RENMINBI INTERNATIONALISATION: THE NEXT STEP AND BEYOND

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CHI LO, SENIOR ECONOMIST
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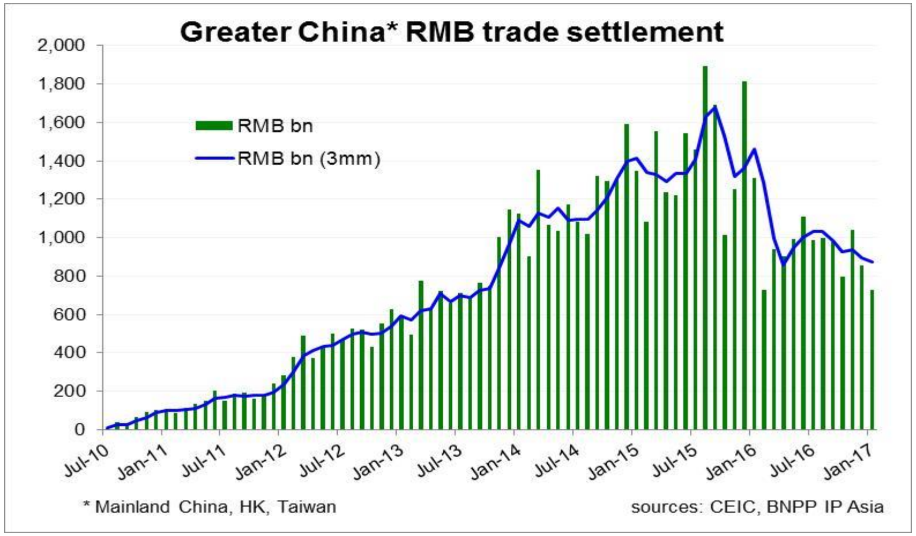
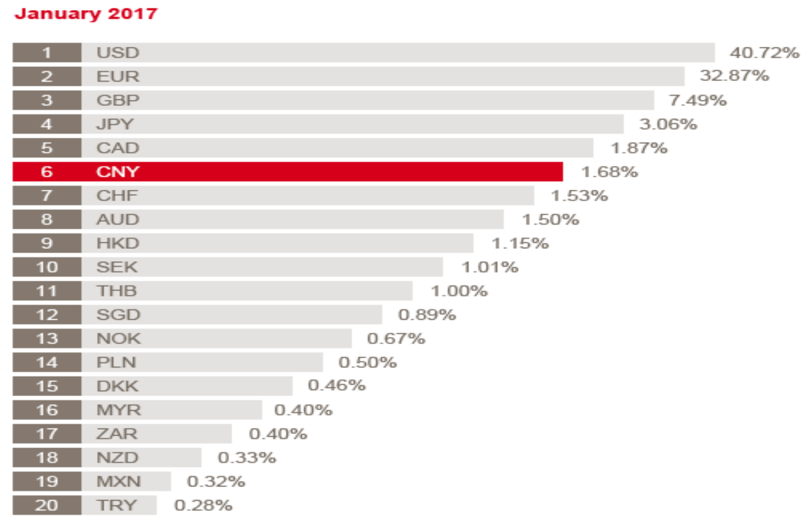
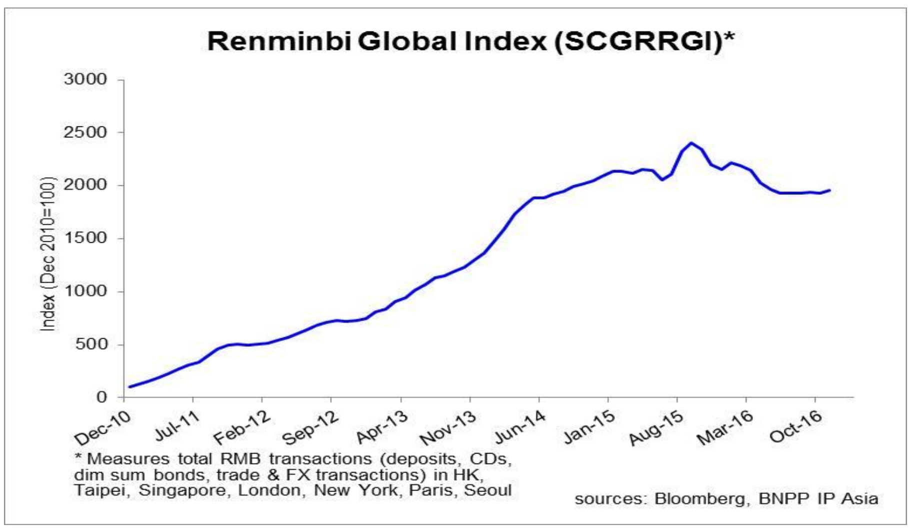
1 RENMINBI INTERNATIONALISATION

First step of internationalisation: trade







- Trade settlement in RMB surged from 10 bn/month in 2010 to a peak of RMB2 trn/month in mid-2015
- Over RMB3 trn swap lines signed with more than thirty central banks
- RMB in the SDR is a recognition of its international role

March 2017

The second step of RMB internationalisation

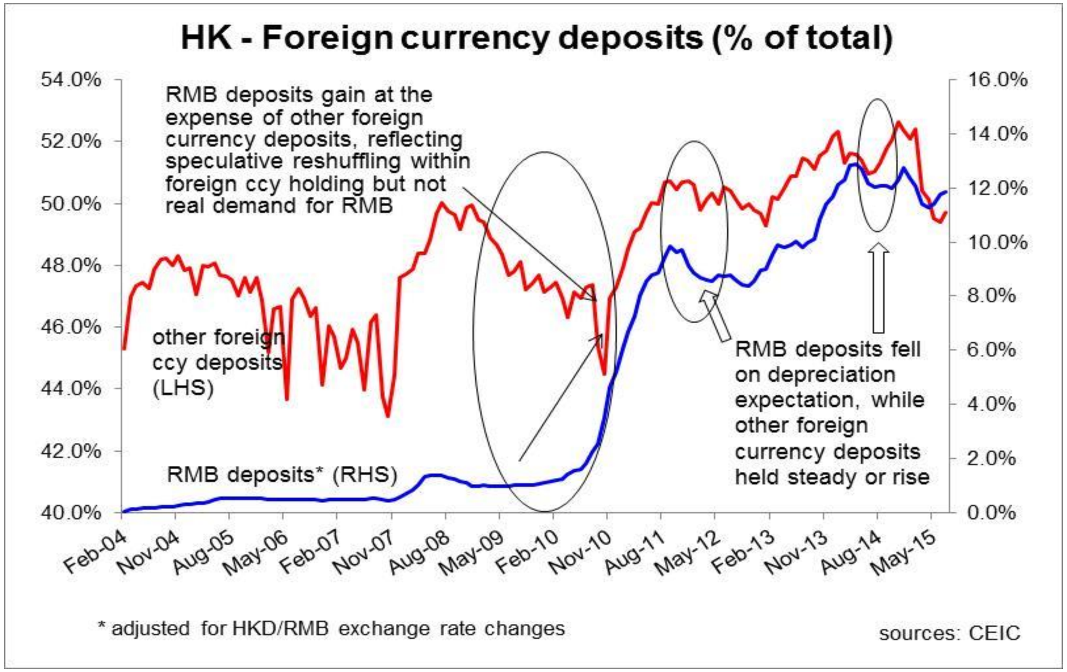
- The first step is hitting a limit; C/A surplus is not conducive to internationalisation

- A demand for money approach to analyse the next step
  - Transactional demand (foreign trade)
  - Precautionary demand (reserve currency, savings)
  - Speculative demand (investment)

- The next step involves developing precautionary and speculative demand for the RMB; i.e. using RMB for financial transactions

- Need a deep and mature Chinese capital market, with RMB financial instruments and hedging tools made available to global players in both the onshore and offshore markets

Non-trade RMB demand remains speculative



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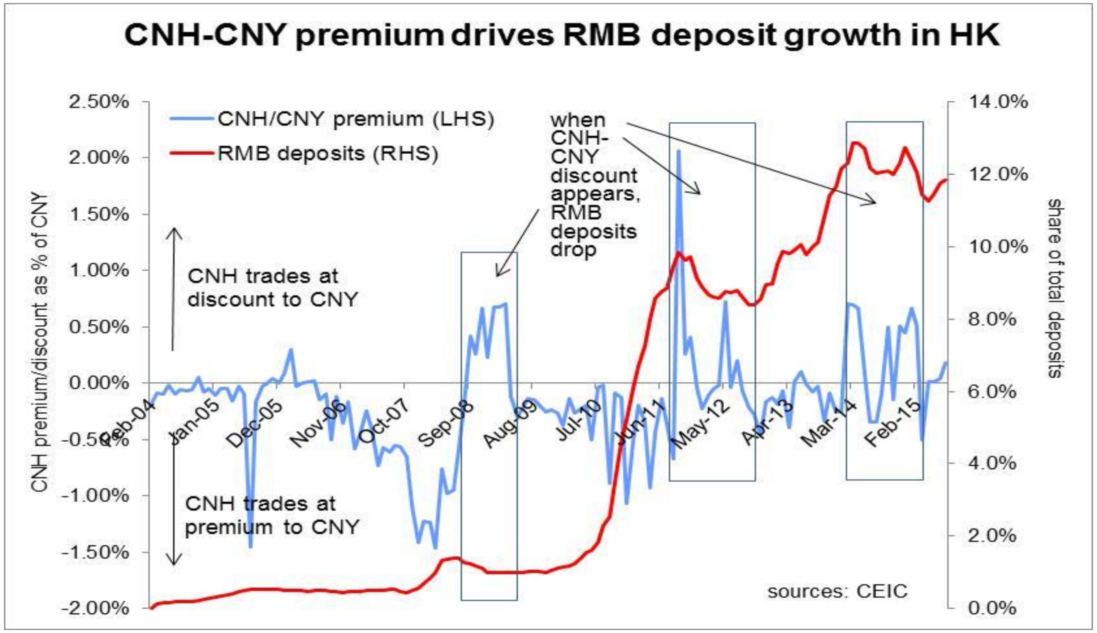
- Offshore demand for RMB has been driven by speculation on the RMB exchange rate movement
- An erratic behaviour in RMB demand is not a sustainable way to internationalise the currency

Internationalisation stuck in first gear



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- Free RMB convertibility offshore:
  - Foreigner bullish on RMB, CNH > CNY (CNH premium) => Chinese importers want to pay in RMB ➔ CNH supply/deposit increases
  - Foreigner bearish on RMB, CHN < CNY (CNH discount) => Chinese exporters want to accept RMB ➔ CNH supply/deposit falls

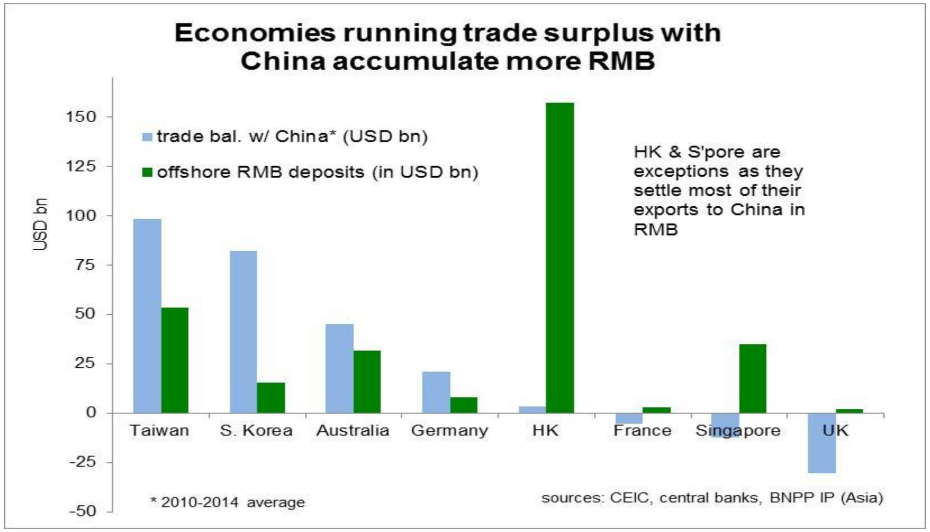
Limited financial demand for RMB

- So CNH supply responds endogenously through the import settlement channel, which is a function of CNH-CNY premium
  - The larger the premium, the bigger the incentive for Chinese importers to settle in RMB ➔ CNH supply (the offshore RMB pool) increases

- => the offshore RMB market is still largely driven by trade, via the Chinese importers RMB trade settlement, but not by capital flows or demand for RMB for financial transactions and investment

- Needs to deepen financial liberalisation, develop a large offshore RMB market by creating more RMB assets and an RMB derivative market (for hedging)

Building up offshore RMB pool



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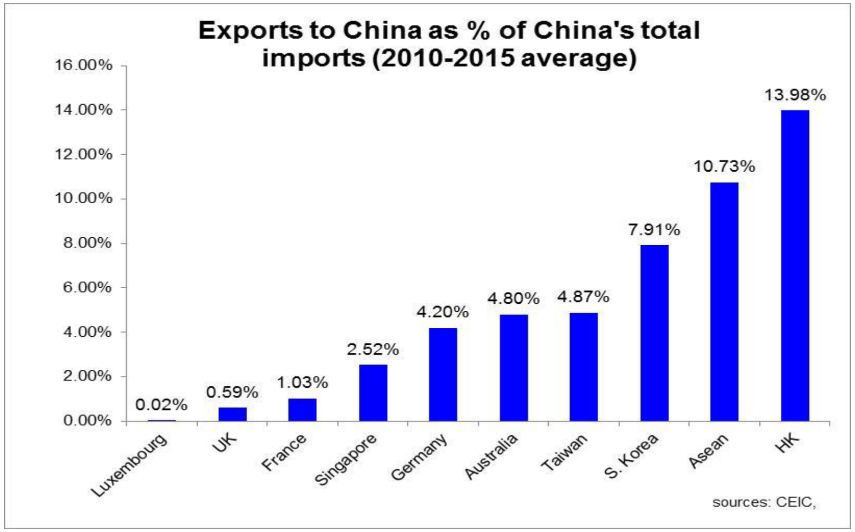
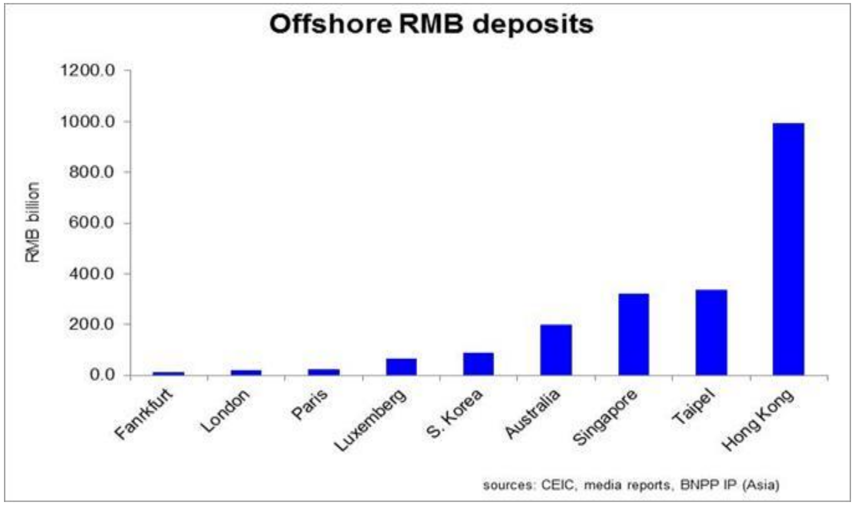
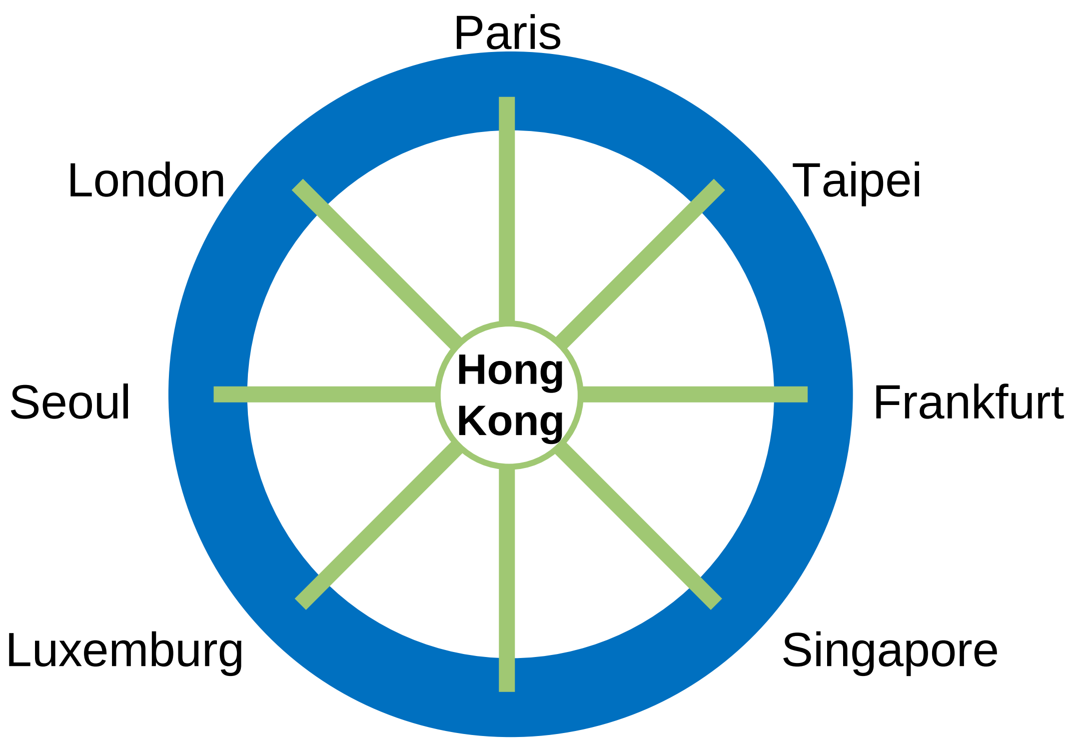


- The pool of offshore RMB comes from accepting RMB from Chinese importers
- What really counts is a country's exports to China
  - Having a larger amount of exports to China settled in RMB than imports settled in RMB is a necessary and sufficient condition for a country to build a large RMB pool

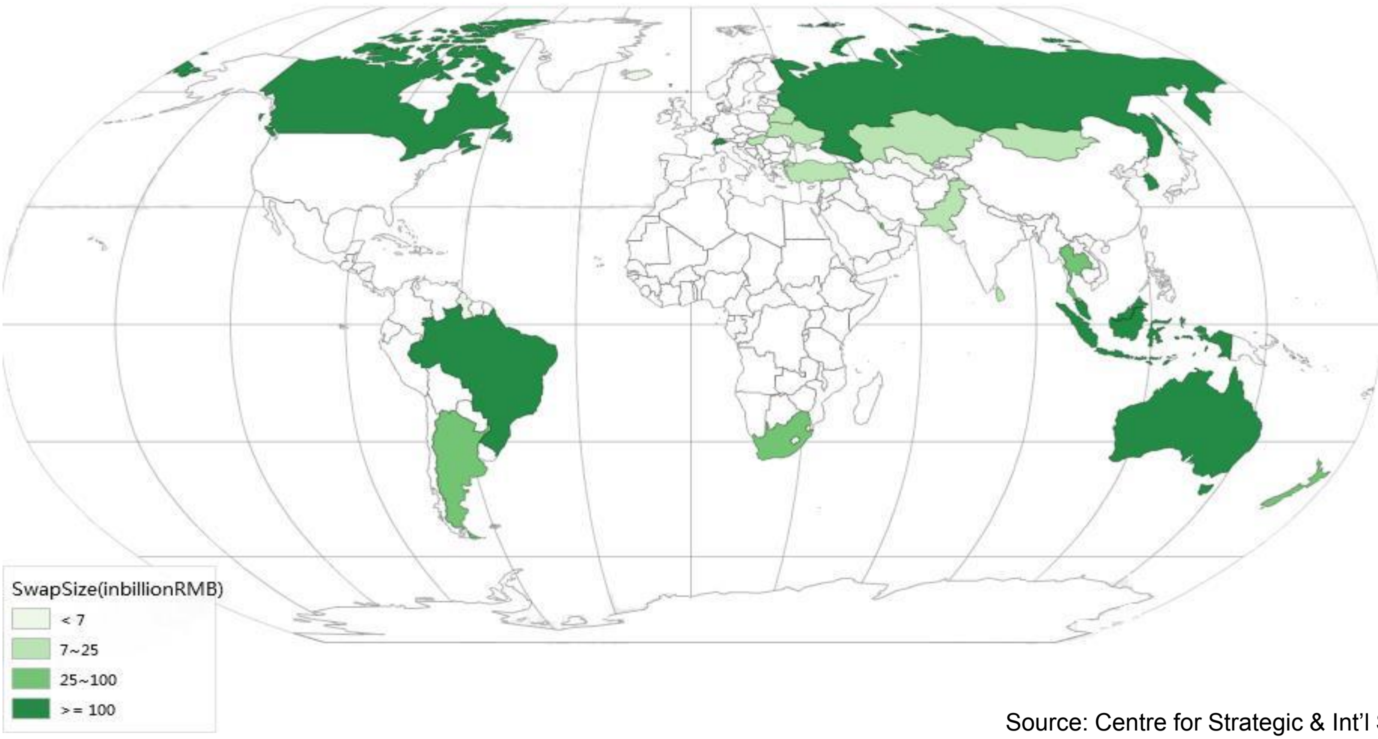


A ‘Chariot Wheel” for the offshore market



- Expansion of offshore RMB market increases the technical merits of the RMB becoming an asset class
- Further QFII / RQFII quota expansion before full capital account opening
- ETFs / Stock Connect / Mutual Recognition etc. = Direct access to China’s onshore stock market

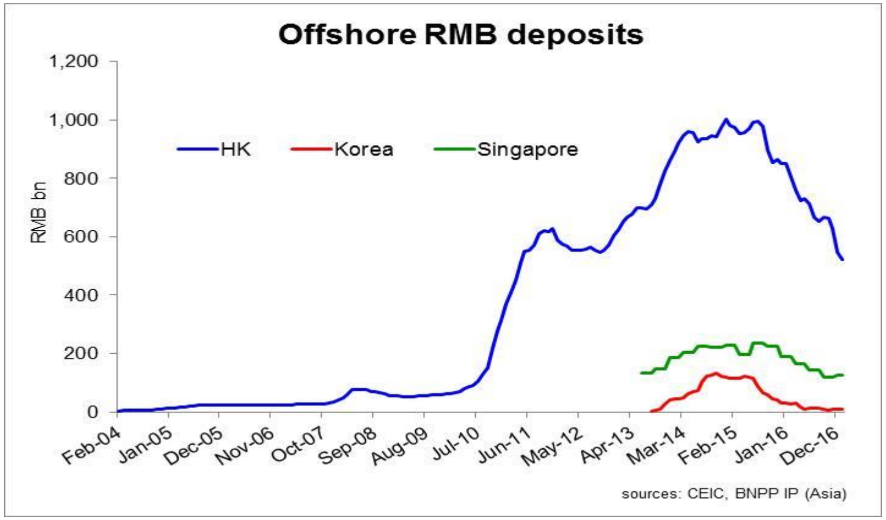
Swap lines & the RMB network



Source: Centre for Strategic & Int'l Studies

- An intermediate approach to internationalising the RMB before full capital account convertibility = swap lines (without the USD)
- More than 30 central banks with swap lines signed totalling > RMB3 trillion

Medium-term internationalisation strategy



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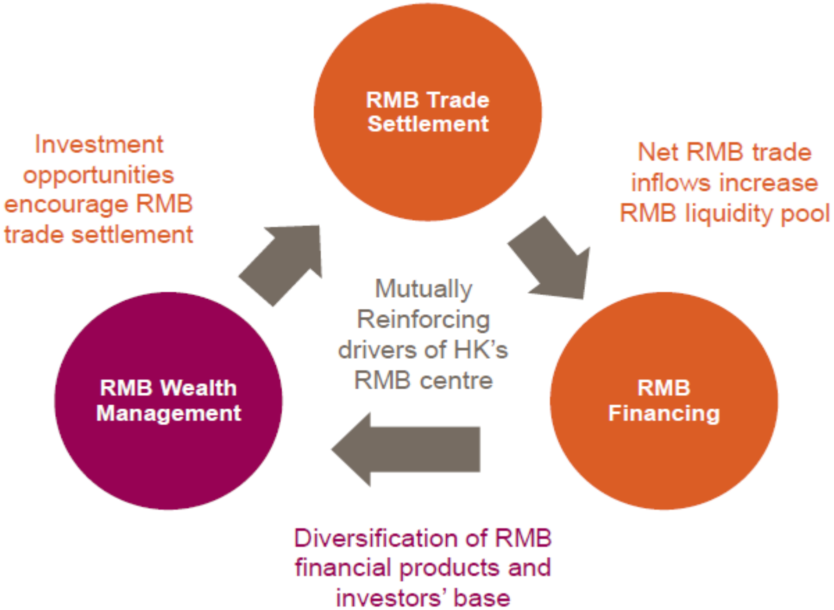

Source: HKMA

- Short-term momentum has slowed down
- Focus: strengthening the RMB's role as a medium of exchange (trade), while continuing financial liberalisation to keep pace with trade settlement progress
- Growth in RMB trade settlement will help support a virtuous cycle of internationalisation by creating non-trade demand for RMB

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BEYOND THE NEXT STEP

G3 currencies' failure = RMB's opportunity

- The basic functions of money (as a unit of account, medium of exchange & store of value) of the G3 currencies have been eroded
- Among the USD, JPY, EUR, GBP and RMB, only the later is likely to see growing international usage in the coming years
  - Beijing's continued financial liberalisation => RMB a growing part of the global financial infrastructure
  - AIIB, Silk Road Fund, New Development Bank & policy banks' international lending to boost RMB's global role under Belt & Road
- Most major currencies are failing to serve as a store of value by not being able to deliver stable positive returns
  - May the RMB be an alternative?
  - China = the biggest country implementing the largest amount of structural reforms
- The USD's dominance in global payments has been eroded
  - Euro's challenge has come and gone - the "European Dream" has been disrupted
  - When global trade re-accelerates, the biggest momentum will be in EM led by China => the share of RMB-denominated trade will rise at the expense of the G3 currencies

The role of the "Chinese Dream"

- The economics of the "Chinese Dream" is crystalised by the Belt & Road (BAR) plans, which unleash a regional infrastructure boom – linking China with Asia, Africa & Europe by land & sea
- BAR boosts RMB internationalisation by encouraging its usage in trade and financial transactions

The future of the renminbi

- It is conceivable that global demand for RMB as working capital by the private sector and as FX reserves by the official institution sector will only increase

- In the past two decades, all new roads (in terms of telecom infrastructure projects and financial architecture development etc.) led to the Europe cities, such as Paris, Frankfurt, Brussels and Luxemburg

- In the next two decades, all new roads of telecom infrastructure, railways, ports, airports and financial engineering will likely lead to Chinese cities, such as Shanghai, Hong Kong, Beijing etc.

- Accompanying these new roads will the rise of the renminbi as a global currency, eventually that is

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