

**REPORT – EIAS Briefing Seminar
The Renminbi on an Internationalisation Trail**

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The Chinese currency, the Renminbi (RMB), is rapidly moving to a centre stage of discussions concerning the international monetary system, which is clearly in need of reform. In the meantime, and with the consent of the Chinese authorities, the use of the RMB is spreading beyond China's borders. Hong Kong, with its own economic system and currency, hereby performs an essential function. Various steps on the internationalising trail of the RMB have already been taken. Monetary prominence thus emerges as a side-effect of the astonishing growth of the Chinese economy and of the country's involvement in global trade and investment schemes. This EIAS briefing seminar was aimed at analysing the rapidly changing status of the RMB and the role of especially Hong Kong in promoting the RMB. The keynote speech was delivered by Prof. Em. Sylvain Plasschaert, member of the EIAS Advisory Board and Prof. Em. of the University of Antwerp and the Catholic University of Leuven. Discussants were Mr. Georges Legros, Vice-Chairman of the Belgium Hong Kong Society and Chairman of the Federation of Hong Kong Business Associations Worldwide; Mr. Peter Dun, Bureau of European Policy Advisors at the European Commission and Mr. Gianni Girolami of the Industrial and Commercial Bank of China (ICBC).

China, since the initiation of Deng Xiaoping's Open-Door policy in the 1970's, has become one of the most important economic and trading actors worldwide. China has profited especially from the increased globalisation, and has worked hard to prove its openness towards free and global trade. With regards to its exchange rate policy, Beijing has proven to be less liberal, preferring to resist calls to unpeg the RMB from the US dollar. The emergence of the RMB, in international financial markets and in the world's monetary arena, a recent and fast unfolding phenomenon. Observers have predicted at numerous occasions that the RMB will, in a "distant" future, reach position as a reserve currency. Most observers link the assumption of a prominent international monetary role by the RMB to the catapulting of China as a global economic and political power. More particularly, as a result of the impressive growth of China's export and its accumulation of official foreign exchange reserves, which are now exceeding a stock of three trillion dollars. Chinese officials at the highest levels have stated that the international monetary system, dominated by the US dollar, clearly indicating the voices in China that change is required in the international monetary system.

Background

As mentioned, the unprecedented economic growth in China, especially of its exports, has led to a current account surplus, especially with the US and the EU. The 2009 financial crisis has only marginally affected the Chinese economy, largely due to huge reflationary programmes of bank-financed investments. The Chinese banking system in the aftermath of the Asian Crisis, was technically bankrupt around the year 2000. Under Prime Minister Zhu Rongji, the system was drastically revamped

and now appears to be rather solid. The EU, and to a lesser extent the US, still suffers from the aftershocks of the financial and debt crises. The crisis did not only affect both

trading blocs but also the markets' trust in their currencies, raising concerns regarding the continuation of the dollar as reserve currency. These developments are likely to persist, at least in the medium-long term. During the G-20 summit in 2008, at the height of the financial crisis, Chinese President Hu Jintao [called](#) for "a new international financial order that is fair, just, inclusive and orderly."

Only three decades ago, the RMB played only a very limited role internationally, mostly due to the centrally-planned communistic type of economy in the People's Republic of China, while the foreign exchange rate was economically meaningless and irrelevant for international trade. In 1994, after Deng Xiaoping's liberalization reforms, the RMB was made convertible, but solely for trade and other current account purposes. The exchange rate was fixed by China's Central Bank, which until recently received also all of the export proceeds. The proceeds had to be converted to RMB, but the Chinese Central Bank sterilized it, impacting the domestic RMB money supply. The internationalisation of the RMB began in 2004, when foreign exchange accounts were allowed in China. Already in 1993, China [indicated](#) that it was to achieve full convertibility by the end of the century. In 1994, the RMB was pegged at 8.6 RMB to one US dollar, and Beijing gradually began removing capital account restrictions. Following the Asian crisis in 1997, China dropped its full-convertibility target. In 2005, the RMB was unpegged and appreciated to \$ 6.8 to one RMB. In 2008, it was again pegged to the US dollar. In June 2010, the RMB began floating again, within narrow limits, and has slightly appreciated towards 6.36 RMB to one \$ in 2011, appreciating 4.5 RMB in one year. China's real effective exchange rate is now also slowly on the rise. It should be emphasised that the RMB is expected to remain stable as Beijing is trying to ensure long-term economic stability – particularly in light of the persisting economic problems in the euro zone and the US markets.

Current Status

Until now, no genuine¹ foreign exchange market² had existed in China. The RMB is traded in some foreign countries but very limited turnover remains though growing. In December 2011, a pilot project was launched by China, simplifying formalities for exports and foreign exchange control and customs. A partial relaxation of Foreign Exchange controls is occurring, a progress that is much similar to that of the opening up of China in the 1980's, by following a slow and steady pace. There is only a limited scope for transactions by non-residents on the PRC's stock exchange, but inward Foreign Direct Investments (FDI) can now be performed in RMB. Invoicing of trade in RMB is now also permitted, and is [growing](#) especially with regards to imports into China, but also in terms of exports from China. In the first six months of 2011, about 10% (\$146 billion) of overall trade (imports and exports) is performed in RMB, a rapid increase since 2010. By mid 2011, RMB deposits in HK equalled roughly \$85 billion, roughly a tenfold increase since 2008. The International Monetary Fund (IMF) denied the RMB Special Drawing Rights³ (SDR) in October 2010, although the introduction of the RMB

¹ A genuine foreign exchange market, is shaped by markets and foreign demand

² The foreign exchange market (forex, FX, or currency market) is a worldwide-decentralized financial market for trading currencies. Financial centers around the world function as anchors of trading between a wide range of different types of buyers and sellers around the clock, with the exception of weekends. The foreign exchange market determines the relative values of different currencies.

³ Special drawing rights (SDRs) are supplementary [foreign exchange reserve](#) assets defined and maintained by the IMF. Not a currency, SDRs instead represent a claim to currency held by IMF member countries for which they may be exchanged.

increasingly questions that position. Such a artificial currency can also be expected to soften volatility of foreign exchange quotations.

Several prerequisites must be fulfilled before a national currency can claim the role of reserve currency.

A mature, wide and deep financial market appears to be the main prerequisite: Its market should also a wide diversity of financial assets, be run efficiently and have a high level of liquidity. Despite the remarkable progress in China's banking system, it is still far from meeting the above qualifications and thus to claim the RMB as a reserve currency. Foreign countries, which have an external surplus, are generally not yet ready to invest their foreign exchange surpluses in RMB assets within China, even when assuming that China would allow free convertibility on capital account. The financial market in China is still relatively underdeveloped, compelling the Chinese authorities to focus their investments on foreign exchange reserves such as the American government bonds, despite the rather weak position of the American current accounts and government budget. Recent events have, however, shown that China is increasingly seeking to diversify its already huge stakes in the US.

On the internationalization trail

China is seeking to internationalise its currency through many different channels. For example, allowing international transactions in RMB with the objective of allowing full convertibility of the currency in the future. While there is still no full convertibility, offshore RMB markets have managed to emerge. Overseas Chinese (Chinese communities in foreign countries and Taiwan as well as in Macau) especially in Hong-Kong (HK), are essential elements in internationalising the RMB. Hong-Kong offers a number of invaluable advantages over mainland China, notably by having more favourable regulatory parameters, a more developed and trusted legal system - thanks to a widespread use of English, a sophisticated financial system and finally, a full convertibility of the Hong-Kong dollar. Authorities, both in Beijing and HK, foster the role of Hong-Kong as a bridgehead to China for the RMB, through closer economic partnerships and agreements to facilitate bilateral transfers of funds. About 10% of amassed deposits of offshore RMB deposits are based in Hong-Kong and RMB denominated "Dim-Sum" bond issues are expanding rapidly.⁴

The RMB is rapidly increasing its potential as an important international currency. Full convertibility is expected to take place in medium terms. China, however, would prefer to move towards a multi-polar monetary system at its own pace. Its status of reserve currency is still remote, due to conditionality of the domestic system in the PRC. Hong Kong on the other hand, serves as an excellent driving force and as a hub in the process of internationalising the RMB, as well as in increasing the off-shoring of the RMB outside of China and as a testing ground for further financial reforms. The exchange of the RMB with other currencies in current account transactions remains very limited and does not exceed one percent of worldwide foreign exchange turnover in exchange markets. Much has still to be achieved in order to reach a prominent and important status on a global level.

⁴ A bond denominated in Chinese yuan and issued in Hong Kong. Dim sum bonds are attractive to foreign investors who desire exposure to yuan-denominated assets, but are restricted by China's capital controls from investing in domestic Chinese debt. The issuers of dim sum bonds are largely entities based in China or Hong Kong, and occasionally foreign companies.

In conclusion, the internationalisation of the RMB has yet to be fully achieved. It is a gradual process, which should not be expected to happen swiftly. The “trial by error” approach - is further underlined in Beijing’s 12th five-year-plan and in the context of the continuing economic crisis in the West. At the same time, 2012 will also be a transition year for China, as it will go through a shift in political leadership, which will most likely result in increased caution towards new economic reforms.