Zeti Akhtar Aziz: Renminbi trade settlement and investment in Malaysia – future prospects

Keynote address by Dr Zeti Akhtar Aziz, Governor of the Central Bank of Malaysia, at the Seminar on "Renminbi trade settlement and investment in Malaysia – future prospects", Kuala Lumpur, 27 September 2012.

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This decade has seen significant change in the configuration of the global economy. In this evolving global landscape, Asia is emerging as an increasingly important component of the world economy. During this period, most of the Asian economies have experienced remarkable growth, despite a most challenging environment. With rising incomes in the region, Asia has also become a huge cumulative market. This trend has in turn prompted greater intra-regional trade and investment activities. A more recent trend in the Asian region is the greater regional financial integration that is facilitating greater cross-border financial flows in the region that is funding productive investment activities in the region.

Following the recent global financial crisis, the most pressing challenge for the world economy is to achieve economic strength that is sustainable. While most national economies have implemented wide ranging policy measures to promote growth, equally important are the efforts to sustain world trade which will be mutually reinforcing to global growth. China's economic journey in this global shift and the growing influence of renminbi ushers us into a new exciting era. China, by its sheer size and its economic performance has significant potential to contribute to world growth. Its demand, trade and cross-border investment activities will reinforce this potential. The recent trend for the use of the renminbi for settlement of trade and cross-border investment activities will facilitate this potential.

It is my pleasure to welcome you to this Seminar on "Renminbi Trade Settlement and Investment". I would like to take this opportunity to extend a warm welcome to our guest speakers from the People's Bank of China and the Ministry of Commerce (Mofcom) of the People's Republic of China. I also wish to welcome our panellists from the financial industry and the corporate sector that are here today to share their experiences in operating in the current challenging economic and financial environment.

The economic relationship between Malaysia and China is longstanding and grounded on strong foundations. Today, China is Malaysia's largest trading partner accounting for 14% of our country's total trade. Malaysia also ranks as China's most significant trading partner in the Asean region. Our trade with China has continued to expand, increasing by 20% annually, in this recent two decades. Our bilateral trade with China is now seven times higher than the level in the early 1990's.

Our economic relations have also evolved and expanded beyond the area of trade – into the services sector, particularly the financial sector, tourism and education. China is among the top five tourism markets for Malaysia and Chinese nationals represent the largest foreign student population in Malaysia's private universities and colleges. Bilateral investment is also gaining importance, notably with the two recent Government-to-Government agreements, involving the establishment of an industrial park in both countries. The cornerstone to the strength of our bilateral economic relations is the ability to continually harness the synergies and economic complementarities that exists between our economies.

The use of renminbi for trade settlement provides a natural hedge for businesses with renminbi obligations. It also generates cost savings and minimises exchange rate risks, in particular, it reduces the exposure to exchange rate fluctuations of a third currency. While the dollar will continue to remain an important currency for settlement of trade obligations, the availability of renminbi would provide companies an additional currency for such trade settlement.

The benefits to be gained can be significant given the large and increasing trade base with China which stood at RM167 billion in 2011. By undertaking the transactions in local currency, exporters and importers in China would be able to eliminate the hedging and conversion costs. The reduction in transaction costs for the exporters and importers will contribute towards more competitive pricing for both exporters and importers. The full potential benefits are however expected to be realised in stages. The benefits will rise as the trade volume settled in renminbi increases and reaches a critical volume in terms of size which will in turn allow for the realisation of economies of scale.

For the renminbi to be considered an option for both exporters and importers to settle their trade obligations in addition to the major currencies. There needs to be an efficient and cost-competitive source of financing in renminbi and a diversified investment avenue. In particular, it is recognised that discernible progress in three areas are needed to be put in place at an early stage to support the use of renminbi, that is, to improve access to renminbi liquidity, to have the supporting infrastructure and framework and to provide information on the use of the renminbi for trade and productive investment transactions. More than three years ago, in early 2009, the Bank entered into a Currency Swap Arrangement (CSA) Agreement with the People’s Bank of China, which was renewed early this year with an expanded amount of Renminbi 180 billion. The objective is to ensure a ready supply of renminbi in the domestic financial markets to meet the demand by businesses.

An important piece of the infrastructure that was put in place in 2010 was the provision of direct quotes between renminbi and ringgit in the interbank foreign exchange market on the China Foreign Exchange Trade System (CFETS). Efforts were also made to enhance the transparency in the exchange rate between renminbi and ringgit for the trade-related settlement transactions. In March this year, the real time gross settlement system in Malaysia was expanded to include settlement services in renminbi. This serves to provide a safe and efficient clearing and settlement platform that supports trade and investment flows in renminbi.

A nationwide awareness program by the banking institutions and the business chambers is also creating greater awareness on renminbi for trade settlement and investment. The Bank has also participated in the Chinese interbank bond market. In 2011 alone, the size of renminbi trade settlement in Malaysia expanded by four times from the level a year ago, reflecting a growing interest in renminbi as a settlement currency.

The expansion in renminbi usage has also been underpinned by a diffusion of corporate players, both in size and across the sectors. Not only has the number of corporate players increased, but there has been a shift in relative significance in the use of renminbi as a trade settlement currency from the smaller to the larger corporations. There has also been more widespread corporate participation from a larger cross-segment of economic activities, namely the commodity based industries, manufacturing and services sectors that also includes tourism and education. There has also been an increase in the number of financial institutions participating in renminbi trade settlements. There are now 19 financial institutions that facilitated such trade settlements, double the number in 2009.

More recently, there has been an increase in the use of the renminbi as an investment and funding currency. In the first seven months of this year, renminbi deposits in the banking system had tripled. Also evident is the growing interest in raising financing in renminbi to meet funding requirements, with two issuances of offshore renminbi sukuk out of Malaysia and a renminbi bond issuance by Malaysian corporations.

The progress made thus far, while modest, has significant potential given the significant volume of the bilateral cross-border trade and foreign direct investment between our economies. Trade settled in renminbi currently only represents slightly above 1% of Malaysia’s bilateral trade with China. There is therefore potential for this to increase. In addition, funding and foreign direct investment activities in renminbi have also increased with the greater awareness on the use of renminbi for the settlement of trade and direct investment transactions and on the potential to raise financing by businesses.

Important to this initiative is the access to a wider array of portfolio investment avenues in renminbi. The availability of renminbi bonds and sukuk as well as other financial products for portfolio investment will not only encourage renminbi receivables, but it will also help to build a pool of trade-driven renminbi liquidity in the Malaysian market. Another important channel that would support the use of renminbi in trade and investment is repatriation as foreign direct investment in real sector activities in China increases.

Raising funding in renminbi has also emerged as a further form of business in the Malaysian financial system. This has been the conventional channels by the banking institutions and the issuance of renminbi instruments in the bond and sukuk market in Malaysia. Malaysia is well positioned to realise this growth potential in renminbi bond and sukuk, given our market size and supporting infrastructure. Malaysia not only has the largest debt securities market in Southeast Asia, but it is also a leading international centre for sukuk issuance. Both markets are evolving as a multi-currency bond and sukuk market.

As the renminbi market expands, more information would be needed to provide awareness on market developments. As we transition to using other currencies for trade settlement it will also require businesses to gain new expertise, develop new arrangements and to build new networks.

Let me now conclude my remarks. As Asia, and in particular, China's greater prominence in the global economy, a dynamic response is required in this new operating environment that is now upon us. One of the changes that will shape the international financial system in the years to come is the wider role of the renminbi in trade and finance. While existing international reserve currencies will remain to be important, this will represent an additional currency in the international financial system. This is an expected development as the world economy becomes increasingly multi-polar.

In a more complex and more challenging economic and financial environment that is prone to greater volatility and increased uncertainty, there will be a greater trend to diversify risks. This will also contribute to overall global stability in the international financial system. On our part, the Bank is committed to collaborate with the Chinese authorities to facilitate the use of renminbi that is anchored on real sector activities for the mutual benefit of our countries. Today's seminar will discuss the issues concerning the use of renminbi in trade and investment. On this note, I wish you all a productive and successful engagement.