



Suggestions for the Internationalization and Stability of the Renminbi¹

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Importance of the Year 2020

For China 2020 is a year of milestone in many senses, and has two important meanings for the renminbi (RMB) internationalization. First, as well known, a plan is going on to make Shanghai by 2020 an international financial center, whose prerequisite is the realization of full convertibility of RMB. Second, it happens to be the year, in which the currency composition and share of the SDR (Special Drawing Right) will be reviewed. SDR is reviewed every five years, including this year and 2015. The Chinese government intends to enhance the role of SDR as a reserve asset, in which RMB should be added as a composite currency. To be included in SDR, RMB must become a “freely usable currency” (synonymous as an international currency), and it will be realistic to set 2020 as a target year.

The Chinese government has always stressed the stability of RMB. Last year it turned around the basic stance towards the currency internationalization from the negative to positive one. Is it possible to realize the internationalization of RMB by 2020, maintaining its stability simultaneously? The author thinks it a tough challenge, but can be met.

Some Suggestions for the RMB Internationalization

Mr. Toyoo Gyohten, former vice minister of Japanese MOF and president of the Institute for International Monetary Affairs, Tokyo, once stated as follows:

¹ This article in Chinese is in Oriental Morning Post (An economic newspaper in Shanghai, China) on May 17th, 2010. The views expressed in the article are those of the author and do not necessarily present those of IIMA.

“How widely a currency can be used internationally depends upon three conditions.

- (1) The issuing country has a well-balanced national power with international confidence.
- (2) The use of currency is free with few restrictions.
- (3) There are big, liquid and free financial markets for the currency.

Whether the yen or RMB, the currency internationalization is up to the extent how much these conditions are fulfilled.” Let me make some suggestions in this regard.

Despite the certainty that China becomes the world second largest economy this year, its credit rating remains A1 (Moody’s) and A+ (S & P), lower than Singapore (AAA) or Japan (AA). The credit rating is an important index for international institutional investors, and its upgrading is essential for the RMB internationalization. Rating agencies point out as negative factors issues like disclosure (e.g. statistics), opaque local fiscal conditions, hidden bad assets of banks and excessive dependence on administrative measures in economic policies. Many of these problems are solvable. As to the issue of disclosure, for example, it would help enhance international confidence in statistics, if China joins the SDDS of IMF (Special Data Dissemination Standard, members of which account for 64 major countries as of April 2010).

IMF defines “freely usable currency” as “*a member's currency that the Fund determines (i) is, in fact, widely used to make payments for international transactions, and (ii) is widely traded in the principal exchange markets*” (Article XXX of Agreement). At present all RMB exchange transactions take place only at CFETS (China Foreign Exchange Trade System) in Shanghai under the supervision of the People’s Bank of China. The participation of nonresidents is permitted only through domestic agent banks for the RMB trade and other settlements. No RMB trading is allowed in London, New York, Tokyo and other principal exchange markets. In order for RMB to become a freely usable currency, sooner or later CFETS must put an end to its role, and the RMB trading must be opened to all major financial markets.

For the wide use of RMB, hedge instruments against foreign exchange risks (e.g. forward exchange contracts, currency options etc.) are indispensable, and such instruments can prevail only against the background of well-developed financial markets. As the RMB trade settlement means the exchange risk transfer from Chinese to overseas trade partners, the free use of RMB risk hedge products outside China is vital for the expansion of RMB denominated trade.

Asian Monetary System for the Stability of RMB

The effective exchange rate of the yen has been, and still is, volatile in comparison with the dollar or deutschemark (DM, euro). It is because the yen, which has adopted

free floating exchange rate regime, is a “solo currency” without any currency zone of its own. While DM maintained fixed rate within the EMS (European Monetary System), EMS currencies as a whole floated freely against third currencies. Accordingly the effective exchange rate of DM, an international currency next to the dollar, remained relatively stable.

Although the Chinese government has tried so far to maintain RMB stable against the dollar, the criterion of currency stability should be switched to a currency basket or the effective exchange rate in view of the growing importance of Chinese economy in the world. At the same, it should become necessary for RMB to have a monetary zone in East Asia to secure further stability.

While ASEAN countries plan to establish the ASEAN Economic Community (AEC) by 2015, there is no monetary program for the stability of member currencies. In view of future economic integration in East Asia, the stability of regional currencies including those of ASEAN had better be secured within the framework of ASEAN+3. In other words, an Asian Monetary System (AMS) should be designed a la EMS with participation of all ASEAN+3 currencies.

The EMS was made of three elements, i.e. ECU for European Currency Unit, ERM for Exchange Rate Mechanism, and credit facilities. ECU was a currency basket to become the euro later. ERM formed a fixed exchange rate grid of member currencies, and short-middle term credit facilities were created for smooth functioning of ERM. EMS members were not necessarily identical with ECU composite currencies or ERM participants. The United Kingdom, an original EMS member, joined ERM only briefly during 1990-92. In the 12 composite currencies of ECU, those of Austria, Finland (both ERM participants) and Sweden (ERM nonparticipant), which joined the European Union in 1995, were not included.

Likewise, AMS should be established on the basis of ASEAN+3, but its currency basket and ERM can be designed with flexibility, starting with such countries that fulfill necessary conditions. Initially, for example, the currency basket consists mainly of the dollar, euro and yen, and ERM is started with China and ASEAN countries as participants. This scheme means essentially the creation of a RMB monetary zone in East Asia, but what is decisively important is that ASEAN+3 offers an institutional platform. From the politico-economic viewpoint, ASEAN countries would prefer the indirect link within AMS to the direct peg of their currencies to RMB. The currency basket should be replaced by an ACU (Asian Currency Unit) at a later stage, and then Japan can join the ERM.

While AMS is an arrangement for the stability of regional currencies in East Asia, whose real economy gets closely integrated, it will form an important part, besides the

dollar and euro, of a future international monetary architecture. It is beneficial also for Japan that the yen's effective exchange rate turns stable through the AMS.

Towards the Third Joint Statement on East Asia Cooperation in 2017

1999 in the first Joint Statement, the ASEAN+3 Summit declared the importance of “enhancing self-help and support mechanism” in monetary and financial cooperation, which led to the realization of the Chiang-Mai Initiative. In the second Joint Statement of 2007, however, despite the pledge among member countries in preparatory meetings to implement the final report of the East Asia Study Group (e.g. pursuit of a regional exchange rate mechanism), no innovative policy in monetary fields was announced. 2017 on the twentieth anniversary of ASEAN+3, the third Joint Statement is expected to be adopted. The author hopes sincerely that discussions about a regional monetary arrangement be deepened so that the concept of AMS will find a consensus by that time.

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