REPORT
15 June 2020

ASIA MACRO STRATEGY

Implications of China's Sovereign Digital Currency

For Professional Investors only in Hong Kong and Accredited Investors (in respect of accounts opted-in to be treated as Accredited Investors) and Institutional Investors in Singapore only

The idea of a state-run digital currency (or e-RMB) has been brewing in China since 2014, with a pilot programme starting in recent months. It is a digital yuan – backed by the government (i.e. People's Bank of China/PBoC).

e-RMB is stored in a digital wallet (such as a mobile device) instead of a bank account – to replace the fiat currency (i.e. yuan notes and coins). Digital transactions are conducted between two digital wallets without involving banks or credit cards.

China's planned framework is designed with three levels – the PBoC at the top and banks at Tier Two. While in theory this should not involve banks, China's state banks dominate its banking system and run as the operational arm of the central bank. Consumers and business users transacting through e-RMB make up Tier Three.

How widely has it been adopted?

China has been further ahead in the digital payment curve compared to most countries. e-RMB could potentially reach 225m Chinese people who do not have bank accounts and who are mostly in rural areas – potentially pulling them in to boost national consumption. Some government employees' and public services' salaries are already partly paid by this virtual cash.

There has been a partial rollout since April 2020 in several cities – Shenzhen, Suzhou (for transport allowances) and Chengdu. Xiong'an, a town south of Beijing which will hold the Beijing 2022 Winter Olympics, is currently testing out food and retail purchases and is targeting a full rollout at the international games.

In China, 80% of mobile phone users pay with their devices. China's mobile apps purchases account for 16% of gross domestic product (GDP), against 1% in the US and UK.

Before the initiative of a state-run e-RMB, the initial push for digital payments - such as Alipay of Alibaba, and WeChat Pay of Tencent - was for the ease of online shopping by the tech giants. As the largest unit of yuan is 100 or about $14, physical currency is too small and inconvenient for big-ticket items. During COVID-19 in particular, digital transactions were preferred to minimise infections.

From the policymakers' perspective, digital payment can help to deter fraud, corruption and counterfeit notes (which was rampant). It also increases social and business governance.

What are the domestic and external implications?

Domestic implications:

Beijing has long been concerned about the digital currency monopoly by tech giants, and their impact on the financial system beyond central bank supervision.

In 2013, one money market fund offered via Alipay, Yu'E Bao, was so popular that it became the world's largest money fund within days. It rang alarm bells at PBoC about the speed and scale of money drainage from China's bank deposit system that the central bank eventually stepped in to restrict the fund.

UBP
UNION BANCAIRE PRIVÉE

However, the real test will be whether Chinese consumers, usually receptive to financial innovation, are concerned about the potential state power behind e-RMB despite its convenience. As a state-owned digital currency, e-RMB may also have to deal with the potential regulatory challenges and data privacy issues faced by Facebook's Libra.

On a positive note, e-RMB's growth would also mean more effective 'online' monetary policy implementation – and along with the growth of China's blockchain and big data development - in terms of liquidity monitoring, settlements, and external payment positions.

External implications:

The biggest, and possibly the most important, objective of e-RMB could be a shot in the arm to RMB internationalisation which has stalled since the China-US trade war started two years ago.

The slowdown is most obvious in RMB trade settlement and trade/investment use of RMB in the One-Belt-One-Road Project.

US' China isolation policy is a wake-up call for China to seek alternative funding outside of US capital markets and particularly the US dollar (USD). The direct response is to step up the RMB capital market and RMB internationalisation.

If Chinese banks are banned from the USD global transaction system (SWIFT CODE), e-RMB could potentially aid China's globalisation but may also pose a real challenge to USD as the world's reserve currency.

For example, a Chinese tourist can settle with e-RMB if the oversea hotel has an e-RMB machine installed that transacts directly through the PBOC settlement system. China's balance of payments flow may also be monitored automatically and accurately.

The same transaction by the Chinese tourist may be conducted in cryptocurrencies (Bitcoin or Ether) but they are not sovereign currency and lack the PBOC's balance sheet and legal tender status as backing.

Potentially, this may grow much faster among emerging markets such as Africa, Latin America, Asia and Middle East, with which China already has close economic, business and strategic ties.

The same argument can be extended to countries that face economic sanctions by, for example, the US on USD transactions/settlements. These countries can circumvent US surveillance of financial flows by transacting via e-RMB once it builds into a global network. China may capitalise on e-RMB to build global strategic alliances against US' China isolation policy.

Conclusion

Many observers fear that growing China-US tensions will extend from a trade war to financial and technology conflicts. China's ambitious e-RMB plan may further broaden the tension's impact by dividing the global economy into currency 'zones'.

e-RMB may also challenge Alipay and WeChat Pay (as they are still backed by bank accounts and credit cards) and cryptocurrencies (in China, at least) as they lack the legal status and the backing of the central bank's balance sheet.

Anthony Chan
Chief Asia Investment Strategist

Disclaimer

This document is a marketing communication containing GENERAL INFORMATION on the financial services and/or financial instruments, and reflecting the sole opinion of Union Bancaire Privée, UBP SA and/or any entity of the UBP Group (hereinafter “UBP”) as of the date of issue. It may contain generic recommendations but should not be deemed an offer nor a solicitation to buy, subscribe to, or sell any currency, product, or financial instrument, make any investment, or participate in any particular trading strategy in any jurisdiction where such an offer or solicitation would not be authorised, or to any person to whom it would be unlawful to make such an offer or solicitation. This document is meant only to provide a broad overview for discussion purposes, in order to determine clients’ interest. It does not replace a prospectus or any other legal document relating to any specific financial instrument, which may be obtained upon request free of charge from UBP or from the registered office of the fund concerned, where applicable. The opinions herein do not take into account individual clients’ circumstances, objectives, or needs. In this document UBP makes no representation as to the suitability or appropriateness, for any particular client, of the financial instruments or services described, nor as to their future performances. Clients who wish to obtain more information about any specific financial instruments can request it from UBP and/or their Relationship Manager. Where an investment is considered, the information on the risks linked to each financial instrument shall be provided in good time by separate means before the investment decision is taken. In any case, each client must make his/her own independent decisions regarding any securities or financial instruments mentioned herein and regarding the merits or suitability of any investment. Before entering into any transaction, clients are invited to carefully read the risk warnings and the regulations set out in the prospectus or other legal documents and are urged to seek professional advice from their financial, legal, accounting and tax advisors with regard to their investment objectives, financial situation and specific needs. This generic information is therefore not independent from the proprietary interests of UBP or connected parties, which may conflict with the client’s interests. UBP has policies governing cases of conflicts of interest. The investments mentioned herein may be subject to risks that are difficult to quantify and to integrate into the valuation of investments. Generally speaking, products with a high degree of risk, such as derivatives, structured products or alternative/non-traditional investments (such as hedge funds, private equity, real estate funds, etc.) are suitable only for clients who are capable of understanding and assuming the risks involved. The value of any capital investment may be at risk and some or all of the original capital may be lost. The investments are exposed to currency fluctuations and may increase or decrease in value. Fluctuations in exchange rates may cause increases or decreases in the client’s returns and/or in the value of the portfolio. The client may be exposed to currency risks if a financial instrument or the underlying investment of a financial instrument is denominated in a currency different from the reference currency of the client’s portfolio or from the currency of his/her country of residence. For more information on risks, the brochure called “Characteristics and risks of certain financial operations” should be consulted. The information contained in this document is the result neither of financial analysis within the meaning of the Swiss Banking Association’s “Directives on the Independence of Financial Research” nor of independent investment research as per the EU’s regulation on MiFID provisions. In principle, EU regulation does not govern relationships entered into with UBP entities located outside the EU, including but not limited to Union Bancaire Privée, UBP SA in Switzerland, which is subject to Swiss law and Swiss regulation, in Hong Kong, and in Singapore, and the subsidiary in Dubai. Reasonable efforts have been made to ensure that the content of this document is based on objective information and data obtained from reliable sources. However, UBP cannot guarantee that the information the Bank has gathered in good faith is accurate and complete. Circumstances may change and affect the data collected and the opinions expressed at the time of publication. Therefore information contained herein is subject to change at any time without prior notice. UBP makes no representations, provides no warranty and gives no undertaking, express or implied, regarding any of the information, projections or opinions contained herein nor does it accept any liability whatsoever for any errors, omissions or misstatements in the document. UBP does not undertake to update this document or to correct any inaccuracies which may have become apparent after its publication. This document may refer to the past performance of financial instruments. Past performance is not a guide to current or future results. The value of financial instruments can fall as well as rise. All statements in this document, other than statements of past performance and historical fact, are “forward-looking statements”. Forward-looking statements do not guarantee future performances. The financial projections included in this document do not represent forecasts or budgets, but are purely illustrative examples based on a series of current expectations and assumptions which may not happen as forecast. The actual performance, results, market value and prospects of a financial instrument may differ materially from those expressed or implied by the forward-looking statements in this document. The projected or targeted returns are inherently subject to significant economic, market and other uncertainties that may adversely affect performance. UBP also disclaims any obligation to update forward-looking statements, as a result of new information, future events or otherwise. Any performance data included in this document does not take into account fees, commissions, expenses charged on issuance and redemption of securities, or any other costs, nor any taxes that may be levied. The tax treatment of any investment depends on the client’s individual circumstances and may be subject to change in the future. This document does not contain any tax advice issued by UBP and does not necessarily reflect the client’s individual circumstances. This document is confidential and is intended to be used only by the person to whom it was delivered. This document may not be reproduced, either in whole or in part. UBP specifically prohibits the redistribution of this document, in whole or in part, without its written permission and accepts no liability whatsoever for the actions of third parties in this respect. This document is not intended for distribution in the US and/or to US Persons or in jurisdictions where its distribution by UBP would be restricted. UBP is authorised and regulated in Switzerland by the Swiss Financial Market Supervisory Authority (“FINMA”).

UK: UBP is authorised in the United Kingdom by the Prudential Regulation Authority, and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority (PRA).

Dubai: This marketing material has been communicated by Union Bancaire Privée (Middle East) Limited, a company regulated by the Dubai Financial Services Authority (“DFSA”). It is intended for professional clients and/or market counterparties only and no other person should act upon it. The financial products or services to which this material relates will only be made available to a client who meets the professional client and/or market counterparty requirements. This information is provided for information purposes only. It is not to be construed as an offer to buy or sell, or a solicitation for an offer to buy or sell any financial instruments, or to participate in any particular trading strategy in any jurisdiction.

Hong Kong: UBP is a licensed bank regulated by the Hong Kong Monetary Authority (HKMA) and a registered institution regulated by the Securities and Futures Commission (SFC) for Type 1, 4 & 9 activities only in Hong Kong. The securities may only be offered or sold in Hong Kong by means of documents that (i) are addressed to “professional investors” within the meaning of the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong) and any rules made thereunder (the “SFO”); or (ii) are defined as “prospectuses” within the meaning of the Companies Ordinance (Chapter 32 of the Laws of Hong Kong) (the “CO”) or constitute offers to the public within the meaning of the CO. Unless permitted to do so under the laws of Hong Kong, no person may issue or have in his/her possession for the purpose of issuing, whether in Hong Kong or elsewhere, any advertisement, invitation or document relating to the securities, directed at, or likely to be accessed or read by, the public in Hong Kong, except where the securities are intended to be disposed of only to persons outside Hong Kong, or only to “professional investors” within the meaning of the SFO.

Singapore: UBP is a bank regulated by the Monetary Authority of Singapore (MAS), is an exempt financial adviser under the Financial Advisers Act (Cap. 110 of Singapore) to provide certain financial advisory services, and is exempt under section 99(1) of the Securities and Futures Act (Cap. 289 of Singapore) to conduct certain regulated activities. This document has not been registered as a prospectus with the MAS. Accordingly, this document and any other document or material in connection with generic recommendations may not be circulated or distributed, whether directly or indirectly, to persons in Singapore other than (i) to institutional investors under Section 274 of the Securities and Futures Act (Cap. 289) of Singapore (“SFA”), (ii) to relevant persons pursuant to Section 275(1), or any person pursuant to Section 275(1A) of the SFA, and in accordance with the conditions specified in Section 275 of the SFA, or (iii) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the SFA. This advertisement has not been reviewed by the Monetary Authority of Singapore.

Luxembourg: UBP is registered by the Luxembourg supervisory authority the Commission de Surveillance du Secteur Financier (CSSF).

Italy: Union Bancaire Privée (Europe) S.A., Succursale di Milano, operates in Italy in accordance with the European passport – held by its parent company, Union Bancaire Privée (Europe) S.A. – which is valid across the entire European Union. The branch is therefore authorised to provide services and conduct business for which its parent company, Union Bancaire Privée (Europe) S.A., has been authorised in Luxembourg, where it is regulated by the Luxembourg financial supervisory authority, the Commission de Surveillance du Secteur Financier (CSSF).

Monaco: This document is not intended to constitute a public offering or a comparable solicitation under the Principality of Monaco’s laws, but might be made available for information purposes to clients of Union Bancaire Privée, UBP SA, Monaco Branch, a regulated bank under the supervision of the Autorité de Contrôle Prudentiel et de Résolution (ACPR) for banking activities and under the supervision of the Commission de Contrôle des Activités Financières for financial activities.

Union Bancaire Privée, UBP SA

Hong Kong Branch
Level 26 | AIA Central | 1 Connaught Road Central
Hong Kong
T +852 3701 9688 | F +852 3701 9668
Union Bancaire Privée is incorporated in Geneva, Switzerland, as a limited liability company

Singapore Branch
Level 38 | One Raffles Quay | North Tower
Singapore 048583
T +65 6730 8088 | F +65 6730 8068
Co Reg No T13FC0154G

Signatory of: PRI Principles for Responsible Investment