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UK's Renminbi Strategy (2): AIIB as a Foothold for the Second Stage

**Kikuko Takeda, Lead Economist
Institute for International Monetary Affairs**

The UK financial services sector contributes about 10% of GDP, the largest share amongst the G7 countries. As discussed in my earlier publication, the UK's long term growth strategy can be described as follows: it lures emerging international currency to London market, the leading international financial center, and provides sophisticated "global-standard" infrastructure. Thus, they enhance financial sector business profitability as well as the London's position as the leading international financial center vice versa. In today's note, I will go over how they "lure" Chinese Renminbi (RMB) and then touch about some recent challenges to this strategy.

In December 2011, the City of London publicized the plan to develop the RMB market in London as a "western hub" and then made an official announcement in April next year. The project was led by five private banks from Asia and Europe (Bank of China, Barclays, Deutsche Bank, HSBC, Standard Chartered Bank) and as observers, the UK Treasury, Bank of England and UK FSA joined the project. Upon the City of London's initiative, it was started as "all-UK" project.

This is of course welcomed by Chinese government. It all started at the "Forth China-UK Economic and Financial Dialogue" held in September 2011. At the meeting, the UK Chancellor of the Exchequer Mr. Osborne obtained the support from Chinese Vice Premier Wang Qishan to proceed the project. Then in January of 2012, when Mr. Osborne visited Hong Kong, the UK Treasury and Hong Kong Monetary Authority (HKMA) set up the "London-Hong Kong RMB Forum" made up of the above-mentioned five banks. To give one example, following the setting up of this forum, the decision was made to extend the Hong Kong's off-shore RMB trading hours. By doing so, London's trading hours could overlap with Hong Kong. In case that the London's market runs short of RMB liquidity, the traders can easily access to Hong Kong market and get RMB supply. In April 2012, the HSBC issued off-shore RMB denominated bond, for the very first time outside Hong Kong, as a commemorative transaction. The success was the best example of cooperation by the forum members and the two governments.

Again, London is the most international financial center in the world. But how? According to

the City of London's report "London: A Center for Renminbi business" released in April 2012, there are five key strengths; 1) Time Zone: Its working day overlaps with that of China, and rest of the globe from NEW Zealand to Brazil, 2) English Law and 3) Regulatory Framework: The UK legal and regulatory systems are respected internationally, 4) Innovation and Liquidity: London's global financial community has a proven record of rapidly responding to new market needs and a strong history of innovation and developing market efficiency, and then, collectively brings massive liquidities, 5) Benchmark: London market has long been the benchmark provider of interest rates and Forex. A truly international currency must have full-scale accessibility. London's position and its strength as the leading financial center exactly fitted to the China's objective to make RMB fully convertible global currency.

In the first place, there long had been just Hong Kong but off shore RM market has expanded to the other centers as London becomes of the center of RMB businesses in western hemisphere. Although in terms of deposits London is far behind Asian competitors, namely Hong Kong and Singapore, it has taken an overwhelming 70% of FX spot transactions outside of mainland China. The fore-mentioned publication, "City of London renminbi series" which was periodically issued to advertise the progress, ended in June 2015 with its seventh issue. What can be assumed from this is that London's RMB strategy reached to the "end of the beginning", the important turning point to the first stage. Five years hence, the building of basic platform to become a western hub might have completed with certain satisfactory achievements, and then recognized new challenges to go through the second stage.

What is the challenge? It is to build up a very sizeable pool of RMB outside China. To become a truly global currency, continued outflows, albeit paced and steady, are required. In other words, the key to the next step will be to set up a reliable channel to induce "desirable capital outflow" from China. As to face such challenge, the AIIB, Asian Infrastructure Investment Bank must be a very important mechanism to "lure" RMB outside mainland China in preferable manner. Others contrivance is the "Hong Kong Shanghai Stock Connection (This allows mutual RMB denominated equity investments)" which started in November 2014. It is said that the system is supporting to increase the supply in Hong Kong market.

Facing the financial market turmoil early this year, the word "capital outflow" has become a very negative buzz word. However, in the perspective of RMB internationalization and development of off-shore market, the large amount of outflow and overseas circulation of the RMB are essential aspects. The AIIB officially launched in January 16th, and UK is the one of the earliest to join as a founding member. The UK's Renminbi Strategy will step into second stage by measuring the development of AIIB and other means to buildup a pool of off shore RMB.