Internationalisation of the Chinese Currency: Towards a Multipolar International Monetary System?

Lucia Országhová[1]

As China establishes itself as the world's second largest economy and top trading nation, its currency, the renminbi (RMB), is also gaining popularity around the world. This article reviews the motivation and different measures undertaken by Chinese authorities for accelerating the RMB internationalisation process. We argue that the recent decision by the IMF to recognise the Chinese currency as fully convertible and to include it into the SDR basket will provide further impetus in increasing the international relevance of the Chinese currency.

China's Journey to Currency Internationalisation

In the past, the renminbi (RMB) could only be held inside China. The Chinese currency had little to no exposure to the international markets because of strict controls that prohibited almost all export of the currency or its use in international transactions. Therefore, transactions between Chinese companies and foreign entities were generally denominated in USD.[2]

Chinese authorities initiated the process towards greater international use of RMB already in 1993. At that time, the government committed itself to achieve full currency convertibility by the end of the century. The following year it started removing capital account restrictions and established current account convertibility by 1996. However, following the Asian financial crisis in 1997, the Chinese authorities abandoned the original target of full convertibility by the end of the century.

Renminbi or Yuan?

The official name of the currency in China is the renminbi, which means 'the people's currency'. It was introduced in December 1948 with the establishment of the People's Bank of China.

The yuan is the name of the basic unit of the Chinese currency, but it is often wrongly used to refer to the Chinese currency generally, especially in international context. An analogy can be drawn with "sterling", the official name of the British currency, and "pound", its primary unit.

The ISO code for the Chinese currency is CNY, but its official abbreviation when traded offshore is CNH. The abbreviation as RMB and the symbol ¥ are also very common.

A difference between onshore and offshore market for RMB has to be made. Offshore RMB (often denoted as CNH) refers to any RMB used outside of mainland China.

The global financial crisis, however, forced the Chinese authorities to revisit the idea of convertibility of their currency. The proximate reason to internationalise RMB was the collapse of trade financing during the global crisis, which resulted in a double-digit fall of Chinese exports. Furthermore, the post-crisis US monetary policy has created strong externality to China and the country was made aware of the instability of the existing international monetary system.

As a consequence, the RMB internationalisation agenda has become one of the main aspects of the country's economic policy, as expressed in the 12th Five-Year Plan (for the period 2011-2015). The plan supports the expansion of the cross-border use of RMB and the gradual liberalisation of the capital account. Furthermore, it foresees the development of Hong Kong as a major offshore RMB market. The ultimate goal of the Chinese strategy is to make the currency fully convertible.

Over the last few years, the Chinese government has undertaken an extensive process to liberalise and internationalise its currency, slowly relaxing rules and expanding the use of RMB for global trade settlement, encouraging a robust offshore RMB environment, and more recently, also relaxing rules and liberalising access to onshore RMB accounts.

RMB Cross-Border Trade Settlement

The Chinese currency plays an important role in trade settlement and bank loan business. With the rapid development of China's foreign trade, the magnitude of RMB in circulation has increased significantly.

Since 2009, a pilot program for RMB settlement of trade with foreign partners was launched. It was initially limited to five cities (Shanghai and four other cities in Guangdong province) and to the trade of Chinese residents with Hong Kong, Macao and ASEAN countries. This established the first legal framework for using RMB to settle current account transactions. The program was later expanded to 20 provinces (out of 32) in mainland

1 *Národná banka Slovenska and University of Economics in Bratislava. The article should not be reported as representing the views of Národná banka Slovenska or any other institutions the author has been associated with. The views expressed and mistakes made remain of the author.*

2 *Furthermore, the bulk of China's foreign exchange reserves were also denominated in USD.*

China and geographically, it covered the trade with the rest of the world. In 2011, cross-border trade settlement was expanded further to the whole country.

Furthermore, China has signed agreements with several countries, e.g. Russia, Vietnam, Thailand, Japan, Australia and South Africa, allowing the trade with those countries to be settled directly in RMB, instead of requiring conversion to USD.

RMB Offshore Market

China encouraged actively a robust offshore RMB environment. The offshore market for RMB is critical in order to overcome the limited convertibility of the Chinese currency, given the ongoing capital account restrictions. Furthermore, it helps broadening the use of RMB outside mainland China. A number of offshore RMB "centres" around the world have been created. The first and still the most important offshore RMB centre is Hong Kong, which was created by the Chinese authorities already in 2003. Other offshore markets have expanded in particular in financial centres, such as Singapore, London or Tokyo.

Further initiative to facilitate the development of the local RMB market worldwide comprises the nomination of official RMB "clearing bank". The "official" status grants the clearing bank a more di-

Table 1 Swap Arrangements, RMB Clearing Centers and RQFII

#	Country	Swap		RMB Clearing Center	RQFII
		Year *	Amount ** (RMB billion)		
1	Indonesia	2009 (2013)	100		
2	Hong Kong	2009 (2014)	400	YES	
3	Korea	2009 (2014)	360		
4	Argentina	2009 (2014)	70		
5	Belarus	2009 (2015)	7		
6	Malaysia	2009 (2015)	180	YES	
7	Iceland	2010 (2013)	3,5		
8	Singapore	2010 (2013)	300	YES	
9	Pakistan	2011 (2014)	10		
10	Thailand	2011 (2014)	70	YES	
11	Kazakhstan	2011 (2014)	7		
12	Mongolia	2011 (2014)	15		
13	New Zealand	2011 (2014)	25		
14	Uzbekistan	2011	0,7		
15	Australia	2012 (2015)	200	YES	YES
16	Ukraine	2012 (2015)	15		
17	Turkey	2012 (2015)	12		
18	UAE	2012 (2015)	35		
19	UK	2013 (2015)	350	YES	
20	EU/ECB	2013	350		
21	Albania	2013	2		
22	Hungary	2013	10		
23	Brazil	2013	190		
24	Canada	2014	200	YES	YES
25	Qatar	2014	35	YES	YES
26	Russia	2014	150		
27	Sri Lanka	2014	10		
28	Switzerland	2014	150	YES	YES
29	South Africa	2015	30		
30	Armenia	2015	1		
31	Suriname	2015	1		
32	Chile	2015	22		
		Total	**3 311,2**		

Source: People´s Bank of China, central banks of respective partner countries and author´s compilation.
Note: Swap lines and RMB clearing centers of the EU countries are highlighted in blue.
All bilateral swap agreements are signed for three years, however they have been renewed and the amount expanded several times.
** Year of the first swap agreement (year when the agreement was renewed the last time).*
*** Only the most recent value is presented. Some renewed agreements were signed for a different amount.*

rect access to China's domestic payment system, including an access to RMB liquidity from the Chinese central bank. As such, it facilitates transactions in RMB with mainland China. There are around 15 clearing banks worldwide, all of which are offshore branches of Chinese banks. The first official clearing bank was established in Hong Kong (2003), followed by Macau (2004), later Taipei and Singapore (2013). Financial centres in advanced countries, such as London, Frankfurt, Luxembourg, Paris and Seoul, were also added recently (2014).

It shall be noted that liquidity can move freely between the offshore centres, but there are measures in place to keep the offshore flows away from the onshore market. Given the capital account restrictions, the flow of RMB between the onshore and offshore markets has been primarily the result of trade-related cross-border transactions between Chinese residents and non-residents.

Liberalisation of the Chinese capital account

The Chinese authorities have continued to make significant progress in liberalising China's financial system. In addition to domestic financial market reform, the partial liberalisation of China's exchange rate and cross-border capital flows have been key elements of the reform process.

While cross-border trade flows have been subject to relatively few restrictions for some time, China's cross-border capital flows have been managed much more closely. In recent times, however, restrictions on direct investment flows have been relaxed, and the capital account liberalisation process has been extended. In particular, the Chinese authorities have started to open up China's debt and equity markets to foreign investment and also, they have allowed Chinese residents to invest more freely in offshore markets.

A dedicated RQFII program[3] with a system of quota was developed. The program allows approved foreign investors to buy and sell designated assets in China's onshore financial markets, using RMB obtained in the offshore market. As such, the scheme provides investors with greater access to China's capital markets. Therefore, the RQFII scheme can be seen as a part of China's broader capital account liberalisation process as well as an initiative, which is designed to encourage broader participation in the offshore RMB market. Access to this program is obtained in two steps: first, the authorities in a given jurisdiction obtain an investment quota for that jurisdiction; and second, individual financial institutions which are domiciled in that jurisdiction apply to the Chinese authorities for an individual portion of the overall quota.

The RQFII program was initially made available to Hong Kong-domiciled investors, with a quota of RMB 20 billion granted in 2011. Hong Kong's quota has since been raised to RMB 270 billion in a number of steps. Since the middle of 2013, RQFII quotas have also been granted to several countries, including the United Kingdom, France and Germany (see Table 1).

Central Bank Initiatives: Bilateral Currency Swap Lines

Traditionally, the currency swap agreements are used to help countries overcome short-term liquidity difficulties with foreign exchange in times of crisis.[4] In the case of China, however, these agreements are not only used to stabilise the international financial markets. Their primary goal, as also stated by official authorities, is to promote and facilitate cross-border trade and investments, in particular in local-currency terms, and thus to promote the international use of RMB. In other words, the bilateral swap agreements allow the central bank to curb the dependence of China and its trade partners on USD for invoicing and settling trade.

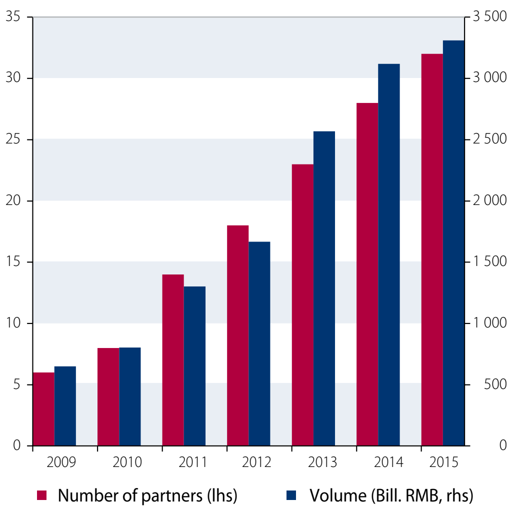
Broadly, China has imposed restrictions on capital transactions between the mainland and the rest of the world. As the country limits the amount of its currency available to settle trade and as foreigners cannot access RMB on international markets, swap agreements represent an alternative approach towards increasing the international flow of RMB. In other words, swap agreements serve to expand the use of Chinese currency without introducing substantial changes to the capital account.

China has been the most active extender of bilateral swap lines since the 2009 global financial crisis. Since then, China has gradually increased the number and volume of bilateral currency swap agreements (see Figure 1).

In 2015, is has signed more than 30 bilateral currency swap agreements in a total amount surpassing RMB 3.3 trillion. What is worth noticing is that all these swap agreements are denominated in RMB and the local currency of the counterparty countries, thus they bypass USD.

Geographically, China has signed bilateral swap agreements with a diverse group of countries. Neighbouring countries and countries with

Figure 1 Bilateral Currency Swap Agreements



Sources: People's Bank of China and author's compilation.

3 *RMB Qualified Foreign Institutional Investor.*

4 *An example of this kind of agreement is the network of bilateral currency swap agreements under the framework of the Chiang Mai Initiative (CMI), which China entered into together with other Asian countries (ASEAN, Japan and Korea) following the 1997 Asian financial crisis. In 2010, The CMI initiative was multilateralised, thus converted into a single agreement, and it was linked to an IMF programme. Furthermore, the size of the agreement was doubled from \$120 billion to \$240 billion in 2014. Contrary to bilateral currency swap agreements China signed after the 2008 global financial crisis, the CMI swap agreements are denominated in USD (not RMB).*

5 As pointed by Zhu (2015), there is a strong correlation between the volume of the bilateral trade and the size of the swap agreement.

6 The RMB´s share of spot turnover was somewhat lower at 0.8% in 2013.

7 Despite some shortcomings (in particular in terms of coverage of the SWIFT network), SWIFT represents high-frequency source of foreign exchange volumes, based on inter-institution back office messages for confirming details of a foreign exchange transaction.

8 The Special Drawing Rights (SDR) is an international reserve asset, used and managed by the IMF.

strong economic and trade links have been frontrunners.[5] However, in the recent years one could observe an increasing number of central banks of advanced economies entering into bilateral swap agreements with China (see Table 1). This indicates that the counterparty central banks all around the world recognise the growing importance of China in the global economy and show an increasing interest to hold RMB in their reserves, e.g. to finance bilateral trade. In this respect, several central banks, e.g. Australian central bank, announced their intention to invest a portion of their foreign currency reserves in RMB-denominated assets.

So far, the RMB swap lines have not been activated much. The only reported cases were Hong Kong in 2010 and Korea in 2013, both activating the swap line to settle trade. In addition, Argentina used the swap line to stabilise its foreign exchange reserves, following a default on its debt in 2014. Similarly, the swap agreement with Russia in 2014 was regarded as a way to support the Russian economy in the wake of the commodities turmoil.

How global is the Chinese currency?

It might be premature to provide a comprehensive assessment of the RMB internationalisation. However, the recent effort has already brought a rapid increase in the use of RMB in trade and investment settlement and in trade credit. It is highly expected that the use of RMB as a trading, investment and reserve currency will continue to grow. The substantial effects of China's trade liberalisation process on the global economy suggest that China's ongoing capital account liberalisation process will also have significant implications for the global financial system.

A broad range of indicators could be used to evaluate the increasing international use of the Chinese currency. According to the IMF survey on official foreign currency assets, 38 countries reported holdings of RMB-denominated assets in 2014 (as compared to 127 holding USD and 108 countries holding EUR). The official foreign currency assets in RMB represented approximately 1.1% of all official foreign exchange reserves in 2014, up from 0.7% in the precedent year. In both years, RMB held 7th place (out of 16 currencies).

The most exhausting data source on global FX market turnover is the BIS Triennial Central Bank Survey. This data source shows that the RMB's share of FX turnover has surged between 2010 and 2013. It represented 1.1% of global FX market turnover in 2013 (with USD 120 billion traded each day), up from 0.4% in 2010 (or USD 34 billion).[6] This catapulted the Chinese currency to top ten most traded currencies (9th place) in 2013, up from 17th place in 2010. Also, BIS Quarterly Review on issuance of debt securities shows a rise of the RMB's share to 1.4% of the total in 2014, up from 0.1% in 2010. As a consequence, RMB ranked 6th in 2014.

Data from SWIFT,[7] the global financial messaging service provider, also points to an impressive development and the continued expansion of RMB as a trade settlement currency. According to SWIFT data on cross-border payments, the RMB's importance is growing exponentially. It covered 1% of all cross-border transactions in 2015, compared to 0.2% two years earlier. The Chinese currency ranked eight in 2015.

In the absence of data on the currency invoicing of trade, SWIFT data on trade finance, namely on the currency denomination of letters of credit, could provide some idea of the RMB internationalisation in trade (trade finance covers roughly one sixth of total trade). In mid-2015, RMB belonged to three most used currencies in global trade finance (together with USD and EUR). It accounted for almost 4% of the total amount.

As indicated above, the international use of the Chinese currency is rapidly becoming common across a range of instruments. The use and trading of RMB has increased substantially in the recent years, although from a very low base. At the same time, the other currencies have not experienced any substantial changes in their relative position, which underscores the impressive developments of the Chinese currency.

Geographically, the use of RMB is rising in particular in Asia. The Chinese currency has already overtaken USD as the exchange rate anchor currency in East Asia. Although more than 100 countries used RMB for payments in mid-2015, more than 90% of flows are concentrated in a few countries. Hong Kong is the world's largest offshore RMB centre, processing more than 70% of all RMB payments.

Implications for the international monetary system

An important milestone for the RMB internationalisation was provided in November 2015, when the Executive Board of the International Monetary Fund (IMF) decided to include RMB in the SDR basket as of October 2016.[8] The Chinese currency will become the fifth currency in the basket, alongside the U.S. dollar (USD), the euro (EUR), the Japanese yen (JPY), and the British pound (GBP, see Table 2). Moreover, the SDR interest rate, which forms the basis for the cost of borrowing from the IMF, will also include an RMB instrument starting in October 2016.

The inclusion of RMB into the SDR basket was subject of the IMF Executive Board discussion already in 2010, during the previous 5-year review of the SDR basket. At that period, it was concluded

Table 2 Currency weights in the SDR basket

	Current basket	As of 1 October 2016
USD	41,9	41,73
EUR	37,4	30,93
JPY	9,4	8,33
GBP	11,3	8,09
RMB	N.A.	10,92

Source: IMF.

that RMB does not fulfil the criteria; in particular it was not considered as a freely usable currency. Five year later, the IMF's Executive Board concluded that China and its currency met the two criteria for inclusion into the SDR basket. Namely, China belongs to one of the largest exporters in the world and its currency, the renminbi, is "freely usable". A currency is determined to be freely usable when it is widely used to make payments for international transactions and widely traded in the principal exchange markets.

This decision could be understood as recognition of the progress made by the Chinese authorities in reforming country's monetary and financial system. Moreover, it reflects major shifts in the global economy, making SDR more representative of the world's major currencies. Furthermore, it represents a confirmation that the RMB trading activity in foreign exchange markets can now accommodate transactions of the magnitude involved in IMF operations. As a freely usable currency, it is expected that RMB will play an important role in the IMF operations (given the fact that the bulk of the lending activities by the IMF takes place in freely usable currencies).

Conclusions: Towards a tripolar monetary system?

Following the current financial crisis, China is seeking a bigger financial role. The recent steps to internationalise its currency have reinforced the positioning of China as a new centre of gravity for the world economy. RMB has increased its international relevance and it has become one of the global reference currencies, along with USD and EUR.

The patterns are changing in favour of RMB, despite still dominant positions of USD and EUR globally. The Chinese currency is considered an important anchor currency in East Asia and the Philippines, weakening thus the position of USD in the region.[9] If China intensifies its efforts, these developments could lead to further currency diversification and an emergence of a tripolar global currency system between Asia, Europe and the USA. Deeper integration of RMB is an opportunity to create a more robust international monetary and financial system that may better fit the underlying forces shaping the global redistribution of power.

However, there is still a long way to go. So far, China has designed and pursued an RMB-based trade policy to spread the international use of its currency. As such, the internationalisation of RMB has taken a very limited form, in particular as an invoicing and settlement currency in trade and a vehicle currency in swap agreements. In order to fully utilize its role as an international currency,[10] further reforms need to be undertaken, in particular with respect to financial market developments, exchange rate flexibility and capital account liberalisation.

9 According to Campanella (2014), the role of USD as a reference currency in Asia is now limited to Hong Kong (due to a peg), Vietnam and Mongolia. Furthermore, according to her, RMB represents the dominant reference currency also in Chile, India and South Africa as well as in FYR Macedonia, Israel, and Turkey.

10 According to Chinn and Frankel (2005), an international currency is considered to play the role of a store of value, a medium of exchange and a unit of account for both residents and non-residents.

References:

Eichengreen, B. (2013). ADB Distinguished Lecture: Renminbi Internalization: Tempest in a Teapot?. Asian Development Review. Vol. 30, No 1, pp. 148-164.

Aizenman, J. (2015). The internationalization of the RMB, capital market openness, and financial reforms in China. BOFIT Discussion Papers,No. 4/2015.

Zhu, Y. (2015). Swap Agreements & China's RMB Currency Network. Link: http://cogitasia.com/swap-agreements-chinas-rmb-currency-network/

Chinn, M. and Frankel, J. (2005). Will the euro eventually surpass the dollar as leading international reserve currency? NBER Working Paper No 11510.

Campanella, M. (2014). The internationalization of the renminbi and the rise of a multipolar currency sstem. ECIPE Working Paper No 01/2014.

IMF (2015). Review of the method of the valuation of the SDR – Initial considerations.

BIS (2013). Triennial Central Bank Survey.

Ponuka podujatí Inštitútu bankového vzdelávania NBS, n. o., na marec 2016

INŠTITÚT BANKOVÉHO VZDELÁVANIA NBS, n.o.

Názov vzdelávacieho podujatia	Dátum konania
Rozvoj analytických zručností	1. – 2. 3. 2016
Novela zákona o kolektívnom investovaní	3. 3. 2016
Úverová analýza 3D – modul II	7. – 8. 3. 2016
Spotrebiteľské rozhodcovské konanie – aktuálne otázky	8. 3. 2016
Školenie ICM TARGET2	9. 3. 2016
CRD IV/CRR	14. 3. 2016
Realitný trh a ohodnocovanie nehnuteľností	14. 3. 2016
Riadenie bezpečnostných rizík vo finančných inštitúciách	15. 3. 2016
Riadenie projektov vo finančnej inštitúcii od A po Z	16. 3. 2016
Overovanie pravosti dokumentov/dokladov	16. 3. 2016
LinkedIn pre finančný sektor	17. 3. 2016