Week in China

Third Edition | 2017

The A to Z of the RMB

New horizons for a global yuan

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The A to Z of the RMB
New horizons for a global yuan

Week in China
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The yuan takes a breather

Slower progress for the RMB outside China

Advocates of the spread of China’s currency in international markets have long been well served by the ancient maxim that “It does not matter how slowly you go as long as you do not stop”.

The Confucian saying seems telling as the yuan takes a breather in its global journey, following a long period in which it had pushed harder for acceptance on the world stage.

After decades of isolation, the renminbi (RMB) took its first steps towards becoming a global currency almost 15 years ago when Beijing dropped the yuan’s fixed peg against the dollar and started to relax a few of the restrictions on cash transfers out of the country.

In Hong Kong banks were then permitted to offer deposit accounts in yuan for the first time but the currency really started to go global from 2009, when the authorities fired the starting gun on a wider range of reforms.

WiC covered the start of the story in the first two editions of The A to Z of the RMB as the yuan began to take on new importance in payments, especially in settlement of cross-border trade with Chinese companies, where it rapidly increased its share.
The next step was investment and again Hong Kong took the lead, with a new market in bonds denominated in yuan. Investment activity widened to other countries and there were signs that yuan-denominated assets were starting to feature in the sovereign reserves of other nations too.

In all of this, Chinese policymakers have been working from a three-step plan. First off, the yuan becomes an international currency, paying for goods and services. Then it takes on a role as a unit of investment, before finally emerging as a ‘reserve’ currency, held by sovereign governments.

At the latter point, the ambition is that the RMB might pose a challenge to the dominance of the US dollar.

The renminbi in reverse
For years the RMB seemed to be advancing according to the blueprint. But the tide turned in mid-2015, triggered by a change in the daily range in which Beijing allowed the yuan to trade against the dollar.

China’s central bank portrayed the move as another step towards a freely floating exchange rate, but the sudden devaluation against the greenback took global markets by surprise, launching a sustained selloff in the currency.

Over the remainder of the next year and a half, the redback fell more than 7% against the dollar, signalling an abrupt end to the one-way bet on yuan appreciation.

Suddenly the story was very different and the RMB seemed to be in retreat: falling down the rankings of international currencies in the payments data; declining in offshore deposits; and dropping substantially as the currency in which China settled its cross-border trade.

Perhaps more importantly in the short term, the slump encouraged millions of Chinese to try to get some of their savings into other currencies. This capital flight unsettled the authorities, who turned their attentions to making it
The People’s Money

Although the renminbi, or the ‘people’s money’ as it translates into English, is the political term for the currency, the Chinese generally refer to their cash as ‘yuan’ in everyday usage. Prices are quoted in yuan and rendered typographically as ¥. Internationally, ¥ is an identifier more commonly associated with the Japanese yen, so the renminbi is often known in its short form as the RMB.

In this book, we refer to the RMB or the yuan.

The yuan is available in six main denominations of notes, with the highest value only Rmb100, or about $15. Newer versions of the notes feature Mao Zedong, the founding father of the People’s Republic, which introduced the new currency in 1949. But some older banknotes carry portraits of China’s 56 ethnic groups, with a message of social harmony and a brighter future.

The images were sketched from real people and the media recently tracked some of them down.

Huang Qiping, a representative of the Tujia community, holds a senior position in Hunan’s agricultural ministry, while the ethnic Korean on the same one-jiao note is Su Chunxi, who works as a museum guide in Jilin (see note on opposite page).

But the story that captured the public imagination most was that of Shi Naiyin, a Dong minority girl from Guizhou who appeared on the one-yuan note. “I forgot I had been sketched,” she told the Chengdu-based newspaper Red Star News. “It was only later when people started saying the money looked like me that I remembered.”

In 2010 a local official confirmed that Shi was the girl in question (the comb in her hair was unique to her area and she still has the heavy silver earrings shown in the image). She never went to school and married at 22 to a man her parents chose for her. Now 56, she lives in relative poverty, raising ducks and growing corn. But a problem with her banknote fame is that others think she must be wealthy and she often receives requests for money. People have even posted her their bankbooks so she can deposit cash into their accounts. Shi says she would help them if she could, although she doesn’t accept she is poor herself. “We have enough to eat,” she says, “We just aren’t rich enough for culture.”

Shi Naiyin (foreground), a member of Guizhou’s Dong minority, was sketched as a young girl and featured on the one-yuan note
harder to get the yuan out of the country.

In chapter two we look at some of the impact on the yuan’s role in trade settlement and cash management. However, the restrictions also alarmed international investors, discouraging them from holding it too.

**Focus on the flows**

Promoters of RMB internationalisation say that China’s currency policy is going through a rough patch in the same way that the forces of globalisation have been taking a hit in other countries, from Britain’s shock withdrawal from the European Union to the rise of the instinctively protectionist Donald Trump.

Another view is that the new volatility in the exchange rate shows that the yuan is maturing as an international currency and brings to an end the era in which people had unrealistic expectations about one-way movements in its value.

A third interpretation is that the story of how the yuan has stepped back from the global stage has been overtold. In this reading, outflows may have slowed, but the metrics are changing, as the yuan enters a new phase.

RMB deposits may have fallen dramatically in Hong Kong, for instance, but that’s partly because there are other options for investing with the yuan, allowing investors to put their cash elsewhere.

This reframing of the debate looks more closely at how capital is flowing across borders, citing the Stock Connects that link Hong Kong’s stock market
with bourses in Shanghai and Shenzhen as primary examples of a new landscape of ‘two-way flows’.

Bond Connect is another of these trends, and in chapter three we look at the new access for global investors to China’s Interbank Bond Market – the world’s third largest in fixed income terms.

Here the reminder is that the focus on the yuan needs to look at what’s going on inside China, and not just at the currency’s outbound flows.

A counter argument is that much of this story is about the world coming to China to invest with the yuan, rather than the two-way flow that would underpin a fuller tale of a genuinely global currency.

The newly opened Bond Connect epitomises some of the contradiction. It was launched in July this year, letting international investors buy Chinese bonds through Hong Kong. But the investment channel is only open ‘northbound’ into China: the regulators are yet to allow Chinese citizens the same privileges in international markets.

At least the debate shows how the spotlight has moved towards how it is getting easier for overseas investors to invest with the yuan inside China, rather than focusing solely on what’s available offshore.

It also highlights how currency policy is an indispensible part of China’s financial reforms at home. And indeed, the domestic agenda will set the pace for how quickly the yuan regains its international momentum over the coming months. Over the last year and a half, Beijing has opted for stability at home over greater progress for its currency overseas. Perhaps that was inevitable in the lead-up to National Party Congress in October, at which China’s leaders were selected for another five-year term. Now that President Xi Jinping has secured his second spell in office, consolidating his personal authority to an unprecedented degree, the mood may change again.

It helps that the chances of China’s economy experiencing a hard landing have receded. The yuan has already regained much of the value lost against the dollar in 2015 and 2016, and there were signs in September that the government is dialling down some of the restrictions on outflows, when the central bank loosened some of its capital controls.

We also need to look at the bigger picture for the forces that are going to underpin RMB internationalisation for years to come. In the final chapter, we pick out a few of the themes. China is the world’s largest trader, its second largest economy, and its third largest creditor – so it seems highly unlikely that the yuan won’t be one of the world’s most influential currencies too.
Turning off the taps on overseas deals

2016 was a record year for Chinese investment overseas with almost $250 billion of deals. But the surge in spending prompted anxiety that some companies were paying too much for their new assets or even overpaying for their targets in an attempt to move money out of China.

Senior figures called for an end to “over-the-top” acquisitions and the authorities started blocking them, before announcing new rules in August that prevent “irrational” investment in sectors like entertainment and real estate. Overseas investment dropped 42% in the first nine months of 2017, compared to last year, the Ministry of Commerce reports. Here’s a quick review of sectors where spending is frowned upon, and where it is still moving forward.

Belt and Road is booming

China's long-term commitment to pouring massive investment into transport, logistics and power generation across Asia, Africa and Europe isn’t subject to the strictest of the restrictions. Indeed the authorities are actively encouraging it, despite instances in which it is being made in high-risk markets, or cases in which some of the loans already seem to have soured.

That’s because Belt and Road is the signature foreign policy of China’s leader Xi Jinping and it has a strong bias towards state-backed spending, where oversight should be greater. Much of the investment is in projects shaped to meet policy goals like upgrading China's industrial capacity too, while acquisitions of infrastructure and natural resources also seem likely to gain favour.
Stick with the state-backed investors
Larger deals have much more chance of getting approvals if the bidder is state-owned. Cases in which the purchase can be portrayed as part of a national-level strategy also have a better prospect of getting the green light. Top of the tree here is ChemChina’s $43 billion takeover of Swiss herbicide and seed producer Syngenta, with hopes that Syngenta’s portfolio of chemicals and patent-protected seeds will improve China’s agricultural output. Another takeover going through at the moment is shipping giant Cosco’s bid for Orient Overseas, Hong Kong’s largest container shipping line. It is being positioned as part of a wider restructuring in which the Chinese hope to exert more control over the world’s bulk shipping and container trades.

But private firms are under pressure
The authorities look a lot less favourably on deals by privately-controlled conglomerates such as Anbang, Dalian Wanda and HNA Group, which accounted for a large share of the international M&A carried out over the last three years.

Some of these companies are difficult to pigeonhole in ownership terms, with rumours of shareholders in both the state and private sectors. But no one denies they were at the forefront of a spending spree. Anbang snapped up trophy assets like the Waldorf Astoria in New York, while HNA has made a play for a bewildering range of targets, including the Hilton hotel group and German lender Deutsche Bank (spending about $40 billion overseas in two years).

The frenzy came to a sudden halt this year when local banks were told to cut funding for the buccaneering group. Since then Anbang’s boss has been called in for questioning by anti-graft investigators, HNA is having a much harder time raising capital, and Dalian Wanda has reined in its overseas spending, making obedient noises about focusing its investment “mainly in China”.

Films are now forbidden
Chinese investment in the American entertainment sector reached $4.78 billion in 2016, before slumping to $489 million over the first nine months of this year, according to research firm Rhodium Group.

Dalian Wanda took the leading role in the initial spree, spending heavily on cinema chains abroad, including US-based AMC Theatres for $2.6 billion, and splurging another $3.5 billion on Legendary Entertainment, a Hollywood studio.

An attempt to buy into Paramount Pictures fell through, before Wang Jianlin, Wanda’s founder, announced that he would open a series of Chinese theme parks that would encircle Disney’s $5.5 billion Shanghai Disneyland like a “pack of wolves”.

Brokers of the deals say the Chinese studios want a greater share of the profit from Hollywood content, while Tinseltown needs help with distribution in China’s movie market, where the release of foreign films is restricted. But the deal flow dried up in 2017. There hasn’t been a major Chinese acquisition since February and some of the deals in progress have been scrapped. Another of Wanda’s blockbusters – a $1 billion bid for Dick Clark Productions, the production company behind the Golden Globes – was one of the takeovers to fall through.

And forget about football
The investment frenzy in soccer started in 2015 when the central government announced its ambitions to turn China into a football force. Buoyed by the belief that the game is Xi Jinping’s...
favourite sport and that they were doing their patriotic duty, Chinese firms went on a spree in Europe, splurging $2.5 billion on local clubs.

The headline takeovers were of Italian rivals Inter Milan and AC Milan, but Atletico Madrid, Espanyol and Granada all grabbed investment in Spain, and the cash flowed furiously into English football, with Chinese stakes in Manchester City and Southampton.

Teams from the English Midlands have been an unlikely focus, however, with West Bromwich Albion, Wolverhampton Wanderers, Aston Villa and Birmingham City all coming under Chinese ownership.

The commercial rationale for investing so much in the sport is unclear. Some of the bidders seem hopeful of selling football content to the media, but most seem to be counting on taking advantage of cheap financing in China before selling the teams on for a profit.

Again, the deal flow has dried up this year when the authorities clamped down on the financing for the takeovers. Indeed, the bid for AC Milan nearly fell through and the Chinese consortium was forced to turn to a US hedge fund for capital at the last minute.
After a long period in which the yuan made progress beyond its country’s borders, China’s currency has paused over the last two years, pulling back from the international scene in 2016 particularly.

Data from SWIFT, a network that the banks use to send and receive money, shows that the value of international payments in yuan fell by nearly 30% over the year, with the currency dropping from a 2.31% share at the end of 2015 to 1.68% a year later.

As of October 2017 it had dropped to number seven in the currency rankings, making up 1.46% of the world’s payments. That put it behind the Canadian dollar and further back on sterling and the yen. It was a significant distance behind the US dollar and the euro, however, which make up 39.47% and 33.98% of international payments respectively.

Vina Cheung, HSBC’s Global Head of RMB Internationalisation, acknowledges that acceptance of the yuan hasn’t grown as quickly as during the early years of the currency’s rise, when it climbed rapidly in the rankings.

Over the last two years, the market situation has been more challenging and the yuan’s progress, although still apparent, has been impacted, she says.

The turning of the tide was similar for yuan deposits in Hong Kong, which had dropped to Rmb547 billion at the end of December 2016, a fall of almost half from their peak of Rmb1 trillion two years earlier.

Another feature was a decline in the yuan’s usage in paying for trade between China and the rest of the world – an area that previously served as a pacesetter for its wider progress.

Traditionally, the Chinese had settled most of their trading activity in the currency of more developed markets. But as its economy grew more powerful, China’s currency started to feature more. In fact, the yuan increased its share from virtually nothing a few years ago to a high of more than a quarter of China’s trade payments three years ago.
Since then its share has halved, however, as the yuan lost ground against other currencies amid concerns that China’s economy was slowing down.

Another dampener for the internationalisation story was a new round of capital controls that have made it harder to move cash out of the country. HSBC’s Cheung acknowledges that the measures have constrained some of her bank’s services to its clients in China and globally, including programmes that support cross-border sweeping of intra-group funds, which had been proving popular with corporate treasurers.

In response the bank has worked to mitigate the impact for its clients, liaising with Chinese regulators and clients in prioritising cash outflows and helping companies with alternative solutions for financing, such as guarantees and funding facilities in the offshore market.

Nonetheless, she says that HSBC hasn’t lost confidence in the yuan’s prospects. “These measures were put in place to stabilise the currency over the shorter term and we don’t think that the Chinese are stepping back from RMB internationalisation in general,” she reports. “It’s better to look at what has been happening as a temporary slowdown of the process, and not as a complete halt.”
Capital punishment: the clampdown on cross-border flows

What capital controls were introduced?
From mid-2015, Beijing has applied a string of measures to tighten controls on the RMB being moved out of the country and converted to other currencies. For instance, the foreign exchange regulator has stepped up scrutiny of foreign currency purchases by individuals and promised to punish illegal outflows, although the $50,000 annual cap for individuals was unchanged. Since July, financial institutions have had to report overseas transfers of $10,000 or more, and the authorities have been on the lookout for a practice called ‘smurfing’ in which a larger sum of money is broken down into smaller amounts, and then wired under the individual quotas of friends and family to a single account overseas.

Banks were also instructed to maintain a balance of inflows and outflows when processing cross-border payments for companies, making sure that there is no net outflow of yuan. Another focus was investment by Chinese firms overseas, with outbound transactions of more than $5 million subject to pre-screening by regulators, down from the previous threshold of $50 million. Regulators have been targeting “irrational” deals involving real estate, entertainment companies and film studios, and sports teams.

Chinese officials claim that most of the restrictions aren’t new, just stricter enforcement of existing measures. But foreign firms complain about confusion over the controls, which have often been introduced informally through ‘window guidance’ by the authorities. The new rules have created genuine headaches for corporate treasurers, disrupting basic procedures like the remittance of dividends or loan repayments, and even making it harder to pay overseas vendors with yuan.
In this respect, signs that some of the restrictions might start to be lifted are encouraging, Cheung believes, giving the cash sweeping programme as an example: “In Shanghai in particular, the regulators seem more open to relaxing some of the restrictions on sweeping for companies, as long as it is for working capital purposes, and not for long-term net outflows or inflows.”

Network effect

Despite the short-term challenges for China’s currency, proponents of the RMB talk more about the foundations for the next stage of its journey.

The early phases of the yuan’s spread were aided by the creation of a number
of clearing banks, or commercial lenders authorised by China’s central bank to provide direct liquidity in the yuan in more than 30 countries.

The clearing banks took on a symbolic value in showcasing the yuan’s reach, although more recently the focus has turned to the contribution of the Cross-Border Interbank Payment System (CIPS) which supports clearing among onshore and offshore participants.

The CIPS replaces a domestic payment network that was difficult to use for companies outside China. The new system brings benefits in using international reporting standards and facilitating payments across multiple time zones simultaneously. “One key benefit is that corporations experience simpler, faster and more cost-effective RMB payment services similar to those in the US dollar, while banks realise continuous improvement on RMB clearing and liquidity management as volumes pick up,” Cheung explains.

In later phases CIPS will also allow international banks to settle payments directly if the volume justifies direct participation in addition to clearing banks or correspondent banking models. “It’s more sustainable and more efficient to direct most of the settlement through markets like Hong Kong and China,

Why conduct more of your business in RMB?

- Improved terms and wider access to Chinese trade partners
- Better risk and liquidity management

- Avoid renegotiation of prices resulting from currency fluctuations
- Broader access to Chinese buyers and suppliers
- More chance of negotiating better prices for foreign companies
- Wider access to RMB trading, hedging and financing in offshore markets
- Greater investment choice and yield opportunities for RMB deposits
- Pooling and cross-border sweeping for better liquidity management
because that is where most of the liquidity is available,” Cheung says.

Another case of how changes in technology are going to promote more acceptance of the yuan overseas comes from the rapid advance of digital payment methods, the rise of Chinese consumers travelling overseas, and the new generation of customers of e-commerce giants like Alibaba and Tencent.

Cheung offers Hong Kong as an example, where regulators are supportive of an ‘e-wallet’ framework that allows for wider collection of digital payments by local merchants. “The RMB is going to become a key constituent of these ‘fast payment’ solutions,” she explains. “Local merchants that want to attract spending from Chinese visitors will have to accept the yuan as a payment currency and this digitalisation process is going to be a major factor for its spread. Hong Kong is an early indicator for this type of trend, and what happens here will start to happen in other markets.”

The fundamentals haven’t changed
Technology may be changing but the reasons for relying more on the RMB have stayed largely the same.

Previous editions of *The A-Z of the RMB* have highlighted the advantages for international companies in transacting more of their trade in the yuan. One
potential benefit is the saving on transaction costs from switching into other currencies. Another is that pricing goods in yuan may help a company attract new customers or improve its negotiating stance with Chinese counterparts.

None of these considerations have changed, despite the slowdown in the yuan’s surge outside China.

From her position overseeing the international landscape of payments and cash management, Cheung has also noted renewed interest from companies in invoicing in the yuan, particularly among Chinese firms who might have preferred the US dollar for much of the last two years.

“These companies are getting more confident about asking for payment in yuan from their international customers,” she says. “We are also seeing that vendors in other countries, especially in Southeast Asian markets like Malaysia and Thailand, are more willing to use it. And they aren’t taking payment in RMB and immediately converting it – they make RMB payments for natural hedging benefits and to manage their exposure relative to their own currencies.”

In the future, more companies will adopt the yuan as a result of changes in market opportunity, she also predicts. By way of illustration Cheung outlines an American firm whose products and services are in greater demand because of the Belt and Road Initiative, Beijing’s plan to boost the flow of trade, capital and services between China and the rest of the world.

“The Belt and Road Initiative is largely spearheaded by Chinese investors and most of the contractors on the infrastructure and engineering projects are going to be Chinese companies,” she points out. “The plan is expected to spur about $2.5 trillion of trade in the next decade and the role of the RMB in the growth will be significant.”

“Companies with no flexibility on the inter-changeable use of settlement currencies like the dollar or the yuan will have to think about the broader context if they want to capitalise from these kinds of opportunities,” Cheung predicts. “They will need to reassess their treasury and working capital models, and extend the yuan’s functional roles for trade, funding, payments, hedging, and investment.”

The inevitability of this process means more dialogue for HSBC’s payment and cash management teams with their clients about the benefits of using the yuan in a more prominent part of their portfolios. “We started this conversation some time ago, even though in some cases it has been on pause for a while. Now it’s time to re-engage with the RMB,” she concludes.
Current account versus capital account

The current account is a component of a country’s balance of payments, made up of its trade balance, as well as its returns on its loans and shareholdings overseas. Famously, China has run a large current account surplus, primarily from exporting more than it imports. But this surplus has narrowed – something raised by those who believe that RMB is no longer as undervalued against other currencies as it was in the past.

The capital account is the second component in the balance of payments calculation, consisting primarily of long-term investment capital (like FDI) and portfolio investment (in shares and bonds).

Although China’s current account is now liberalised, direct and portfolio investment options under the capital account are only partially open. The channels that are available include the Stock Connects and the Bond Connect. Qualified investors are also allowed to invest their Chinese currency deposits in bonds issued and traded within China (the onshore interbank bond market).
The RMB on the road in 2017
A few of the places the yuan has made headlines

Belgium: January. Payments processor SWIFT announced that the value of international payments made in yuan declined 29.5% in 2016.

New York: June. Global equity indices provider MSCI says that Chinese stocks will be added to its equity benchmarks in June 2018.

Washington: January. The Trump presidency begins in Washington but the new leader does not name China as a currency manipulator, contrary to his campaign rhetoric. March. An IMF survey on sovereign reserves provides information on RMB assets for first time.

Jamaica: October. Bank of Jamaica announces that it is looking at adding RMB assets to its sovereign reserves.

London: February. Officials from the City of London tell the press they are hopeful about the prospects for a London-Shanghai stock-trading link to be launched similar to the Shanghai-Hong Kong Stock Connect.

Germany: June. The European Central Bank announces that it has invested in yuan-denominated assets for its sovereign reserves.
**Hungary:** July. Hungary hires HSBC to sell Panda bonds in the China Interbank Bond Market.

**Mongolia:** July. The PBoC renews its currency swap arrangement with the Bank of Mongolia. China has more than 30 swap lines in place with other countries, providing more than Rmb3 trillion in liquidity.

**Doha:** April. The Qatar Central Bank opens the first Renminbi Clearance Centre in the Middle East in Doha.

**Beijing:** May. Xi Jinping pledges another Rmb100 billion for the Silk Road Fund, a state-backer investor in projects under the Belt and Road Initiative.

July. The PBoC announces the first relaxation of capital controls since 2015, scrapping a series of procedures previously introduced in January.

May. Zhou Xiaochuan, the governor of China’s central bank, says that using local currencies instead of dollars for Belt and Road investment will reduce risk from exchange-rate fluctuations.

**Shanghai:** July. Bond Connect is launched in Hong Kong and Shanghai.

**Hong Kong:** February. The Hong Kong Monetary Authority reports that the city’s yuan deposits have fallen 46% from their 2014 peak.

**Moscow:** October. Reports that aluminium giant Rusal, will issue RMB bonds on the Moscow Exchange, opening the so-called Baikal bond market. In the same month, the Chinese launched a new ‘payment versus payment’ system to allow simultaneous settlement of transactions in yuan and the Russian rouble.

**New Zealand:** May. The PBoC renews its currency swap with the Reserve Bank of New Zealand, maintaining a swap line of Rmb25 billion.
Changing the channels
New opportunities in China’s currency for investors

A year ago the world’s financial media was captivated by China’s battle to defend its forex reserves, which had dipped below $3 trillion, sending jitters through global markets.

The reserves were seen as evidence of China’s economic might – they reached close to $4 trillion at their peak in the summer of 2014, more than the German economy generated in the same year.

But by January 2017 they had slipped to their lowest point in six years. And as investors tried to get their money into foreign assets, Beijing was aggressively defending the currency, selling down a portion of its sovereign holdings in a bid to keep the outflows from tanking the yuan.

The reserves have since stabilised but when it comes to assessing the extent to which China’s currency is going global, analysts have generally looked more at the reserves of other nations for signals. Tracking them is a challenge.

**Share of foreign exchange reserves**

<table>
<thead>
<tr>
<th>Currency</th>
<th>Q2 2017</th>
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<tbody>
<tr>
<td>US Dollar</td>
<td>63.8%</td>
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<tr>
<td>Euro</td>
<td>19.9%</td>
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<tr>
<td>Japanese yen</td>
<td>4.6%</td>
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<td>British pound</td>
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<tr>
<td>Chinese renminbi</td>
<td>1.1%</td>
</tr>
<tr>
<td>Swiss franc</td>
<td>0.2%</td>
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because central bankers are cautious about revealing too much information. But news reports have suggested that more than 60 countries now hold yuan assets, often governments that want loans from Beijing or countries that trade heaviest with the Chinese.

In March 2016, the IMF offered a formal assessment of yuan-denominated reserves for the first time. It suggested that public officials managed reserves in total worth almost $11 trillion at the end of last year. More than $5 trillion were held in dollar-denominated assets and about $1 trillion in euros, with smaller amounts in sterling and yen. The yuan accounted for $84.5 billion, or an equivalent of about 1.1% of reported reserves worldwide.

That means the RMB is still a long way behind its peers and it trails the currencies of much smaller economies, such as the Canadian dollar and Australian dollar. Nonetheless, analysts expect a steady shift into the yuan in the years ahead, as it moves closer to the weighting it has been allocated in the IMF’s currency basket. Hence the headlines in the media in mid-2017 when the
Investments and reserves

The A-Z of the RMB

Feeling special: the RMB joins the IMF basket

Special Drawing Rights currencies aren’t used for everyday trade and investment but serve a purpose as currencies that can be swapped between central banks.

Issued by the International Monetary Fund, they are important because the currencies in the basket are held in a greater proportion in the reserves of sovereign governments.

SDRs previously comprised of the US dollar, the euro, the pound and the yen. After persistent lobbying from Beijing, the IMF added the yuan in October last year. It makes up 10.92% of the basket.

The Chinese were pleased because they expect more central banks to include the RMB in their holdings. It could also trigger a review by global asset managers, who increase their yuan-denominated investments. But critics of the IMF’s decision say it came too early. There are two main prerequisites for currencies to qualify for the basket: they should come from a major trading country and they must be ‘freely usable’. China passes easily on the first parameter, but the second is complicated by Beijing’s use of capital controls. Generally, they’ve been receding but rather awkwardly, soon after the yuan joined the basket last year, the Chinese announced a string of new measures to tighten controls on money moving out of the country, including closer scrutiny of outbound investments and foreign exchange purchases.

European Central Bank announced that it had switched €500 million of US dollars into yuan-denominated assets. That’s only a sliver of the ECB’s forex reserves, but the move was seen as a further signal that one of the world’s biggest central banks was starting to increase the proportion of its assets held in yuan.

Dim sums in decline

In her role as Global Head of RMB Business Development at HSBC, Candy Ho has been monitoring the currency closely since the early days of its emergence on the world stage. Bigger picture, she says that the yuan’s rise has already been significant. “Obviously, the process won’t be fully complete until the currency gets to a situation of full convertibility,” she says. “But to a large extent, the yuan is freely usable in cross-border trade and investment, and it has emerged as an international, market-oriented currency”.

Of course, one of the features of the last 18 months was the RMB’s decline against the dollar, dropping by more than 6% in 2016 alone. In 2017 it regained most of its ground against the greenback and Ho says that the two-way volatility in the exchange rate is another sign that the RMB is maturing.
But she also argues for a broader perspective on yuan internationalisation. “At HSBC we see the story as more than just a journey for the currency”, Ho explains. “It’s also about how China is globalising and how its capital markets are integrating into world markets”.

Part of the picture is the narrowing gap between the onshore and offshore markets in the currency. “Of course there are still some discrepancies between the two but we are going to see more convergence, especially as more offshore investors come directly into China,” she says.

**Dim sum bonds**

Bonds denominated in RMB, and issued in Hong Kong (their colloquial name comes from the term *dim sum*, or individual portions of steamed and fried food popular with the Cantonese, the local people of Hong Kong). Issuers of *dim sum* bonds in Hong Kong have included Chinese and international banks, foreign corporations like McDonald’s and supranationals such as the Asian Development Bank.

The large majority of *dim sum* issuance has come from Hong Kong, although they have also been sold in cities including London and Singapore. Initially, investors were prepared to accept lower yields for *dim sum* than other fixed income investments, as they had higher expectations of Chinese currency appreciation. As these expectations faded it became more expensive for companies to issue them, and the market for *dim sums* has slowed since 2015.
Bond Connect, another new avenue for global investors

There was another important milestone for the RMB as an investment currency in July 2017 with the opening of Bond Connect, a new mutual market access scheme that allows investors from mainland China and overseas to trade in each other’s bond markets.

At the end of the third quarter the amount of bonds bought through Bond Connect had reached Rmb65 billion. While that’s still a small share of the available market, it is expected to grow significantly over time, especially if Chinese credit gets included in the three major bond indexes in 2018.

Because Bond Connect offers access to the same credits as the CIBM, Candy Ho says that it is best to think about the trading link as another channel into the interbank bond market, albeit through an intermediary layer in Hong Kong.

“For trading on the CIBM you deal directly with an onshore counterparty. But for Bond Connect the trading, custody and settlement is completed through a Hong Kong-based electronic platform, which serves as a conduit into a large group of market makers in China,” she explains.

One of the inferences is that doing business on the Bond Connect platform is a more familiar process, which appeals to global investors who want to test the water before jumping more directly into the CIBM.

Also appealing for investors is that their exposure stays in Hong Kong, rather than residing in mainland China itself.
Investments and reserves The A-Z of the RMB

Like the Shanghai and Shenzhen Stock Connects – sister programmes that support cross-border equity trading – Bond Connect has a southbound channel through which Chinese investors can access bonds in global markets. While the northbound route is up-and-running, its southbound equivalent hasn’t been opened yet to Chinese investors. This one-way traffic undermines some of the scheme’s claims as an internationalisation of investment flows. But Ho doesn’t expect the southbound channel to stay in deep-freeze for long. She says that management of outbound flows is more complicated for bonds than for stocks because bonds are generally sold over-the-counter, with a much wider range of counterparties. That means that regulators are taking their time in deciding which bonds will be eligible for purchase by Chinese investors. And Ho also anticipates strong interest from mainland investors once the restrictions are lifted, noting that southbound business through the Shanghai Stock Connect – the older and larger of the two cross-border share-trading links – is outpacing incoming flows from outside China.

In the past Week in China has looked at how the yuan has been gaining acceptance outside China – in effect, the rise of the CNH (as the currency is identified offshore), compared to the CNY, which trades inside China.

We also reported on the growth of the offshore market in RMB-denominated bonds, more colloquially known as dim sum. Issuance of these bonds – mostly in Hong Kong – surged in the early years of the new asset class.

Demand for dim sum faded dramatically when China rattled global markets with a shock devaluation of its currency in August 2015. Suddenly investors took on a negative view of the yuan’s prospects and sales of new bonds shrank spectacularly as funding costs soared.

A huge drop in yuan deposits in the international financial hubs hasn’t helped, with the slump in offshore liquidity further squeezing the dim sum market. Issuance of yuan bonds more than halved from its peak, amounting to Rmb111 billion in the first nine months of 2017, the lowest since 2012. International issuers largely disappeared, although there were signs of life in the final quarter, when German carmaker BMW, Singapore-based BOC Aviation, and banks from Canada and Australia sold RMB-denominated bonds. Issuers have been buoyed by an improved outlook for the Chinese economy and expectations of a stronger yuan against the dollar.

**China’s bond market is open for business**

Ho agrees that changes in sentiment have impacted on demand for dim sums but she says that the opening up of the onshore bond market in China is also
creating new opportunities for investors.

Rather than trade yuan-denominated bonds in Hong Kong, more investors are opting to buy them in the China Interbank Bond Market, or CIBM, the world’s third largest in fixed income, with a value approaching $10 trillion.

Despite the size of the market, less than 2% of its bonds are owned by global investors, however. Chinese policymakers want to increase this and they have been encouraging international asset managers to buy onshore bonds in yuan.

“‘They started by granting access to the smaller group of RMB clearing banks, RMB-participating banks in Hong Kong with yuan deposits, and central banks from other countries. Otherwise the bonds were off-limits to foreign investors,’” Ho explains. “Then in February 2016 the People’s Bank of China opened up the market to institutional investors with medium to long term investment horizons, welcoming asset managers like pension funds and insurance companies.”

Interest has been persistent: at the end of September 2017, the amount of bonds held by overseas investors moved past Rmb1 trillion, up from Rmb843 billion three months earlier.

Access to the CIBM is less restricted than the earlier opportunities to buy into China’s capital markets. For the initial channels for ‘qualified investors’ (RQFII), participation was limited to a smaller number of asset managers, who were subject to lengthy application procedures, limited quotas and longer holding periods.

Few of the same restrictions exist in the CIBM: registration procedures for foreign entities are just a few days, for instance, compared to waiting periods of about six months for licences for the qualified investor schemes.

Another attraction is the liquidity of the interbank market, dwarfing demand for dim sum bonds, which have been harder to trade in the secondary market.

Investors have a much larger universe of credits to choose from too. Government bonds and policy bank paper make up more than half of the market, but there is plenty of issuance further down the credit curve from commercial banks, state-owned companies and corporations.

China’s bond market has obstacles to overcome before it pulls in more international capital, including a shortage of recognised ratings, which is a limiting factor for asset managers who want to compare Chinese bonds with credits from other countries. Ratings are available from local agencies but they tend to be much more positive than their international counterparts. About 41% of China’s corporate bonds are graded AAA, according to data compiled by
Bloomberg on ratings issued by the four main domestic agencies, versus about 6% in the United States, based on assessments by the international firms.

In July 2017 the PBoC gave the green light to the foreign rating agencies to set up wholly-owned subsidiaries in China but it’s unclear when they will finally get started. Relations with the government also took a turn for the worse when Moody’s and Standard & Poor’s downgraded China’s sovereign debt. The Ministry of Finance struck back by not bothering with a rating when it sold $2 billion of sovereign bonds in Hong Kong in October, the first issue of its kind in more than a decade.

Despite the earlier downgrade, the Chinese sovereign issues were priced close to US Treasury bonds, which delighted the Chinese press. “They [the investors] know that the possibility of default on the bonds is nearly zero. There are barely any risks with this investment,” Xi Junyang, a professor at the Shanghai University of Finance and Economics, told the Global Times.
What role do Pandas play?

Another asset class getting traction as an investment option is the market for Panda bonds – yuan-denominated debt issued in China by overseas entities.

The Panda market was pioneered more than a decade ago but it has only taken off in the last couple of years. Sales of bonds last year were Rmb122 billion, close to nine times the levels of 2015, and they have been outpacing dim sum issuance in Hong Kong.

HSBC was one of the debutants in the Panda market in 2015 and it celebrated another major breakthrough in October this year when it was the first foreign bank to be approved as a lead underwriter for issuance of Panda bonds by non-financial corporates.
South Korea, Poland and Hungary were the first sovereigns to sell Pandas, although tighter liquidity has pushed up the cost of funding since late 2017, discouraging others from joining them.

However, Singaporean logistics giant GLP, Daimler, the carmaker, and Rusal, the Russian aluminium producer, have all been active in the corporate space in 2017 and there are signs that more companies will come to market as funding costs improve.

In the meantime most of the new issuance is coming from the overseas subsidiaries of Chinese companies, many of them property developers.

Regulators are encouraging participants to use the proceeds in China and uncertainty about whether the funds can be transferred offshore has also deterred some issuers. But that’s not always the case, says HSBC’s Ho, especially for sovereigns like Poland and Hungary, which may elect to use the proceeds of their bond sales to pay for infrastructure built by Chinese contractors under Xi Jinping’s Belt and Road Initiative.

What’s happening to the hubs?

In earlier reports on the rise of the RMB, WiC focused on which of the world’s financial capitals were likely to profit most from trade and investment in the Chinese currency.

Ho counters that it is better to look at internationalisation as a process across a range of markets, trade flows and asset classes, rather than as a battle between financial hubs.

“We track the way the currency is advancing more in terms of connectivity in trade and investment,” she explains. “For instance, countries like Malaysia have been tapping into the wider opportunity. One local financial institution has just issued a Panda bond that was available to investors through Bond Connect in Hong Kong. And it announced that the proceeds would be used for financing Belt and Road projects, which ticks quite a few of the boxes in the RMB story!”

Pushed for a view on which of the world’s financial capitals will prosper most from the yuan’s emergence, Ho responds that each financial centre is hoping to play to its own strengths.

“London is the leader in foreign exchange; Singapore and Hong Kong are the hubs for trade and investment in Asia; and New York looks well positioned as China starts to attract more yuan-denominated investment directly from the US,” she suggests.
Another feature is that the hubs have been getting more focused on two-way flows, as Chinese companies extend their own reach into Asia. “What we are seeing is that some of the larger Chinese corporates are setting up treasury and risk management centres in cities like Hong Kong and Singapore,” Ho says. “In the past, Western multinationals have come to Hong Kong to do the same for China and to Singapore for their operations across Southeast Asia. But now Chinese firms are doing something similar as they step up their own activity in the rest of the world.”
Runners and riders in the RMB race

Hong Kong
Still the leader in offshore RMB on all fronts, helped by its political and economic ties to mainland China. RMB deposits in Hong Kong have plummeted and issuance of RMB bonds has shown signs of drying up. But almost half of offshore RMB payments in volume are processed through Hong Kong and the city still serves as the testing ground for the newest yuan-denominated products and services. Hong Kong is also home to the two Stock Connects with the Shenzhen and Shanghai bourses, and the Bond Connect platform that opens up the China Interbank Bond Market to global investors.

Singapore
The Lion City has established itself as the leading hub for the yuan in ASEAN (a huge trading partner with the Chinese) and as a major commodity-trading centre. Singapore’s private banking industry is generating greater demand for yuan services and the city-state also benefits from links with industrial parks in China that facilitate cross-border flows of the RMB. As one of the largest recipients of Chinese investment and the third largest offshore clearing centre, Singapore has a crucial role to play in the yuan’s journey overseas.

The United Kingdom
London’s time zone advantages and its status as the world’s biggest international financial centre more than offsets its shallow pool of yuan deposits. As the largest trading centre for foreign exchange, with average daily turnover exceeding $2.2 trillion (more than a third of market share) London is also home to more than a third of FX trading in the yuan outside China. There is also speculation that it might get its own stock-trading link with Shanghai, bridging the time difference between the Asian, European and North American markets. Brexit is a wild card for Britain’s ambitions as an RMB leader – withdrawal from the EU may weaken its international ranking, or it might encourage the UK government to focus even more fiercely on championing the yuan.

The United States
American financial hubs were conspicuous in their absence in the race for the RMB for years, although that started to change last year when the US was granted the second largest RQFII allocation by the People’s Bank of China (Rmb250 billion), trailing only Hong Kong’s in quota. That reflected that cities like Chicago and New York should have much more say in the RMB’s rise because of the huge number of investors from the US with an interest in Chinese business. There are still obstacles to overcome, however, partly because of the political rivalry with the Chinese, and also due to the dollar’s dominance as the world’s reserve currency. As clearing times in the United States are out of ‘China hours’ this also creates challenges if yuan liquidity is insufficient for local settlement activities.
What happens next
Five reasons why the yuan is still going global

Talk about a turnaround. After dropping like a stone against the US dollar in 2016, the yuan has surged back in 2017. Despite giving up some of its gains against the greenback since then, it is still set for its first yearly advance against the dollar since 2013.

In part that’s because the dollar has retreated from its earlier strength, easing some of the pressures that prompted the yuan’s pullback and which spurred Beijing to impose capital controls.

The redback’s rally is also a sign of how its fortunes have fluctuated over the last two years – all in all, a more challenging period for its spread outside China. Progress has slowed on a number of fronts, dampening hopes that it would mount a more meaningful challenge to the dominance of the dollar.

Instead, the currency’s newfound volatility alarmed the authorities, who turned back to a more cautious approach, promising evolution rather than revolution in their policy for the yuan outside China.

But that doesn’t mean that they have dropped their ambitions for the currency completely or that it won’t continue its global advance.

We finish with a few of the features that are going to push the RMB forward as it establishes itself in international portfolios.

Seek out the Silk Road

Much of the optimism about the future of the yuan is based around the Belt and Road Initiative – Beijing’s commitment to revitalising trade along the ancient Silk Road between China and Europe.

The premise is straightforward: that China’s vast ambitions for the plan will spill over into a major boost for its currency.

Much of the fundraising for the investment in roads and railways in Belt and Road is denominated in yuan and the recipients of the loans are directing the finance back towards Chinese providers of goods and services.

That means round-trip, cross-border flows as currency moves offshore and returns home in payments for the construction, engineering and financial services that Chinese contractors are delivering.

The Belt and Road blueprint is still at an early stage of its implementation,
although Zhou Xiaochuan, governor of China’s central bank for 15 years (though expected to soon retire), told a government journal earlier this year that demand for financing in yuan is already significant because there’s such a shortage of capital for infrastructure projects in general.

Countries like Kazakhstan, Kyrgyzstan and Tajikistan are already seeing a significant increase in the use of the RMB for payments, according to Swift, and the same trend is being reported for key Southeast Asian markets like Indonesia, Malaysia and Thailand.

The RMB will also be a major player in the trade sparked by the new investment in roads, railways, ports and power stations. As prosperity spreads along the Silk Road, demand for Chinese exports will pick up. Much of this business is likely to be invoiced in yuan. Many of these markets aren’t well connected to China in trade and transport terms at the moment, so the incremental gains should be significant as Belt and Road starts to pay off.

Going the ‘last mile’ with the yuan
The early phases of the RMB’s rise were supported by a series of steps that allowed it to flow more freely outside China.
The People’s Bank of China committed to currency swaps worth more than Rmb3.3 trillion with more than 30 countries and it designated a number of China’s banks as clearing agents for yuan transactions in many of the new markets.

More recently, the central bank has been promoting a new payment network that allows businesses in Asia and Europe to wire RMB funds, such as remittances, directly to bank accounts in China, rather than relying on routings in which more of the settlement stays offshore.

Another of the priorities is the Stock and Bond Connects that channel investment through Hong Kong into yuan-denominated assets.

Most of these policies might be classed as ‘top-down’ initiatives, with the goal of embedding the yuan across a wider range of markets and asset classes.

What’s interesting about a newer trend that commentators are calling the ‘last mile of RMB connectivity’ is that it is coming from the ‘bottom up’, courtesy of a new generation of digital disruptors in areas like internet finance, peer-to-peer lending and mobile payments.

As of summer 2017, China’s banking regulator had issued 30 licences to digital companies to make cross-border payments, for example, with third-party mobile payments enjoying double-digit growth over the last three years,
according to SWIFT. HSBC’s Vina Cheung suggested in chapter two that payment apps like Alipay and WeChat Pay are going to introduce the yuan to merchants around the world. Fintech giant Alipay already has about 450 million users, while Tencent’s WeChat has 800 million (though not all are using its payments systems). Most are inside China, but a surge of tourism to other countries is bringing millions of Chinese visitors to new markets. Businesses that want to capture their spending will have to adapt to their new technology, and they will need to know more about the currency in which many of the tourists will want to pay.

The next wave of fintech disruptors could start to transform other areas of banking in a similar way to the revolution in payments. New lending platforms could make loans to businesses outside China, for instance, making the yuan a currency choice in more countries.

**A commodity currency**

China is a voracious consumer of many of the world’s commodities, which is fuelling the forecasts that it is only a matter of time before a larger proportion of the commodity trade is priced in RMB.
Reserve currencies versus international currencies

Reserve currencies are held in significant quantities by governments as part of national foreign exchange reserves. They are also the preferred tender in the international pricing of products traded on global markets, like oil or gold. Reserve currency status delivers various benefits: for instance, global demand for US dollars generally means that the US government can borrow at a lower cost and it also allows for dollar-denominated trade to be conducted with less exchange rate risk and lower transactional costs.

International currencies are widely accepted as the means of exchange in trade and they also feature in investment portfolios. Sometimes they are held as reserves, although they are below reserve currencies in the monetary pecking order. The euro, the British pound, the Japanese yen and the Swiss franc would all qualify, as the yuan does too.

Chinese cities like Dalian (iron ore) and Shanghai (steel) have already set up benchmarks priced in yuan. The Shanghai Gold Exchange has ambitions to challenge the ‘London Gold Fix’, the reference point for the gold industry for almost a century.

But the wider reality is that the commodity world relies on non-Chinese exchanges for pricing its goods and it settles its transactions almost entirely in dollars.

The current debate about how this could change is concentrating on the oil sector, with signs of closer ties between China and Saudi Arabia. In autumn 2017 there was talk that China’s state-owned oil majors PetroChina and Sinopec might serve as cornerstone investors in Saudi Aramco’s debut listing, which is
The Future of the RMB

set to become the world’s biggest ever IPO. Senior Saudi ministers have also announced that they’re looking actively at the Chinese debt market for funding, including sales of Panda bonds.

Certainly, it wouldn’t be much of a surprise if the Chinese asked to pay for more of their oil purchases from Aramco with yuan rather than dollars. China is already looking for ways to use its own currency in the oil market and the Shanghai Futures Exchange is launching yuan-denominated contracts for crude. Persuading Riyadh to take payment in yuan would be a massive breakthrough, challenging the status quo established by Richard Nixon’s pact with the Saudis in 1974, which instilled the greenback as the currency of choice in the oil trade. The symbolism would be telling as Aramco’s ties with the United States are longstanding. The clue is in the name – the Arabian-American Oil Company was formed in the 1930s and it was headquartered in the US during its early years.

Others have cautioned that it is too early to announce an end to the petrodollar’s reign. Despite being a major importer, the Chinese don’t have the same pricing power in oil that they enjoy in some of the other commodities. Probably more importantly, restrictions on how the yuan is traded internationally could deter the oil producing nations from accepting it more.

Beijing still has plenty of leverage with the producers, however, and it could negotiate hard in promising to buy more of Riyadh’s oil. Imports from Saudi Arabia haven’t grown nearly as quickly as some of the other oil producers. Russia has taken over as China’s leading supplier and the Saudis have been superseded by Angola as well, which classes the yuan as its second legal currency.

The implication is that more of China’s oil contracts could be predicated on producers taking payment in yuan. And reportedly, the Chinese are trying to do something similar by sweetening the offer on the oil futures on the Shanghai exchange. These contracts are going to be convertible into physical gold, making them more attractive for oil nations still anxious about taking payment in yuan.

The domestic agenda

For all the talk about winning over the rest of the world to the yuan, the first battle in changing how it is perceived has to be won at home in China.

On one side are those who see another round of currency reform as a way of sweeping aside vested interests and pushing forward with changes that support the transition towards a more modern, consumer-driven economy.
On the other are more conservative forces, including some of the largest state-owned enterprises, which aren’t convinced by the reform agenda, especially if it threatens the conditions that have helped them to prosper in the past.

Xi Jinping spent much of his first term in office concentrating on his anti-corruption campaign and consolidating his personal authority across the key institutions of government. Policies that helped China’s currency to establish itself overseas were a lower priority. The question is whether Xi will be ready to refocus as he starts his second term, delivering on the promises to make the yuan a more convertible currency.

For proponents of yuan reform like Zhou Xiaochuan, the central bank governor, there is little time to lose in returning to the previous path. He has warned that the opportunity to open the economy further “must be seized”.

Zhou was a prominent backer of a slew of measures that prompted the International Monetary Fund to designate the yuan as an official reserve currency alongside the dollar, euro, yen and pound two years ago.

Since then, Beijing has taken a step back by making it harder to move the yuan in and out of China.

“No country can achieve an open economy with strict foreign exchange controls,” Zhou warned in an interview with Caijing, a financial magazine, in the autumn. “Time windows are very important for reforms and must be seized. If missed, the cost of reform will be higher in future.”

Still a case of catch-up

Beyond the speculation about politics and policy, there is a much broader backdrop to the yuan’s prospects as a global currency.

The reality is that the RMB still lacks influence relative to the size of China’s economy and its contribution to global growth. Yes, usage has grown relatively quickly to about 2% of global payments, but that is nowhere near China’s share of global gross domestic product (about 14% according to Michael Pettis, a professor at Peking University).

And in spite of its title as the world’s largest trader, China still settles no more than a fifth of its foreign trade in yuan, a much smaller proportion than the euro’s share of Europe’s external trade or the yen’s share of international trade with Japan.

In this regard, the RMB has a lot of catching up to do. China is home to the world’s biggest banking sector, the second biggest stock market and the third
The largest bond market. Why shouldn’t its currency aspire to a more significant presence as well?

This kind of context provides fertile ground for RMB internationalisation, although it isn’t a guarantee of success as the yuan starts a new phase of its journey.

The yuan has made steady progress for the best part of 10 years since making its debut outside China. But with hindsight, some of its spread was down to the view that it was a sure-fire bet. People and companies were willing to hold it because they expected it to increase in value against the dollar. When that expectation changed two years ago, the yuan’s progress soon slowed.

In the next phase of the internationalisation process the challenge for policymakers is how to get the yuan moving forward again. Longer term, the trends look positive as the currency catches up with China’s contribution to the global economy. But the Chinese must continue to make the case for their currency overseas too, making it easier to buy and sell with the yuan, and to invest with it.
The duel with the dollar

Currency analysts have been predicting the demise of US dollar dominance since the 1960s. And over the last 10 years the yuan has been characterised as its most likely challenger.

In fact the dollar’s share of trades in the foreign currency markets hasn’t changed much for the last 20 years, featuring in between 85% and 90% of transactions, according to data from the Bank for International Settlements. The euro and the yuan, at 31% and 4% respectively, aren’t even close.

What’s more, the dollar is the chosen currency for almost two-thirds of the world’s foreign-exchange reserves.

Another way of looking at the greenback’s grip is that more than half of American banknotes (and the large majority of its hundred-dollar bills) circulate outside the US.

This sense that the dollar is so much more dependable than local currencies frustrates America’s rivals and provides Washington with many privileges, such as the opportunity to borrow money at much lower yields than would otherwise be the case. It also allows Washington to frame the rules of the global financial system, including which of the world’s companies and countries should be allowed to participate.

That kind of political influence is the envy of other governments and barely a week goes by without a newspaper headline that rival nations are doing their damnedest to dislodge the dollar, and that its dominance won’t last forever.

But signposting the yuan’s future as an inevitable confrontation with the dollar would be a mistake. Rather than a clash between two currencies, the future is more likely to see the dawn of a multi-currency world in which the dollar continues to lead, but other currencies also feature, including the euro. The contribution to global growth of countries like India and Brazil may get more recognition for their currencies too.

The conundrum for Chinese policymakers is that for the yuan to be a prominent part of this picture, they need to open up China’s capital account and allow its currency to be market-driven. So far that is something they have been reluctant to do. Indeed, some experts say that it is surprising that the RMB has made it so far without the traditional prerequisites of an open capital account and flexible exchange rates.

They also believe it will be a lot harder for the yuan to become the safe-haven currency that Beijing hopes unless it takes further steps to endow the yuan with the full characteristics of a reserve currency, like creating deeper and more open capital markets, a trusted legal system, and market-determined currency and interest rates. If that does happen, the RMB will be in a much better position to challenge the greenback.
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