

## Event comment

# China-Eurozone currency swap deal marks another step forward in the RMB internationalization process

11 October, 2013

Comment on the PBOC ECB currency swap agreement

## Key forecasts

## U.S.

|                      | 12   | 13E  |
|----------------------|------|------|
| %                    |      |      |
| GDP                  | 1.7  | 2.0  |
| CPI                  | 2.1  | 2.1  |
| Unemployment         | 8.1  | 7.5  |
| Current Account /GDP | -2.7 | -2.6 |
| Fiscal balance /GDP  | -6.7 | -5.8 |
| Policy rate          | 0.25 | 0.25 |
| Dollar index         | 79.7 | 86.0 |

## Eurozone

|                      | 12   | 13E  |
|----------------------|------|------|
| %                    |      |      |
| GDP                  | -0.6 | -0.5 |
| CPI                  | 2.5  | 1.5  |
| Unemployment         | 11.4 | 12.3 |
| Current Account /GDP | 1.28 | 1.54 |
| Fiscal balance /GDP  | -3.7 | -2.8 |
| Policy rate          | 0.75 | 0.5  |
| EUR/USD              | 1.32 | 1.20 |

## Japan

|                      | 12    | 13E   |
|----------------------|-------|-------|
| %                    |       |       |
| GDP                  | 2.0   | 1.7   |
| CPI                  | -0.04 | 0.01  |
| Unemployment         | 4.3   | 4.0   |
| Current Account /GDP | 1.0   | 0.9   |
| Fiscal balance /GDP  | -9.9  | -10.0 |
| Policy rate          | 0.0   | 0.0   |
| USD/JPY              | 86.8  | 98.0  |

Sources: Bloomberg, CMS (HK)

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## Event:

The ECB and the PBOC agreed to a currency swap line on October 10<sup>th</sup>, valued at RMB 350 bn or EUR 45 bn, and valid for three years. The arrangement will allow for both central banks to freely purchase and repurchase their currencies from each other, and will “serve as a backstop liquidity facility.”

## Comment:

The ECB and PBOC’s currency swap deal is the newest in a series of bilateral currency swap deals, and is the third largest currency swap agreement for China, behind only Hong Kong and South Korea. Our views on the currency swap deal are as follows.

- The deal marks another step of RMB internationalization in Europe, and improves the RMB’s global status.** The ECB / PBOC swap comes several months after the PBOC signed a deal with the Bank of England in June for RMB 200 bn. China had already signed deals with Hungary, Albania, and Iceland earlier this year. The agreement with the ECB is a big step for the RMB internationalization process globally; with a CNY-EUR swap set, the only major currency China does not have a swap line set up with is the USD. **We do not expect a swap line with the Fed to be set up in the near future, given political factors and a lack of actual need.**
- The deal will promote bilateral trade and investment.** The currency swap deal marks the growing importance of the RMB in international trade. Though RMB denominated trade is expected to rise to nearly 15% of China’s total trade in 2013, most of this trade is centered in China’s trade with Asia. This deal will allow for China-Europe trade contracts to be increasingly denominated directly in the RMB and Euro, reducing exchange rate risk and costs, and allow for companies to utilize the ECB as a source of liquidity if the RMB is not easily available on the market.
- The RMB swap deal can also increase the use of RMB as an international reserve currency and in asset portfolios.** The swap line can provide an easier way for European countries to obtain RMB, as the RMB is not freely convertible in the market yet. Countries seeking to diversify their foreign reserves to include the RMB can benefit from swap deals in order to obtain more sizeable quantities of the currency. MNCs are also encouraged to include the RMB in their asset portfolios
- As the currency swap deals are designed as “backstop liquidity facilities”, the tangible swaps are less important than the symbolism of the deals.** In terms of financial stability, Eurozone banks can now be reassured of RMB availability, mitigating liquidity risk. Additionally, the willingness of the ECB to engage in the deal reflects their implicit belief in the value of the RMB. Currency swaps allow for economic actors to acclimate themselves to utilizing the RMB in settlement and investment, and have the benefit of familiarizing the international community with the currency. **In terms of offshore development of the RMB, any offshore center in Europe would most likely be in London rather than continental Europe, as London is well entrenched as the world’s leading FX center.**

With the ECB becoming the latest central bank to sign a swap deal, China has taken another important step forward in the RMB’s internationalization process. With this deal, China now has over RMB 2.5 tn in currency swap deals with countries around the world.

**Chart 1: China's recent currency swap deals in Europe**

| Country  | Date   | Swap Quantity (RMB) | Comment              |
|----------|--------|---------------------|----------------------|
| Eurozone | Oct-13 | 350 bn              | Initial swap         |
| Iceland  | Sep-13 | 3.5 bn              | Renewal of 2010 swap |
| Hungary  | Sep-13 | 10 bn               | Initial swap         |
| UK       | Jun-13 | 200 bn              | Initial swap         |
| Ukraine  | Jun-12 | 15 bn               | Initial swap         |
| Turkey   | Feb-12 | 10 bn               | Initial swap         |
| Belarus  | Mar-09 | 20 bn               | Not renewed          |

Sources: Bloomberg, CMS (HK)

**Chart 2: Ranking of currencies by global FX trading and world payments**

| Currency | Percentage of global FX trading | Percentage of world payments |
|----------|---------------------------------|------------------------------|
| USD      | 40.14                           | 37.93                        |
| EUR      | 16.16                           | 36.48                        |
| GBP      | 11.31                           | 8.19                         |
| JPY      | 5.78                            | 2.34                         |
| AUD      | 3.21                            | 1.95                         |
| CHF      | 2.34                            | 1.60                         |
| CAD      | 1.99                            | 1.84                         |
| CNY      | 1.49                            | 0.84                         |
| RUB      | 1.16                            | 0.40                         |

Sources: Bloomberg, CMS (HK)

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| <b>RATING</b>      | <b>DEFINITION</b>  |
|--------------------|--|
| <b>OVERWEIGHT</b>  | Expected to outperform the market index by > 10% over the next 12 months                           |
| <b>NEUTRAL</b>     | Expected to outperform or underperform the market index by 10% or less over the next twelve months |
| <b>UNDERWEIGHT</b> | Expected to underperform the market index by >10% over the next 12 months                          |

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