

## RMB Internationalization

Gao Haihong Senior fellow, Institute for World Economy and Politics  
Chinese Academy of Social Sciences

It is a great privilege for me to be invited again by the IIMA and I am very glad to be here to discuss these very important issues. First of all I would like to point out that the RMB is actually not yet an international currency. It is neither a major invoicing nor a reserve currency. It is far from so-called vehicle which should play a third party currency in international transactions. I think the US dollar still remains as a major vehicle and it will be in the same situation in many years to come.

There are some empirical evidences, however, on this usage of the RMB and China's influence in Asia. For example, in its recent research report the ECB found that there exist some co-movements between China and the rest of Asian currencies in terms of exchange rate fluctuations and monetary policy. The ECB called it the RMB dominance hypothesis and compared it with the Deutsche mark's dominance hypothesis back in 1970s. However, in terms of standard functions, I don't think the RMB is comparable to the existing international currencies including the Japanese Yen.

Secondly I would like to highlight some key developments so that you could have an idea that the RMB is not a giant yet but it grows very fast. The first and the most concentrated area by the Chinese government is RMB trade settlement. It started from nothing to the peak time of the Q2 2011 and now accounted for 7.7% of China's total trade, as Mr. Eddie Yue just showed us. Recently the figure declined, partly because of slow pace of RMB appreciation, and partly because policy effect is exhausting, and the market preference is not yet in place.

As for the offshore, RMB deposit in Hong Kong was the initial and prime source of RMB liquidity and it gave Hong Kong the priority to be the first RMB business mover. The size of RMB deposits increased sharply by 628 times, and it was highly correlated with the value of the currency. In recent months, the size of the RMB deposit started declining, along with low expectation of RMB appreciation. There is also another reason, which I think more fundamental, is the divergent demands in different financial centers, because London and Singapore came in on board, and Tokyo probably the next.

Briefly speaking, the current usage of the RMB mainly reflects how open the Chinese capital account is and I think it has a strong policy intention. For private purpose, it is involved with many different markets. For public purpose, the bilateral swaps between central banks are phenomenal: 19 contracts amounted to 1.686 trillion yuan. As for reserve currency, some central banks have included it in their foreign exchange holdings. So, at current stage the use of RMB is like scattered pieces, putting them together is not even sizable, but expands very quickly.

Thirdly, as for the challenges ahead, I think there are primarily five which highly matter to the next stage of RMB's internationalization.

The first one is the issue of convertibility. In dealing with relatively low liquidity and accessibility of the RMB assets, there is a dilemma facing the policy makers at current stage: the risk of capital account opening and insufficient liquidity of the RMB in global market. How to effectively get rid of unwanted capital flows and at the same time to encourage market liquidity by relaxing capital controls is a great challenge.

The second one is domestic financial liberalization. Two years ago it was not a major consideration but now it turned to be at the center of not only the RMB strategy but also China's reform agenda for the next five years.

The third one is exchange rate flexibility. I think the policy makers tend to be more liberal on this matter. I am confident of more forward steps taken in the years to come.

The fourth one is the independence of the central bank. In fact the PBoC has been questioned for years about its independency. I think now it becomes apparent that the independence of the PBoC is critical for establishment of its credibility over time, which ultimately is a matter for the currency being used as reserve currency held by nonresidents. In this respect I am quite optimistic and I think we do not need to wait for too long to see a more independent central bank in China

The last challenge is market appetite. There are a number of factors to support a strong market demand for the RMB, like, is the market integrated? Does it have efficient liquidity? How sensible are interest rate differentials and exchange rate movement? All those factors determine the market appetite.

Now I would like to say last several words about the role of Tokyo. First of all, fundamental links between the two markets are very important. Secondly, I am not sure how much are there the RMB deposits in Tokyo, but I think it is time to make a calculation. It is also important to foster a natural customer base for RMB products and services and facilitate financial institutions and corporates in general and Japanese firms in particular to issue RMB bonds. Consensus building between the policy makers is also crucial. To cooperate in practical manners and in technical areas is mutually beneficial for two currencies. For instance, the direct trade between the two currencies is a very encouraging move for both Yuan and Yen transactions in the forex market.

The role of Tokyo is not just about Tokyo's own. I think, like Mr. Yamasaki pointed out earlier, that the task of Yen internationalization in the past decade actually provided with tremendous lessons and references for Chinese Yuan.