RMB Internationalization at Half-time: Retrospect and Prospect

The Asian Financial Leaders Program

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1. Historical evolution of RMB internationalization
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1.1 Main Background of RMB Internalization

- Prior to 1993, as part of the foreign exchange control, China in principle prohibited cross-border carrying of RMB banknotes, as well as cross-border pricing and settlement in RMB.

- After 1993, RMB internationalization gradually started.
  - Before the end of 2014, it was not officially called "RMB internationalization", but rather “cross-border RMB business”, or “RMB cross-border circulation and use”.
  - At the end of 2014, the Central Economic Work Conference stated clearly to "steadily promote internationalization of the RMB” for the first time.
  - In June 2015, the People's Bank of China issued the first “RMB Internationalization Report".
  - At the end of 2015, the “13th five-year plan” proposed to “steadily promote internationalization of the RMB”.
1.2 Four Stages of RMB Internationalization

1. Early stage
2. Pilot stage
3. Burgeoning stage
4. Wave-like stage
1.2.1 Early Stage: 1993-2003

- The **early stage** of RMB internationalization started from personal carrying of the currency and border trade.
  - At the beginning of 1993, limits on the amount of cash one could bring in or take out of the country were implemented and set at 6,000 RMB. In the areas where open border market and small border trade were allowed, the local authority could adjust the limits according to actual situations.
  - At the beginning of 2003, the RMB was allowed to be used as denomination and settlement currency in border trade on a voluntary basis, the exchange rate was quoted at bank counters. The institutional constraint on cross-border use of RMB was started to remove.
1.2.2 Pilot Stage: 2003 - 2008

- Formal launch of Hong Kong and Macao personal RMB business signaled the development into a new stage.
  - On November 19, 2003, the People's Bank of China issued a circular to provide clearing arrangements for banks that handle personal RMB deposits, exchange, bank cards and remittance services in Hong Kong Special Administrative Region.
  - In November 2005, the authority expanded the RMB business in Hong Kong, raising limits on individual RMB cash exchange and remittances, cancelling the credit limit on Hong Kong bank RMB cards, allowing Hong Kong resident individuals to use personal checks in Guangdong for consumer spending.
  - In 2007, Hong Kong RMB business was further expanded to allow the issuance of RMB denominated bonds (ie. dim-sum bonds) in Hong Kong by mainland financial institutions.
1.2.2 Pilot Stage: 2003 - 2008

- Formal launch of Hong Kong and Macao personal RMB business signaled the development into a new stage.
  - In August 2004, with reference to the RMB business in Hong Kong, the People's Bank of China officially started to provide clearing arrangements for the individual RMB business of banks in Macau Special Administrative Region.
  - In October 2005, IFC and ADB issued RMB-denominated bonds (i.e., Panda bonds) in China.
  - QFII and QDII schemes were launched in end of 2002 and early of 2007 respectively.
1.2.3 Burgeoning Stage: 2008 - August 2015

- RMB internationalization in its real sense began since the 2008 global financial crisis.
  - In December 2008, the People's Bank of China and the Korea Central Bank signed a currency swap agreement with value of 38 trillion won (28 billion US dollars) and term of 3 years.
  - In 2009, with the RMB cross-border trade settlement as a starting point, the RMB internationalization kicked off.
  - Different from the "step by step, easier reforms first" approach of RMB convertibility reform, the internationalization of the RMB was promoted in both trade and investment at the same time, with the feature of "involving a broad range of areas and fully rolled out". Policy dividend was realized in a short period of time.
  - Hong Kong has established its position as the primary offshore center of the RMB by virtue of its natural geographical advantages and preferential policies for the RMB business.
1.2.4 Wave-like Stage: from August 2015 to now

- After the "8.11" reform of the RMB exchange rate, the progress of RMB internationalization experienced large fluctuations.
  - At the end of November 2015, the RMB was included in the SDR basket. This is undoubtedly the biggest highlight.
  - On August 31, 2016, the World Bank successfully issued the first SDR-denominated bonds in China; on October 1, the RMB was formally included in the SDR basket as scheduled.
  - The opening-up of domestic inter-bank bond market and the foreign exchange market accelerated.
  - Shanghai-Hong Kong Stock Connect, Shenzhen-Hong Kong Stock Connect, mutual recognition of funds between mainland and Hong Kong.
  - Standardization of cross-border RMB outflows.
  - Reserve requirement for nonresidents’ RMB deposits.
  - Adjustment of the commission fees for overseas RMB business clearing banks’ transactions in domestic foreign exchange market.
The RMB became the third largest currency by weight in the SDR basket
RMB is the second largest cross-border settlement currency of non-banking sectors in China.
Wavelike development of RMB internationalization

RMB deposit in HK (100mil yuan)

Outstanding currency swaps between PBC and foreign central banks (100mil yuan)
Wavelike development of RMB internationalization

Share of RMB in global payment by SWIFT

BOC and Standard Charted Bank’s RMB index
1.3 Three Periods of “Short-side rule" in RMB Internationalization

• The international supply and demand of a currency:
  • The supply is the national currency issued by a sovereign government that performs monetary functions outside the jurisdiction.
  • The demand is the national currency that non-residents outside the country are willing to hold.

• The "short-side rule" of currency internationalization:
  • The degree of internationalization depends on the side less willing to trade: if there is excess supply, the demand side is the “short-side”; if there is excess demand, the supply side is the “short-side”.
  • From the perspective of currency internationalization, whether the government or the market is the dominant force depends on which is the “short-side” of the supply and demand.
    • If the market has excess demand for a currency, then the government's money supply is the decisive force of the process of currency internationalization.
    • If the market demand for the currency is not sufficient, then the government's money supply may become wishful thinking.
## Four dimensions of currency internationalization

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<th>Government policy perspective</th>
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<td>Market demand perspective</td>
<td>Non-internationalization</td>
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<td>Less market demand</td>
<td>More market demand</td>
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</table>
1.3 Three Periods of “Short-side rule" in RMB Internationalization

• The first period 1960s and 1970s: market was the short-side.

  • In order to avoid losses in export earnings due to the devaluation of western country currencies, China began pilot programs of RMB pricing and settlement in 1968 in trade with Hong Kong.

  • From January 1, 1970, the pilot program was expanded to nationwide. In 1973, the RMB pricing and settlement was further expanded to cover trade with multiple countries and regions.

• The intention was not to promote RMB internationalization. At that time, the Bank of China named the RMB used in international settlement as foreign exchange RMB in doing businesses, the account name was accordingly foreign exchange RMB current account, and the business was strictly treated as foreign exchange business and completely separated from domestic currency business. This means that the RMB for international settlement is only an account symbol, RMB cross-border transfer was not in place.
1.3 Three Periods of “Short-side rule" in RMB Internationalization

• The first period 1960s and 1970s: market was the short-side.
  • This RMB pricing and settlement lacked support by market demand.
    • During the planned economy period, the RMB was completely unconvertible and faced internal devaluation and external overvaluation pressures. The market demand for the RMB was quite small. Due to fear of changes in the RMB exchange rate, foreign companies were not very willing to accept RMB settlement.

    • After the reform and opening-up, this policy in the planned economy period was carried on. But in this period, the country devalued the RMB continuously to correct overvaluation, leading to RMB depreciation, which adversely affected companies doing foreign trade. The amount of RMB settlement gradually shrank.

    • On 20 October 1998, the State Administration of Foreign Exchange required the Bank of China to cease the use of RMB in international settlement from November 15 of that year.
1.3 Three Periods of “Short-side rule" in RMB Internationalization

• The second period is the Hong Kong and Macao individual RMB business period: the government was the short side.
  • Before the introduction of Hong Kong and Macao RMB business, the market demand for RMB had been very buoyant. Since the unification of RMB exchange rates, the RMB has gradually become an emerging strong currency, earning the reputation of ‘quasi dollar’ in neighboring countries and regions.
  • With a stable value, convenience to use, the RMB eventually stood out in in the border trade payment and settlement, occupying a higher market share. At the same time, China's continuous opening of trade and personnel exchange also provided opportunities for the cross-border use of RMB.
  • In contrast, the policy supply in the same period was obviously lagging behind. Apart from progress in personal consumption use, tourism and border trade (with small amounts of border trade and border market as the main part), polices in other areas were not yet open.
  • Moreover, the financial system including banks did not provide sufficient support to RMB cross-border business. The Hong Kong and Macao individual RMB business was also mainly confined to personal and small amount consumer spending.
1.3 Three Periods of “Short-side rule" in RMB Internationalization

• The third period is after the 2009 pilot program of cross-border RMB business: the market became the short side again.
  • The outbreak of the global financial crisis in 2008 became an important opportunity for the internationalization of the RMB.
  • Since then, the government policy is no longer lagging behind, but is to “use supply to create demand”.
    • “Catching up“ in the short-term, the degree of openness of cross-border RMB use is to be comparable to that of foreign currency.
    • "Common but differentiated" principle, policies on cross-border RMB use in some areas are more liberalized than those on foreign currency.
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2. Costs and benefits of RMB internationalization
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2.1 Micro level

2.2 Macro level

2.3 International perspective
2.1.1 Influence on Enterprises

- RMB has become a settlement currency of Chinese enterprises in foreign trade and economic activities.
  - According to SWIFT, in January 2012, the share of the RMB in global payment was only 0.25%, ranking 20th; in August 2015, the market share reached 2.79%, ranking significantly higher at the 4th.
  - Because of the weakening of the RMB, the market share has decreased, but as of the end of 2016, the RMB still accounted for 1.68% of global payment, ranking 6th in the world.
2.1.1 Influence on Enterprises

- RMB has become a major settlement currency of Chinese enterprises in foreign trade and economic activities.
  - According to SAFE statistics, in 2010, total cross-border payments and receipts in RMB in China's non-banking sector were only 306 billion US dollars, accounting for 1.7% of the total cross-border flows, RMB ranked the 4th largest cross-border payment and receipt currency.
  - By 2015, the total payments and receipts in RMB rose to 1.05 trillion US dollars, 31 times of that in 2010, the share also increased to 29.0%, making it the 2nd largest cross-border payment and receipt currency.
  - In 2016, total RMB cross-border receipts and payments reached 1.42 trillion US dollars, the share dropped to 24.0%.
  - The countries and regions that use RMB for cross-border trade settlement continue to expand. In 2009, when the RMB cross-border settlement business was piloted, the regions were limited to Hong Kong, Macao and Southeast Asian countries. By 2015, cross-border RMB payment and receipt business was expanded to 192 countries and regions, of which the share taking up by countries and regions excluding Hong Kong reached 47.1%, close to half.
2.1.1 Influence on Enterprises

- RMB internationalization is supportive to China's foreign trade.
  - *Pricing and settlement with the RMB in cross-border trade can help enterprises avoid and hedge exchange rate risk.*

- *Pricing and settlement with the RMB in cross-border trade can help enterprises save costs associated with exchange rate risk management.*

- *Even when RMB is used only in settlement of cross-border trade, it can help companies reduce exchange costs and save time.*

- *RMB as an international settlement currency reduces the cost of enterprises, increases the global competitiveness of Chinese products, and is conducive to increasing the global market share of China's exports.*
2.1.1 Influence on Enterprises

• RMB internationalization helps enterprises to expand their financing channels.

• In July 2007, China Development Bank issued the first offshore RMB dim-sum bond in Hong Kong, since then the issuance of offshore RMB bonds have been on the rise. Domestic enterprises and their affiliates abroad are the main issuers of offshore RMB corporate bonds.

• According to Wind statistics, from July 2007 to the end of December 2015, there were 601 issuances of offshore RMB bonds, the cumulative value reached 635.52 billion yuan, an average annual growth of 30%. Among them, 258 were corporate bonds, with total value of 277.46 billion yuan.
2.1.1 Influence on Enterprises

- RMB internationalization helps enterprises to expand their financing channels.

- Domestic enterprises and their affiliates abroad are also the main borrowers of offshore RMB loans. Since the pilot program in Qianhai Shenzhen at early 2013, cross-border RMB loan business has been carried out in nine provinces, autonomous regions and municipalities.
  - According to the statistics of the People's Bank of China, RMB loans as a type of financial assets held by overseas institutions and individuals reached 531.0 billion yuan at the end of 2013, and increased to 975.0 billion yuan in July 2015, after which the balance declined to 616.4 billion yuan by the end of 2016.

- With the advancement of RMB internationalization, the degree of acceptance of the RMB at the international level has increased, and the overseas financing activities of Chinese enterprises using domestic RMB assets as collateral (domestic guarantee for overseas loans) also exist widely.
Offshore RMB bond issuance
(100 million yuan, number of issuance)

Domestic RMB financial assets held by foreigners (100 million yuan)
2.1.2 Influence on Individuals

- UnionPay bank card “going abroad" facilitates overseas consumption of Chinese resident individuals.

- UnionPay card began to go abroad with the launch of Hong Kong's individual RMB business in 2004.

  - Holders of UnionPay bank card can directly use the card for consumption abroad, the China UnionPay, rather than individual card holders, will purchase foreign exchange for repayment. So individuals do not need to hold foreign exchange.

  - Technology that can identify specific shop and commodity codes ensure that the cards are only used for small amount current account purchases, so the relevant purchase of foreign exchange does not count in the annual foreign exchange quota of $ 50,000 per person.
2.1.2 Influence on Individuals

- UnionPay bank card “going abroad” facilitates overseas consumption of Chinese resident individuals.
  - RMB internationalization helps China UnionPay to become the largest international card organization in the world.

- In 2014, there were about 50 million UnionPay cards, accounting for 52% of the total international cards; Visa issued less than 30 million cards, accounting for 30%.

- According to the China UnionPay official website, as of September 2016, more than 40 countries and regions abroad have issued 60 million UnionPay cards, more than 160 countries and regions now accept UnionPay card.

- According to the latest report of the US market research firm Packaged Facts, in 2014 the total consumption using global bank cards was 17.26 trillion US dollars, of which UnionPay card transactions were 5.92 trillion US dollars, accounting for 34.3% of total; following are Visa (27.6%), MasterCard (19%), Visa Europe (11.2%) and American Express (5.9%).
2.1.2 Influence on Individuals

• UnionPay bank card “going abroad” facilitates Chinese resident individuals’ overseas consumption.

• This development facilitates the overseas travel and consumption of Chinese resident individuals.

  • In the past, resident individuals can only use their own foreign exchange or a small quota of foreign exchange purchase for overseas consumption, now they can use the card directly for consumption if they have RMB.

  • In the past, most people did not have or could not apply for a foreign currency card, now they can apply for a RMB card and use it directly overseas.
UnionPay card catches up
2.1.2 Influence on Individuals

- The influence of RMB internationalization on Chinese citizens' overseas travel and study.

- Overseas travel by Chinese people grows very rapidly.
  - Since 2013, the number of Chinese people traveling abroad has ranked 1st in the world for three consecutive years, reaching 120 million by 2015, an increase of 12% over the previous year, which makes one of every 10 international visitors a Chinese.

- The average annual growth rate of overseas trips between 2003 and 2009 was 15.4%, between 2009 and 2015 it was 16.6%, an increase of 1.3 percentage points.
2.1.2 Influence on Individuals

- The influence of RMB internationalization on Chinese citizens' overseas travel and study.
  - China’s overseas expenditure is even higher.
    - According to SAFE's balance of payments statistics, in 2015, China's overseas travel expenses reached 253 billion US dollars, up 53% over the previous year. Between 2003 and 2009, the average annual growth rate of overseas travel expenses was 19.3%, while the average annual growth rate for 2009-2015 was 34.0%, a substantial increase of 14.7 percentage points.

- The number of Chinese students studying abroad also grows rapidly.
  - In 2015, the number of Chinese students studying abroad exceeded 520,000, an increase of 14% over the previous year. Compared with the average annual growth rate of 11.8% between 2003 and 2009, the average annual growth rate of overseas Chinese students between 2009 and 2015 was 14.8%, 2.9 percentage points higher than before.
Number of overseas trips by Chinese residents (10 thousand)

Overseas travel expenses by Chinese residents under international balance of payments (100 million US dollars)
Number of Chinese students studying abroad
(10,000 person)
2.1.2 Influence on Individuals

- RMB internationalization facilitates individuals’ diversification of assets.

- Qualified Domestic Institutional Investor System (QDII) opens up legitimate channels for residents to allocate assets in the overseas market.
  
  - China's earliest bank QDII products were launched in July 2006. According to SAFE statistics, as of the end of 2016, the cumulative approved QDII quota reached 90 billion US dollars.

  - Although the asset management agencies can use RMB, US dollars or other major foreign currencies to raise funds, most of the QDII products directly raise RMB funds from investors. Settlement of product purchases and redemption are also mostly in RMB.
2.1.2 Influence on Individuals

• RMB internationalization facilitates individuals’ diversification of assets.

• "Shanghai-Hong Kong Connect" and "Shenzhen-Hong Kong Connect" give Chinese residents direct channels to invest in Hong Kong stock market.

  • Through the "Shanghai-Hong Kong Connect“, as of the end of 2016, Hong Kong shares held by mainland investors reached 317.2 billion yuan, while Shanghai stock exchange shares held by Hong Kong investors reached 132.6 billion yuan.

  • Through the "Shenzhen-Hong Kong Connect", as of the end of 2016, Hong Kong shares held by mainland investors reached 6.2 billion yuan, while Shenzhen stock exchange shares held by Hong Kong investors reached 15.2 billion yuan.
2.1.2 Influence on Individuals

- RMB internationalization facilitates individuals’ diversification of assets.
  - Qualified Domestic Limited Partner (QDLP) and other innovative products facilitate Chinese residents’ overseas investment.
    - Overseas hedge funds participating in the QDLP pilot program need to register a contact fund in Shanghai, the contact fund is to complete fund-raising from high net worth individuals and purchase foreign exchange. The funds are then entrusted with overseas hedge funds and invested in stock markets abroad. QDLP benefits high net worth individuals by enabling them to invest in the world’s leading hedge funds’ flagship fund and earn higher overseas investment returns.

- In April 2014, the Harvest Fund was approved of 1 billion US dollars quota of “Foreign Exchange Connect” pilot business, which is not included in the 50,000 dollars annual foreign exchange purchase quota of individuals, and there are no restrictions on the scope of investment. Harvest Fund provides "customized accounts" to domestic investors. If an overseas project is deemed legitimate after due diligence by Harvest fund, then the quota can be used to invest in the project.
2.1.3 Influence on Banks

- The impact of RMB internationalization on the traditional business of commercial banks:

  - In terms of asset businesses, in addition to lending and account overdraft to correspondent banks, RMB trade financing and offshore loans are the main business opportunities for banks.

    - According to SWIFT, the RMB has become the world's second largest trade financing currency.
2.1.3 Influence on Banks

- The impact of RMB internationalization on the traditional business of commercial banks:
  - In terms of liability business, the benefits of RMB internationalization to China's commercial banks are more significant:
    - As settlement banks and clearing banks, banks now have relatively cheap overseas RMB deposits.
    - Bond financing abroad. According to Wind statistics, as of the end of 2015, various types of Chinese banks issued a total of 294 offshore RMB financial bonds in the Hong Kong offshore market, totaling 222.7 billion yuan. Most of them bear interest rates lower than that of the onshore bonds.
2.1.3 Influence on Banks

- The impact of RMB internationalization on the traditional business of commercial banks:

  - In terms of intermediary business, the domestic commercial banks can carry out a full-range of cross-border business along with RMB internationalization, including settlement, agency, guarantee, risk management, securities issuance, underwriting, trading, corporate restructuring, merger and acquisition, investment analysis, venture capital investment, project financing and information advisory services, which all bring new profits to banks.
2.1.3 Influence on Banks

- On the most basic intermediary business, i.e. international settlement, the internationalization of the RMB as a whole will significantly increase the business volume.

- With the continuous improvement of the international status of the RMB, there will be more settlement and clearing of the RMB among foreign entities; for domestic banks, this means new business and new sources of profits.

  - By the end of 2015, a total of 20 RMB clearing banks were set up outside of China.

  - According to the annual report of the Bank of China, from 2013 to 2015 the bank’s cross-border RMB clearing amounted to 129.1 trillion yuan, 240.8 trillion yuan and 330.9 trillion yuan respectively.
The Influence of RMB Internationalization on Banks

Cross-border RMB settlement by the five major banks (100 million)

Issuance of RMB financial bond in Hong Kong (100 million, number of issuances)
2.1.3 Influence on Banks

• The impact of RMB internationalization on the transnational operation of Chinese banks:

  • Expansion of overseas affiliates

    • As of the end of 2015, the five major banks in China had set up 1,258 overseas branches in the world, ICBC, ABC, BOC, CCB, and BCM have offices in 42, 14, 46, 25, and 13 countries and regions respectively.

  • The proportion of overseas assets increased.

    • Since the launch of RMB internationalization in 2009, the scale of overseas assets of the five major banks grew rapidly from 2,633.9 billion yuan at the end of 2009 to 9,875.6 billion yuan at the end of 2015, at an average annual growth rate of 24.6%.
2.1.3 Influence on Banks

• The challenges of RMB internationalization to commercial banks in China:
  • In the process of doing cross-border RMB business, such as overseas RMB loans and offshore RMB bonds, the types of international businesses of Chinese banks will become more diversified and the international customer base will continue to grow.
  • By the end of 2015, the Bank of China had 24,983 overseas employees, an increase of 5.9% over the previous year, accounting for 8.1% of the total staff of the bank, up 0.4 percentage points over the previous year. However, by 2015, the Bank's overseas assets accounted for 27% of total, much higher than the 8.1% share of overseas employees.
  • Agricultural Bank of China is one of the top five state-owned banks, but as of the end of 2015, its foreign affiliates had only 722 local employees, accounting for only 0.1% of all employees.
2.1.3 Influence on Banks

• The challenge of RMB internationalization to Chinese commercial banks:
  
  • Diversification of financial needs test banks’ product innovation ability.
  
  • As the production, procurement, sales, and investment of domestic and foreign enterprises go global, their financial needs are no longer limited to deposit, loan, exchange and other traditional services. Demand for financial services including investment banking, insurance and financial leasing will inevitably increase. At the same time, financial demand related to domestic individual’s travel and overseas investment also increases, thereby increasing the types of demand for cross-border financial products and services.
  
  • In the past, income of Chinese banks mainly comes from the traditional deposit and loan interest differentials, the proportion of innovative intermediary business income is very small, the diversified financial demand brought by RMB internationalization brings pressure for product innovation. At the same time, the opening of the capital market with the internationalization of the RMB has also brought great competition pressure to the commercial banks.
2.1.3 Influence on Banks

- The Challenge of RMB internationalization to Chinese commercial banks:
  - The international business capacity of commercial banks still lags behind the internationalization of RMB and the internationalization of enterprises.
    - The vast majority of assets and branches are still local, overseas branches are not as many compared to banks in developed countries.
    - In the case of Bank of China which has a high degree of internationalization, by the end of 2015, it had 644 overseas branches in 46 countries and regions. In contrast, Citibank has more than 1,300 branches in more than 100 countries and regions.
  - Foreign business is affected by more factors and faced with more risks.
    - Chinese banks doing the RMB business abroad face changes in the international as well as the host country environment. These environmental factors are often uncertain, increasing the difficulty of responses and management.
According to Accenture's study in 2010, the level of internationalization of China's four major state-owned commercial banks are extremely low.
2.2.1 Macro Benefits of RMB Internationalization

• Enhance China's economic and financial power.

  • RMB internationalization is a manifestation of comprehensive national strength, especially after the financial crisis, China promoted cross-border use of the RMB and the reform of the international monetary system, many countries in the world have given great attention and actively participated in the process of internationalization of the RMB.

  • RMB’s inclusion in the SDR basket shows the IMF's recognition of the achievements of China's economic and financial reforms, the RMB will hopefully become many countries’ reserve currency.

  • RMB internationalization has given China more bargaining power in international economic and financial affairs, and provided new options in international trade and investment.
2.2.1 Macro Benefits of RMB Internationalization

- Promote the reform and opening-up of the domestic financial industry.

- RMB internationalization strengthens the comprehensive strength of China's financial industry. After the RMB becomes an international currency, more international trade and capital transactions will be denominated in RMB. In these businesses, the Chinese banks and other financial institutions will have a clear advantage.
2.2.1 Macro Benefits of RMB Internationalization

- Promote the reform and opening up of domestic financial industry.
  - RMB internationalization strengthens the comprehensive strength of China's financial industry. After the RMB becomes an international currency, more international trade and capital transactions will be denominated in RMB, where the Chinese banks and other parts of the financial sector will have a clear advantage.

- RMB internationalization enhances China's financial efficiency. After the RMB becomes an international currency, foreign central banks and institutional investors will hold RMB bonds and deposits, which will provide a huge source of funds for the domestic banking system and the government. After conversion into loanable funds through the domestic banking system and government fiscal institutions, they will generate profits. At the same time, with more foreign banks and financial institutions entering the Chinese financial industry, more competition will accelerate the reform of China's financial system.

- In recent years, with the progress of RMB internationalization, capital account convertibility and market-oriented interest rate and exchange rate reforms are also steadily advancing.
2.2.1 Macro Benefits of RMB Internationalization

- Increase seigniorage revenue

  - When a currency becomes an international currency, the scope of currency holders is extended to the world, and the seigniorage revenue of the currency issuer also comes from international currency holders worldwide, which is equivalent to issuance of international currency in exchange for imports of real resources in the world.

  - Assuming that the inflation rate is $P$, the printing cost of money is almost zero, the monetary authority’s new money supply is $\Delta M$, then the domestic seigniorage revenue $Se = \frac{\Delta M}{P}$. The international seigniorage is equivalent to the newly added international reserve of the currency held by other central banks, i.e., $Se = \frac{\Delta Mr}{P}$, where $\Delta Mr$ is the increase of reserve asset.

  - With the increase of net outflows of the RMB, RMB assets abroad will increase, and the corresponding seigniorage will also increase significantly. According to our estimates, in 2015 there was 300.8 billion yuan of seigniorage revenue, about 48.3 billion US dollars.
### Estimate of seigniorage revenue with RMB internationalization (100 million yuan)

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<th>2010</th>
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<tr>
<td><strong>RMB reserves held by foreign central banks</strong></td>
<td>620.37</td>
<td>1564.40</td>
<td>2346.60</td>
<td>4558.34</td>
<td>6662.19</td>
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<tr>
<td><strong>Newly added RMB reserves by foreign central banks</strong></td>
<td>620.37</td>
<td>944.03</td>
<td>782.2</td>
<td>2211.74</td>
<td>2103.85</td>
<td>3047.88</td>
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<td><strong>RMB Internationalization Index (RII)</strong></td>
<td>0.23</td>
<td>0.58</td>
<td>0.87</td>
<td>1.69</td>
<td>2.47</td>
<td>3.6</td>
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<tr>
<td><strong>Inflation rate</strong></td>
<td>103.3%</td>
<td>105.4%</td>
<td>102.6%</td>
<td>102.6%</td>
<td>102.0%</td>
<td>101.4%</td>
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<tr>
<td><strong>International seigniorage (RMB)</strong></td>
<td>600.55</td>
<td>895.67</td>
<td>762.38</td>
<td>2155.69</td>
<td>2062.60</td>
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<td><strong>International seigniorage (USD)</strong></td>
<td>88.71</td>
<td>141.87</td>
<td>120.77</td>
<td>348.07</td>
<td>335.78</td>
<td>482.87</td>
</tr>
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</table>
2.2.1 Macro Benefits of RMB Internationalization

• Enhance the potential for international financing.
  • After the RMB becomes an international currency, when the balance of payments is in deficit, the central bank can finance the deficit through increasing its debt, or issuing RMB. The advantage of having a "deficit-financing" capability is that there is no longer a need to compromise domestic economic benefits by adjusting short-term balance of payments deficit, that is, no need to sacrifice internal balance to reach external balance.

• After the RMB becomes an international currency, it will help to save the cost of foreign exchange reserves.
  • As of the end of December 2015, in terms of currency denomination of external debts, China had 656.7 billion US dollars external debts in RMB, accounting for 46% of total, and 759.5 billion US dollars external debts in foreign currency (including SDR allocation), accounting for 54% of total.
2.2.1 Macro Benefits of RMB Internationalization

• Enhance the potential for international financing.
  • After the RMB becomes an international currency, more foreign trade and financial transactions will be denominated and settled in RMB, greatly reducing the currency conversion costs and exchange rate fluctuation costs arising from the use of foreign currency, and reducing the risks caused by exchange rate changes.
    • *We estimate China’s aggregate effective currency mismatch (AECM) at 2.85% as of the end of 2015, down by 56% from that of the end of 2009.*
**Estimate of China’s aggregate effective currency mismatch (AECM) (100 millions)**

<table>
<thead>
<tr>
<th>Year</th>
<th>NFCA (Net foreign currency assets)</th>
<th>MGS (Imports of goods and services)</th>
<th>FC (Foreign currency debt)</th>
<th>TD (Total debt)</th>
<th>AECM=(NFCA/MGS)*(FC/TD)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>11881</td>
<td>9561.2</td>
<td>3892.2</td>
<td>57684.1</td>
<td>0.0838</td>
</tr>
<tr>
<td>2008</td>
<td>14938</td>
<td>11325.7</td>
<td>3901.6</td>
<td>73980.1</td>
<td>0.0696</td>
</tr>
<tr>
<td>2009</td>
<td>14905</td>
<td>10059.2</td>
<td>4286.2</td>
<td>97789.5</td>
<td>0.0649</td>
</tr>
<tr>
<td>2010</td>
<td>16880</td>
<td>13962.4</td>
<td>5489.4</td>
<td>122988.6</td>
<td>0.0540</td>
</tr>
<tr>
<td>2011</td>
<td>16884</td>
<td>17434.8</td>
<td>6950.0</td>
<td>148432.4</td>
<td>0.0453</td>
</tr>
<tr>
<td>2012</td>
<td>18665</td>
<td>18184.1</td>
<td>7369.9</td>
<td>180204.6</td>
<td>0.0420</td>
</tr>
<tr>
<td>2013</td>
<td>19960</td>
<td>19499.9</td>
<td>8631.7</td>
<td>208413.7</td>
<td>0.0424</td>
</tr>
<tr>
<td>2014</td>
<td>17764</td>
<td>19592.4</td>
<td>8954.6</td>
<td>239121.7</td>
<td>0.0340</td>
</tr>
<tr>
<td>2015</td>
<td>15965</td>
<td>16795.6</td>
<td>7595.0</td>
<td>252707.0</td>
<td>0.0285</td>
</tr>
</tbody>
</table>
2.2.1 Macro Benefits of RMB Internationalization

• Reduce and transfer the cost of debt crisis.

• In the face of large-scale debt servicing, the debtor countries can "naturally" reduce the scale of foreign debt by issuing more money or devaluing the currency.

• From 1986 to 2012, the US international balance of payments deficit generated new debt with a total of 8.57 trillion US dollars, but the actual net external debt increased by only 3.93 trillion US dollars, more than half of the deficit was offset by "dark matter".
2.2.1 Macro Benefits of RMB Internationalization

• Reduce and transfer the cost of debt crisis.

  • In the process of RMB internationalization, if the majority of China's credit and debt are denominated in RMB, then the cost of transferring debt will naturally be lower.

    • At the end of 2015, China’s outstanding external debt was 656.7 billion US dollars, down 167 billion from 823.7 billion when the domestic and foreign currency external debt data was first released in March 2015.

    • At the end of 2015, the outstanding external debt denominated in yuan was 4264.3 billion yuan, down 771.4 billion yuan from 5035.7 billion yuan when the domestic and foreign currency external debt data was first released in March 2015.

    • Excluding the valuation effect brought by the change of accounting currency, external debt denominated in RMB did not change as much as when denominated in USD, the valuation effect accounted for about ¼ of the change.
2.2.2 Macro Costs of RMB Internationalization

- The effectiveness of monetary policy faces challenges.
  - The challenge to quantitative adjustment: money demand is more complex.
    - After the internationalization of the RMB, not only domestic but also external demand for money should be considered, otherwise it will be difficult for the monetary policy to realize the desired results. It is worth mentioning that currently China's monetary policy framework is changing from quantitative to price-based control, the internationalization of RMB and the resulting frequent cross-border RMB flows will also have complicated impact on domestic interest rate and other major monetary policy variables.
  - With the advancement of the RMB internationalization, the central bank needs to pay attention to not only the domestic economic and financial situation, but also the spillover effect of domestic monetary policy and the impact of foreign policies. This makes monetary policy-making and implementation more difficult.
2.2.2 Macro Costs of RMB Internationalization

- The effectiveness of monetary policy faces challenges.

- Difficulty of price-based control: the Greenspan Puzzle.

  - Between June 2004 and June 2005, the Federal Reserve raised interest rates several times, the federal funds rates rose from 1% to 3.25%, but the 10-year Treasury yield fell from around 4.7% to around 4.2%. This phenomenon of short-term interest rates rising but long-term interest rates declining is called “Greenspan Puzzle”.

- An important symbol of the internationalization of the RMB is that foreign countries use the RMB as a reserve currency. If the bond explanation of Greenspan puzzle is true, then China may also face the same problem in the future.
2.2.2 Macro Costs of RMB Internationalization

• The effectiveness of monetary policy faces challenges.
  • Mundellian Trilemma and constraint of international coordination.
    • With the gradual advancement of the RMB internationalization, China may not face the standard “trilemma" in the future, even if the fixed exchange rate system is to be abandoned, and the free flow of capital allowed, monetary policy still cannot be fully independent.
      • The free flow of capital is a necessary condition for the internationalization of RMB. If capital cannot flow freely, it is difficult for the country's currency to become an international currency. More importantly, every step of the internationalization of the RMB is essentially a step toward the free flow of capital.
      • Floating exchange rate is the inevitable requirement of RMB internationalization. On the whole, increasing exchange rate flexibility can curb risk-free arbitrage or speculation, an exchange rate floating around the equilibrium rate within a reasonable range will help reduce the impact of arbitrage.
      • International monetary coordination is an important responsibility. China should have a clear understanding of its own status and the spillover effect of its monetary policy. It should consider possible policy objectives of other countries, and balance its own interests and the possible policy impact on other countries.
2.2.2 Macro Costs of RMB Internationalization

- Maintaining financial stability becomes more difficult.
  - Differentials between offshore and onshore exchange rates create opportunities for arbitrage and speculation.
    - Arbitrage based on differentials of onshore and offshore spot exchange rates.
    - Arbitrage based on ‘domestic guarantee and external borrowing’ using RMB letters of credit.
  - Increase the difficulty of maintaining financial stability and financial regulation.
    - Risk of high frequency currency substitution.
    - Cross-border speculation may cause huge volatility of asset prices.
- Impact on export competitiveness.
  - After the internationalization of the currency, capital inflows may increase, increasing the pressure of appreciation of the currency, thereby weakening the competitiveness of export enterprises. Germany and Japan had resisted the internationalization of their currencies, fearing that the appreciation of the currency will affect the competitiveness of export enterprises.
2.2.2 Macro Costs of RMB Internationalization

• Obligation to provide liquidity externally.
  
  • The Triffin dilemma.

  • The degree of internationalization of the RMB still needs to be enhanced, and the RMB has not really been faced with Triffin dilemma. But in the long run, with the advancement of the RMB internationalization, the demand for RMB abroad will increase, China may encounter the Triffin dilemma.

• It is worth mentioning that the economic structure featuring long-lasting trade surplus is not necessarily an obstacle to the RMB going global.
2.2.2 Macro Costs of RMB Internationalization

- Obligation to provide liquidity externally.
  - Obligations to provide international liquidity.

- From the perspective of bilateral currency swap agreements, since 2009, the People's Bank of China has signed currency exchange agreements with 33 foreign central banks (monetary authorities), and the total value is about 3.16 trillion yuan by the end of 2015.

- The use of the bilateral currency swap agreement has increased significantly. In 2014, foreign central banks or monetary authorities initiated currency swap agreements of 1 trillion yuan, and utilized a total of 38 billion RMB. By the end of 2014, foreign central banks or monetary authorities had initiated currency swap agreements of 2.3 trillion yuan, and utilized a total of 80.7 billion RMB. PBoC has initiated currency swap agreement of 4.1 billion yuan, and utilized a total of 1.58 billion RMB.
2.3.1 Benefits from an International Perspective

• Promote the reconstruction and diversification of the international monetary system.

• The internationalization of the RMB has provided one more choice of currency for international investors, alternative investment assets for market players, new reserve assets and currency options for central banks, and new facilities and opportunities for global trade and investment.

• After the internationalization of the RMB, the international monetary system is expected have a new pattern of reserve currencies with the dollar, the euro, the RMB and other currencies, which can not only help reduce the pressure of growing balance of payment deficits of issuers of reserve currencies, but also facilitate the diversification of central bank reserve assets. It can also weaken the privilege of reserve currency issuers, strengthen their policy discipline, and benefit the stability of the international monetary and financial system.
2.3.1 Benefits from an International Perspective

- Promote the reconstruction and diversification of the international monetary system.

- The RMB will gradually become one of the "second-tier" reserve currencies (the dollar being the first-tier). This will help market players and monetary authorities diversify and hedge the exchange rate and asset risks. At the same time, it means that China has the responsibility and ability to deeply get involved in the discussion and formulation of international monetary system rules, and become an important force in the diversified, balanced and reasonable development of the international monetary system.
2.3.1 Benefits from an International Perspective

- Promote the reform and improvement of the global governance system.
  
  - Since the crisis, the international community has made clear measures to improve the global governance system. An important part is to reform the governance structure of the International Monetary Fund and the World Bank to enhance the representation of emerging markets and developing countries.

- The US Congress approved the IMF share reform program in mid-December 2015, and the IMF's "Board Reform Amendment" came into effect on January 26, 2016. The share and voting rights of China and other developing countries in the IMF have increased significantly, with China’s share rising from 3.996% to 6.394%, its ranking rising to third from sixth, second only to the United States and Japan.

- This result reflects the growth of China’s economic output and comprehensive strength, continuous increase of international use of the RMB has also played an important role.

- In the future, China will participate in global financial governance through major international financial institutions such as the International Monetary Fund, the World Bank and other international financial organizations, as well as new international financial institutions such as the Asian Infrastructure Investment Bank and Silk Road Fund, and will play a positive and leading role when necessary.
2.3.1 Benefits from an International Perspective

- Promote the reform and improvement of the global governance system.

  - The RMB internationalization is conducive to increasing China's voice in global financial and monetary affairs, improving the representation of emerging markets, and vocalizing developing countries’ appeal in the discussion and formulation of international financial rules.
2.3.1 Benefits from an International Perspective

- Further promote regional economic integration.

  - The basis for the internationalization of RMB is the trade and investment between China and neighboring regions and the world.

  - From the perspective of regional economic development, the internationalization of the RMB means that bilateral trade and investment can be carried out conveniently through RMB rather than third-country currency. If the bilateral exchange rate of the national currencies and the RMB is relatively stable, it can significantly reduce the risk of exchange rate fluctuations, which is very favorable for the neighboring countries and regions with close economic and trade ties with China, and bilateral trade and connections can be enhanced.

  - In the process of RMB internationalization, the earliest demand for the cross-border use of RMB arised in bilateral trade and investment between China and neighboring countries and regions.
2.3.1 Benefits from an International Perspective

- Promote global demand for RMB assets and liabilities and the development of international financial markets.
  - RMB internationalization has promoted the opening of China's financial markets, high-yield RMB assets will help ease the global "asset shortage" for international investors, provide new financial assets and risk management tools, and new opportunities for the onshore and offshore RMB asset markets.
    - According to HSBC's survey of 72 central banks in 2015, 53% of respondents said they had been or were considering investing in RMB assets, and the respondents expected 2.9% of global foreign exchange reserve assets to be invested in RMB assets by the end of 2015, and more than 10% in 2020.
    - On March 4, 2016, IMF announced that the RMB would be listed separately in its quarterly data on currency composition of official foreign exchange reserves (COFER) starting October 1, 2016.
2.3.1 Benefits from an International Perspective

• Promote global demand for RMB assets and liabilities and the development of international financial markets.

• In the offshore market, since 2009, the relaxation of controls on RMB cross-border use has significantly stimulated the demand for RMB assets by overseas investors, Hong Kong, London, Singapore, Frankfurt and other international financial centers are expected to gain from the “RMB business”.

• In the onshore market, the RMB internationalization is stimulating a large demand for RMB assets.
2.3.2 Costs from an International Perspective

- There might be more negative spillovers of China's economic and financial instability.

  - The high liquidity of international currencies relies on the scale of the offshore market, and the depth, width, and openness of the domestic financial market.

  - Overall, the overseas RMB liquidity is still limited due to lack of formal liquidity channels, less than sufficient openness of domestic financial markets, and uncertainty in policy and control. Therefore, the liquidity overseas is prone to large fluctuations, which is not conducive to stabilizing the market expectations.
2.3.2 Costs from an International Perspective

- There might be more negative spillovers of China's economic and financial instability.

  - In the long run, the internationalization of the RMB calls for a two-way opening of the domestic financial market.

  - At present, China's aggregate external assets and liabilities only account for 107% of GDP (i.e., financial openness), the ratio is much lower than those of Japan and the United States. According to IMF estimates, if overseas assets of Chinese households account for 10% of their savings deposits, the volume of overseas assets will increase 1 trillion dollars. Goals of future RMB internationalization include adapting to domestic investors’ increasing demand for global allocation of assets, promoting the opening of the capital account in an orderly manner, and gradually broadening the channels for domestic enterprises and residents to invest in overseas financial markets.
2.3.2 Costs from an International Perspective

- There might be more negative spillovers of China's economic and financial instability.
  - In the long run, the internationalization of the RMB calls for a two-way opening of the domestic financial market.
    - To meet the demand for holding and using RMB by overseas market participants, it is necessary to vigorously develop and open the domestic financial market, and expand the channels and scale of overseas holding and trading of RMB assets in an orderly manner. To this end, the monetary authority needs to make appropriate institutional arrangements to speed up the development of domestic financial markets and financial infrastructure, improve the market mechanisms for the supply and adjustment of liquidity overseas.
2.3.2 Costs from an International Perspective

• The fluctuations of RMB exchange rate may cause shocks.
  • *International currencies need to have relatively stable values. In the case of the US dollar, the relatively stable international purchasing power, stable and low inflation rate, risk and returns on investment are the factors maintaining the international currency status of the dollar. When any of these factors changes, it is often the time when the international status of the dollar is threatened.*
  • *In the process of RMB internationalization, the Chinese monetary authority should strengthen the goal of maintaining stability of the currency, enhance the credibility of the central bank, and avoid the ups and downs of the inflation level. At the same time, in the RMB exchange rate marketization process, the monetary authority should try to avoid surprise adjustment measures which could result in abrupt changes of market expectations.*
  • *Under certain conditions, such as domestic hyperinflation, financial market turbulence, drastic changes of the RMB exchange rate, the willingness of overseas investors to hold RMB assets will be affected, which may lead to sale of RMB assets and purchase of dollars, or even a reversal of the international use of RMB in the short-term.*
2.3.2 Costs from an International Perspective

- The competition and friction between the RMB and the “reigning international currency" may increase.

- The history of the development of the international monetary system is also a history of competition among major countries and currencies. The rise of the RMB in the international monetary system means the loss of and challenge to the “reigning international currency" to some extent, which implies weakening of the “reigning currency” and transfer of interests.

- Since the acceleration of RMB internationalization in 2009, some are optimistic, some doubtful, and some just let it take the course. With the advancement of RMB internationalization, the competition between the RMB and other major currencies will not only be reflected in the external pressure of the RMB exchange rate, but also in the competition in trade and finance.
2.3.2 Costs from an International Perspective

• The competition and friction between the RMB and the "reigning international currency" may increase.

• It should be noted that RMB internationalization has only a history of over 20 years even counting from the 1990s when the RMB was used in border trade. In recent years, the huge progress of RMB internationalization is largely due to the low starting point and less prominent performance of other currencies. At this stage, the international use of RMB and the scope of acceptance is still at a low level, far from being a challenge to the dominant currency. It is not a start of a new international monetary order, let alone a challenge to or even a replacement of the US dollar.
2.3.2 Costs from an International Perspective

- Delayed reform of economic institutions and systems may cause troubles to international financial markets.
  - The Fed and the European Central Bank play important roles in maintaining the credibility of and confidence in the US dollar and the euro. Central banks' core competencies include at least:
    - *Monetary policy decision-making and implementation capacity*, including mainly relatively clear monetary policy framework, a complete monetary policy tool system and an effective policy transmission mechanism;
    - *Monetary policy decision-making support mechanisms and capabilities trusted by the market*, including mainly prudent and sound monetary policy decision-making mechanism, outstanding macroeconomic analysis and research ability, ability to make reliable economic and financial forecast;
    - *Ability to communicate with the market and guide market expectation*, including mainly the high transparency of monetary policy, timely and effective communication with the market, clear and appropriate guidance for the market.
2.3.2 Costs from an International Perspective

- Delayed reform of economic institutions and systems may cause troubles to international financial markets.

- With the deepening of the internationalization of the RMB, monetary control will face increased pressure to maintain internal and external balances. Thus, improving the governance and capacity-building of the central bank under an open economy should be put on the agenda as soon as possible.

- At present, 80% of the central bank’s assets are foreign exchange assets, mainly dollar assets. It is no doubt of great importance to maintain international payment ability and financial stability, but this balance sheet structure is obviously not in line with the need of a globally important central bank of a big economy.
Contents

1. Historical evolution of RMB internationalization
2. Costs and benefits of RMB internationalization
3. Outlook for RMB internationalization
3.1 RMB internationalization is a reasonable choice along with China's financial development

- The RMB internationalization is not only necessary, but also possibly gaining momentum. This possibility is supported by the solid economic development, backed by market demand and supported by government strategy. Its opportunity comes with the 2008 international financial crisis.

  - *China is a big and open economy and has an advantage with its size.*
  - *Market demand for RMB internationalization is huge.*
  - *Policy and institutional dividends related to RMB internationalization continue to play out.*
  - *As of end 2016, RMB reserves amounted to $84.51 billion, 1.1% of allocated foreign reserves, which is 13% higher that as of end 2014.*
3.2 Benefits & costs of RMB internationalization cannot be measured simply on other currencies’ standards

- The structure of the international monetary system features center-subcenter-periphery, which means that the composition of international reserve currencies also has a center-subcenter hierarchy, with one reserve currency as an international legal tender (or central currency, key currency) and other reserve currencies as only ordinary international currencies.
  - Currencies at different positions enjoy significantly different benefits.
  - Benefits and costs increase with position levels.
  - Benefits and costs are different at different time periods.

- The internationalization of the RMB can not copy the experience of other countries.
  - Benefits of RMB internationalization can not be measured with those of the dollar.
  - Costs of RMB internationalization can not be measured with those of a mature currency.
3.3 It is necessary to maximize the benefits and minimize the costs of RMB internationalization

- Government gets reputation while market gets real benefits.
  - *RMB internationalization is the process during which the government gives up some interests to the market, the private sector is the biggest beneficiary.*
  - *The macro gains at the government level include enhanced international influence and reputation, such as the increase of China’s quota in international financial organizations, the inclusion of RMB in the SDR currency basket. These are generally soft powers. Compared to the more implicit gains, the above-mentioned costs are relatively explicit, and to some extent constitute the government's hard constraints.*
3.3 It is necessary to maximize the benefits and minimize the costs of RMB internationalization

- The gains from the internationalization of RMB needs to be further consolidated.
  - The rise of RMB as a cross-border trade settlement currency largely depends on the fact that international investors regard the RMB as an investment currency.
  - The attractiveness of the RMB is not based on the economic strength from international economic division of labor and commodity price-setting ability as in the case of existing international currencies such as the dollar and the euro. Rather, it is based on the stable rate of return thanks to high interest rates, currency appreciation, and low volatility of exchange rate in the past few years.
  - This situation is an enabling environment for the internationalization of the RMB, but it should also be noted that internationalization based on the investment function is fragile and reversible.
3.3 It is necessary to maximize the benefits and minimize the costs of RMB internationalization

- The macro costs of RMB internationalization can not be ignored.
  - At the beginning of the internationalization, a large amount of RMB flew out, increasing capital inflows, adding to the pressure of imbalance of foreign exchange supply and demand, restricting exchange rate and other related financial reforms.
  - In the more recent stage, the exchange rate flexibility is insufficient, capital control has to be strengthened, which in turn brings setbacks to the internationalization of the RMB.

- RMB internationalization should pursue relative rather than absolute gains.
  - As long as net benefits of the private sector are greater than the net costs of the monetary authority, or the total benefits are greater than the total costs, the total social welfare could be improved.
  - In the long run, we should gradually optimize the structure of benefits and costs of the RMB internationalization, eliminate the risk-free gains of arbitrage, and improve the effectiveness of macro policies.
3.3 It is necessary to maximize the benefits and minimize the costs of RMB internationalization

• In practice, the costs and benefits are dynamically evolving.

  • *In the early stage of internationalization, the benefits are usually greater than the costs. In the ascending period, the benefits are also usually greater than the costs. But the process of the RMB internationalization is not linear but wave-like, the key is to control the of peaks and troughs, and prevent the reversal of the internationalization process.*
3.4 RMB internationalization continues to be an established reform direction

- The Thirteenth Five-Year Plan clearly states that China should adhere to the vision of open development, enlarge two-way opening up of the financial industry, push forward the orderly transition to RMB capital account convertibility, promote the RMB to be included in the SDR basket and become a convertible and freely usable currency.

- RMB internationalization driven by one-way appreciation expectation is not sustainable. Along with two-way fluctuations of the currency, temporary hardships will occur.
Incomplete exchange rate regime reform constraints the RMB internationalization. When the RMB assumes international currency functions, it should be treated the same as foreign currencies, and cross-border flow of RMB should be under regulation.

The strengthening of regulation over cross-border RMB businesses does not mean a suspension of RMB internationalization. The policy focus at current stage includes enlarging channels for RMB flows back onshore, further facilitating holding of RMB financial assets by nonresidents, and improving relevant market infrastructure.
### New “Impossible Trinity” in Coping with Capital Flows

<table>
<thead>
<tr>
<th>Time periods</th>
<th>During the Asian financial crisis</th>
<th>At present</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Exchange rate policy</strong></td>
<td>No (the exchange rate of RMB against USD largely remained stable at 8.28 till the reform on July 21, 2005 when a one-off appreciation of 2.1% was implemented, increasing the exchange rate from 8.2765 to 8.11).</td>
<td>Yes (with reference to a basket of currencies, the RMB exchange rate against the USD was kept stable within a range. By the end of 2016, the central parity rate dropped by 11.8% compared with that on August 10, 2015; CNY and CNH dropped by 10.6% and 10.9% respectively; BIS index dropped by 7.0%).</td>
</tr>
<tr>
<td><strong>Foreign exchange intervention</strong></td>
<td>No (except for few months, reserves were not used to intervene in the market. By the end of 2000, foreign exchange reserve balance was USD165.6 billion, an increase of 25.7 billion compared with that of the end of 1997).</td>
<td>Yes (using reserves to stabilize exchange rate is an important measure. By the end of 2016, foreign exchange reserves stood at USD3.01 trillion, a decrease of USD982.7 billion from the top in June 2014, of which USD640.8 billion or 65% occurred after August 2015).</td>
</tr>
<tr>
<td><strong>Capital controls</strong></td>
<td>Yes (1. strengthening authenticity check over current account payments; 2. stricter controls on capital account foreign exchange usage; 3. strengthening foreign exchange law enforcement, cracking down on evasion of surrender and cheating on purchase).</td>
<td>Yes (1. encouraging capital inflows and settlement; 2. introducing macro-prudential measures; 3. strengthening authenticity check on capital flows).</td>
</tr>
</tbody>
</table>
Major Events on RMB Internationalization in 1Q 2017

• IMF disclosed holdings of RMB reserve assets for the first time.
• Shanghai Clearing House opened first overseas office in London.
• Russian aluminum producer UC Rusal issued the first “One Belt One Road” panda bond.
• Pledge-style repo using foreign currency bonds was allowed in the interbank bond market.
• HSBC (China) and a foreign investor conducted the first RMB derivatives transactions in the interbank bond market.
• Citigroup included China's onshore bonds in its emerging markets and regional indexes.
Major Events on RMB Internationalization in 1Q 2017

• The China Central Depository and Clearing Company (CCDC) and Clearstream Banking entered a partnership.
• Bloomberg launched two new fixed income indices that include China bonds.
• CEINEX introduced first derivatives on CSI300 index ETF on Eurex platform.
• Hong Kong Exchanges and Clearing Limited (HKEX) introduced the first Renminbi (RMB) Currency Options.
• NDRC included 21 firms in the pilot reform program on external debt issuance.
• Citibank (China) received bond settlement agent license in the China interbank bond market.
• An American bank received approval and license to underwrite corporate bonds in China’s interbank bond market for the first time.
IMF Started to Separately Identify the RMB in the Survey of COFER

- At the end of 4Q16, member countries participated in the official foreign exchange reserve currency composition survey reported RMB reserves of USD84.51 billion, 1.07% of the total foreign exchange reserves of these countries.

- IMF started to list the RMB assets separately in its quarterly data on currency composition of official foreign exchange reserves (COFER) starting October 1, 2016. IMF said the inclusion reflected China’s efforts in supporting RMB internationalization, it could improve statistics on RMB reserves, and might improve acceptance of RMB assets in reserves.
Currency composition of foreign reserves
3.5 Homework must be done to push forward RMB internationalization

- Promoting economic transformation, upgrading and restructuring

- Enhancing the depth and width of financial markets to establish the first defense against external shocks

- Continuing the market-oriented exchange rate reform, policy credibility is the key to its success

- Accelerating the transformation of the monetary policy framework, and continuing to improve monetary management capability
The 2017 Government Work Report

• We will continue to pursue a prudent and neutral monetary policy. ... We will apply a full range of monetary policy instruments, maintain basic stability in liquidity, see that market interest rates remain at an appropriate level, and improve the transmission mechanism of monetary policy. We will encourage a greater flow of financial resources into the real economy. ... The RMB exchange rate will be further liberalized, and the currency's stable position in the global monetary system will be maintained.

• We should make progress while maintaining stable performance and keep our strategic focus. Stability is of overriding importance. We should ensure stable growth, maintain employment, and prevent risks. To ensure overall economic and social stability we must not allow the redline to be crossed concerning financial security, people's wellbeing, or environmental protection.
CV of Dr Tao GUAN

• **Tao GUAN**

• **Senior Fellow & Member of Academic Committee, China Finance 40 Forum**

• Dr. Guan is a senior fellow at China Finance 40 Forum (CF40), and member of G50 Economists. Previously he worked at the State Administration of Foreign Exchange (SAFE), and was Director-General of the Department of Balance of Payments (BOP) from 2009 to 2015. Since 1994, he has been playing an active role in China’s exchange rate reform, and published numerous reports and research papers.

• Dr Guan’s research focuses on currency convertibility, balance of payments, exchange rate policies and international capital flows. Dr Guan received a doctorate in economics from Peking Normal University and a master’s degree in development economics from Australian National University.

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Introduction of CF40

- The China Finance 40 Forum (CF40) is a non-government, non-profit, and professional think tank dedicated to policy research on economics and finance. CF40 was founded on April 12, 2008, and operates as a “40×40 club” that consists of forty influential experts around 40 years old. CF40 aims to enhance the academic foundation of China’s finance, provide high-quality research on emerging financial issues, and promote financial reform and development.

- Website: http://www.cf40.org.cn
THANKS