

(BN) Yuan Revolution Gains Converts as Merk Stuffs Funds: Currencies

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Nov. 4 (Bloomberg) -- Evidence the yuan is becoming truly global can be found in Rongrong Huo's passport, which shows the HSBC Holdings Plc banker bouncing from Switzerland and South Africa fielding inquiries from a growing number of clients on how they can trade China's currency.

"The market potential is huge," Huo, who heads HSBC's yuan business development for Europe, said in an Oct. 29 interview after returning to London from Warsaw. "Companies are asking, how can we make progress on this front? And investors are asking, how can we bring the yuan into our asset allocation? It's encouraging to see the engagement. It's about the future."

Three years after China allowed the yuan to start trading in Hong Kong's offshore market, banks and investors around the world are positioning themselves to get involved in what Nomura Holdings Inc. calls the biggest revolution in the \$5.3 trillion currency market since the creation of the euro in 1999.

Daily yuan transactions surged to \$120 billion in April from \$34 billion in 2010, making it the ninth most-traded currency in the world, according to a September report by the Bank for International Settlements in Basel, Switzerland.

Yuan Derivatives

Merk Investments LLC in Palo Alto, California said it's adding "as much as" it can of offshore yuan to its \$450 million of funds. Union Bank NA, a unit of Bank of Tokyo-Mitsubishi UFJ Ltd., is pushing wealthy clients to diversify their savings into deposits denominated in the currency, while CME Group Inc., the world's largest futures exchange, began offering trading in offshore yuan derivatives in February.

International use of the yuan is picking up as the world's second-largest economy opens up its capital markets. In the first nine months of this year, about 17 percent of China's global trade was settled in the currency, compared with less than 1 percent in 2009, according to Deutsche Bank AG.

Yuan-denominated debt sold by companies in the international market rose to 221 billion yuan (\$36 billion) this year through today, from 16 billion yuan in 2009, data compiled by Bloomberg show. HSBC is the biggest underwriter of Dim Sum bonds, or debt denominated in yuan and sold offshore by companies ranging from French carmaker Renault SA to Seoul-based Korea Development Bank.

'Biggest Story'

"The development of the yuan market is the biggest story for the foreign-exchange market in many years," Stuart Oakley, Nomura's head of currency cash

trading for Asia outside Japan, said in an Oct. 24 phone interview from London. “I would compare it to the inception of the euro in terms of its significance.”

A sign of the currency’s growing global acceptance is that trading in offshore yuan forwards has eclipsed that of non-deliverable contracts, the dominant instrument for foreign investors to speculate on the exchange rate since the 1990s. The NDFs are settled in dollars, skirting China’s capital controls.

HSBC estimates the average daily trade in deliverable yuan forwards was \$10 billion in October, up from \$6 billion a year earlier, while it was little changed at \$3 billion for NDFs.

“I prefer using the deliverable yuan for hedging because that market is now much deeper,” Ken Hu, who manages this year’s best-performing Dim Sum bond fund as chief investment officer at BOCHK Asset Management, said in an Oct. 22 phone interview. “The deliverable market is more about real commercial users so it’s more representative, while the non-deliverable ones are dominated by hedge fund flows.”

Yuan Infrastructure

While rising, the yuan’s share of global currency trading is still only about 2 percent, compared with 87 percent for the dollar, according to the BIS report. Daily volumes are less than for Mexico’s peso and about half those of Canada’s dollar.

Many banks and companies have yet to set up the necessary infrastructure to facilitate transactions, according to Derek Sammann, a senior managing director at Chicago-based CME.

“As part of the internationalization of any currency, you need global banking facilities to handle the payment of the underlying currency,” Sammann said in an Oct. 22 interview.

Kate McNally, a vice president at San Francisco-based Union Bank, said her bank’s push for offshore yuan business is making progress, with 150 percent more transactions handled in the first nine months of this year than in the same period of 2012.

She declined to disclose specific figures.

Currency Swaps

“Everyone is getting more comfortable with the currency and looking at it as a viable currency to diversify their portfolio,” McNally said in an Oct. 29 interview.

HSBC’s Huo said their presentations in smaller developing countries such as Turkey and Poland were met with similar interest from clients to those in global financial centers, drawing thousands of corporate treasurers, lawyers, government officials and trade groups.

“It’s very broad interest,” Huo said. “The yuan business is linked so closely with the China story. You have to get there early.”

Beijing’s drive to internationalize the yuan is gaining momentum and the People’s Bank of China now has currency-swap lines with more than 20 overseas counterparts, encouraging greater overseas use of the currency for trade and finance.

In October, a 350 billion-yuan swap was agreed with the European Central Bank, while London won an 80 billion-yuan quota for the city’s investors to buy assets in China’s domestic markets and Singapore got a 50 billion-yuan limit. Plans were also

announced to introduce direct trading with the yuan for both the British pound and Singapore's dollar.

China's currency has gained 2.1 percent to 6.0992 per dollar in Shanghai this year, making it Asia's best performer, and reached a 20-year high of 6.0802 on Oct. 25. The offshore exchange rate advanced 2.2 percent.

Merk Investments boosted assets denominated in offshore yuan, known as CNH, to 31 percent of its \$44 million Asian Currency Fund as of Sept. 30, from 4.5 percent a year earlier.

"We are using the CNH market as much as we can," Axel Merk, founder of Merk Investments, said in an Oct. 21 phone interview. "The Chinese are taking all these small steps to open up the market."

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