Internationalization of the Renminbi: Progress to Date

As China’s current account surplus and foreign exchange reserves began to surge in the mid 2000s and appreciation pressures on the renminbi intensified, controlled capital account liberalization started to gain importance on the policy agenda. But it was only after the financial crisis in 2008 that China began to move in earnest toward liberalizing its capital account. Although full capital account convertibility is still many years away, the first phase of this process, termed “RMB (renminbi) internationalization,” has become an increasingly important policy objective for the Chinese authorities.

Perhaps what hastened this move toward RMB internationalization was the realization that the existing international monetary arrangements depend excessively on a few funding markets and a handful of currencies. When those markets shut down, the collateral damage is severe. China joined other emerging countries to urge the international community to give emerging market economies a larger role in the international financial order. Chinese policymakers recognized that with its growing significance in the global economy and financial system, the RMB was set to play a more important part in international transactions, particularly in Asia. Greater use of the RMB in international transactions (i.e., the RMB's internationalization) would help reduce exchange rate risks for Chinese firms, strengthen the international competitiveness of Chinese financial institutions, and preserve the value of China's international savings. Against this background, the Chinese government, especially the People's Bank of China, has been pushing hard for greater RMB internationalization since the onset of the global financial crisis.

This push to internationalize the RMB has taken two forms: official transactions and private transactions. At the official level, since the crisis began China has concluded a number of bilateral swap arrangements, denominated in RMB, with the central banks of other Asian and emerging economies, including South Korea, Hong Kong, Malaysia, Indonesia, Russia and Argentina. The swap arrangements have amounted to more than RMB 1.2 trillion.

In the private sector, the Chinese authorities have taken three very deliberate and cautious steps: (i) controlled exit of RMB from the mainland; (ii) letting RMB circulate offshore; and then (iii) carefully managing the return of RMB onshore. Over the medium and long term the two-fold goal is to deepen the offshore RMB market and eventually open up China’s capital account. Both of these goals will take many years to achieve.

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China’s very deliberate approach helps qualify the widely assumed relationship between currency internationalization and capital account liberalization. It is often said that capital account convertibility is a prerequisite for currency internationalization. In the Chinese approach, however, managed internationalization of the RMB is an important first step toward the eventual opening up of the capital account, not the other way around. The Chinese approach is thus unusual, and has been the subject of recent debate on capital account liberalization.

To begin with, the Chinese authorities used the Hong Kong banking sector to experiment with offshore, private-sector RMB transactions. They also used Hong Kong’s equity markets to allow offshore listing and trading of mainland equities in the late 1990s. Around 2004, RMB deposits were allowed in Hong Kong banks for spending by Chinese tourists. The size of these transactions was limited, such that total RMB deposits in Hong Kong banks amounted to the equivalent of US$ 1 billion by 2008.

The process accelerated in 2009 when the mainland authorities allowed trade settlements to be conducted in RMB in Hong Kong. Since then, importers and exporters have grown accustomed to holding RMB in Hong Kong. By mid 2011 offshore RMB deposits reached RMB 620 billion, or more than 10 percent of Hong Kong’s total bank deposits and broad money supply. Since then, however, the growth of RMB deposits has stabilized. Compared to China’s domestic money supply, offshore RMB deposits are still modest at less than 1 percent.
The international use of the RMB requires that offshore banks have access to clearing balances with onshore banks; in other words, some degree of non-resident RMB convertibility has to be granted to offshore banks. Before July 2009, offshore banks generally were unable to maintain or have access to renminbi balances in onshore banks. This changed in 2009, when the RMB trade settlement allowed overseas banks to open correspondent accounts with mainland banks.

In July 2010, the scope of RMB business was expanded considerably. Corporations were allowed to open RMB accounts and transfer funds across accounts for any purpose, and banks were permitted to introduce RMB-linked products such as certificates of deposit, deliverable forwards, mutual funds and insurance products. This effectively created a deliverable RMB market in Hong Kong. Inter-bank RMB deposits and RMB deliverable forwards began trading in the market, and RMB deposits ballooned.

The development of the RMB market is related to the offshore (“dim sum”) bond market in Hong Kong. The China Development Bank was the first to issue offshore RMB bonds in 2007. The Chinese government began issuing such bonds in 2009. As with RMB deposits, bond issuances were limited until 2010. Thereafter, the types of issuance were expanded, foreign financial institutions and corporations were allowed to issue in RMB provided that the proceeds were kept offshore, and three types of offshore institutions—clearing banks, RMB trade-settlement banks and selected central banks—were allowed to reinvest offshore RMB accumulated from cross-border trade settlements in the onshore inter-bank bond market.

The dim sum bond market expanded rapidly from 2010 to mid 2011. The demand for such instruments was high because of foreign investors’ lack of access to Chinese papers and because of RMB appreciation. Bond issuance was very broad-based. Chinese government and quasi-government institutions, international organizations such as the Asian Development Bank, and some high credit quality American and European corporates issued the bonds. Many mainland corporations and financial institutions of varying credit quality also issued these bonds to take advantage of lower interest rates driven by high foreign demand.

The Chinese authorities are now working toward the third step in the RMB internationalization process: allowing offshore RMB to return to the mainland. Three different routes have been opened so far. The first is through a Qualified Financial Institutional Investor (QFII) that initially allows Hong Kong companies to make RMB investments in mainland securities (with a cap of RMB 20 billion). The second permits selected offshore banks to buy onshore bonds. The third allows non-residents to invest RMB (accumulated through trade, bond issuance or share sales) in China upon government approval.

Because there are natural advantages to settling trade in domestic currency and latent demand for Chinese credit instruments remains high, offshore RMB deposits and China’s bond market will continue to grow, albeit at a slower pace than in 2010–11.

When global conditions turned sour in the second half of 2011, Chinese exports slowed, and RMB appreciation was no longer a one-way bet, both RMB deposits and dim sum bond issuance fell sharply. In recent months RMB deposits have stabilized, but new bond issuance remains dormant. Most analysts believe that a slowdown of this sort was expected given the initial flurry of activity. Because there are natural advantages to settling trade in domestic currency and latent demand for Chinese credit instruments remains high, offshore RMB deposits and China’s bond market will continue to grow, albeit at a slower pace than in 2010–11.

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3 He, Dong, “Renminbi Internationalisation: A Primer,” Hong Kong Monetary Authority, Hong Kong Institute of Monetary Research, Munich Personal RePEc Archive, July 31, 2012.
4 He, Dong, “Renminbi Internationalisation: A Primer,” Hong Kong Monetary Authority, Hong Kong Institute of Monetary Research, Munich Personal RePEc Archive, July 31, 2012.
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RMB Internationalization and Latin America

Thus far there have been only a few examples of RMB-denominated lending in Latin America and of RMB currency swaps. In 2010, for instance, the China Development Bank denominated half of a US$ 20 billion loan to Venezuela in RMB. The loan was denominated as such because Venezuela agreed to spend much of it on Chinese goods and services. China’s Ex-Im Bank has also issued RMB-denominated lines of credit to Jamaica and Bolivia for equipment and construction. Brazil and China agreed on a US$ 30 billion currency swap in 2012 as part of broader “currency swap diplomacy” efforts over the past four years. An RMB 70 billion swap with Argentina will allow China to receive RMB instead of dollars for its exports to the country. And in 2009, China and Brazil completed a groundbreaking cross-border RMB settlement managed by Bank of China (Brazil) Co. Ltd. and Bank of China Guangdong/Shanghai.

China remains interested in reducing exchange rate risk by settling its imports from Latin America in RMB. It is here that Latin America and other emerging market economies stand to gain. Latin America runs a trade surplus with China which should continue in the medium term. If Latin American nations receive this surplus in RMB, their holdings would likely appreciate against the dollar. Additional benefits for Latin American partners settling commercial transactions in RMB include better payment terms, more efficient processing of payments and currency diversification, according to the Bank of China.

There are few technical barriers when settling trade transactions in RMB. Latin American firms can conduct their transactions in RMB in Hong Kong’s financial markets with relative ease. The more important question is whether, beyond the current examples of RMB-denominated lending and currency swapping, there is sufficient demand in Latin America to use RMB when settling transactions. While the possibility of RMB appreciation is attractive to some, Latin America’s much higher domestic interest rates mean that returns on Chinese deposits or papers will be particularly lucrative only in the event of a sharp RMB appreciation. And while some Latin American firms would find it useful to reinvest RMB-based proceeds in China, they are in the minority.

At present, then, it appears likely that there will not be great demand from Latin America in the coming years to settle Chinese trade in RMB. This situation could change as Chinese authorities expand the avenues through which offshore RMB return to the mainland and as the offshore RMB market becomes more liquid. For now, though, apart from cyclical demand arising from RMB appreciation or the narrowing of interest rate differentials, Latin America’s interest in RMB internationalization remains fairly limited.

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