RMB seen as third reserve currency, after dollar and euro

By Editor Test *Tue, Jan 24, 2012*

Holding RMB is important for investors who have global aggregate portfolios or diversified global bond portfolios, said Jim McCaughan, CEO of Principal Global Investors.

The growth of an international market for trading Chinese currency and renminbi-denominated bonds will help institutional investors that need alternatives to the U.S. dollar and the euro, according to executives at US-based Principal Global Investors, a unit of the Principal Financial Group.

"The world needs multiple reserve currencies to allow diversification," Jim McCaughan, Principal's CEO, told *Investments & Pensions Asia.* "For investors who have global aggregate portfolios or diversified global bond portfolios, having the RMB as an extra source of diversification is really important."

Sovereign reserve funds in particular regard the RMB, which first became available as an investment currency in July 2010, as a potential alternative reserve currency, McCaughan said.

In 2011, the Chinese government introduced a yield curve by issuing two-, three-, five-, seven- and 10-year bonds, with China Development Bank in early January selling the first 15-year offshore yuan bond. The bank, China's biggest bond issuer after the Ministry of Finance, priced the bonds to yield 4.2%.

Asian reserve funds have been holding 20%-30% of their funds in euros to hedge the dollar. But they regard the euro as overvalued, despite the impact of the European debt crisis. Increasingly, they see the yuan is seen as source of diversification and potential growth.

When the RMB first became available to investors, it attracted a rush of money. Indeed, the high demand pushed yields downward. In 2011, the currency appreciated only 4.8%, which reduced demand and helped restore the balance between the yield curves of onshore and offshore yuan bonds.

Meanwhile, Hong Kong announced plans to help London become an offshore trading center for the yuan. The two financial centers will collaborate on clearing and settlement systems, market liquidity and development of new RMB-denominated products.

The RMB could help satisfy a demand for specialty high-yield bond investments among Asian pension funds, said Andrea Muller, Principal's chief executive for Asia. The region's institutional investors want to diversify away from domestic fixed income "and into emerging market debt and equities across the region," she said.

"There has also been growing interest in commercial real estate, in particular from government pension funds across the region," she added. "We've seen an increased demand for niche products such as mortgage-backed securities, REITS and high-yield debt." They are also buying property in Japan, Australia, Europe and the U.S., she said.