

Development in China & Globalisation: Impact on Corporate Treasurers

Global Treasurers Summit

Hong Kong, 9th November, 2007

www.rbsmarkets.com

Panel Discussion Noted by Dr. Charles Li, Head of RBS Global Banking & Markets, China

Ladies and Gentlemen,

Good morning!

RBS is honoured to be the lead sponsor for the Global Treasurers Summit in Hong Kong & I am delighted to have been invited to speak by the International Association of CFO's & Corporate Treasurers (China) & the Hong Kong Association of Corporate Treasurers in partnership with the Hong Kong Monetary Authority.

Today, I would like to share some of my thoughts on development trends in China and their impacts on our businesses and in particular on corporate treasurers.

First of all, I will start by briefly highlighting some of the factual developments from a global, local & product perspective.

Globalisation:

- Trade barriers are being removed or dislocated
- Economies of scale are building in China & India
- Technology is making the World a smaller place
- Financial markets are becoming increasingly inter-linked

China:

- Benefits from being a manufacturing centre
- Accumulated a huge amount of wealth in a relatively short period
- Currency revaluation pressure on RMB
- Cost of manufacturing is rising

Financial markets in China:

- Increased awareness of risk management in an environment where interest rate & exchange rate are still controlled

- Government is building a platform to support market dynamics once restrictions are lifted:
 - Interest rate, inflation & currency products are evolving
 - Corporate bond issuance is developing
 - Loan markets (increasing reserve requirements)
 - Securitisation as alternative means of distribution
- Banks are positioning themselves to support & capture the anticipated explosion in business

I would now like to develop these factual points to focus on 3 areas which I believe corporate treasurers need to prepare for:

1) China's trade flows with the rest of the world become increasingly diversified. This requires those involved in risk management to pay greater attention to currency exposure.

Let's have a look at how China's export shares have evolved since 1997.

Europe 23.1% today vs. 15.8% in 1997

Africa 3.0% today vs. 1.7% in 1997

Latin America 4.0% today vs. 2.1% in 1997

Japan 8.7% today vs. 20.2% in 1997

Asia (ex. Japan) 38.1% today vs. 40.3% in 1997

- Note the big increase in exports to Europe. The EUR has appreciated 20% against the USD since the start of 1996. True, this is favourable for China's exports. But it also highlights the risk that the EUR may WEAKEN, not just STRENGTHEN, in the future against the USD.
- We argue that CNY must adjust not just against the USD, but also against the EUR. In fact, the CNY has weakened against the EUR since 2006. But as the CNY enjoys greater flexibility it is more likely to strengthen against the EUR because of China's still large trade surplus.
- Note there are gradual increases in export shares to Africa and Latin America. These two continents are also important suppliers of raw materials and energy to China from an import perspective.
- Export share to Asia (ex. Japan) remains high. However, Asian currencies are increasingly flexible versus the USD as central banks are no longer so willing to intervene to prevent the value of their currencies from rising.

As China becomes one of the major manufacturing base for the world, currency risks will become a major challenge to corporate treasurers.

2) RMB is likely to continue to strengthen and the RMB currency regime will become more flexible.

There exists a wealth of debates by economists on the subject. The key arguments tend to include the following:

- a) The size of the trade surplus is expected to widen further. Faster currency appreciation will relieve some of the pressures on the PBoC, which must drain the extra liquidity created by FX intervention, or let it push money market rates even lower at the risk of fuelling further price rises in the already over-heated equity and real estate markets;
- b) Central bank intervention results in an excessive build-up of foreign reserves, which must be invested abroad; a cheaper exchange rate raises the risk of imported inflation; a cheap exchange rate encourages speculation on the exchange rate itself and the resulting capital inflows can be destabilising for financial markets.
- c) More rapid currency appreciation would slow the growth of the export sector, helping the authorities to redirect resources towards satisfying domestic demand and the development of the interior provinces, thereby addressing their expressed concerns over the growing imbalances developing in the economy.
- d) The approaching US presidential primary elections and the growing impatience with China's exchange rate policy in the Democratic-controlled US Congress, builds up renewed international political pressure on China to act.

While it would be hard to argue against RMB's appreciation, one must ask the question how long the ride will go on. This is clearly an issue of risk management facing every corporate treasurer in China.

3) It is increasingly important for CFO/Treasurers to better hedge risks against spill over from developed financial markets

Historically, risk management was a term used to address insurable risks. However, since the 1990's risk management has evolved to also encompass the use of derivatives to hedge or customise market risk exposures for Companies, a reflection of product evolution keeping pace with globalisation.

Recent global market events around sub-primes highlight another key dimension of risk management for corporate treasurers. Since August 07, Asset Backed Securities (ABS) using sub-prime mortgages as collateral (through Collateralised Debt Obligations, CDO) significantly fell in value on the back of rising mortgage defaults in the US following a series of interest rate increases. This had a universal effect on global markets – primarily due to 1) Risk being shared by numerous institutions rather than being concentrated in a few; 2) The increased popularity & leverage associated hedge funds. Institutions were not sure how to react [or who would be left holding the joker] consequently liquidity for CDO dried up & values fell. Investors subsequently took it out on the banks who sold them these assets by selling their shares, & banks on fellow institutions by demanding more collateral & charging each other punitive rates. Global Markets remain jittery

Although Asian banks have limited exposure to sub-prime market and hence seeing less impact than European and International banks and Asian Corporates are less affected by credit crunch as traditionally rely more on strong support of banking market than their international peers, there are important risk management lessons to be learned from the subprime events. The challenge must be, as Asian companies and Chinese companies become increasingly globalised, how to secure diversified corporate funding to support the growth and globalisation.

I would like to finish my remarks here. Thank you.

Dr. Charles Li Head of RBS Global Banking & Markets, China



Dr Charles Li is currently Head of Global Banking & Markets, China of the Royal Bank of Scotland, responsible for developing GBM business in China across product divisions. He is also the Branch Manager of RBS Shanghai Branch.

Dr Li has been with the RBS Group since 1994. He joined NatWest Markets in London as Asia Pacific Economist in 1994. Between 1995 and 1998, Dr Li held various senior positions in economic research, business planning and strategy, business integration and disposal at NatWest Markets in Hong Kong. From 1998, Dr Li has been managing NatWest and subsequently RBS business in China. He led the efforts of establishing both branches in Shanghai and Beijing. He has been actively involved in activities which expand the RBS Group business interests in China, including the strategic investment in Bank of China.

Prior to joining RBS Group, Dr Li worked as a financial commentator at the BBC World Service London. He remains an active participant in various senior level discussion panels/forum on China and Asian affairs.

Dr Li holds a PhD in Strategic Management from Aston Business School, UK; MSc in Management from Birmingham University, UK and a BEng in Mechanical Engineering from Beijing Institute of Technology.

Dr Li was Treasurer of the British Chamber of Commerce in China between 2000 and 2002. He was elected into Society of Fellows at Aston Business School in 2007 as the first Chinese member of the Society. He also serves as an Advisor to the Centre of Global Finance at University of Nottingham (NingBo).

Dr Li is married with 3 boys. He enjoys travelling, hiking and history.