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China's yuan hits headwinds in bid to be global currency

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By Adam Jourdan and Michelle Chen

SHANGHAI/HONG KONG (Reuters) - China's campaign to get the world using its currency, the yuan, is hitting headwinds in corporate boardrooms, raising doubts as to whether it will ever challenge the dominance of the U.S. dollar in global trade and finance.

Despite aggressive marketing by banks touting its benefits and steady pressure from China itself, the multinationals whose acceptance will ultimately determine the fate abroad of the yuan, or renminbi, remain reluctant.

In particular, executives say, they are not convinced using yuan will lower the cost of doing business with suppliers and customers in China. Holding yuan will remain problematic as long as China controls the flow of money in and out of its economy, they say.

And executives and economists alike are sceptical about just how eager China is to open up and expose itself to the vagaries of international capital flows.

"I'd say that (the advertised savings) are mostly bank marketing," said the treasurer in charge of implementing yuan settlements at one of Europe's largest multinationals. He requested anonymity because he was not authorised to speak to the press.

"We would very much like to settle in yuan and reduce our currency risk a little, but the clients in the major European countries and the U.S. won't do it," said Li Bin, manager at Lipac, a manufacturer of bathroom fixtures in Wenzhou, China.

After explosive initial growth, therefore, the shift to yuan in China's trade abroad appears to be easing. The proportion of trade settled in yuan expanded just 3 percentage points, to 12 percent, in 2012, after surging to 9 percent from just 3 percent in 2011, Reuters calculations of data from China's central bank show.

"Volumes do look like they flattened out a bit," said David Blair, managing director at Acarate, a Shanghai-based financial consultancy that advises companies on using the yuan. "Beijing already got the early-adopter types who had been thinking about this, knew what kind of savings were in it for them and were willing to do the legwork - the low-hanging fruit."

SOUND AS A POUND

The dollar eclipsed the British pound as the currency of choice in investment and trade after World War Two. China's rising economic prowess might make its own currency's rise seem similarly inexorable.

But China faces a chicken-and-egg dilemma: to make yuan widely available abroad, they need to be widely accepted; to earn wide acceptance, they need to be widely available.

"We are playing a waiting game in some respects," said Adam Vos, global head of forward foreign-exchange contracts at Deutsche Bank in London. "Clients would like to do more, but they will only do more once market depth and liquidity has further improved."

Beijing first launched efforts to internationalise its yuan in 2003. Collecting dollars for exports was fine when the dollar was relatively strong and China was trying to export its way to development.

But after amassing $3.31 trillion in largely dollar-denominated reserves so it could keep racking up trade surpluses without its own currency rising, China is now trying to prepare for a future in which it is as big an importer as exporter. That means lower trade surpluses and a need for greater purchasing power abroad.

Being able to trade and invest in its own currency not only boosts China's global economic and political clout, it shifts the foreign-exchange risk from its own companies onto its trading partners' and allows China and its companies to borrow abroad in their own currency.

Borrowing in dollars has helped the United States fund its perennial trade deficit despite government debt in excess of the U.S. gross domestic product. It also opens local banks to new competition, forcing them to lower rates and improve services and so plays into China's plan to liberalise its financial sector.

The yuan's early gains have been impressive. Lured by higher interest rates on a currency whose value seemed to be rising in line with China's economy, investors and companies flocked to the yuan when it first became available in Hong Kong. Now rival financial centres Singapore, Taipei and London, have won Beijing's endorsement to host yuan transactions themselves and a handful of central banks have introduced small portions of renminbi alongside dollars in their reserves.

In January, the yuan overtook the rouble as the 13th most popular currency for international payments, according to the Society for Worldwide Interbank Financial Telecommunication (SWIFT), the Brussels-based consortium that handles most international bank payments. The share of global transactions based in yuan nearly tripled between January 2012 and January 2013, the consortium said.

But that still represents a mere 0.63 percent of all international payments. And attracting investors isn't likely to be as easy now that the renminbi no longer looks to be a one-way bet up. After rising roughly 30 percent between 2004 and last year, the People's Bank of China, China's central bank, let the yuan sink 1.6 percent in the first seven months of 2012 amid sluggish exports and slowing economic growth. Its own data suggests that the willingness of China's suppliers to accept yuan depends largely on whether the currency is appreciating.

THE BUCK DOESN'T STOP HERE

Reluctance is perhaps greatest in the country whose currency is still number-one. Transactions in yuan by U.S. companies fell 38 percent in December from November, data from SWIFT shows. Few have yet implemented systems for settling in any currency other than dollars, according to the head of SWIFT's yuan internationalisation division, Lisa O'Connor.

"It's just cheaper to do business using dollars," said Mark Williams, chief Asia economist at Capital Economics in London.

Per Lindvall, managing director for the China operations at Norwegian automotive parts manufacturer Defa Technology, said Defa offers to settle and invoice in yuan, but the only takers have been other companies in Asia. "If I went to my North American partners, they'd say, 'Are you crazy?' They wouldn't do it."

Banks offering renminbi-denominated services suggest companies using yuan for trade in China can save up to 7 percent on transaction costs. HSBC, drawing from a poll of its Chinese corporate clients, recently estimated that 41 percent of suppliers in China were willing to offer discounts of up to 3 percent on trades settled in yuan.

That does not impress many executives worried about China's controls on moving funds in and out of the country. When it leased generators to the operator of Beijing's Olympic Games in 2008, for example, UK company Aggreko (AGGK.L: Quote, Profile, Research, Stock Buzz) charged in dollars. The potential savings from billing in yuan were attractive, said Prabhakar Kesavan, Asia-Pacific finance director at Aggreko, but "for remittance of profits out of the country, what exactly are we talking about? I'm not clear."

Opening up to freer flows of capital would help reduce that kind of uncertainty. But it would in turn expose China's economy to the kind of rapid inflows and outflows that have wreaked havoc in other, more open economies.

China's officials and economists are divided on how quickly China should proceed down that path. "Progress is slowing down because the government has developed a few reservations about whether the process is as controlled as it would like," said Eswar Prasad, an economist at Cornell University and former head of the International Monetary Fund's China division.

"Fascination with the yuan is understandable," said Prasad. "But I don't think it's going to become a very important international currency any time soon."

(Additional reporting by Pete Sweeney and Chen Yixin in SHANGHAI; Editing by Wayne Arnold)