

Internationalization of the RMB: Developments, Problems and Policies

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Outline

- Introduction
- The development of RMB internationalization
- RMB Offshore markets
- The problems behind RMB internationalization
- Policy Suggestions

1.Introduction

- Motivations : Not A Single One
 - To match RMB's international status with Chinese economy's international status
 - a way of enhancing the competitiveness of Chinese banks and firms
 - To reduce the reliance on USD in international trade and investment
 - To push forward domestic structural reforms by using RMB internationalization as an external commitment device or a catalyst
 - One Pillar of the Integrated Systemic Reform: interest rate, Exchange rate, capital account and RMB internationalization

1.Introduction

- Approaches : Four Pillars
 - To promote RMB settlement in cross-border trade and direct investment
 - To develop offshore RMB financial centers
 - To enhance official currency cooperation
 - To improve capital account liberalization

2.The development of RMB internationalization

- 23.7% of Chinese cross-border settlement was settled in RMB in 2014, compared with near zero in 2009
- RMB was the No.2 biggest trade financing currency, No.5 biggest of payment currency, and No. 6 most active currency of FX market by the end of 2014.
- RMB settlement in current account was 6.55 trillion yuan, 41.6% yoy; RMB settlement of ODI was 186.6 billion yuan, 117.9% yoy; RMB settlement of FDI was 862 billion yuan, 92.9%.
- The RMB deposit in Hong Kong reached 1 trillion in December 2014;The new issuance of RMB bonds in Hong Kong per year has been higher than 100 billion since 2011;
- RMB deposit in main offshore markets was about 2 trillion yuan; RMB bonds outstanding was 535 billion yuan.
- By the end of May 2015, PBC signed bilateral local currency swap with more than 32 central banks and the accumulated scale was near to RMB 3 trillion.
- The Hong Kong –Shanghai stock connect and the coming Hong Kong –Shenzhen connect are the important testing for capital account liberalization.

2.1 RMB Settlement in Current Account

- RMB settlement in current account was 6.55 trillion yuan, 41.6% yoy;
- RMB settlement of Goods was 5.9 trillion yuan, 42.6% yoy
- Services and others was 656 billion yuan, 31.3% yoy.

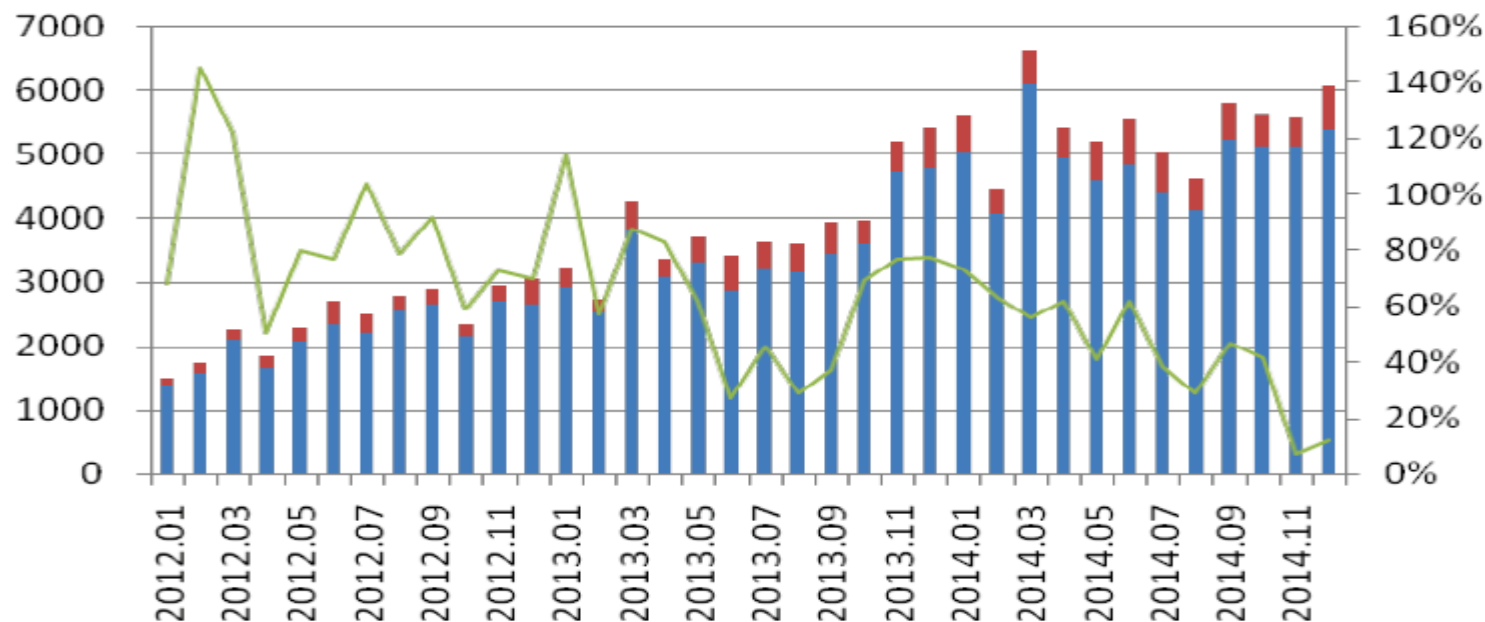


Figure1:RMB settlement in Current Account(Monthly)

Blue/Red column: goods/services and others(Left, 0.1 billion yuan)

Green line: YoY growth rate of current account

Sources:PBC(2015)

2.1 RMB Settlement in Current Account

- RMB receipts in current account was 2.73 trillions
- RMB payments was 3.83 trillions, net outflows was 1.1trillion yuan in 2014

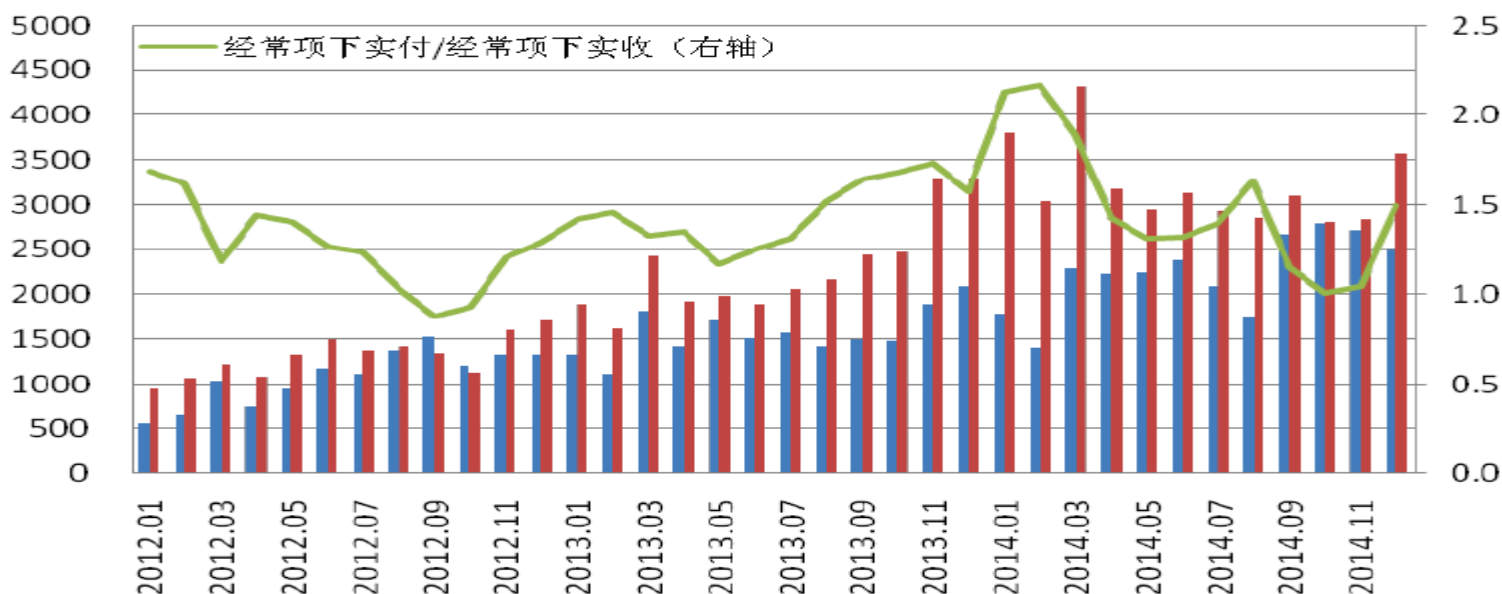


Figure2: The RMB Receipts and Payments in Current Account

Blue/Red column: receipts/payments(Left, 0.1 billion yuan)

Green line: The rate of payments divided by receipts(Right)

Sources:PBC(2015)

2.2 RMB Settlement in ODI

- RMB settlement in ODI was 186.6 billion yuan in 2014, yoy 117.9%
- The total RMB settlement in ODI was 332 billion yuan by the end of 2014

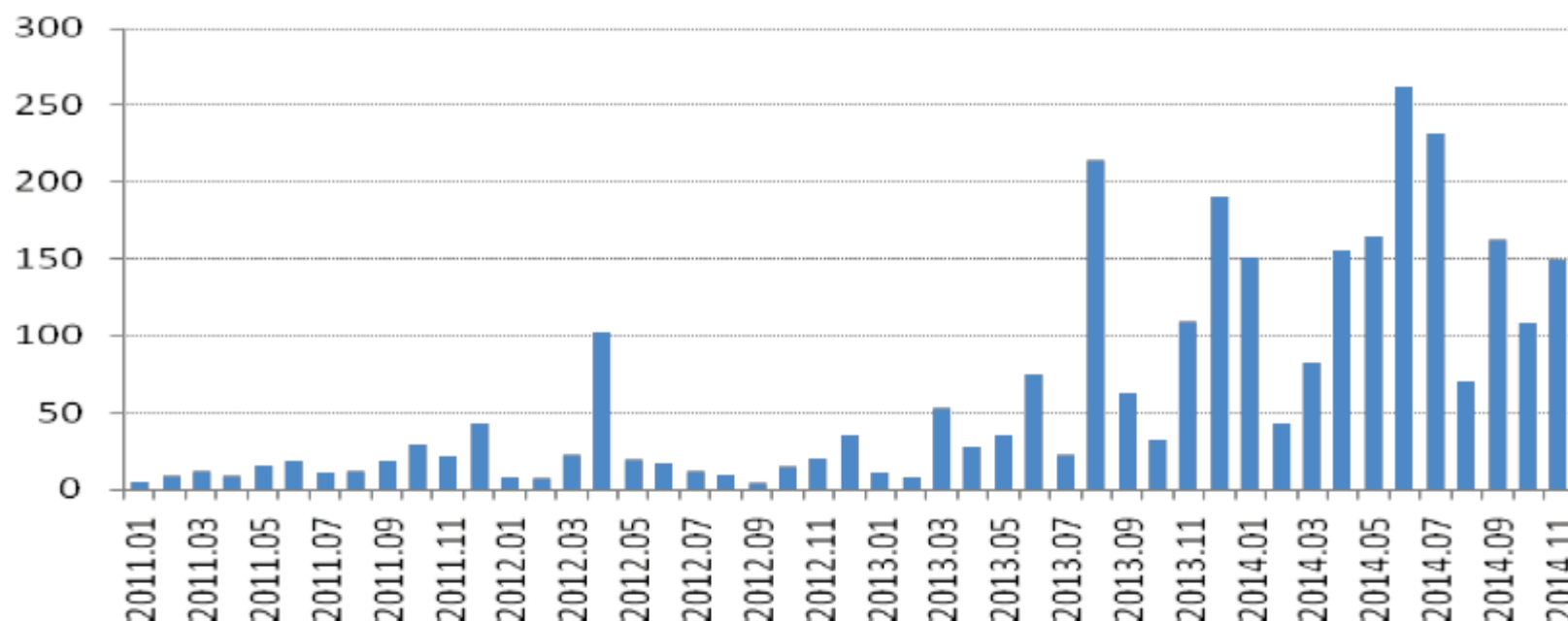


Figure3: The RMB Settlement in ODI(monthly,0.1 billion yuan)

Sources: PBC(2015)

2.3 RMB Settlement in FDI

- RMB settlement in FDI was 862 billion yuan in 2014, yoy 92.4%
- The total RMB settlement in FDI was 1.69 trillion yuan by the end of 2014

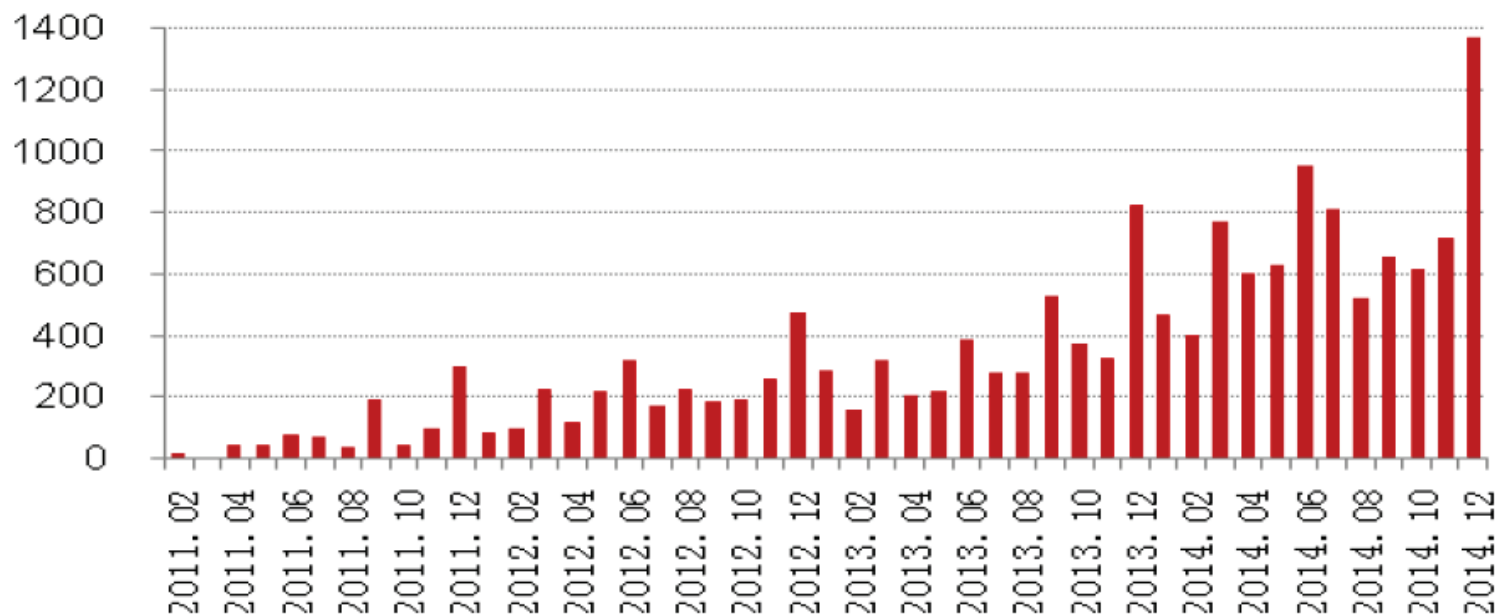


Figure4: The RMB Settlement in FDI(monthly,0.1 billion yuan)

Sources: PBC(2015)

2.4 RMB Being a Reserve Currency

- The overseas central banks held RMB assets were 666.7 billion yuan.
- PBC signed 5 new currency swap agreements.
- PBC re-signed 8 currency swap agreements with old partners
- By the end of May 2015, PBC has held currency swap arrangements with 32 central banks, the total number was 3.1 trillion yuan.
- Both sides used currency swaps , overseas central banks used RMB about 38 billion yuan; PBC used RMB about 4.1 billion yuan.

3.1 RMB Offshore Markets: Settlement and Clearing

- RMB receipts and payments took place in 189 economies (excluded HK, Macau and Chinese Taiwan). HK occupied 52.7% in 2014, decreased 2.7 points from 2013.
- Seoul established a RMB clearing bank 3rd July 2014.

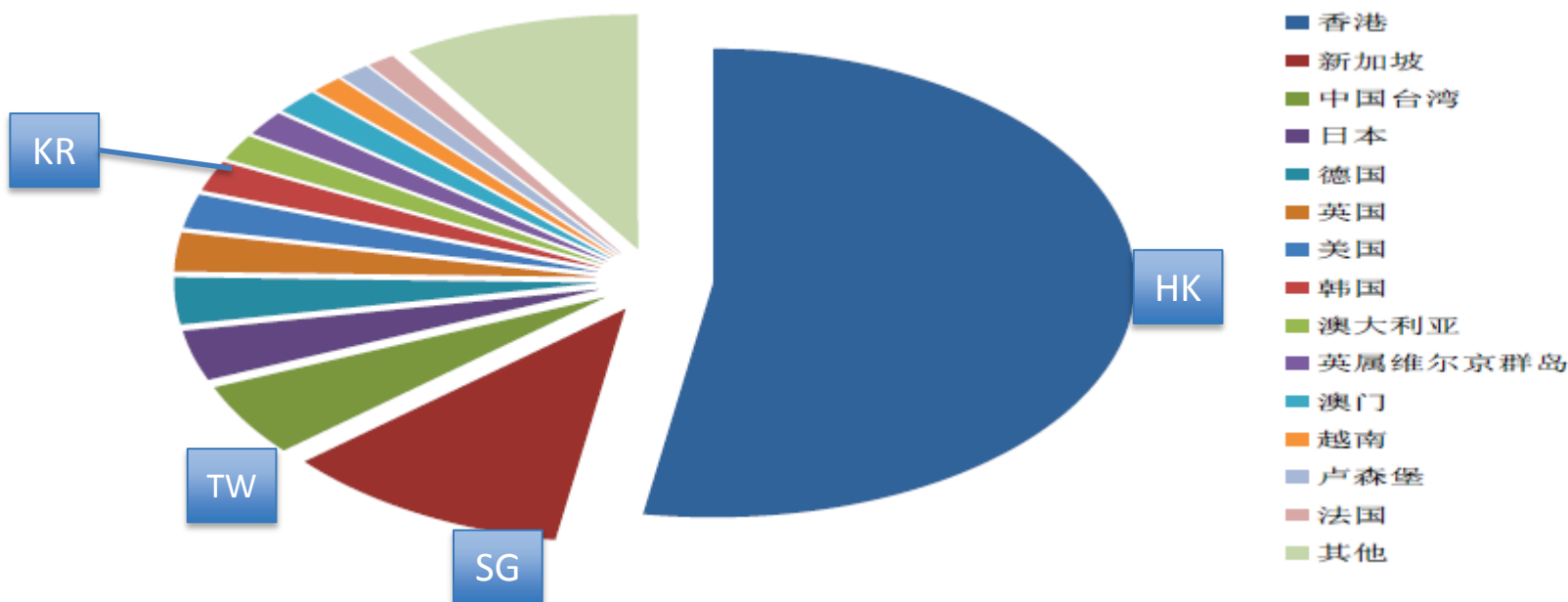


Figure5: Main Hubs of RMB Receipts and Payments in Current Account in 2014

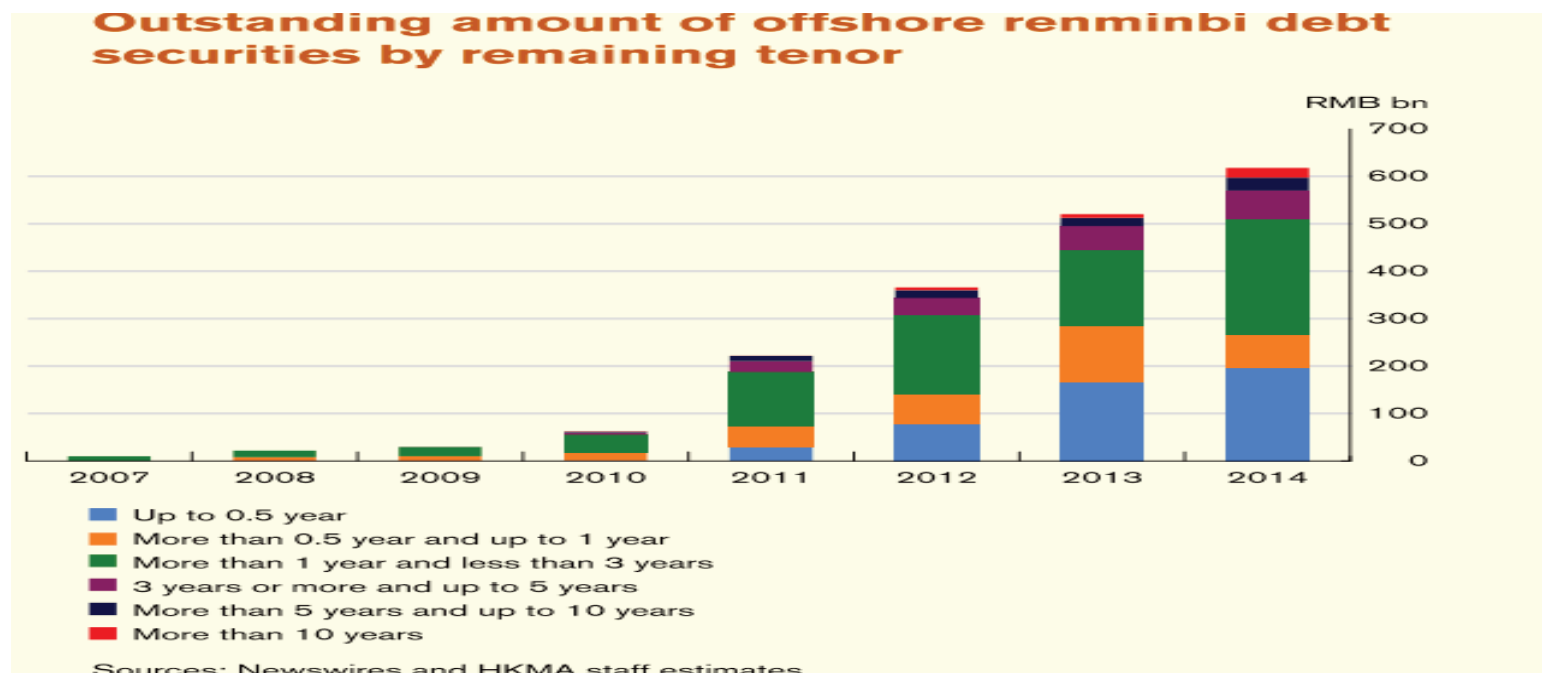
Sources:PBC(2015)

3.1 RMB Offshore Markets: Settlement and Clearing

Country/Region	Time	Clearing Bank
Hong Kong	Dec., 2003	Bank of China (Hong Kong) Limited
Macau	Sept., 2004	Bank of China Macau Branch
China Taiwan	Dec.,2012	Bank of China Taipei Branch
Singapore	Feb.,2013	ICBC Singapore Branch
UK	June,2014	CCB (London)Limited
Germany	June,2014	Bank of China Frankfurt Branch
Korea, Re.	July,2014	Bank of Communications Seoul Branch
France	Sept.,2014	Bank of China Paris Branch
Luxembourg	Sept.,2014	ICBC Luxembourg Brance
Qatar	Nov.,2014	ICBC Doha Branch
Canada	Nov.,2014	ICBC(Canada)Limited
Australia	Nov.,2014	Bank of China Sydney Branch
Malaysia	Jan.,2015	Bank of China(Malaysia)Limited
Thailand	Jan.,2015	ICBC(Thailand) Limited
Chile	May,2015	CCB Chile Branch

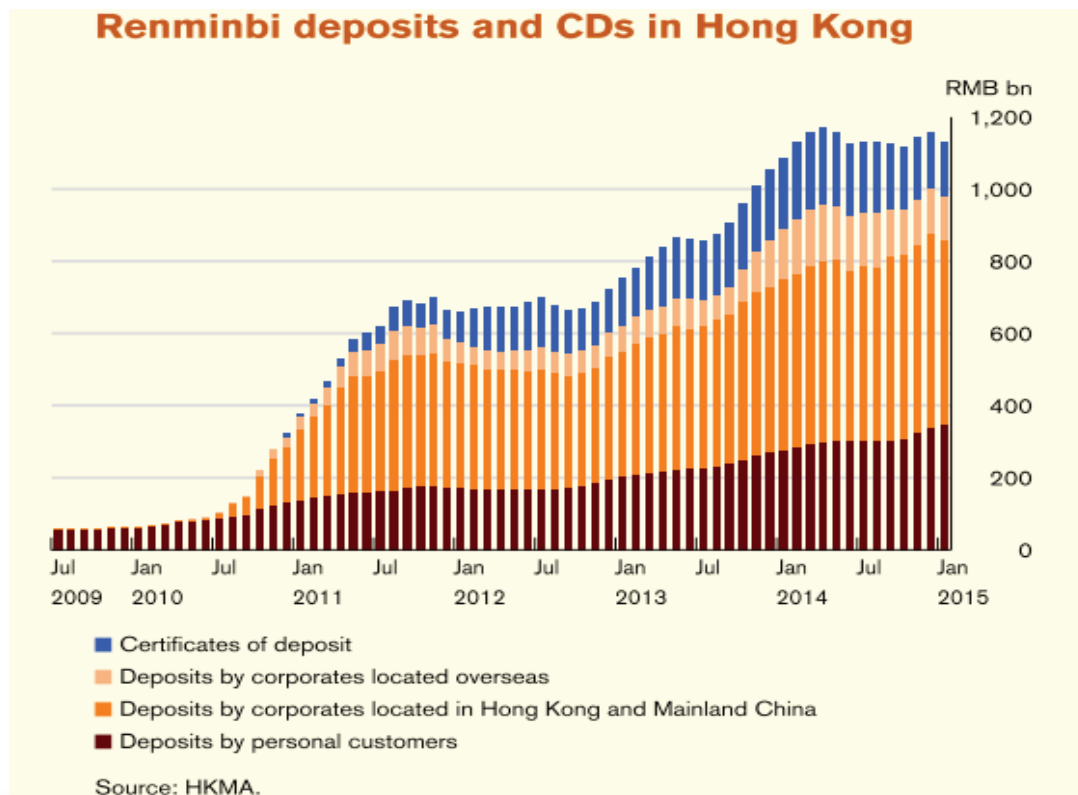
3.2 RMB Offshore Markets: Bonds

- The international RMB bonds(narrow statistics by BIS) outstanding was 5.35 billion yuan by the end of 2014. Panda bonds(issued in China in RMB) was 4.6 billion yuan
- HK is the biggest RMB offshore debt market, new issuance of debt securities was 34.7 billion yuan in 2014, non-CD debt was 288.5 trillion. The outstanding amount was 618.1 billion yuan by the end of 2014.
- ICBC issued the first RMB bond , 180 mn yuan, in Seoul on 14 Oct.2014.



3.3 RMB Offshore Markets: Deposits

- The main RMB offshore markets held nearly 2 trillion yuan deposits.
- Hong Kong's RMB deposit is over 1 trillion yuan deposits(Ex CDs.), 17 % yoy
- South Korea's RMB deposit was about 120 billion yuan, increased 70 times in last 18 months



3.4 RMB Offshore Markets: Investments

- RQFII is the main investment channel for offshore RMB to invest mainland China
- South Korea holds 80 billion yuan quota of RQFII till May 2015.

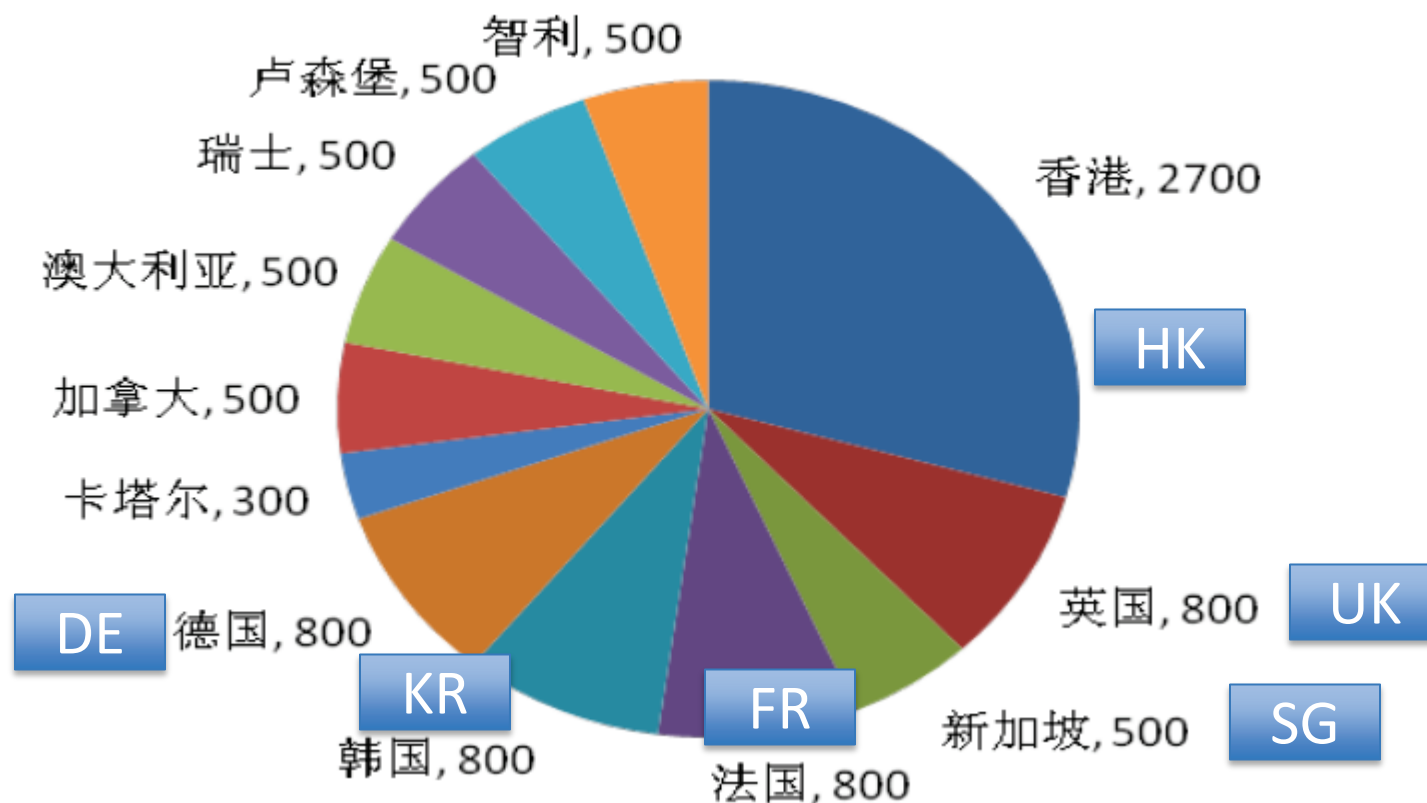


Figure6: RQFII quotas for foreign investors till May 2015

4.1 The problems: cross-border settlement

- The cross-border exchange rate and interest rate arbitraging has been rampant;
 - The sustained cross-border RMB exchange rate or interest rate spread created attractive space for onshore offshore arbitraging;
 - The arbitraging has been done under the disguise of RMB settlement in cross-border trade;
 - The arbitraging would result in both the valuation loss of PBC and the bubble of RMB settlement;
- The development of RMB invoicing is lagging behind the development of RMB settlement significantly;
 - If the cross-border trade is only settled in RMB and still invoiced in USD, the exchange risk facing Chinese companies could not be mitigated;
 - The choice of invoicing currency in international trade is influenced by such factors as bargaining power, trade structure and market inertia;
 - The countries with more developed financial markets and more open capital accounts tend to invoice less in USD and more in home currencies;

4.2 The problems: asset pooling

- The RMB asset pooling is quite limited
 - The offshore RMB assets worth 250 billion dollars
 - 0.1 % of global financial assets
 - What can the offshore RMB invest?
- The RMB asset in official reserve is also limited
 - The currency swaps have not essential progress
 - The RMB is not a freely convertible currency and not freely used in FX markets

4.3 The problems: Impacts on monetary policy

- Domestic monetary policy
 - It has become more and more difficult for PBC to control both the interest rate and the exchange rate of RMB;
 - RMB internationalization tends to make both money supply and money demand more unstable, which would add difficulty to the traditional quantity-based monetary operation of PBC;
 - China's monetary policy regime is facing important transition at the current stage.
 - With the gradual liberalization of interest rate and the burgeoning of shadow banking system, it is more and more difficult for PBC to use money aggregate as a monetary policy tool;
 - With the shrinking twin surplus in China's balance of payments and more volatile international capital flows, to purchase USD on foreign exchange market (and the relating sterilization) is no longer the stable channel to issue base money for PBC.

4.4 The problems: BOP

- International balance sheet
 - The scale of RMB settlement in import has been distinctly higher than that of RMB settlement in export, as a result PBC ends up with more foreign exchange reserve even under the same trade surplus;
 - Under the environment of persistent RMB appreciation against major currencies, the currency mismatch on China's international balance sheet would result in a severe valuation loss;
- Short-term capital flow
 - The RMB trade settlement scheme offered new opportunities for domestic and foreign companies to conduct exchange rate and interest rate arbitraging between CNY and CNH markets;
 - A two-track capital flow management structure has been established since the start of RMB internationalization. Under this scheme, the RMB denominating flows face much looser control compared with foreign currency denominating flows;
 - PBC's experiment by using capital account liberalization to promote domestic structural reform may be very tricky and even dangerous;

4.5 The problems: coordination

- Domestic financial reform
 - Interest rate liberalization
 - Foreign exchange rate liberalization
 - Capital account liberalization
 - RMB internationalization
- RMB internationalization
 - Cross-boarder trade settlement
 - Investment and financial
 - Asset-Liability management
 - Onshore and offshore markets

5.1 Policy suggestions

- To promote RMB internationalization in a more steady and sustainable way is beneficial to China ,five policy suggestions:
 - Both RMB internationalization and capital account liberalization should be carried forward under appropriate policy sequencing and coordination, and the reform of RMB exchange rate and interest rate formation mechanisms should be carried on as soon as possible
 - Chinese government should accelerate financial reforms and make domestic financial market more deep, broad and liquid;
 - PBC should clarify its monetary policy objectives and streamline its monetary policy tools
 - Chinese government should also carry forward the reforms on legal, political and administrative systems to boost the long-term confidence about RMB
 - The Government should establish a sound macro-prudential regulation system to address the potential risks

5.1 Policy suggestions

- Development of the RMB Offshore markets is the key incentive to promote RMB internationalization
 - To promote the infrastructure, like CIPS and RCPMIS
 - To enhance RMB as an invoicing currency
 - To expand the RMB offshore asset scales and amounts, particularly the RMB bonds
 - To strengthen the recycling mechanism of offshore RMB
 - To establish a RMB-USD-Other Currencies linkage mechanism. Foreign central bank can swap RMB or USD and promote the essential effectiveness of bilateral currency swaps

- It is a process, but not a stage
- It is a result, but not an objective

Thank you!

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