.¹⁷

The changing trade dynamics and the China-Australia Free Trade Agreement (ChAFTA) are expected to further boost Australia's cross-border trade relationship with China.



Understanding the lay of the land leads to success for Blue Ribbon Group.

Trading successfully with China hinges on mutually beneficial relationships based on trust, and supported by a solid understanding of the business culture.

Blue Ribbon Group adopted this approach when it expanded its business into Asia to cater to the strong demand for Australian mung bean in China, Taiwan and Singapore. The mung bean is a staple in traditional Chinese diets, and consumption is correlated with population size.

Blue Ribbon Group is a major global supplier of quality Australian pulses, dahls, grain, grass seed, pulse food ingredients and other products. Its operations include processing, handling, marketing, containerised distribution and retail-ready packaging of its products.

Managing Director Stephen Donnelly has built strong relationships with Chinese agents over the years.

"We have employed many expatriate Chinese employees who speak the language and understand the nuances in trade negotiations."

Blue Ribbon's mung bean exports to China have steadily grown at around seven to ten per cent annually since entering the Chinese market. Part of this success is due to successfully navigating China's regulations affecting supply and demand, liquidity in the market and import permits.

"I am confident that the ChAFTA will bring greater transparency in trading with China. While we currently invoice in USD, we are looking at incorporating RMB."

Under ChAFTA, Blue Ribbon Group is eligible for lower import tariffs on grains and the elimination of tariffs of up to seven per cent on pulses such as mung bean by 1 January 2019. Blue Ribbon Group's partner company, Foods from the Earth, is also set to benefit from tariff reductions on processed foods.

blueribbongroup.com.au



UNSW aspires to be the leading RMB and China-ready university globally

China is the single largest international partner market and a critical source of revenue for the University of New South Wales (UNSW). The university has about 14,000 full fee-paying foreign students, contributing about AUD\$430 million in tuition fees every year. Of this, about AUD\$240 million now comes from Chinese students, up from AUD\$190 million in 2013.

China plays an important role in knowledge exchange and technology transfer for UNSW, which established a high-level agreement with the Chinese Ministry of Science and Technology in April 2016 to create the Torch Innovation Precinct over the next decade.

"In total, we expect to attract more than AUD\$100 million in investment from China," – UNSW Executive Director, International, Laurie Pearcey says. "Torch's focus is research into energy and the environment, our photovoltaic and renewable energy capabilities and thinking about advanced materials and biomedical research."

"In many cases, the research... will be supported by the establishment of joint ventures in China, in which UNSW will have an equity stake, that commercialise the technology," Mr Pearcey says.

The use of the RMB will be critical to the businesses that emerge from the research. UNSW'S R&D partners are interested in RMB payment solutions because they can make it more convenient for them to facilitate investments in Australia and China.

UNSW opened an office in China in November 2014, about the same time ChAFTA negotiations were concluded.

ChAFTA promises greater mobility for staff and students, and the ability for institutions to market and recruit directly.

"Before ChAFTA, if we wanted to do a billboard advertisement in China, we'd have to go through infuriating red tape to get it approved," Mr Pearcey says.

To further position UNSW as a China-ready university, UNSW has been expanding on its acceptance of RMB payments from Chinese students.

"UNSW's ambition is to become Australia's, if not the world's leading China-ready university. Without RMB connectivity and market readiness, we are not doing ourselves any service at all."

international.unsw.edu.au

THE AUSTRALIAN INVESTMENT STORY

Approximately 68 per cent of China's investment into Australia in 2015 is related to residential real estate transactions, many being attributed to high-profile deals by Chinese companies. Dalian Wanda Group, for instance, announced in 2014 that it would invest US\$900 million in a major five-star hotel and serviced apartment complex in Queensland. Other industries benefited too. For instance, Jemena, jointly owned by the State Grid Corporation of China and Singapore Power, submitted the winning bid in late 2015 to build and operate the AUD\$800 million North East Gas Interconnector in northern Australia. This project covers 623 kilometres of gas pipeline. However, there was a decline in investment of \$20billion in the mining industry, making it clear that the overall increase in Chinese investment was driven by diversification into other industries. This trend is expected to continue.¹⁸



New markets for Australian exporters

Alibaba Group has been at the forefront of assisting Australian exporters in accessing new markets.

Research shows the value of China's e-commerce market exceeded US\$600 billion in 2015. Of this amount, Alibaba alone contributed around US\$485 billion in sales in e-commerce, making Alibaba Group the world's largest retail e-commerce company.

Australian products are increasingly popular on Chinese e-commerce channels. Alibaba sees strong and growing demand for a range of products such as dairy, premium foods, healthcare, skincare, and mother and baby products.

Each year, Alibaba runs the largest shopping festival in the world, the Double 11 Shopping Festival, on 11 November. In 2015, Australia ranked 5th among 41 countries globally on Tmall Global, the platform for international branded goods, with Chemist Warehouse hitting RMB10 million in the first 46 minutes of the shopping festival.

Alibaba Group has also forged a strategic partnership with Australia Post. Australia Post's Tmall store provides a solution for exporters, particularly small and medium enterprises, to access some of the 420 million Chinese consumers active on Alibaba Group's platforms.

Alibaba Group has plans to open an office in Australia at the end of the 2016 calendar year to better support its Australian clients, and to help more Australian companies access the Chinese market. Currently, there are over 1,300 Australian companies on Tmall and Tmall Global, with over 80% of them accessing China for the first time via Alibaba's platforms.

The momentum is likely to continue with the staged implementation of ChAFTA. While Australian products are already high on the wish list of Chinese consumers due to the premium and quality reputation of products made in Australia, ChAFTA will further reduce tariffs and increase the competitiveness of Australian produce.

alibabagroup.com

AUSTRALIA'S JOURNEY TO THE EAST

The first major milestone on renminbi (RMB) in Australia was in 2013, with the announcement of direct trading between the Australian dollar and the RMB, thus enabling more efficient pricing, and the execution of a Bilateral Swap Agreement (BSA) between the People's Bank of China (PBoC) and Reserve Bank of Australia (RBA) to support RMB usage in Australia. The RBA currently holds five per cent of its foreign exchange reserves in RMB-denominated assets to encourage domestic uptake of the currency by the private sector.¹⁹

In 2014, two more announcements cemented the RMB's role in Australia. The appointment of Sydney as an official offshore RMB hub for Australia using the Australian Securities Exchange's (ASX) Austraclear platform, and the allocation of a RMB50 billion RQFII quota, providing the foundations for the growth of RMB use in Australia.

The internationalisation of the RMB – and China's associated move towards a liberalised capital account and more flexible exchange rate regime – has the potential to create a seismic shift in the international monetary and financial landscape.

– Dr Philip Lowe, then Deputy Governor, RBA²⁰

Product innovation was a key requirement and, accordingly, the ASX announced in August 2016 a new capability to issue and clear RMB-denominated securities.

The importance of the RMB to the Australian economy was underscored in comments by New South Wales Premier Mike Baird in late 2015, when he announced²¹ the goal to increase RMB settlement from one per cent of Australian merchandise trade with China to 20 per cent by 2020.

These initiatives came at the most opportune time, roughly coinciding with the successful conclusion of the decade-long negotiation on the ChAFTA, and the agreement coming into effect at the end of 2015. The implications of ChAFTA for companies in China and Australia will be explored in more detail in Chapter 3. In brief, the trade agreement heralds a new phase in the already close relationship between the two nations, paving the way for companies and industries to find new markets in each other's countries, fuelled by the added benefit of the inclusion of the 'most favoured nation' clause in the agreement.

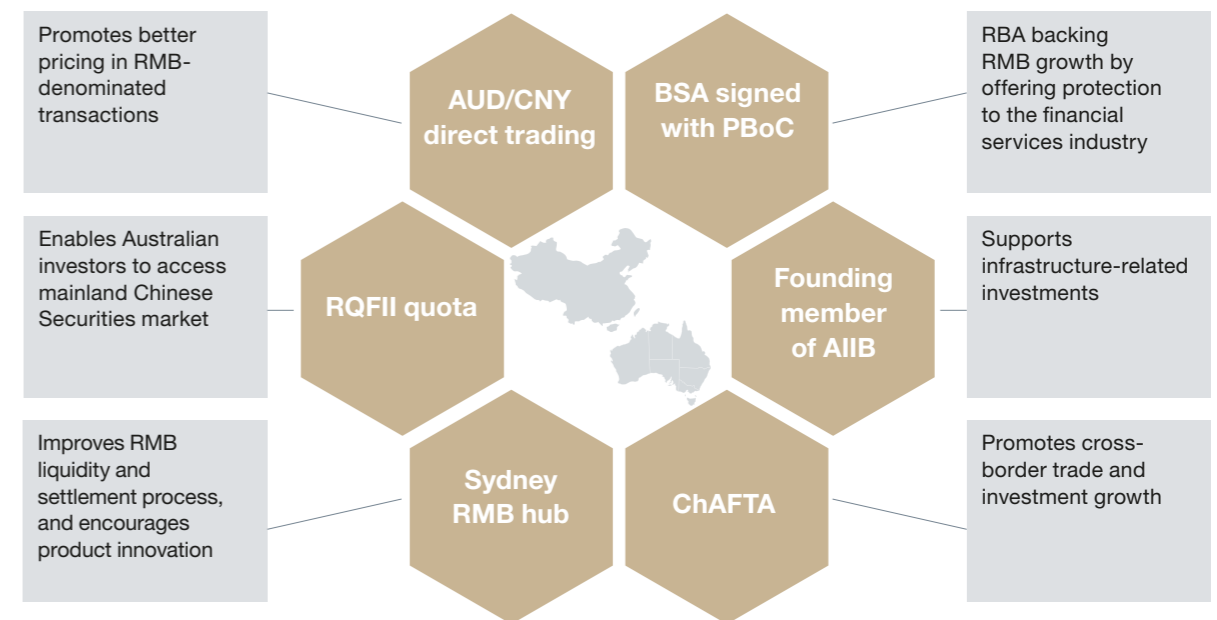
As mentioned in previous chapters, Australia's inclusion among Asian Infrastructure Investment Bank (AIIB) members in early 2016 was another noteworthy milestone, creating a stronger linkage with China, and one that is likely to create significant opportunities for both nations.

CONCLUSION

The number of success stories emerging from Australian companies venturing into China and Chinese companies investing in Australia is growing. It is also increasingly obvious that significant opportunities exist across both trade and service sectors to meet the increasing demand of a growing consumer market. Beyond the obvious commercial opportunities, however, there are benefits to be gained from including the RMB in finance and risk management strategies when negotiating new relationships or re-negotiating existing partnerships.

In the next chapter, we look at how ChAFTA is providing even greater incentives to Australian companies to expand into China.

Figure 10: Key Australian initiatives to support RMB internationalisation



Source: RBA, ASX, Australia RMB Working Group



CHAPTER 3

ChAFTA – a new era in Australian trade with China

“ Already, ChAFTA is injecting new energy and ambition into our own economy. It’s adding strength, breadth and dynamism to the relationship between our two peoples. ”

The Hon Malcolm Turnbull, Prime Minister.²²

“ ChAFTA is indeed a landmark agreement. It is also a high-quality agreement, one that will deliver lasting mutual benefits for our economies, and our societies in the years and decades ahead. ”

The Hon Andrew Robb, then Minister for Trade and Investment.²³

“ The ChAFTA represents a new phase in our trade relationship with China and an unprecedented opportunity to deepen and diversify our well-established two-way trading relationship. The Australian business community, working with their Chinese trading partners, needs to think broadly about the possibilities created by this agreement and the benefits it provides. ”

Andrew Parker, Partner, Asia Practice Leader, PricewaterhouseCoopers.

The Australian Government has negotiated an impressive portfolio of free trade agreements, with a particular focus on its leading trading partners in North Asia. The China-Australia Free Trade Agreement (ChAFTA), which came into force on the 20 December 2015, is arguably the most significant free trade agreement ever brokered by Australia.

Free trade agreements (FTAs) are unique political instruments. Negotiated at a government-to-government level, and typically over many years (a decade in the case of China), they are the foundation of a cooperative economic partnership. However, these agreements are only effective if the affected business communities capitalise on the opportunities presented. As such, an FTA may be seen as an invitation to trade – a reciprocal endorsement of each party as a preferred trading partner, supported by specific commitments to key areas of trade and investment.

WHY IS CHAFTA SO IMPORTANT?

ChAFTA represents a new phase in Australia's trade relationship with China. It is the most significant trade agreement Australia has secured with the largest two-way trading partner.

ChAFTA's commitments have the potential to deliver significant benefits, building on an established trading relationship that already contributes significantly to the Australian economy. And it lays the groundwork for Australia to keep pace with China's growth trajectory.

ChAFTA's benefits

- Allows Australian goods to be exported to China at more competitive tariff rates: This has been achieved via the phased elimination of Chinese import tariffs in almost all Australian product sectors, including pharmaceuticals, agricultural and processed food products, and manufactured products.
- Allows Australian services to be exported to China with greater market access: The agreement improves market access for Australian service providers seeking a commercial presence in China, including those offering legal services, education, telecommunications, financial services, tourism, aged-care and travel-related services.
- Allows Chinese goods to be imported into Australia at more competitive tariff rates: Most tariffs on Chinese imports have been eliminated and remaining Australian import tariffs in sensitive sectors such as steel, aluminium, clothing, footwear and automotive are subject to phased elimination.

SERVCORP

Servcorp stresses the importance of a Wholly Foreign Owned Enterprise (WFOE) and the right partners in China

Servcorp is committed to being the world's best global serviced office and virtual office provider, says Anton Clowes, Servcorp CFO. "We created the world's first 'virtual office' in 1980, allowing businesses to have the presence, support and facilities of a serviced office without the cost of full-time office space. We now operate in Singapore, France, Japan and across South East Asia, Belgium, the Middle East, China, India and New Zealand."

The group expanded into mainland China in 1998, and now has 10 locations. It was established according to Chinese laws as a WFOE, which is a limited liability company. "This means shareholder liability is limited to the assets they bring into the business. WFOEs can make profits and issue local invoices in RMB to customers, which is crucial as invoices are the basis for securing tax deductions in China," says Anna Chavez, Senior Manager of Servcorp China.

"Compared to a joint-venture, a WFOE has greater freedom and independence, and can better protect its intellectual property. This was crucial to our business. It also meant that we could employ local staff directly, without being obliged to use employment agencies."

When applying to set up a WFOE, the business scope must be specified in the application, and there are minimum capital requirements that vary by industry and region. "This can be a clear challenge for any business setting up in China," Ms Chavez adds.

"We believe that the most effective way of avoiding commercial disputes in China is choosing the right business partner. This means understanding the company, its history, structure and background, as well as the key individuals involved. The most commonly expressed regret by Australian businesspeople is that they didn't put enough effort into this exercise."

Looking at the long term, Mr Clowes says Servcorp sees ChAFTA as a great step forward in business relations between Australia and China. "We hope that ChAFTA will encourage bilateral trade and complement the low-risk, flexible, fully managed business solutions that Servcorp offers to Australian and Chinese businesses in each market."

servcorp.com.cn

THE CHALLENGE AND OPPORTUNITY

Australia's success in negotiating ChAFTA is only half of the story. Now that ChAFTA is in force, the responsibility shifts to Australian businesses and investors to activate the benefits of the agreement.

Historically, Australian exporters have been relatively slow to act on trade enhancement opportunities presented by the FTAs the government has negotiated. This is partly due to the relatively sheltered and comfortable competitive environment that Australian businesses have historically enjoyed, coupled with a lack of preparedness to deal with structural change as well as perceived barriers to operating effectively in an Asian environment.

However, since ChAFTA's ratification, there has been a noticeable shift in the Australian business community towards a more proactive approach to exploring the benefits the agreement may offer. This is changing the way Australia uses FTAs to engage more efficiently with Asian markets. It is also helping to dispel the misconceptions that have historically made Australian businesses reluctant to pursue opportunities. Importantly, the business community has a greater appreciation of the comparative commercial advantages of ChAFTA, and how it can be incorporated into supply chain management and market engagement strategies to facilitate trade and create commercial value.

TWO-WAY TRADE IN GOODS

ChAFTA benefits both sides of international trade transactions. Australian manufacturers have enhanced access to diverse Chinese supplier markets, competitively priced raw materials and finished goods used to make Australian products. For importers of Chinese finished goods, progressive tariff reductions have reduced the landed cost of many Chinese goods.

Australian exporters are enjoying greater exposure to growing Chinese demand for Australian goods and services, which are sought after for their quality, safety and reliability.

Australian importers and exporters must, however, understand that access to ChAFTA's benefits depends on meeting specific compliance requirements. These include satisfying product-specific Rules of Origin, which means securing valid documentation certifying the origin of the goods, adhering to specific restrictions on the trade routes used, and observing limitations on how goods can be handled along international supply pathways between Australia and China.

To overcome these issues, businesses in China and Australia in supplier-customer relationships must collaborate on:

- document management to ensure the efficient flow of commercial information needed to secure relevant certificates or declarations of origin.
- supply chain or trade-lane management to standardise the trade routes of goods exported to and from Australia, and the precise management of any cargo shipment eligible for ChAFTA benefits.

Australian importers and exporters must engage early with their Chinese suppliers to ensure the above elements are embedded in standard procurement and supply chain management practices. Australian exporters also need to recognise ChAFTA's commercial value, and understand the role they play in working with Chinese importers to develop ChAFTA-enabled and ChAFTA-compliant supply chains. This means Australian companies must ensure ChAFTA is on the agenda in any commercial negotiation with their Chinese counterparts, and not wait for them to ask for the necessary information.

Many Australian exporters still need to ensure their business practices meet these requirements. Reports such as this one help Australian firms understand the requirements to deploy ChAFTA meaningfully in their business strategies, as well as guide them in working with their banking partners, such as Commonwealth Bank or business partners such as PwC, to ensure all documentation is accurately completed.

EXAMPLE:

Some companies are integrating ChAFTA compliance requirements into their usual export and marketing practices. These companies are claiming commercial benefits beyond improved profit margins, including using enhanced price flexibility to expand marketing activities and to increase customer loyalty and lock down distribution channels, while also promoting procurement certainty with key Chinese customers.

Ironlak®

Patience is the key for Ironlak

Ironlak owns its own factory in China and plans to open retail stores across the country. The wholly foreign owned enterprise (WFOE), with a holding company in Hong Kong, makes arts and crafts materials under its own brand, and produces industrial products as a contract packer for multinational companies.

Ironlak received local government support in Jiangxi province where it is currently based. Through the WFOE structure, Ironlak was able to employ local workers and partially overcome the hurdles of obtaining relevant business licenses.

ChAFTA will open the doors to the Chinese domestic market for components and raw materials exported from Australia. "Up to this point, we haven't bothered exporting to China because it can be a little bit costly, but with (ChAFTA) now in place that's something we are working on," Managing Director Levi Ramsey says.

"One of the things I'd say about China is that anything and everything is possible – it just takes time and patience," says Mr Ramsey. "If you approach it by understanding the local culture and how things work, it creates a lot more harmony and you can fast-track things."

ironlak.com

FORCAST

Forecast changes to the RMB

Women's fashion wholesaler and retailer Forcast is now doing business with China in RMB and using currency hedging to manage with currency fluctuations.

Forcast started as a wholesaler in 1992, expanded into retail in 2005 and now has about 50 stores across Australia. The company focuses on the 25–35 age group, providing fashion items for office and evening wear. It also sells accessories such as shoes and handbags. Its clothes are designed in Australia but made in China.

"I prefer transacting in RMB because funds go directly into the supplier's account, but if you pay in US dollars they have to be converted to RMB and it takes time to do that," Forcast Director Monica Lek says.

Transacting in RMB gives Forcast access to a much larger supplier base by offering the option of RMB and USD. "Some manufacturers in China accept US dollars; others accept RMB and we are quite flexible".

Ms Lek uses a combination of RMB forward and option contracts to hedge her exposures, which allows her to lock into a confirmed exchange rate.

forcast.com.au

TRADE IN SERVICES – AUSTRALIA'S BEST-KEPT SECRET

The ChAFTA negotiations occurred at a pivotal time for global trade in services, with growth in this sector outstripping goods trade growth for the first time in 2014.

According to Australia's Department of Foreign Affairs and Trade statistics for 2014–15, Australia's service industry is worth AUD\$133.9 billion annually, contributing about 70 per cent to total Gross Domestic Product (GDP).¹⁷

China is Australia's largest services export destination. However, the total value of this trade is only a fraction of the capacity of Australia's services industries, and smaller still compared to the size of China's current services demand and the predicted growth of its consumer classes.

ChAFTA includes preferential commitments to Australian service providers. These commitments offer 'best ever access' to China's services market. The benefits offered are underpinned by:

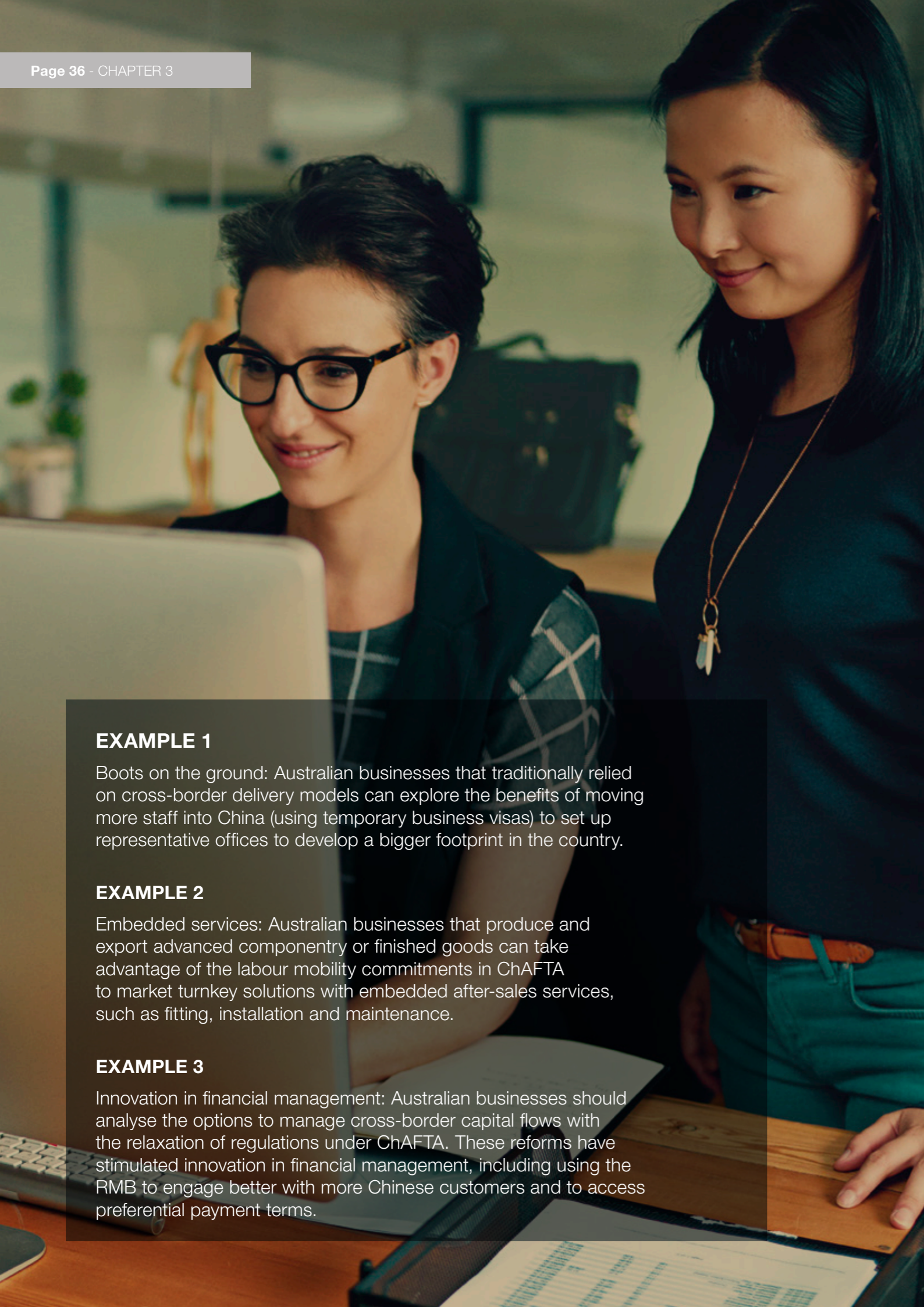
- a broad definition of what constitutes trade in services
- mechanisms for Australian businesses to sell services to Chinese customers
- assurance that, should competitors from other markets receive better treatment through their own future FTA, Australian service providers will be accorded equivalent treatment under ChAFTA's 'most-favoured nation' clauses.

ChAFTA has specifically established cross-industry market access commitments and industry-specific benefits, allowing:

- improved movement of people under specific visa classes
- pathways to consider the mutual recognition of qualifications
- the establishment a commercial presence in China
- fewer restrictions on the flow of capital necessary for service delivery.

ChAFTA also establishes complementary frameworks for market access to the broader Chinese market and a relatively liberalised trade environment in free trade zones.

Australian service providers should consider how these preferential benefits can help achieve their commercial objectives. Some Australian service exporters have started making structural changes to create sustainable service supply chains that integrate ChAFTA's benefits into their delivery structures, targets, marketing, workforce planning and financial management considerations.



EXAMPLE 1

Boots on the ground: Australian businesses that traditionally relied on cross-border delivery models can explore the benefits of moving more staff into China (using temporary business visas) to set up representative offices to develop a bigger footprint in the country.

EXAMPLE 2

Embedded services: Australian businesses that produce and export advanced componentry or finished goods can take advantage of the labour mobility commitments in ChAFTA to market turnkey solutions with embedded after-sales services, such as fitting, installation and maintenance.

EXAMPLE 3

Innovation in financial management: Australian businesses should analyse the options to manage cross-border capital flows with the relaxation of regulations under ChAFTA. These reforms have stimulated innovation in financial management, including using the RMB to engage better with more Chinese customers and to access preferential payment terms.



Charles Sturt University's long-term strategy pays off in China

With more than 1,000 fee-paying students graduating in China each year, Australia's Charles Sturt University (CSU) is proof of the benefits of long-term relationship building in China.

More than a decade ago, CSU established a joint cooperation program with a number of Chinese universities. It now works with local universities in Tianjin, Yunnan, Yangzhou and Jilin to provide its courses to students in China.

This success has been achieved despite Australian education costs being comparatively higher than the China equivalent. While not all Chinese students can afford to study in Australia, many are still willing to pay for an Australian education.

"This demand means that even when the Australian dollar is unfavourable for Chinese students, Australian education is still an export earner," says Heather Cavanagh, CSU's Pro-Vice Chancellor of International Education and Partnerships.

Historically, CSU invoiced Chinese students in AUD using an agency-type arrangement. In recent years, RMB internationalisation allowed CSU to invoice all arrangements in RMB, which has enabled CSU to strengthen its relationships and negotiating power with its partner universities.

Repatriation of RMB for services trade was somewhat of a challenge for CSU and its partner universities. However, this was effortlessly resolved by the Chinese and Australian counterparts collaborating.

csu.edu.au



JLL sees benefits for China

JLL, the world's leading integrated real estate services firm, estimates Chinese investors have poured US\$9 billion into Australia in the past 24 months and says there are no signs of their appetite for Australian property abating.

"Demand from JLL's clients to improve their global investment strategies has enabled us to promote the RMB as a major alternative international currency," JLL Head of China desk, Australia Michael Zhang says.

"If the RMB continues to be successfully internationalised, it should ease the downward pressure on China's foreign reserves, which (at least in theory) should partly relax the Chinese government's restriction on capital outflows."

"Successful internationalisation of the RMB may also help China rebalance its economy by lowering onshore interest rates and the costs of currency hedges for investors."

jll.com.au

REGULATORY CHANGE IN A FREE TRADE ENVIRONMENT

ChAFTA delivers a differentiated trade and regulatory environment for two-way goods and services trade between Australia and China.

The agreement's commitments slightly modify aspects of domestic regulation that otherwise apply to foreign goods and services. However, Australian companies doing business in China must remember that ChAFTA operates within China's and Australia's respective legal and regulatory regimes, which involve diverse sector-specific rules and regulations as well encompassing varying economic regions, such as free trade zones.

Given the pace of regulatory reform in China, Australian companies need to consider the potential impact of rapid changes in China on their commercial operations and supply chains. This dynamic was illustrated in May 2016 when China refined regulations governing cross-border e-commerce. Limited advance notice was provided, which raised concerns in Australia that the changes would curtail e-commerce. Subsequent guidance from China's authorities clarified the reforms and the implementation of certain transitional measures. But some Australian exporters remain concerned about the future of e-commerce once the changes are fully enacted.

It is not uncommon for governments to implement regulatory change, but the e-commerce reforms in China illustrate the importance of:

- staying abreast of domestic policy and regulatory changes
- ensuring that Australian companies can assess and manage risks associated with regulatory change
- ensuring that operational models are resilient and capable of adapting to changing environments
- maintaining or having access to alternative supply chains or routes to export markets in the event of significant structural changes and impediments.



Fletcher embracing ChAFTA

Australia is the world's largest exporter of mutton and the second largest exporter of lamb. Fletcher International Exports is a privately-owned company operating two state-of-the-art meat processing plants, one near Albany in Western Australia and one in Dubbo, New South Wales. Fletcher's philosophy is to process as much of the animal as possible to as many countries as possible, processing not only chilled lamb, frozen mutton to over 90 countries but also sheepskins, runners for sausage casings, tallow, bloodmeal, meat meal and MDM.

North Asia is a major destination for these products and export opportunities are set to grow under the free trade agreements (FTAs) with China, Japan and Korea. These agreements will progressively eliminate tariffs on lamb, sheepmeat and sheepskins, giving Australia a significant edge over our competitors worldwide.

China is Australia's second most important sheepmeat export destination. The China Agreement positions Australian farmers to increase sales by phasing out tariffs on sheepmeat as well as sheepskins.

"Fletcher is one of the largest processors and exporters of sheepmeat and sheepskins to China, processing and exporting over 51,000 tonnes of sheepmeat to China in the last two years. In China's case, our import duties started reducing late last year and early this year. In seven years or so we won't have a duty on sheepmeat in China. That's so important for our customers' cash flows – they don't have to pay the duty when they're clearing the product from the wharf and that will help them buy more products and help increase the exports of Australian sheepmeat into China. The trade agreement with China has other benefits as well, not just for the sheepmeat and lamb that I've spoken about, but also for sheepskins. As we reduce that duty down to zero over time, that will give a lot more confidence in the business and help increase exports to China," says Bernard Gooch, Export Manager, Fletcher International Exports Dubbo.

fletchint.com.au

Courtesy of Austrade openforbusiness.gov.au/welcome

CONCLUSION

ChAFTA is a significant step forward in the evolution of Australia's trade relationship with China. Much more than just a political exercise, the agreement has secured access to an extensive range of benefits for Australian and Chinese businesses, presenting unprecedented opportunities to help Australia's goods and services remain a competitive and preferred choice in China.

ChAFTA includes review mechanisms to ensure that it remains dynamic and keeps pace with the changing global trade environment, which helps Australian businesses retain a competitive edge or at least stay on a level playing field with China's other trading partners.

It is now up to Australian businesses to understand ChAFTA and examine how it can be effectively integrated into commercial operations as business as usual.

CHAPTER 4

THE PRACTICAL APPLICATION OF THE RMB FOR CROSS-BORDER BUSINESS

“ Our close link with China means that developments in RMB internationalisation have important implications for Australian companies. We are in a competitive position and have the necessary infrastructure in place to facilitate cross-border trade and investment with China in RMB. ”

Sangeeta Venkatesan, Head of RMB and China Solutions, Commonwealth Bank.

“ More corporations are now settling in RMB. We're also seeing greater fluctuations in the currency, so as a result, RMB is increasingly being incorporated into clients' hedging strategies to secure better financial outcomes. ”

Chris McLachlan, Managing Director Client Risk Solutions, Commonwealth Bank.

“ Australian companies have the opportunity to benefit from better trade terms and a wider supplier base when they conduct their trade in RMB. Factoring RMB in cross-border trade may also provide foreign and Chinese companies with a more efficient and cost-effective solution. ”

Geoff Cox, Head of Global Trade and Transaction Services, Commonwealth Bank.

RMB CROSS-BORDER SETTLEMENT SCHEME

Chapter 1 provided an overview of renminbi (RMB) internationalisation and capital account liberalisation.

This chapter explains how companies can use various schemes introduced by China in combination with the RMB for cross-border trade and investments. It also offers a guide to corporates on using RMB to enhance capital and liquidity management strategies, and to unlock the benefits of the currency in an occasionally complex environment.

The Cross-Border RMB Settlement scheme allows eligible counterparties to settle trade and service-related transactions in RMB. There are two key features:

1. All receipts and payments of RMB in and out of China, including buying and selling the currency, are permitted, providing there is a valid purpose for payment and supporting documentation. This might include goods and service trade and direct investment.
2. Offshore participants can choose between the onshore CNY and offshore CNH exchange rates when converting the proceeds of eligible transactions into their chosen currency. Due to the nature of the two markets, the rates may differ and offshore participants may choose the most favourable rate.

This means Australian companies trading with Chinese companies can settle trades in RMB and convert the invoiced amount, or alternatively, set up a RMB foreign currency account to park the RMB funds. As demonstrated in (Figure 11), the bank supporting the Australian company can pay or receive RMB from the Chinese company.

BENEFITS TO AUSTRALIAN BUSINESSES

Settling in RMB offers several benefits.

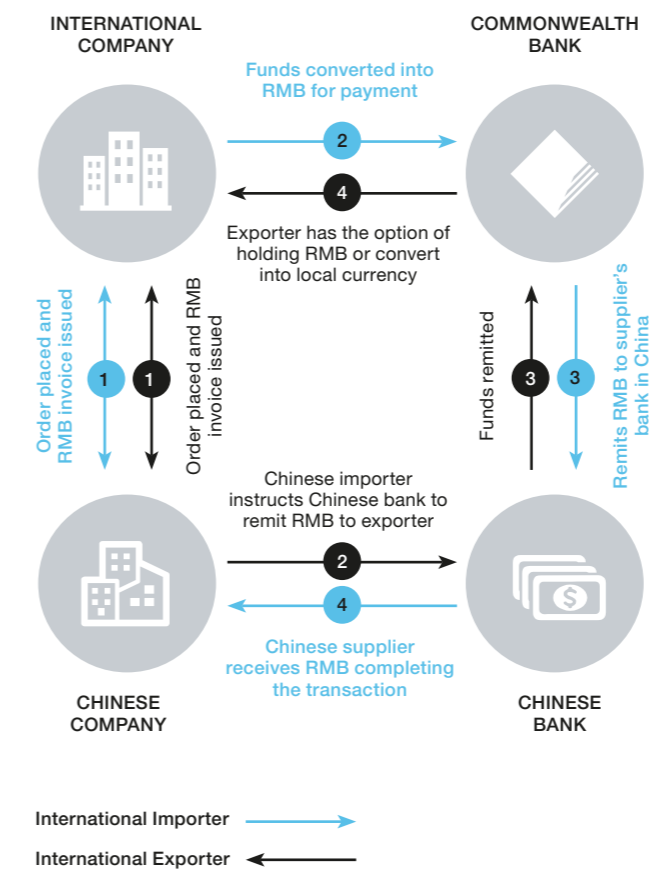
From a currency risk-management perspective, the scheme means that Chinese counterparties can invoice and settle in RMB and therefore no longer need to factor foreign currency hedging or conversion risks when invoicing or settling their trade and service partners. This allows foreign companies to access favourable trade terms and more transparent pricing when dealing with their Chinese counterparts.

A number of hedging instruments are available in the offshore market enabling foreign importers and exporters to effectively hedge exposures. Hedging costs could be cheaper outside China, creating incentives for both parties to transfer foreign exchange risk management from mainland China to offshore.

The adoption of the RMB also enables foreign companies to build deeper relationships with their Chinese counterparts and access a broader supplier or client base in China, in many cases resulting from a preference for the Chinese companies to invoice their exports or settle their exports in RMB.

With both trade and service transactions being eligible for RMB settlement, the announcement of a number of offshore hubs with designated clearing banks, and the launch of the CIPS platform, RMB settlement is on the rise.

Figure 11: How export/import companies can settle trade in RMB



HEDGING RMB EXPOSURE

As mentioned previously, initiatives such as the introduction of the RMB cross-border trade settlement scheme have allowed Chinese companies to transfer their hedging risk offshore. Foreign companies outside China have access to a wide spectrum of hedging instruments. A detailed illustration of how denominating trade invoices in RMB benefits both Chinese and Australian parties, and how the exposure to RMB fluctuations can be hedged is demonstrated in Figure 12.

Figure 12: How trading in RMB is creating opportunities for Australian businesses



Example: Protection against currency fluctuations for Chinese real assets

Some global asset manager clients have, until recently, held Chinese assets without hedging. The main reason is that until early 2015, the Chinese currency traded offshore (CNH) was appreciating in value. For most, CNH depreciation was considered relatively low-risk and hedging was expensive from a risk-reward perspective. Commonwealth Bank's early engagement with clients – focusing on the risks of CNH depreciation and the subsequent impact on final US dollar values when assets are sold – has assisted our clients immensely as the RMB is no longer a one-way bet.

"While we have ongoing investment appetite for Chinese real assets, FX volatility is an issue because it has the potential to detract from investment returns and asset valuation stability. As a consequence, we have been active risk management participants in the USD–CNH market to hedge the translated value of RMB assets back into USD."
Commonwealth Bank client.

RMB IN CAPITAL AND LIQUIDITY MANAGEMENT

China has released a number of carefully crafted reforms to enable controlled capital flows, allowing both Chinese and foreign companies to manage their capital and liquidity better.

These reforms permit companies in China to fund overseas projects. They also allow businesses to integrate the intra-day liquidity of their China subsidiaries into their global liquidity strategies to maximise baseline profits. In the past, multinationals struggled to repatriate income earned in China to their home countries. This chapter is aimed at providing various options to resolve this challenge, illustrated by the accompanying case studies and flowcharts.

The table below outlines the main channels available, with the relevant benefits and considerations for each solution.

Table 4: Capital and liquidity management options

Solution	Pros	Cons
Outward direct investment (ODI)	<ul style="list-style-type: none"> Simple and straight-forward registration process for most scenarios. 	<ul style="list-style-type: none"> One-way repatriation. Proceeds cannot be used for any purpose other than direct investment.
RMB intercompany loan	<ul style="list-style-type: none"> No prior approval required and minimal restrictions on the term of loan. Quick implementation with minimal lead time. Potential cheaper source of funding for the offshore-based entity. 	<ul style="list-style-type: none"> Tax considerations on the interest earned by the onshore lender (potentially offset with the interest payable by the offshore borrower). Depending on the terms of the loan, liquidity sharing is only on a temporary basis.
Cross-border guarantee	<ul style="list-style-type: none"> High degree of flexibility. Cost-efficient as onshore deposit can fully or partially offset offshore loan. Simple registration process with no regulatory approval required. 	<ul style="list-style-type: none"> 'Virtual' solution as funds are not moved physically across the border. Short-term solution. Tax considerations on onshore deposit interest earned vis-a-vis interest payable for offshore loan facility.
Dividend payment	<ul style="list-style-type: none"> Repatriation of excess cash out of mainland China. 	<ul style="list-style-type: none"> Withholding tax applicable for dividend payments. Inflexible process and complex approval process.
Cash pooling	<ul style="list-style-type: none"> Intra-day two-way liquidity management. High degree of flexibility. 	<ul style="list-style-type: none"> High barrier of entry – eligibility is based on profitability, capital and scale. Expensive and time-consuming to implement.

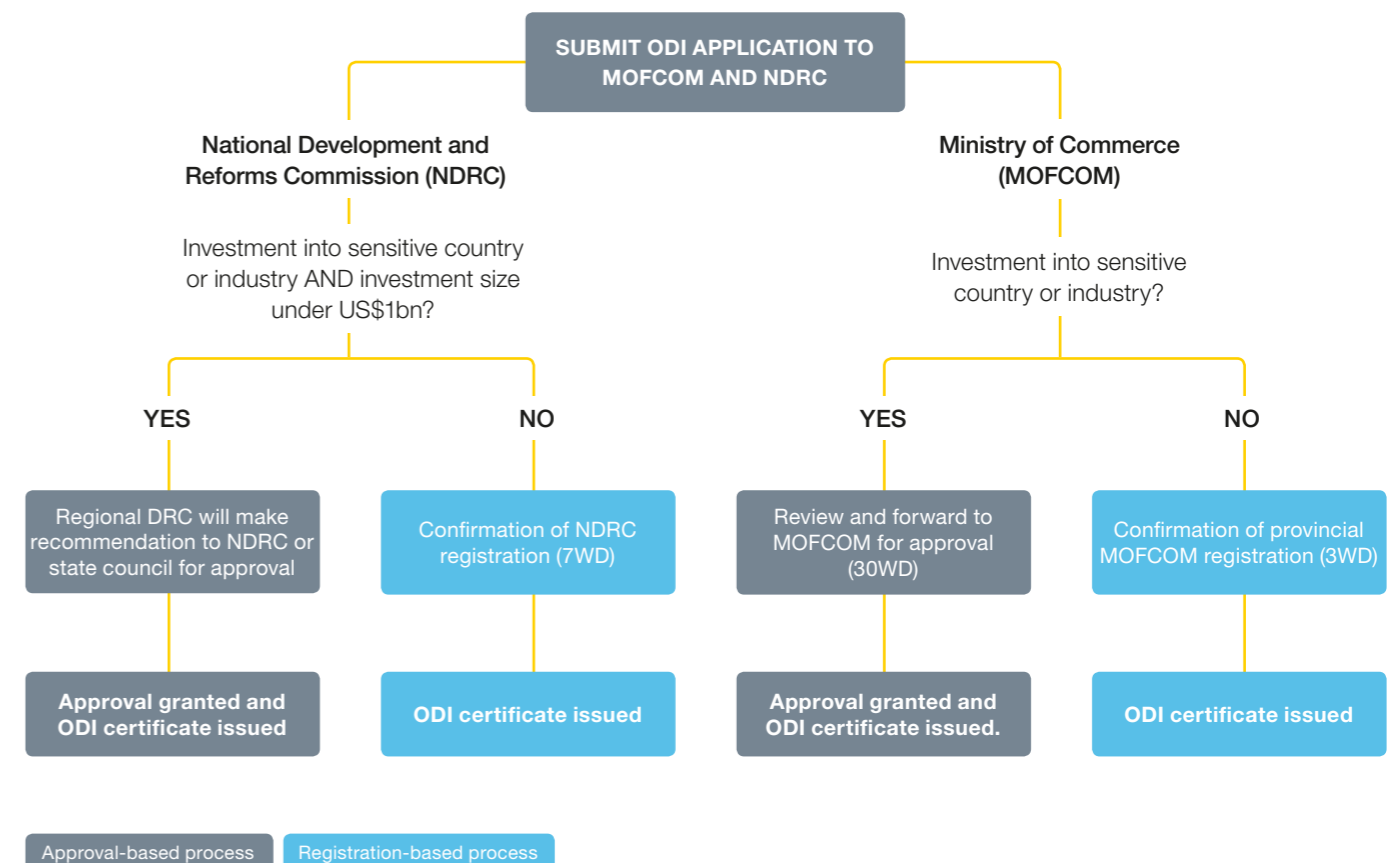
DIRECT INVESTMENT

Capital account liberalisation reforms have resulted in the use of Foreign Direct Investment (FDI) and Overseas Direct Investment (ODI) channels by companies to facilitate investments.

These reforms replace complex approval processes with simple registration with Chinese regulators where applications satisfy eligibility criteria.

ODI from China is an effective way for companies to remit capital for acquisitions or greenfield investments with minimal administrative burden. Funds can be remitted in RMB and parked in an RMB foreign currency account, and hedging instruments can be used to protect against foreign exchange fluctuations for the duration of the investment.

Figure 13: Registration and approval processes for outward direct investment in RMB



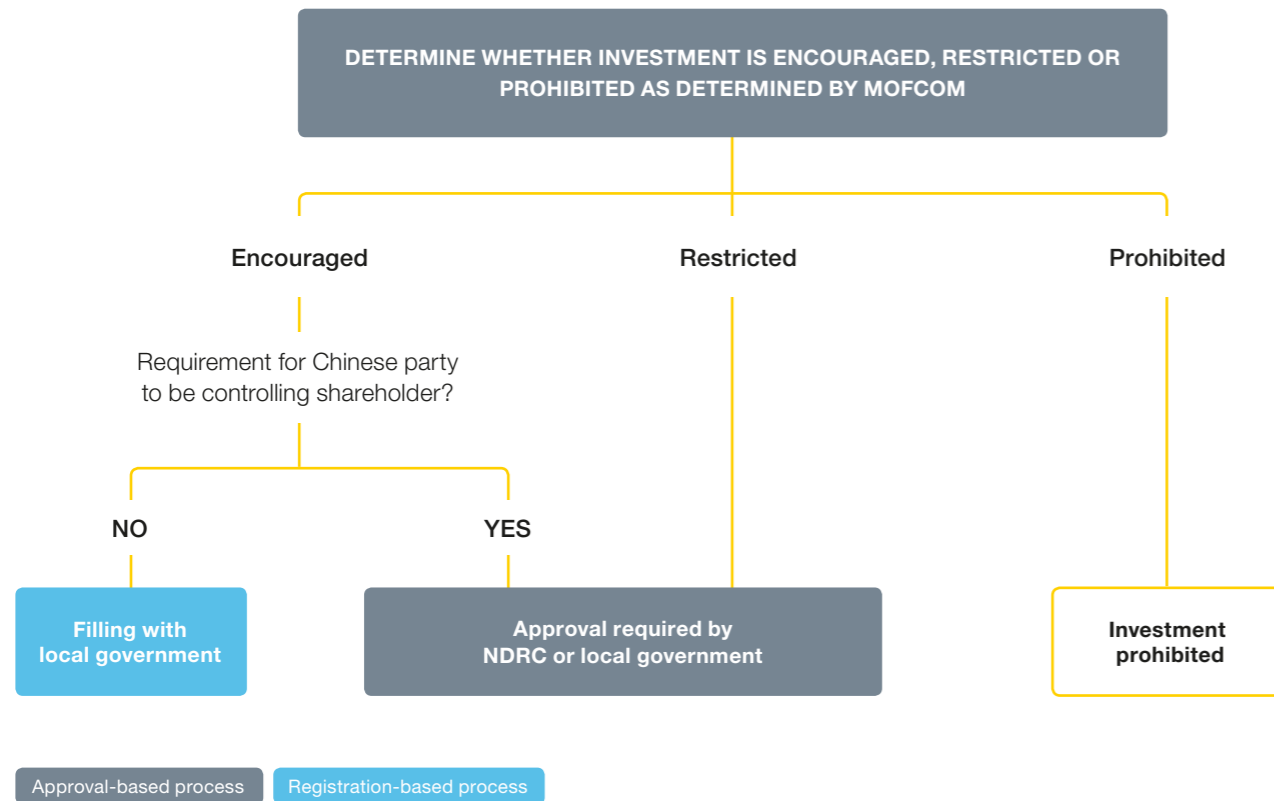
Sources: Ministry of Commerce (MOFCOM) and National Development and Reforms Commission (NDRC)

As illustrated in Figure 13, ODI processes have been streamlined to a simple registration with the National Development and Reform Commission (NDRC) and the Ministry of Commerce of the People's Republic of China (MOFCOM), and can be typically completed within seven working days. While certain projects may require additional approvals, most require only registration.

Similarly, in the case of FDI, foreign companies first need to understand whether their proposed projects are categorised 'encouraged', 'restricted' or 'prohibited' by MOFCOM, as illustrated in Figure 14. In 'encouraged' industries, the controlling shareholder must be a Chinese entity.

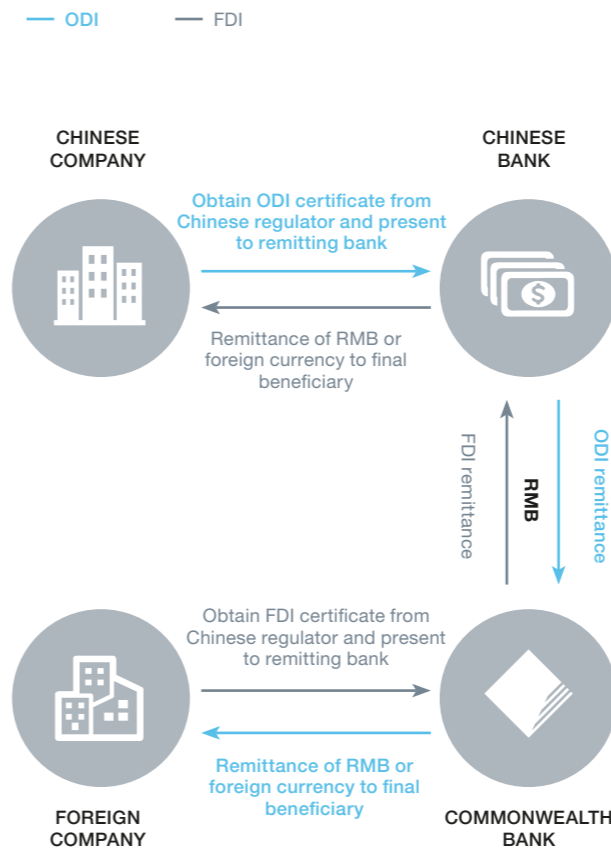
Once the registration for direct investment is complete, remitting investment proceeds is a simple three-step process, as shown in Figure 15.

Figure 14: Registration and approval processes for foreign direct investment in RMB



Sources: Ministry of Commerce (MOFCOM) and National Development and Reforms Commission (NDRC)

Figure 15: The three steps for remitting investment proceeds



Macrolink embraces opportunities in Australia

Macrolink, a diversified consortium with businesses in various industries, has a positive view about the investment outlook of the Australian market: "Australia has a relatively stable political landscape, and this is the (key) pre-requisite for foreign investors," says Michael Gao, Managing Director and Chief Representative of Macrolink in Australia.

Founded 26 years ago, Macrolink Group employs more than 45,000 people and has businesses in 25 provinces and autonomous regions in China. It also has operations in France, Spain, South Korea, Malaysia, Australia, Indonesia, Zambia, Peru and others. It has eight listed subsidiaries that reported total revenue of RMB60.5 billion in 2015.

While there are regulatory considerations on movement of capital across the Chinese border, Macrolink has actively sought the most efficient channels to invest in Australia.

Its recent acquisition of the prestigious 71 Macquarie Street property overlooking Circular Quay was funded in RMB, including the use of the RMB cross-border guarantee scheme. With this, Macrolink is well positioned to expand in Australia. "We expect the signing of ChAFTA will further streamline investment processes, and this will enable us to seek new opportunities in other industries including dairy, gold and other precious metals mining."

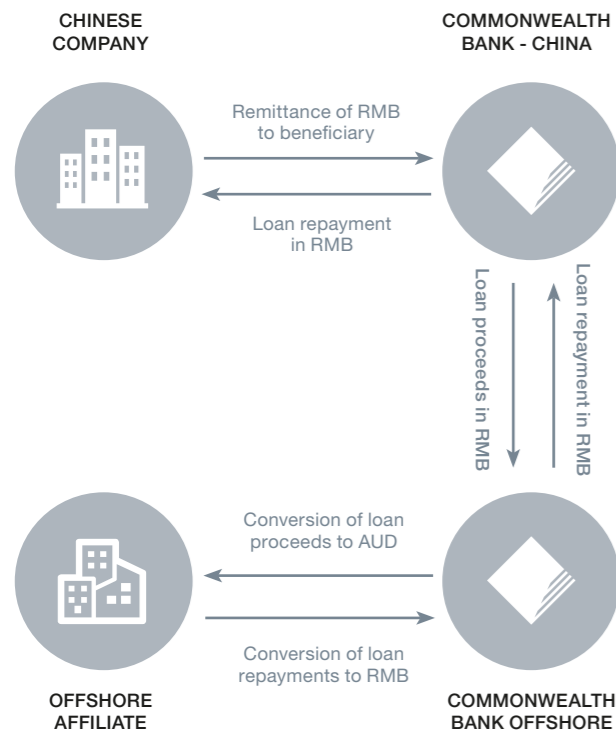
Macrolink Real Estate will benefit from Australia's decision to increase the number of visas for primary and secondary students, a move Mr Gao says will enhance the development of the local real estate market.

He believes there will also be other opportunities as Australia's economy is generally on a positive track and China's gradual implementation of its OBOR plan "heralds the advent of a new boom in Australia's mining industry".

INTERCOMPANY LOANS

Domestic Chinese businesses providing funding for international expansion, or Chinese subsidiaries of foreign companies sharing liquidity to fund head-office operations can make use of intercompany loans for their funding needs. This option is efficient and simple to implement, as there are few regulatory hurdles. Companies agree on loan terms and submit the loan contract to their bank to process the remittance.

Figure 16: Processes for using intercompany loans



The example below shows an outbound intercompany loan denominated in RMB. More stringent controls apply to inbound loans and/or those denominated in foreign currencies. These fall under a separate scheme governed by China's State Administration of Foreign Exchange.

Table 5: Advantages and considerations of intercompany loans

Why intercompany loan?	Considerations
Companies with excess cash in China can help with the liquidity needs of offshore head offices or affiliates requiring funding for investment projects.	The offshore borrower and onshore lender should be part of the same group.
It's a simple, efficient process to release surplus cash without the burden of regulatory approvals.	Tax considerations may apply.
Loan terms are relatively flexible providing conditions are at arm's length.*	Depending on the terms of the loan, liquidity is only shared temporarily.

*Arms-length transactions refers to transactions on commercial terms. i.e. as if dealing with an unrelated counterparty.



GroupGSA recognises opportunities through Wholly Foreign Owned Enterprise (WFOE)

China's government-led urbanisation drive is enabling GroupGSA to identify significant opportunities, Director Lisa-Maree Carrigan says.

"The shift from an agrarian and manufacturing economy to a city-based one has led to the rapid growth of China's Tier 1, 2 and 3 cities. The latter in particular need considered planning to cope with the enormous influx of workers coming in from China's outlying regions," Ms Carrigan says.

"There are unparalleled opportunities for urban design in China – to create new cities, universities and other places. You don't see projects of this scale anywhere else. In other countries, it would take decades to achieve this momentum."

GroupGSA is a multidisciplinary design practice covering architecture, urban design, interior design, landscape design and graphic design. It has eight offices, including in Ho Chi Minh City, Hanoi, Shanghai and, most recently, Beijing.

Being a WFOE has been strategically important to GroupGSA's ability to take advantage of the opportunities. But becoming a WFOE takes time.

"Even with ChAFTA, which should reduce the complexity of the process, the time needed to set up and the commitment required are not to be taken lightly," Ms Carrigan says.

"Consider whether you want to do it, and be very clear about your strategic advantage and positioning in China, because there are many design practices here. Then plan for the time and investment it takes."

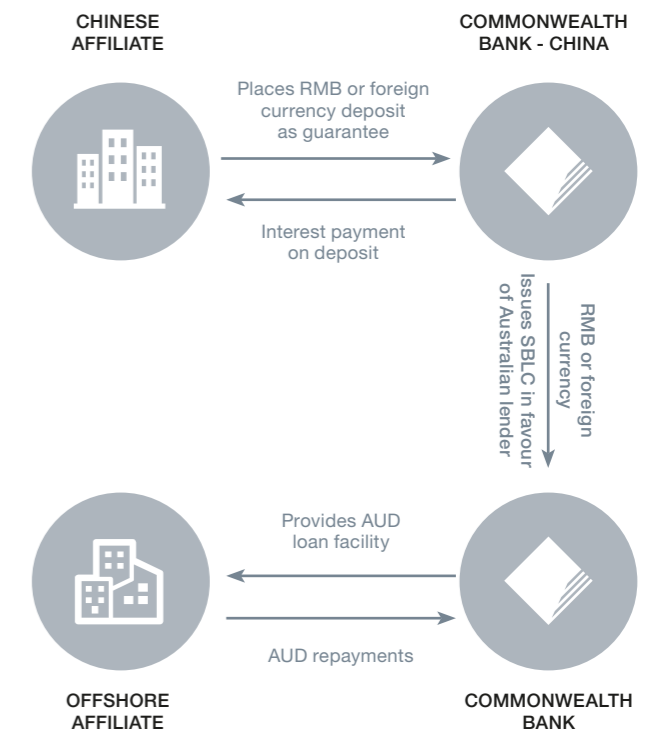
The benefit of WFOE is expected to be extended further with the implementation of ChAFTA. As a wholly foreign-owned enterprise, GroupGSA was only licensed for design work, and the full spectrum of services has had to be outsourced to local institutes. "Now with ChAFTA, a full-scope service licence will be available. This means we'll now be able to offer all our skill sets," says Ms Carrigan.

groupgsa.com

CROSS-BORDER GUARANTEE

The cross-border guarantee, permitted for the first time by the People's Bank of China (PBoC) in 2013, is a simplified option for multinationals to optimise liquidity management. A company can deposit excess cash with its China-based bank – for instance, with Commonwealth Bank in Shanghai – as collateral for a loan by Commonwealth Bank to the company's offshore parent company or affiliate. This structure is flexible and can be tailored to the company's specific requirements. With no physical movement of cash, the company can retain money in China to continue funding its operations and expansion.

Figure 17: Processes for using cross-border guarantees



* The example illustrated above is between a Chinese security provider and an Australian lender. The same process can be applied to companies in all offshore locations.

Table 6: Advantages and considerations of a cross-border guarantee

Why a cross-border guarantee?	Considerations
It's cost-effective. Interest earned from onshore deposits may partially or fully offset offshore borrowing costs.	The tax implications on the interest on the deposit and loan must be taken into account.
This is a simple and efficient process to release surplus cash without physically moving the fund.	This is a 'virtual' solution to address liquidity management issues as cash is not moved physically across the border.
The cash deposit in China allows flexibility, with the opportunity to use it later as required.	This is a short-term solution only as the loan facility usually has a short tenure (e.g. one year).
The security provider can be a parent, a subsidiary or any unrelated company or individual.	
The borrower can be a parent, a subsidiary or any unrelated company.	



Li & Partners on challenges faced by Chinese investors in Australia

"Against the backdrop of the OBOR initiative and ChAFTA, there will be an increase in the volume and diversification of Chinese investment in Australia," according to Li & Partners, a multi-jurisdictional legal practice specialising in cross-border legal issues.

Li & Partners believes that there will be three challenges facing Chinese corporates seeking investment opportunities in Australia, including:

1. The economic and political considerations of Australian government towards foreign investment;
2. Lack of deep understanding of Australian legal, regulatory and tax regimes; and
3. Difficulty in obtaining local financing due to the high debt ratio and low revenue during the initial period.

While those are genuine challenges, there are ways to mitigate and manage this risk, namely seeking the assistance of expert advisory firms (especially cross-border legal and other professions) in order to stay on top of concessions made under bilateral free trade agreements and comply with the relevant legislations, as well as seeking credit support from Chinese parent companies.

li-partners.com

CONCLUSION

Over the past three decades China has gained prominence as a global economic player. The events of the past few years – during which China has implemented wide-reaching economic reform – has opened up many opportunities worthy of consideration by Australian companies when developing their international strategies.

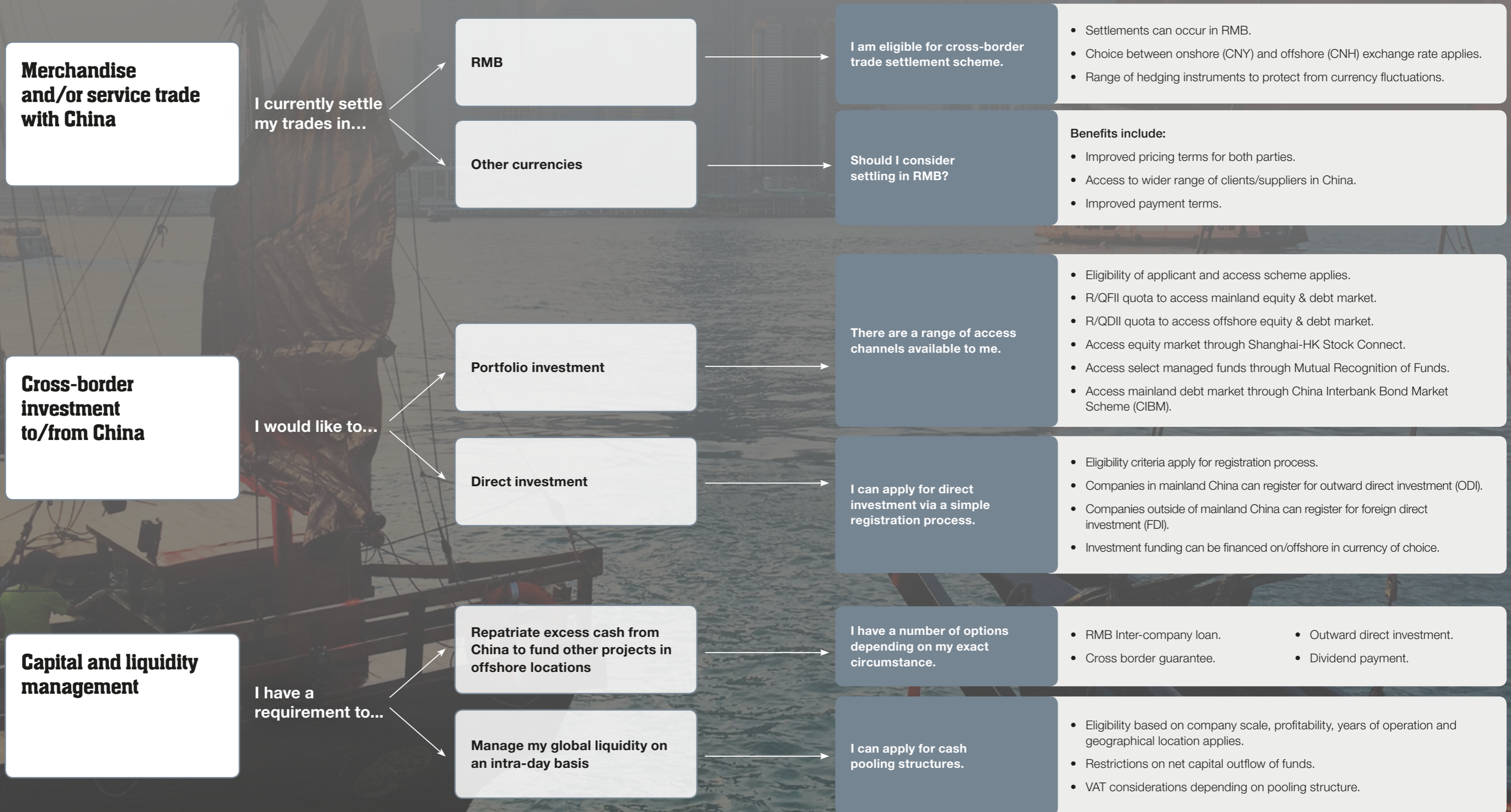
Those companies that have already recognised the opportunities have the 'first-mover' advantage. This does not mean other companies that have taken a more cautious approach will not benefit – the sheer size of the market in China means that the full potential is far from being tapped.

With companies now having greater access to the RMB, they can strengthen their operational strategy by shoring up their liquidity requirements. Having enough firepower in this regard can make a significant difference to the success of any venture that includes China. The plethora of schemes and solutions means that businesses – from small to medium enterprise operations to global multinationals – now have more choice and flexibility to fine-tune effective strategies to capitalise on China's efforts to globalise its currency.

Chapter 5 provides an outlook for China's economy and the RMB.

SUMMARY: PRACTICAL GUIDE TO CONDUCTING CROSS-BORDER TRADE AND INVESTMENT WITH CHINA

I am interested in...



Merchandise and/or service trade with China

I currently settle my trades in...

RMB

Other currencies

I am eligible for cross-border trade settlement scheme.

- Settlements can occur in RMB.
- Choice between onshore (CNY) and offshore (CNH) exchange rate applies.
- Range of hedging instruments to protect from currency fluctuations.

Should I consider settling in RMB?

- Benefits include:**
- Improved pricing terms for both parties.
 - Access to wider range of clients/suppliers in China.
 - Improved payment terms.

Cross-border investment to/from China

I would like to...

Portfolio investment

Direct investment

There are a range of access channels available to me.

- Eligibility of applicant and access scheme applies.
- R/QFII quota to access mainland equity & debt market.
- R/QDII quota to access offshore equity & debt market.
- Access equity market through Shanghai-HK Stock Connect.
- Access select managed funds through Mutual Recognition of Funds.
- Access mainland debt market through China Interbank Bond Market Scheme (CIBM).

I can apply for direct investment via a simple registration process.

- Eligibility criteria apply for registration process.
- Companies in mainland China can register for outward direct investment (ODI).
- Companies outside of mainland China can register for foreign direct investment (FDI).
- Investment funding can be financed on/offshore in currency of choice.

Capital and liquidity management

I have a requirement to...

Repatriate excess cash from China to fund other projects in offshore locations

Manage my global liquidity on an intra-day basis

I have a number of options depending on my exact circumstance.

- RMB Inter-company loan.
- Cross border guarantee.
- Outward direct investment.
- Dividend payment.

I can apply for cash pooling structures.

- Eligibility based on company scale, profitability, years of operation and geographical location applies.
- Restrictions on net capital outflow of funds.
- VAT considerations depending on pooling structure.

CHAPTER 5

CHINA – THE ECONOMIC AND EXCHANGE RATE OUTLOOK

“ China’s ultimate goal is to make the RMB a large global reserve currency, up from its current status as a partial reserve currency. To achieve this, China will liberalise its capital account. ”

Richard Grace, Executive Director Currency and Rate Strategy and International Economics, Commonwealth Bank.

“ Income growth in China and the transition towards consumer-led growth offer many opportunities for Australian services industries that may ultimately eclipse the earlier commodity boom. ”

Michael Blythe, Managing Director Economics, Commonwealth Bank.



CHINA'S LONG-TERM ECONOMIC OUTLOOK

Despite the current cyclical downturn, Commonwealth Bank is positive about China's long-term growth outlook. The country has made clear progress in the economic transition from investment-led gross domestic product (GDP) growth to consumption-led GDP growth. Consumption and service industries now play a more important role in driving China's GDP growth than investment and exports.

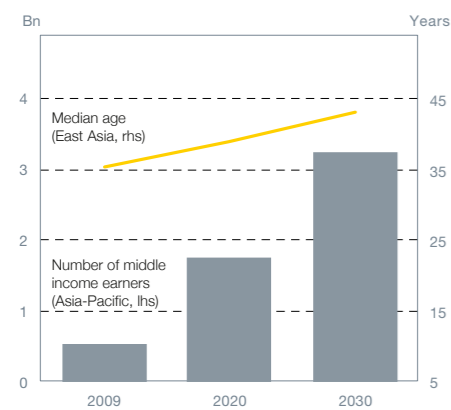
Further urbanisation will complement growth. China's aggregate urbanisation rate was only 56 per cent in 2015, well below the standard urbanisation level of 80 per cent in most major developed economies. Every year, 20 million Chinese people move from rural regions into cities, spurring consumption and investment growth. The average urban Chinese person consumes three times as much as the average rural person.

More housing, roads and schools are still needed for inland China as more people move into inland cities. Per capita capital stock in China's inland regions is only one-third of that in more developed cities and regions such as Beijing, Shanghai and Tianjin.

China's economy will continue to grow rapidly, although the pace of GDP growth will naturally moderate as the economy matures. China is currently the world's second largest economy, increasing in value from RMB0.4 trillion in 1978 to RMB67.6 trillion in 2015.

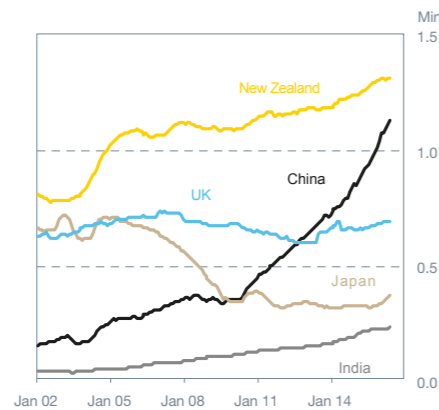
China's per capita GDP increased 129 times over the same period, from RMB382.00 to RMB49,351.00. However, annual growth in China's economy will likely gradually moderate to between five per cent and six per cent per annum by 2020 because the economy is so much larger. That said, even with a slower economic growth rate, China will generate an increasing value-added amount each year. Commonwealth Bank's calculations suggest an average growth rate of 5.8 per cent for China's economy between 2016 and 2020, is equivalent to growth of 10.5 per cent per annum a decade ago.

Figure 18: Trend in middle class income and median age demographic



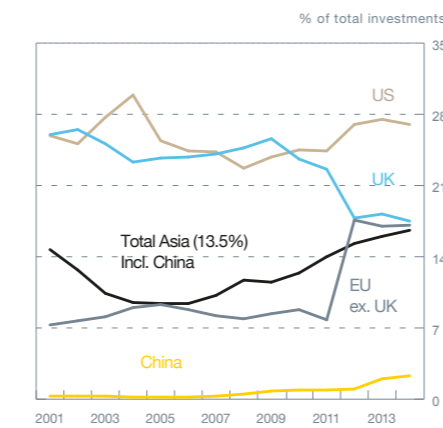
Source: Kharas and Gertz/United Nations

Figure 19: Number of visiting tourists in Australia



Source: ABS

Figure 20: Foreign investments in Australia, 2001-14



Source: ABS

RMB INTERNATIONALISATION

China's ultimate goal is to make the RMB a real global reserve currency from its current status as a partial reserve currency. To achieve this, China needs to liberalise its capital account. This means there are plenty of currency reforms to come. At the meeting of the International Monetary and Financial Committee in April 2015, People's Bank of China Governor Zhou Xiaochuan indicated that China will eventually achieve managed convertibility of the capital account. This means that restrictions on most capital transactions with a genuine economic basis will be considerably reduced, while some short-term controls will be maintained on speculative flows.

For large cross-border direct investments, Commonwealth Bank believes there will be negligible restrictions. The restrictions may only apply to very large deals and in a few strategic industries. Capital repatriation will also become unrestricted – but monitored – and not just limited to once per year, as is currently the case. For portfolio investments, there are likely to be significant increases in RMB Qualified Foreign Institutional Investor (RQFII) and Qualified Foreign Institutional Investor (QFII), as well as Qualified Domestic Institutional Investor (QDII) quotas, as well as increased market access. Repatriation approval may only be needed on very large amounts, and lock-up periods will probably be removed. An international stock exchange will also be established, allowing offshore entities to raise capital on the mainland.

Commonwealth Bank also anticipates that commodities will be traded in RMB. Commodities currently comprise 33 per cent of China's total imports, amounting to US\$500 billion in 2015. Even if a small portion of China's commodity imports is re-denominated into RMB, it will provide a significant boost to transactional demand for the redback.

Crude oil and iron ore are two major commodities imported by China. Given that the suppliers of these two commodities are oligopolistic, invoicing in RMB appears highly likely, sooner rather than later. As RMB pricing becomes more popular, it's not hard to imagine that some commodities might be priced in RMB on exchanges. The acquisition of the London Metals Exchange by Hong Kong Exchanges and Clearing Limited should indeed facilitate the progress of commodity re-domination to include pricing in RMB.

ACKNOWLEDGEMENTS

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Managing Director,
Macrolink Australia Land Pty Ltd

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Australia, JLL

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RMB INTERNATIONALISATION - KEY MILESTONES

2003	羊 	Jan	The Qualified Foreign Institutional Investor (QFII) scheme is approved for foreign investment in listed mainland bonds and equities.
2004	猴 	Feb	Hong Kong banks permitted to offer RMB deposit accounts to residents, a major step to develop the offshore market.
2005	雞 	Jul	People's Bank of China (PBoC) undertook a one-off 2% revaluation of the fixed RMB exchange rate, before immediately replacing the pegged regime to a managed floating exchange rate regime, allowing USD/CNY to float within a tight range of +/- 0.3% around the central mid rate at the previous day's close.
2006	狗 	Apr	The Qualified Domestic Institutional Investor (QDII) program is launched, allowing domestic mainland China institutions to convert RMB into foreign currency and invest in overseas equities and bonds.
2007	豬 	May	USD/CNY daily trading band widened to +/- 0.5%.
2009	牛 	May	HSBC and Bank of East Asia gain approval to issue the first offshore RMB Dim Sum bonds.
		Jul	Pilot RMB trade settlement scheme launched between five mainland cities and Hong Kong, Macau and ASEAN countries. Only merchandise goods are eligible under the pilot scheme, and onshore participation is limited to 365 Mainland Designated Enterprises (MDE).
		Jul	Chinese exporters will now receive the same export tax rebate when invoiced in RMB (previously only eligible in foreign currencies). Claiming process streamlined for RMB trade settlement with requirement to file with State Administration of Foreign Exchange (SAFE) removed.
2010	虎 	Feb	Foreign firms approved to issue Dim Sum bonds.
		Jun	Expanded pilot scheme to 20 mainland provinces and the rest of the world. Services and other current account items are now eligible under the scheme.
		Aug	Approval is given to foreign central banks, offshore RMB clearing banks and participating banks to invest RMB raised offshore in the mainland interbank bond market.
2011	兔 	Jan	Mainland firms can now apply to take RMB offshore for overseas direct investment in foreign firms.
		Aug	Pilot cross-border trade settlement scheme extended to cover entire China.
		Oct	Rules are formalised to allow approved foreigners to invest RMB raised offshore directly in mainland firms, including through the provision of RMB cross-border loans.
		Dec	The RMB Qualified Foreign Institutional Investor (RQFII) scheme is approved to allow RMB raised offshore to be invested in listed mainland bonds and equities.
2012	龍 	Mar	All onshore eligibility restrictions (including MDE list) are now removed for cross-border trade and settlement.
		Apr	PBoC widens the daily trading band for the USD/CNY exchange rate to 1.0% +/- the reference rate.
2013	蛇 	Apr	PBoC grants approval for direct convertibility of AUD/CNY.
		Jul	Relaxation of rules on cross-border credit support, guarantee and intercompany loans.
		Sep	China opens its first Free Trade Zone in Shanghai.
		Oct	One Belt One Road (OBOR) initiative announced by Chinese leader Xi Jin Ping.
		Dec	Streamlining the process on foreign direct investments, delegating authorities from state council to National Development & Reforms Commission (NDRC) and allowing a registration based system for most applications.

2014	馬 	Mar	PBoC widens the daily trading band for USD/CNY exchange rate to 2.0% above or below the reference rate.
		Apr	MOF/COM streamlined the process on outward direct investments, allowing a registration-based system for most applications.
		May	SAFE issued provisions to simplify eligibility criteria and process for conducting cross border guarantees.
		Nov	HK-Shanghai Stock Connect launched, allowing mainland investors to purchase select companies listed in HK, and foreign investors to access Shanghai A Shares in a less restrictive manner.
2015	羊 	Nov	BOC Sydney announced as official RMB clearing bank in Australia.
		Nov	NSW Treasury Corp issued inaugural CNH (Dim Sum) Bond for RMB 1 billion.
2015	羊 	Mar	Reserve Bank of Australia (RBA) signed 200billion RMB Bilateral Swap Agreement (BSA) with PBoC.
		May	Three additional Free Trade Zones established in Guangdong, Tianjin and Fujian.
		Jun	Approval process for China outbound direct investments moves to a registration-based process for most ODI's.
		Jun	The Asian Infrastructure Investment Bank (AIIB) is formally incorporated, with China being the largest stakeholder holding 26% of voting rights. Australia will join as founding member.
		Jul	HK-China Mutual Recognition of Funds Scheme becomes operational, allowing eligible HK & mainland China funds to be sold to retail investors in respective regions.
		Aug	PBoC undertook a one-off +1.9% adjustment in the USD/CNY daily fix as a correction to the disparity between the spot and daily fix. Fixing mechanism also adjusted to allow the market to play a bigger decisive role in determining the fixing price.
		Aug	PBoC released circular 250 to allow offshore participating banks to enter into CNY derivative contracts on the back of genuine client needs basis.
		Oct	Cross-border Interbank Payment System (CIPS) is launched.
		Nov	Foreign sovereign entities including central banks and sovereign funds are allowed to enter and conduct FX trading in mainland China.
		Nov	IMF published decision to grant RMB to enter the SDR basket, effective Oct 16 with weighting of 10.9%.
		Dec	China Australia Free Trade Agreement (ChAFTA) enforced.
		2016	猴 
Feb	Opening of China Interbank Bond Market to allow access by a wide range of foreign financial institutions including commercial banks, superannuation and managed funds.		
Apr	Extension of pilot cross-border financing regime to entire mainland China.		
Aug	Australian Securities Exchange (ASX) announced the ability to support the issuance of RMB-denominated securities in Australia via Austraclear platform.		

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