

RMB Internationalization: A Process Rather Than A Result

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1. Background of RMB Internationalization

- One of the hottest topics worldwide at present, just like what happened to JPY more than thirty years ago.
- Started at the turn of the 21st century with RMB was used as pricing and settlement currency in China's frontier trade, which was called as RMB regionalization.
- With China's high speed development, constant exchange rate regime reform and capital account liberalization, and active international economic and financial cooperation, RMB internationalization is improving. RMB is the 2nd most used currency in trade finance and the 4th most used payments currency now.
- China's position in the international monetary system is changing with RMB internationalization deepening, which makes China play a more positive role in the new round of international monetary system reform.

- Process of RMB internationalization
- Main drivers for RMB internationalization
- Position and future of RMB in international monetary system
- Experience: JPY internationalization
- Conclusion

2. Process of RMB internationalization

2.1 Outset: RMB regionalization

- One the one hand, RMB has maintained as a stable currency since the exchange rate reform in 1994, even during the Asian Financial Crisis of 1997-1998.
- One the other hand, China's neighboring nations with less developed economy generally lacked enough international hard currencies like USD to be used for international trade.
- Nations with less hard currency were more willing to use RMB. The share of RMB pricing and settlement in Sino-Mongolia, Sino-Vietnam and Sino-Myanmar trade was significantly higher than that in Sino-Russia trade.
- According to my survey, in the frontier trade between Guangxi province and Vietnam, be it imports or exports, nearly 90% transactions were settled in RMB.

2. Process of RMB internationalization

2.2 Evolution: RMB offshore (CNH) market

- In 1996, RMB's offshore NDF (non-deliverable forwards) market emerged in Hong Kong and Singapore, but have become active until 2002 that.
- During the peak period from 2008 to 2009, daily trading volume in RMB NDF market was up to 10 billion USD.
- By the end of 2014, CNH deposits in HK have amounted to 1 trillion RMB.
- And according to the data of Standard Chartered, the amount of CNH bond issuance in HK, the present largest CNH market, was 564 billion Yuan in 2014.

2. Process of RMB internationalization

2.3 Fast forward: cross-border use of RMB

- In April 2009, the trials of settling cross-border trade accounts in RMB was launched, accelerating the pace of RMB internationalization.
- In October 2014, UK became the first western nation to issue RMB-denominated government debt. According to PBC's report, the share of China's trade in goods settled in RMB exceeded 20% in 2014

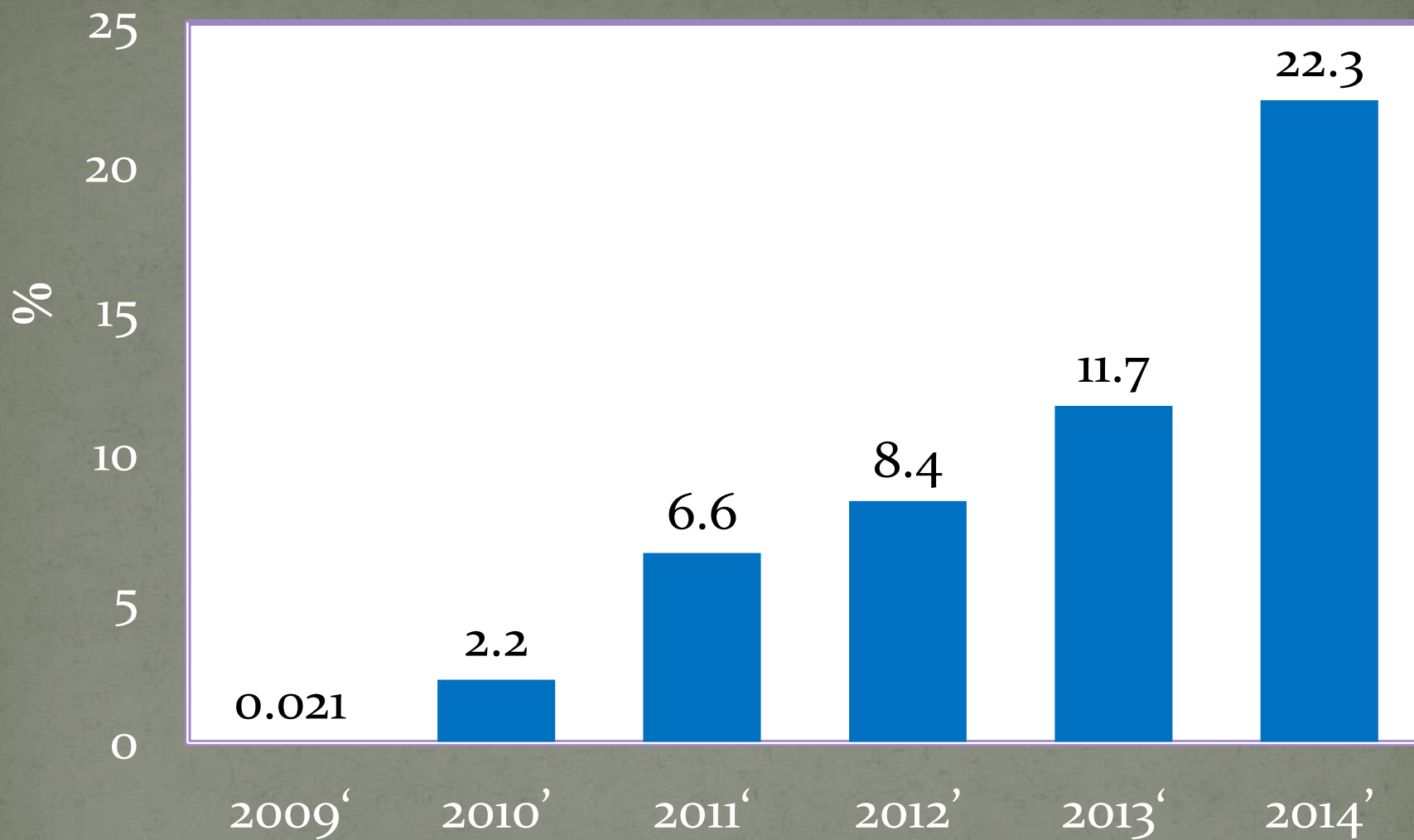


Figure 1: China's Trade in Goods Settled in RMB (share in percent)

Note: Calculated based on RMB settlement amount for current account and total value of China's imports and exports provided in 2015

Source: 2015 *RMB Internationalization Report* released by the PBC.

•Data released by IMF on July 16 fully reflect the achievements of RMB internationalization.

Share of RMB used in cross-border payments in global total (%)	2012: Q2—2013: Q1	2014: Q2—2015:Q1
	0.2	1.0
Share of RMB used in international debt securities (%)	2010: Q1	2015: Q1
	0.1	0.6
Share of RMB used in issuance of international debt securities (%)	2010	2014
	0.1	1.4
Share of RMB used in global foreign exchange market turnover (%)	2010	2013
	0.4	1.1
Share of RMB used in official foreign currency assets (%)	2013	2014
	0.7	1.1

Source: Review of the Method of the Valuation of the SDR Initial Considerations, IMF, July 16 2015,

3. Main drivers for RMB internationalization

3.1 Constant improvement of China's international economic status: providing solid base for RMB internationalization

- China is the 2nd largest economy.
- China had been the world's largest trader for two consecutive years.
- China became a net capital exporter in 2014 as the ODI exceeded FDI for the first time

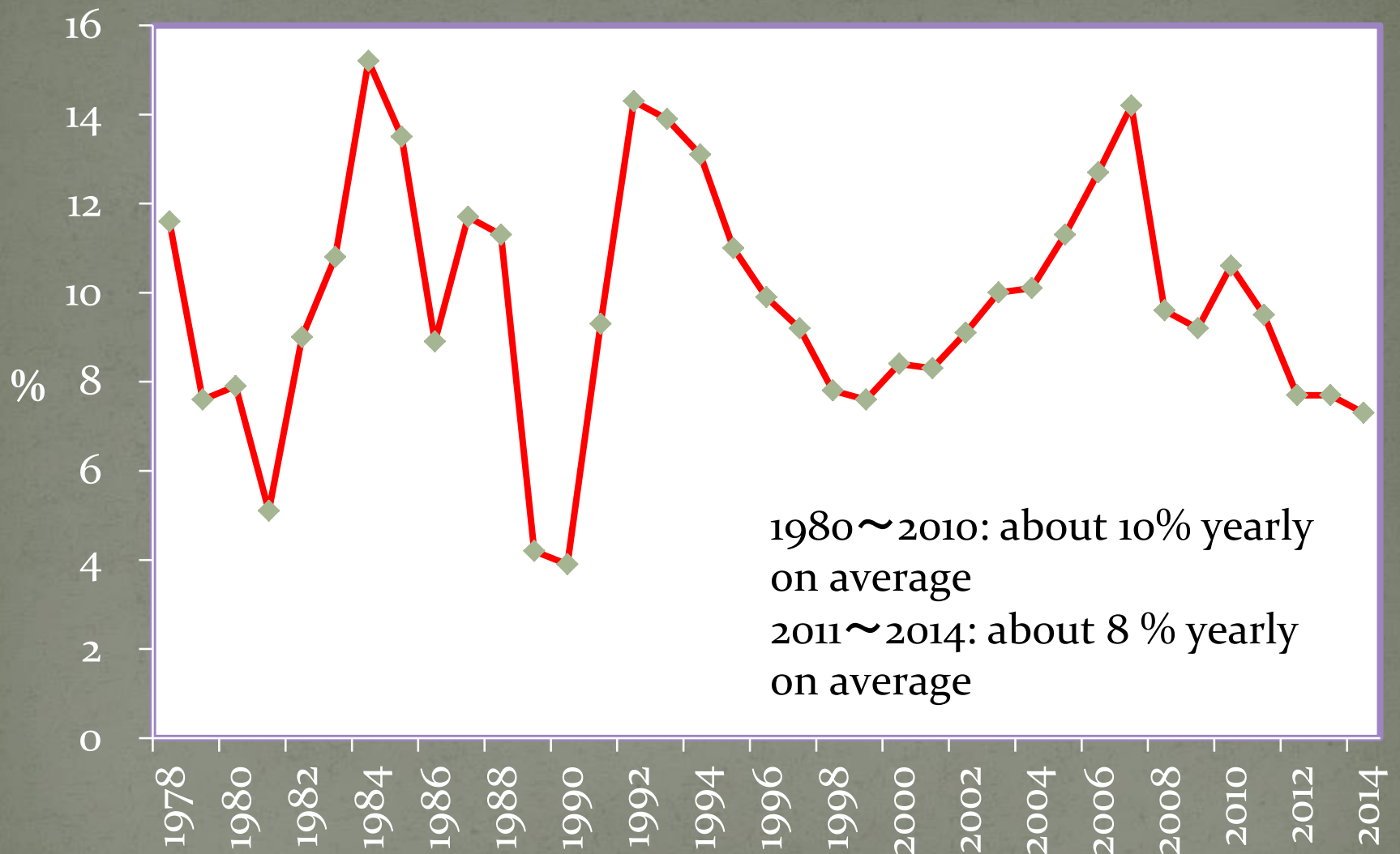


Figure 2: China's GDP growth rate from 1978 to 2014

Source: Wind database.

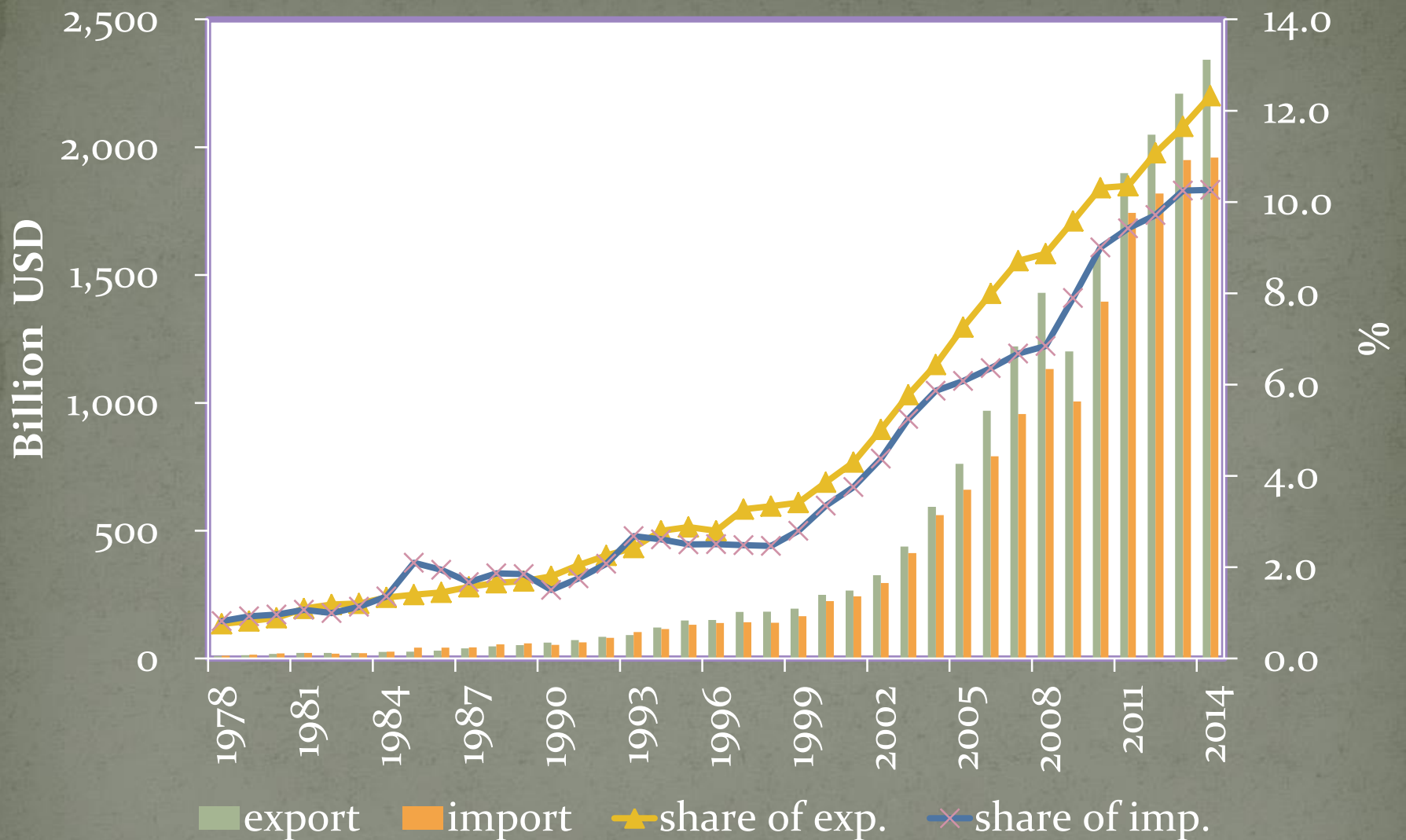


Figure 3: The share of China's exp. and imp. in the world total from 1978 to 2014
 Source: Wind database.

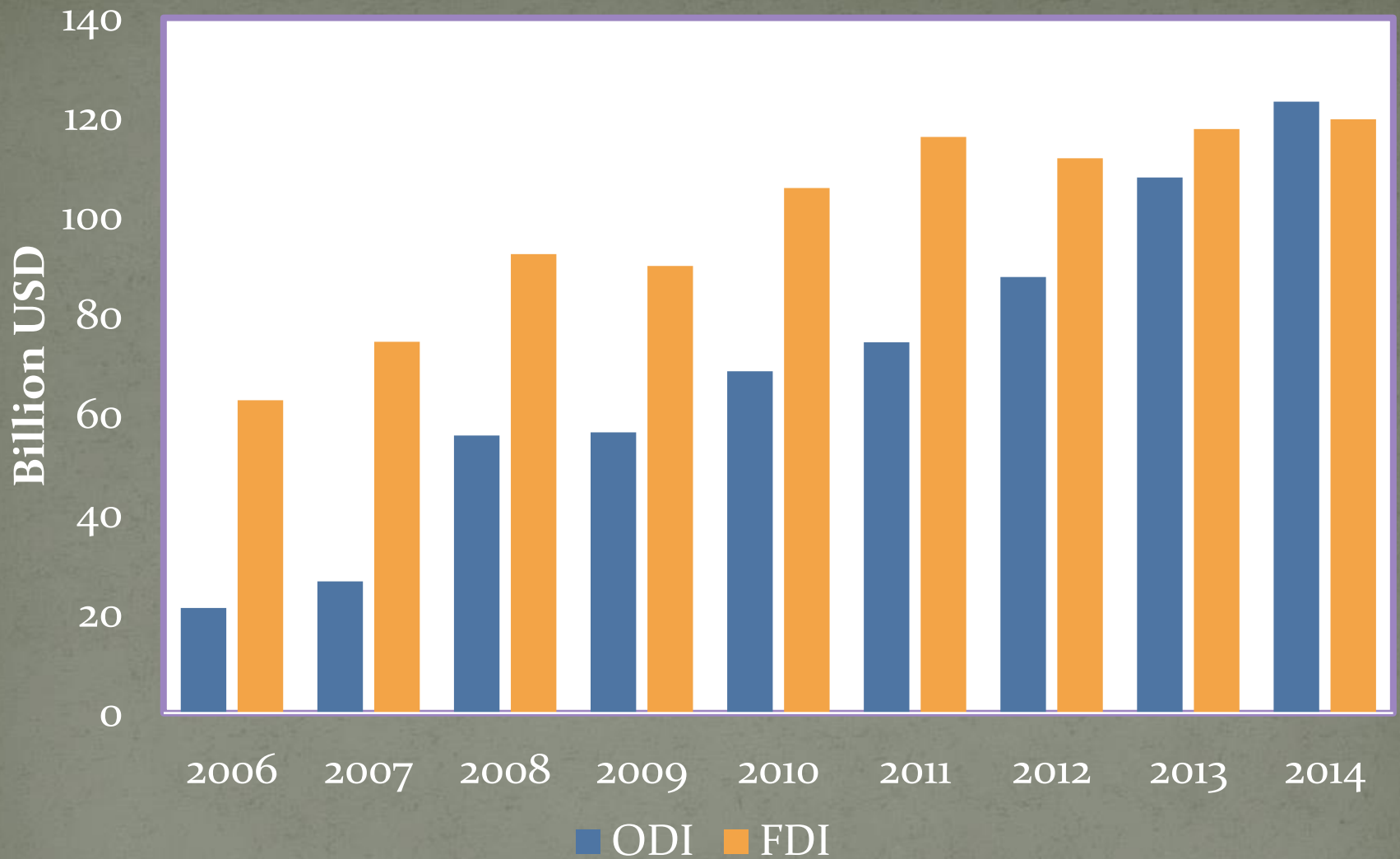


Figure 4: China's ODI and FDI from 2006 and 2014
Source: Wind database

3. Main drivers for RMB internationalization

3.2 Reform of exchange rate regime and liberalization of capital account: step by step

- 1979-1993: shift from planning to market-oriented mechanism. Main measures were to establish exchange swap market and dual exchange rate system, relax the restrictions on operating foreign exchange business, etc.
- 1994-2000: unification of exchange rates and current account convertibility. In 1994, RMB official exchange rate and market exchange rate were unified to a market-oriented, single and managed floating exchange rate system. In 1996, full convertibility of RMB current account was officially realized.

- 2001-2008: further liberalization of foreign exchange control. In 2005, the exchange rate system referring to a basket of currencies for adjustment was put into use. The channels for capital inflow and outflow were expanded by launching QFII and QDII systems. As of 2007, China has realized basic convertibility for nearly 30 items among 43 capital account transactions categories classified by IMF.
- 2009 till now: expanded use of RMB in cross-border payments. In 2010, exchange rate reform of 2005 was re-launched to enhance the flexibility of RMB exchange rate. In August 2015, the PBC decided to improve the quotation for central parity rate in RMB in exchange for USD.

3. Main drivers for RMB internationalization

2.3 Further promotion of China's international cooperation: positive attitudes

- China has signed 14 FTAs with 22 economies up to the end of October 2015, including China-ASEAN, China-Chile, CEPA, China-Korea, China-Australia, and so on. Seven FTAs are under negotiation, including CJK FTA.
- By the end of May 2015, the PBC has signed bilateral local currency swap agreements with central banks or monetary authorities of 32 countries and regions and total size of these agreements amount to 3.1 trillion RMB.
- China proposed the belt and road initiative in 2013, and then the AIIB (Asian Infrastructure Investment bank) and the Silk Road Fund established.

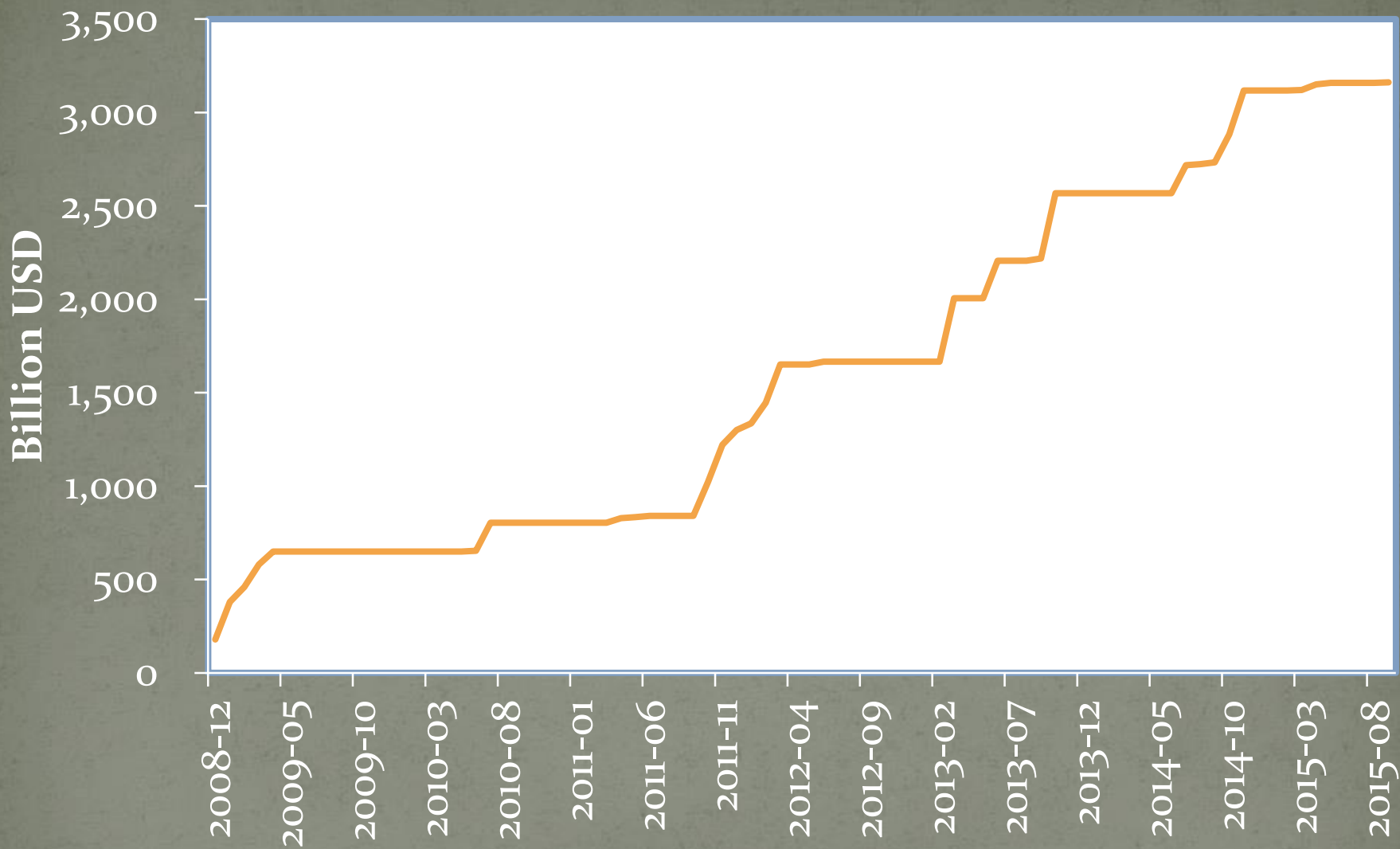
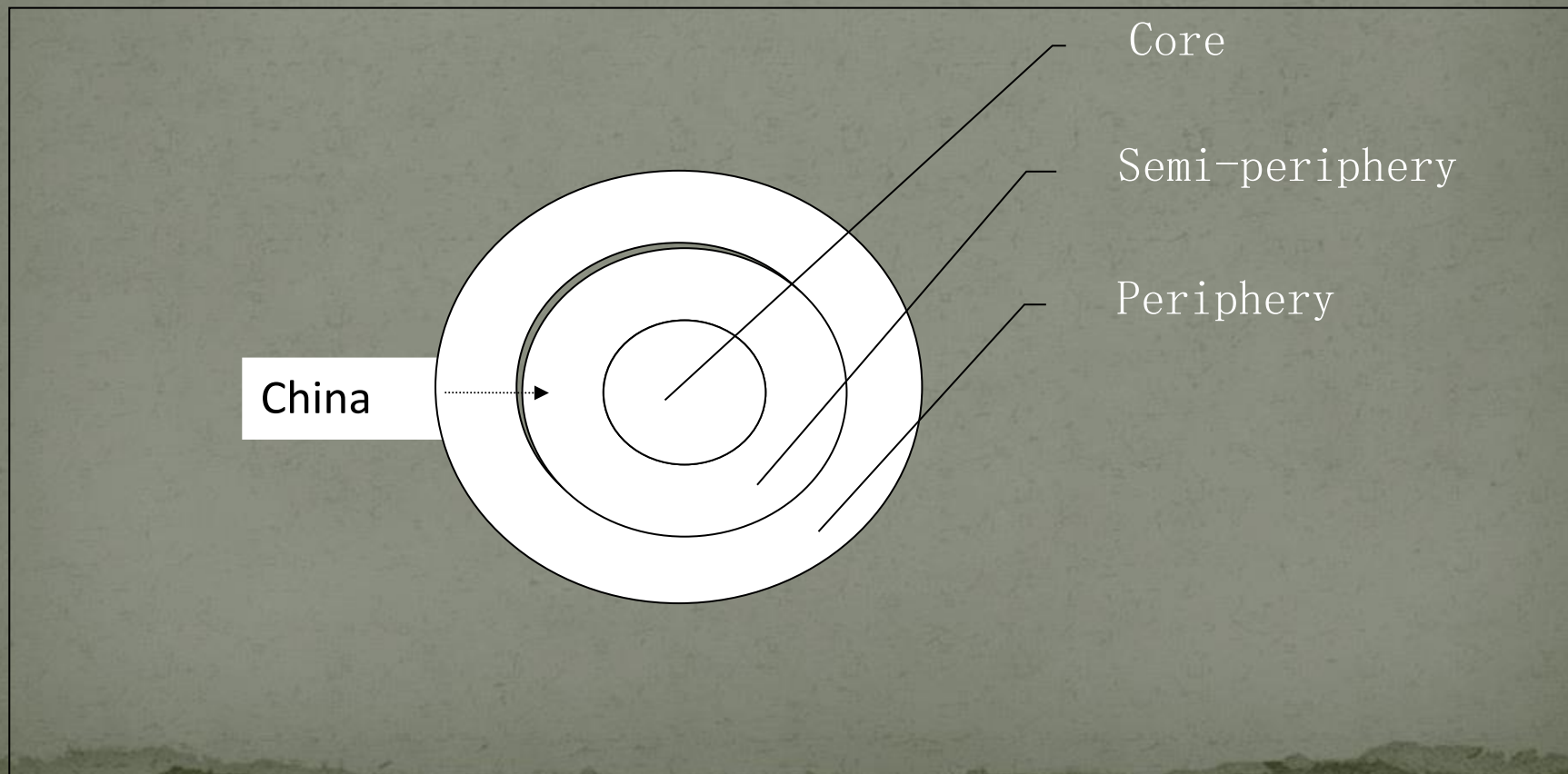


Figure 6: National currency swap of RMB
Source: Wind database.

4. Position and future of RMB in international monetary system

4.1 China is transforming from a periphery economy into a semi-periphery economy



4.2 Future strategic option

- To support international currency diversification. The international monetary system will still be dominated by international currency diversification. RMB internationalization is the main content of this trend. RMB's inclusion in SDR is just a matter of time.
- To maintain the exchange rate basically stable by narrowing the gap between nations, building up information exchange and sharing mechanism for cross-border capital flow, and helping emerging economies build efficient control mechanism. China shall actively participate in the actions and keep promoting the market-oriented reform of RMB exchange rate, meanwhile maintain relative stability of the exchange rate.

- To improve collective intelligence in crisis management. The top priority of the international monetary system reform is to improving 'collective response' in dealing with financial crisis, reducing 'self-security' demands . To satisfy the demands, some emerging economies accumulated a large amount of reserve and some developed countries used trade protectionism . To build and improve effective 'collective response' system shall be the important content for China to actively participate in construction of international monetary system.

5. Experience: JPY internationalization

- JPY internationalization started from 1970s, accompanied with rapid economic rise and substantial accumulation of balance of payment surplus.
- Revision of *Foreign Exchange Law* in 1980 is the watershed divide for JPY internationalization. Japan's current account basically realized convertibility and its capital account also transited from restricted control to deregulation in principle since the revision.

- JPY's performance as international currency: the share of yen used in global trade payments is 3.3% from 2014 Q2 to 2015. And since 1995, ratio of JPY in official foreign exchange reserves has been under 7% with a continuously falling trend.
- Two important characteristics for a currency internationalization. Firstly, the country must liberalize the capital account. Secondly, capital account liberalization won't necessarily make the country's currency become a major international currency. It is always market force that decides the destiny of currency internationalization.

6. Conclusion

- RMB internationalization is advancing rapidly. Further deepening needs further liberalization of capital account and improved flexibility of exchange rate.
- It's also increasingly difficult to maintain the balance between risk and stability.
- The level of RMB internationalization eventually depends on market force and there is still large uncertainty for the final result.
- RMB internationalization shall continue to follow the model of gradual improvement and go with the trend.
- As the level of RMB internationalization is improved, China can contribute more to reform and improvement of the international monetary system.

Thank you!

