

# Cut to the Chase

## Petro-Yuan

Gold-backed crude oil futures contract will be issued in yuan

# WHAT is Petro-Yuan?

- Petro-Yuan is the term used for gold-backed crude oil futures contract that will be issued in yuan. China is expected to launch these contracts on the Shanghai Energy Exchange (INE), potentially creating the most important Asian oil benchmark and allowing oil exporters to bypass petrodollar-denominated benchmarks by trading in petro-yuan.

# HOW will it benefit China?

- The petro-yuan system will provide at least three immediate benefits to the China.
  - » It increases global demand for yuan;
  - » It increases global demand for China debt securities and
  - » It gives China the ability to buy oil with a currency it can print at will.
- Paying in yuan for oil could become part of President Xi Jinping's "One Belt, One Road" initiative to develop ties across Eurasia, including the Middle East. The move will also strengthen the ability of the world's top oil importer to determine the price of crude oil sold to its neighbors.
- However, Beijing faces skeptical global oil markets and global perceptions of too much state control.

# WHEN will trading begin?

- The trade will begin from 26th March 2018. It will include seven global crude oils such as Dubai crude, Oman crude, Basrah light oil and China's Shengli oil. The push for oil futures gained impetus in 2017 when China surpassed the U.S. as the world's biggest crude importer. Crude oil imports to China hit record high in January, reaching 9.57 million barrels daily, for a total of 40.64 million tons.

# HOW could it affect dollar?

- Should the oil market move oil trade out of the U.S. currency and into the yuan, world's transaction currency could suffer lesser demand for U.S. securities across the globe.

- Moving oil trade out of dollars into yuan could shift between \$600 billion and \$800 billion worth of transactions out of the dollar into a stronger demand for products in China, whether it's securities or goods and services<sup>1</sup>. In the long run it makes more sense to look at transactions in yuan because China is a key market. It may not happen right away, but the launching of the crude oil benchmark on the Shanghai exchange could mark the beginning of the end of the petrodollar.

## WHERE do oil exporters come in?

- China requires large oil producers and consumers to use the yuan and invest in the Shanghai benchmark. Without some major countries participating, like, say, Saudi Arabia or Russia, it will be difficult to create a market that is deep and liquid enough to make a difference.
- Overseas oil producers and traders would need to accustom to China's penchant for occasional market interventions as well as its capital controls. Restrictions on moving money in and out of the country have been tightened in the past two years after a shock devaluation of the yuan in 2015 prompted a surge in money leaving the mainland.
- If oil majors start accepting yuan pricing of oil it is likely that the rest of the oil market will move along with them. At that point, things could really start to change, and the dollar may start to lose its top status. Some see that as unlikely, as Saudi Arabia would likely be met with blowback from the U.S. But it would be a difficult choice for Saudi Arabia. Big Chinese participation in Aramco's planned initial public offering could help sway Saudi opinion toward accepting yuan, which is used in less than 1.5 percent of global payments measured by SWIFT<sup>2</sup>.
- Countries such as Iran, Venezuela and Russia are already eager to see a new oil-trading currency because this would allow them to circumvent U.S. sanctions and trade freely in the oil market.
- However, one major challenge for Middle East producers to accept a big share of their oil contracts in yuan would be the exchange-rate risk they would run, given that most of the region maintains currency pegs to the dollar.

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<sup>1</sup> CNBC

<sup>2</sup> Bloomberg

## References

1. [How China is About to Shake up the Oil Futures Market](#)
2. [China will 'compel' Saudi Arabia to trade oil in yuan — and that's going to affect the US dollar](#)
3. [China Oil Imports Hit another Record in January](#)
4. [China has grand ambitions to dethrone the dollar. It may make a powerful move this year](#)
5. [Petro-Yuan Rising: The Must-Read Truth behind China's Plan to Dethrone the Dollar](#)

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