

RENMINBI INTERNATIONALISATION (II): PROGRESS AND PROSPECTS

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Executive Summary

1. China has ambitious plans for a greater international role for its currency, the Renminbi (RMB), since the beginning of the century. Some suggested that China's strict capital control and the limited development of its financial markets could pose roadblocks to the RMB's internationalisation.
2. Others expected a significant role for the RMB sooner rather than later, given the size of China's economy, and its economic growth and role as the world's largest trading nation. They suggested that the RMB's growing international role, including its inclusion in the Special Drawing Rights (SDR) basket, could potentially pose a significant challenge to the US dollar.
3. Predictions of the RMB rapidly posing a serious challenge to the dollar on the international stage have yet to be realised. The US dollar continues to retain its dominance as the world's most international currency, but the RMB's role as an international currency is gradually growing.
4. RMB now constitutes a 2% share of world's foreign exchange reserves and is the currency for about 1.75% of the world's payments, and about 4% of the world's foreign exchange trading. While these shares are rising, they are still small relative to the other major international currencies – the US Dollar, the Euro, the Yen and the Pound Sterling.
5. While the international role of the RMB, on several measures, increased rapidly between 2009 and 2015, it slowed considerably thereafter and is now gradually beginning to recover to the 2015 level. For example, Hong Kong's RMB outstanding loans and the issuance of RMB bonds peaked in 2015 and have yet to reach the same level now.
6. Cross-border trade and direct investment settlement in RMB also reached historical highs in 2015 before they were significantly reduced. This can be partly attributed to the 2015-16 policy responses to stem capital outflows. The US-China trade

disputes and the possibility of the exclusion of certain Chinese firms from the US dollar-based international payment system have also posed challenges.

7. China's RMB internationalisation still has some way to go as its policy steps have been gradual, in view of risks to the opening up of the capital account. Pronouncements by policymakers suggest a continuation of such policy steps. However, RMB internationalisation will mainly depend on the trust in China's policies, deeper financial markets, and the further liberalisation of the capital account and exchange rate regimes.

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RMB Internationalisation Strategy

- 1.1 China's major public policy push to internationalise the renminbi (RMB) has begun since 2009.¹ Capital inflows to China are now much more open and a variety of avenues for cross-border clearance and payment systems have been put in place. The exchange rate regime has also been reformed. It is now much easier for foreign investors to participate in China's onshore financial markets and for China's global trade to be settled in RMB. China has signed bilateral currency swaps with a number of countries to provide them with access to RMB liquidity in case of emergencies. The RMB is now part of the Special Drawing Rights (SDR) basket of the International Monetary Fund (IMF), making it an official reserve currency.

What Does It Mean to Be an International Currency?

- 2.1 Money, in any economy, performs at least three basic functions,² as a store of value, a medium of exchange and a unit of account. An international currency needs to perform these functions outside of its own borders as well (Table 1). Non-citizens also need to be able to use the currency for these three purposes. Although the three functions are correlated, it is still useful to examine the state of internationalisation of the RMB along these three dimensions.

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¹ For a historical review and policy measures taken by China in its drive to internationalise the RMB, please refer to P S Srinivas and Ruijie Cheng, "Renminbi Internationalisation (I): A Historical Review and China's Policy Measures", *EAI Background Brief*, No. 1597.

² Cohen, B J (1971). *Future of Sterling as an International Currency*. Palgrave Macmillan UK.
Kenen, P B (1983). *Role of the Dollar As an International Currency*. Group of Thirty. https://www.group30.org/images/uploads/publications/G30_RoleDollarIntlCurrency.pdf, accessed 3 July 2021.
Frankel, J (2012). Internationalization of the RMB and Historical Precedents. *Journal of Economic Integration*, 27(3), 329–365.

- 2.2 The most widely used international currency today is the US dollar. It functions as a store of value for governments other than the United States' since central banks across the world hold significant shares of their foreign exchange reserves in US dollars. When private citizens choose to hold their savings in dollars or dollar-denominated financial assets, it functions as a store of value for non-US private citizens.
- 2.3 When a non-US government is trying to stabilise the movements of the exchange rate of its currency with other currencies, it often intervenes in the market by buying or selling US dollars in the market, a typical example of the use of the US dollar as a medium of exchange by governments. Private citizens or companies that trade with each other in goods and services often choose to invoice and settle these transactions in US dollars. This illustrates the international medium of exchange function of the US dollar by non-governmental actors.
- 2.4 Many countries, including China, use the US dollar (sometimes as part of a basket of currencies along with other international currencies such as the Euro and the Yen) as anchors to determine the exchange value of their own currency. This is an example of the international use of the US dollar as a unit of account by governments. Prices of globally traded commodities such as oil and gold are still mostly denominated in US dollars, which is an example of the use of the US dollar as a unit of account by private actors. These functions of the US dollar hold even if there is no US counterparty involved in the transaction.

TABLE 1 FUNCTIONS OF AN INTERNATIONAL CURRENCY

Function of money	Use by governments	Use by the private sector
Store of value	Foreign currency reserves	Substitute for local currency
Medium of Exchange	Currency for intervention in foreign exchange markets to manage the exchange rate of domestic currency	Invoicing trade and financial transactions
Unit of account	Anchor to peg local currency's exchange rate	Denominating trade and financial transactions

Source: Cohen (1971), Kenen (1983) and Frankel (2012).

- 2.5 For the RMB to achieve the desired status of an international currency, its ability to perform these three functions are critical.

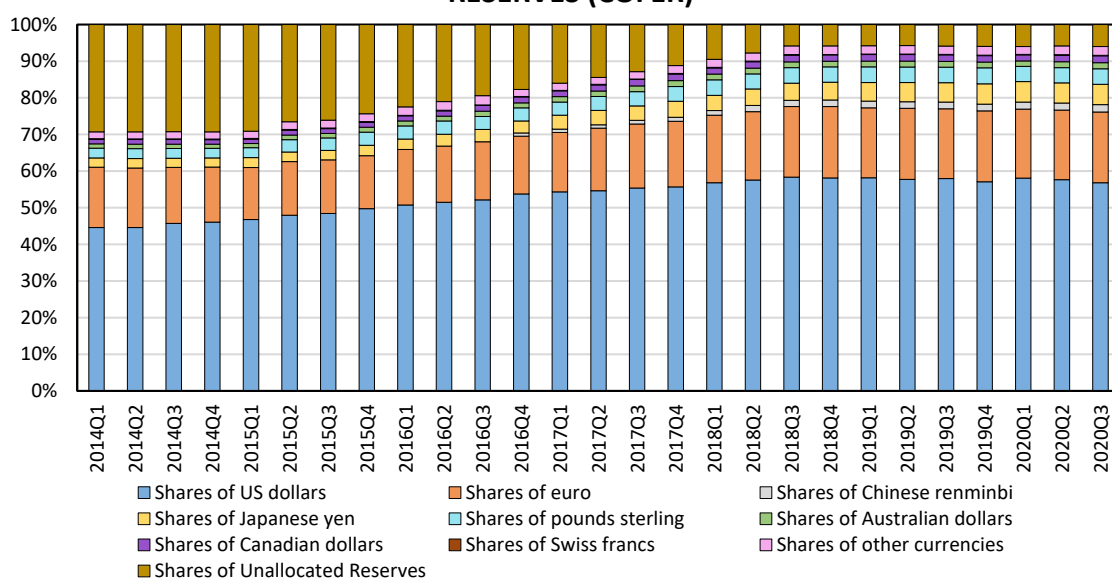
The RMB's Role as an International Currency

- 3.1 As a result of the policy measures, the international role of the RMB has gradually increased. In particular, these measures have helped promote the RMB as a store of value for governments due to an increasing share in countries' official foreign exchange reserves and for private sectors because RMB deposits and bonds are rising in the offshore markets. They have also enhanced the RMB as a medium of exchange due to the increasing use of the RMB in cross-border trade and direct investment settlement as well as in international payments. The RMB as a unit of account has also improved as some commodities have started to be priced in the RMB.

The RMB as a store of value

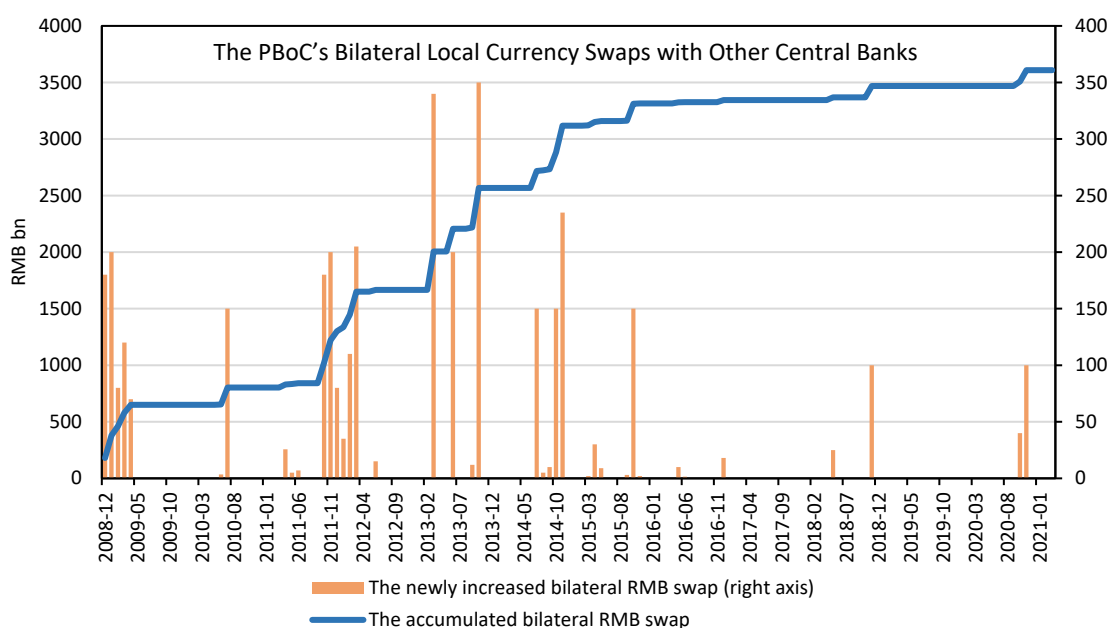
- 3.2 The RMB has begun to assume a gradually increasing role as a reserve currency and to figure in countries' official foreign exchange reserves since the IMF began to separately identify the RMB in its official foreign exchange reserves database from 1 October 2016 (when the RMB was included in the basket of currencies that make up the IMF's SDR, Figure 1). The presence of the RMB in countries' official foreign exchange reserves is gradually rising, though it is not a major reserve currency yet. The share of RMB had increased from 1% in 2016 to just above 2% in 2020Q3. This indicates a gradually increasing, though still small, role of the RMB as a store of value for governments.
- 3.3 The RMB is also playing an increasing role as contingent reserves, through swap agreements between the PBOC and central banks of other countries. These swaps can meet the liquidity requirements arising from the increasing demand for RMB from cross-border settlement and offshore RMB markets as well as support the balance of payments needs through conversion to other currencies. By the end of 2019, China had signed bilateral currency swap agreements with the central banks or monetary authorities of 39 countries and regions, totalling more than RMB3.7 trillion (Figure 2), which accounted for around 4.5% of the world's foreign currency reserves.

FIGURE 1 CURRENCY COMPOSITION OF OFFICIAL FOREIGN EXCHANGE RESERVES (COFER)



Source: IMF Currency Composition of Official Foreign Exchange Reserves database. The figure shows the changing currency composition of holdings of official foreign exchange reserves across the IMF membership over time.

FIGURE 2 BILATERAL CURRENCY SWAPS



Source: CEIC.

3.4 While governments are gradually beginning to hold the RMB as a store of value for their reserves, another role played by some other international currencies, such as the US Dollar, Swiss Franc, or Japanese Yen, that the RMB has yet to play a major role is that of a “safe haven” currency. A “safe haven” currency is one that investors move to in times of financial market stress and disruptions. The view among several

academic and market observers is that while China satisfies some of the economic conditions required of a safe haven currency (such as being a net international creditor), others such as continued capital controls constrain this role for the RMB.³

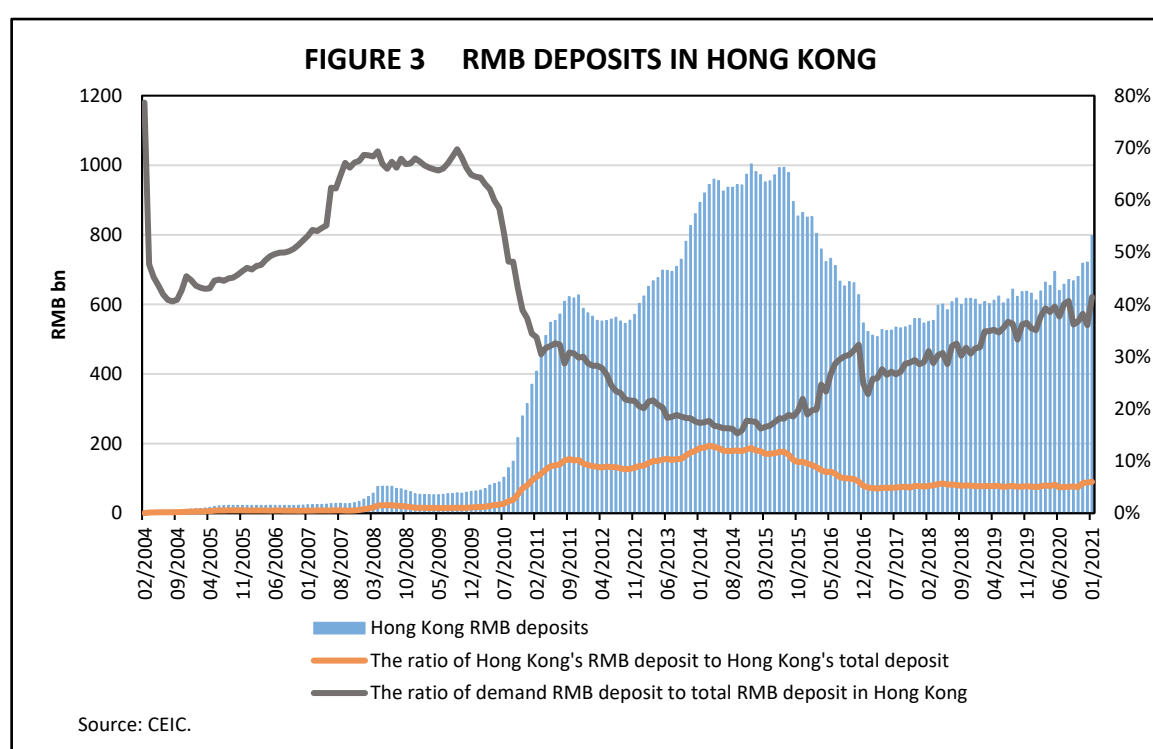
- 3.5 The typical use of a foreign currency as a store of value by private actors is when the actors choose to substitute holdings of domestic currency with the foreign currency, possibly due to reduced faith in the domestic currency's ability to hold value. In the US dollar context, this is often referred to as "dollarisation" in the economy. While partial dollarisation is seen in several countries, full dollarisation has been sparingly used and usually in small countries experiencing severe bouts of macroeconomic difficulties. The use of a foreign currency instead of the domestic currency as a store of value is one measure of the degree of internationalisation of the currency. There is, currently, little evidence that the RMB is being used in this manner in any country by private citizens.
- 3.6 An alternative measure of the use of the RMB by private actors as a store of value can be inferred from the growth in holdings of RMB deposits outside of mainland China. Almost all of such deposits are currently in Hong Kong. Licensed banks in Hong Kong began accepting RMB deposits in early 2004, initially to support mainland tourism and remittances. The pace of accumulation accelerated when cross-border trade settlement in RMB was permitted in 2009.
- 3.7 Offshore RMB deposits in Hong Kong rose sharply to a record-high level of RMB1 trillion at the end of 2014 (from less than RMB100 billion in 2009) as the RMB appreciated against major currencies over this period. The volume of offshore RMB deposits subsequently dropped to around RMB500 billion in early 2017 (Figure 3) before it bounced back; it has been increasing steadily in more recent years.

³ See Prasad, E (2016). China's efforts to expand the international use of the renminbi. *Brookings*. <https://www.brookings.edu/research/chinas-efforts-to-expand-the-international-use-of-the-renminbi/>, accessed 3 July 2021.

Frankel, J (2012). Internationalization of the RMB and Historical Precedents.

Cheung, Y W (2020). *A Decade of RMB Internationalization* (Issue GRU_2020_024). City University of Hong Kong, Department of Economics and Finance, Global Research Unit. https://econpapers.repec.org/paper/cthwpaper/gru_5f2020_5f024.htm, accessed 3 July 2021.

3.8 Similarly, the ratio of RMB deposits to total deposits in Hong Kong was rising until 2014 before subsequently stabilising at a level of 5% to 6%. In addition, more than 80% of Hong Kong's RMB deposits in mid-2014 were fixed-term time deposits rather than demand, implying that the overall demand for offshore RMB financial products was still limited. Nevertheless, the ratio of demand RMB deposits to total RMB deposits in Hong Kong has also shown a rising trend since 2016, which might suggest that other offshore RMB products created in Hong Kong such as real estate investment trusts, exchange-traded funds, insurance products, derivatives and commodity products continue to develop to meet the increasing demand.



3.9 Another measure of the RMB's role as a store of value for international investors is Hong Kong's RMB-denominated bond market that was developing rapidly prior to 2015 (Figure 4). The new issuance of RMB bonds ("Dim Sum" bonds) reached nearly RMB200 billion in 2014. Offshore RMB loans also grew fast until 2017, with outstanding RMB loans totalling nearly RMB300 billion in 2015 and 2016.

3.10 In line with the gradual opening up of the Chinese financial markets, onshore RMB-denominated bonds held by overseas investors have also increased rapidly (Figure 5). Onshore RMB deposits held by foreigners, by contrast, have grown much more slowly, accounting for less than 2% of total saving deposits since 2016 (Figure 6).

FIGURE 4 OFFSHORE RMB LOANS AND BONDS

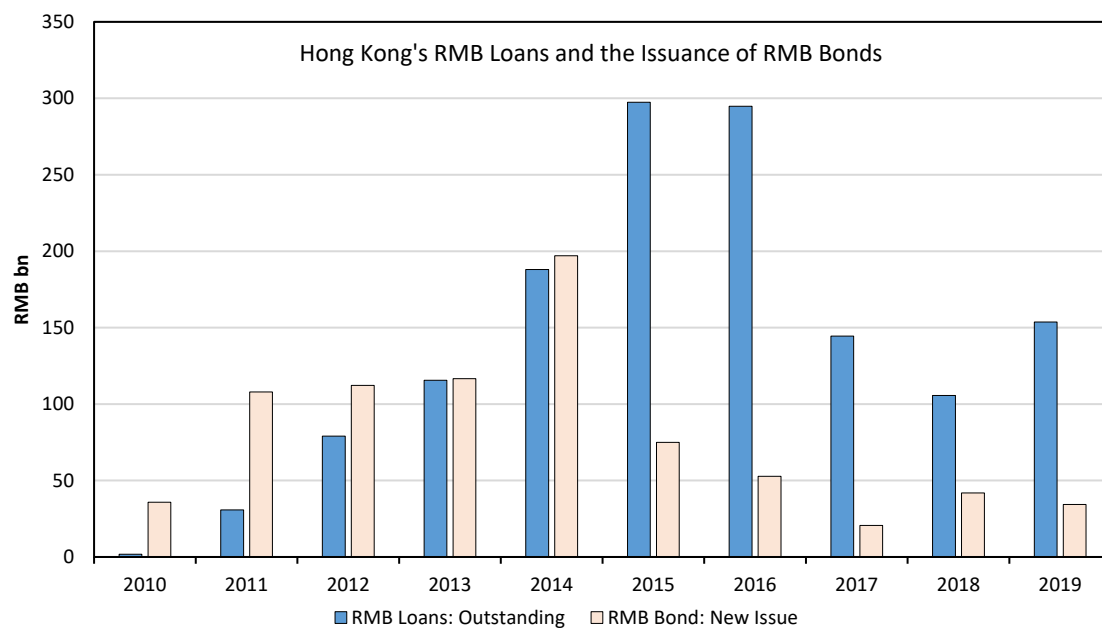
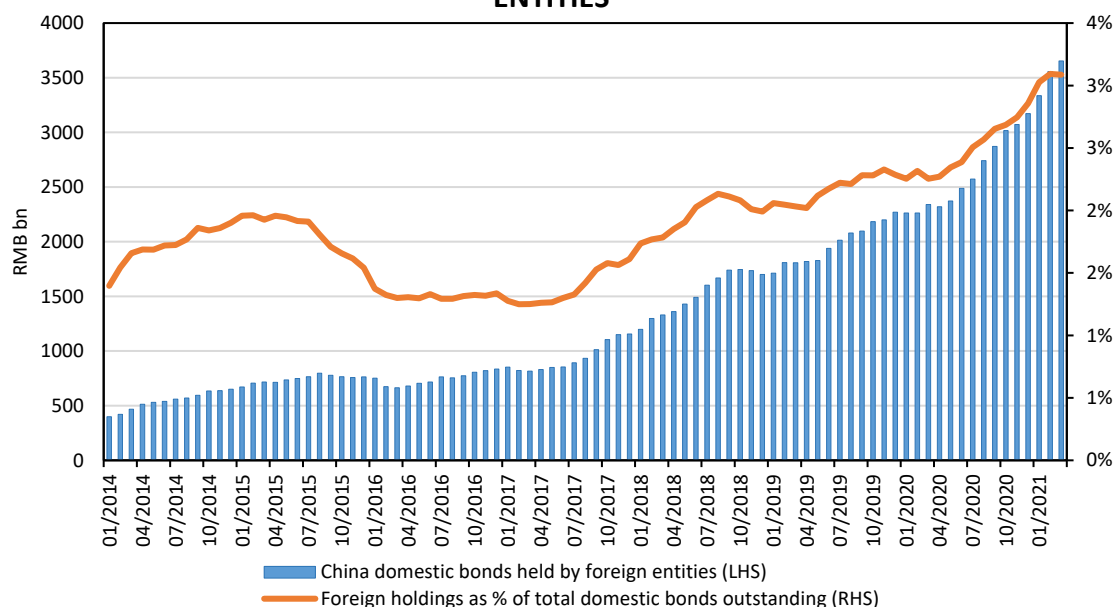
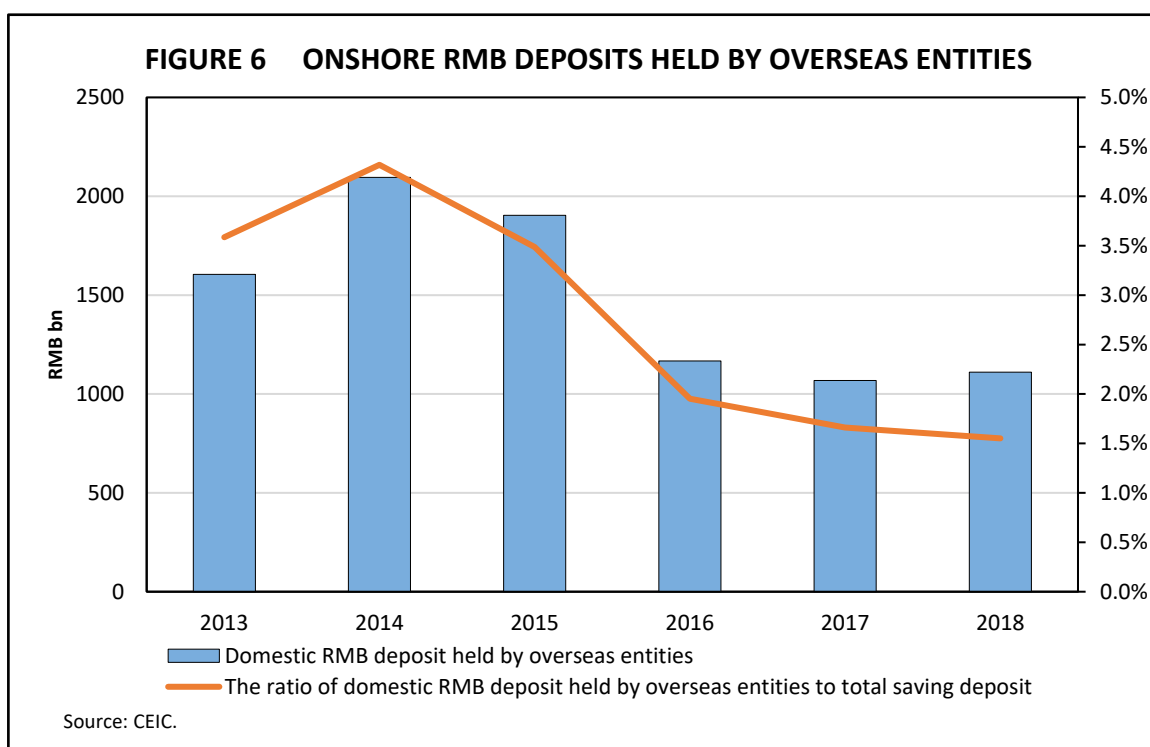


FIGURE 5 DOMESTIC RMB-DENOMINATED BONDS HELD BY OVERSEAS ENTITIES



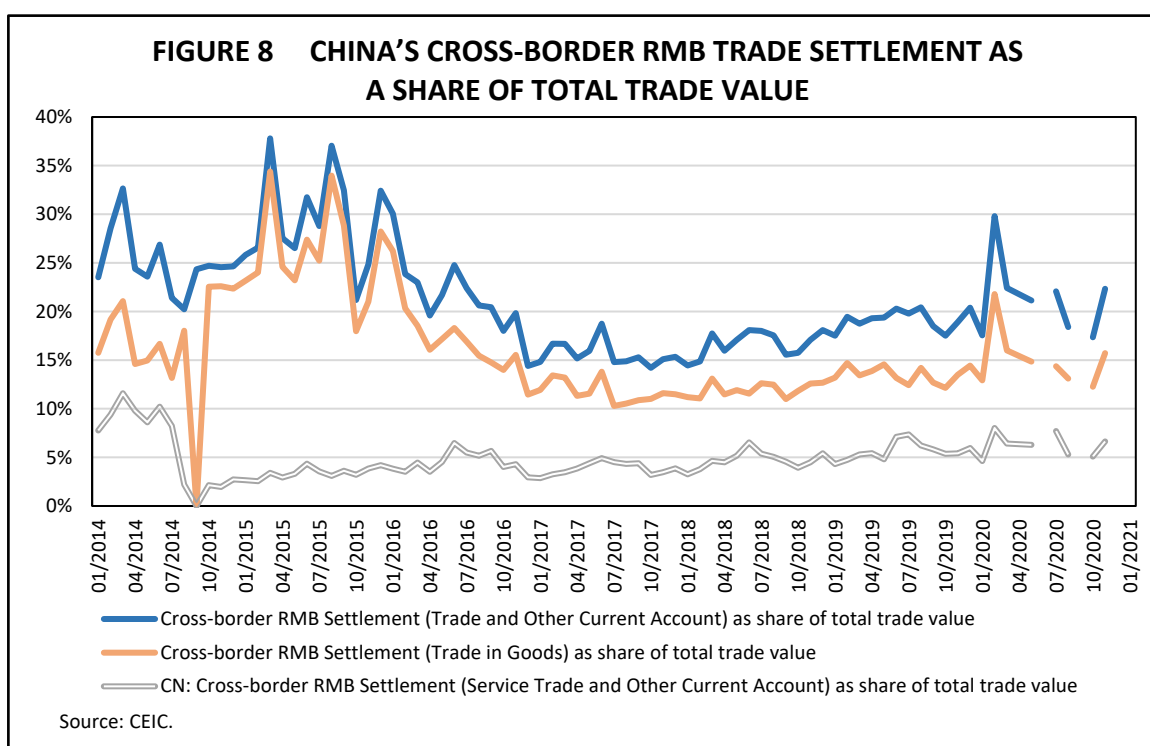
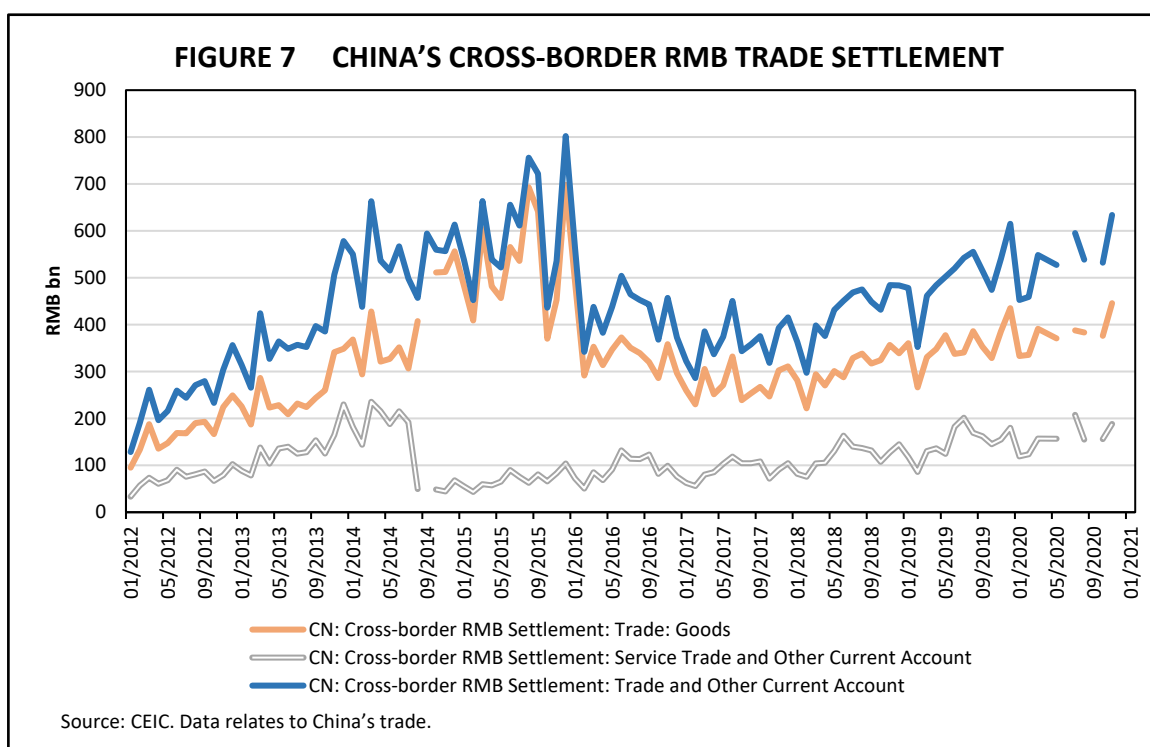


The RMB as a medium of exchange

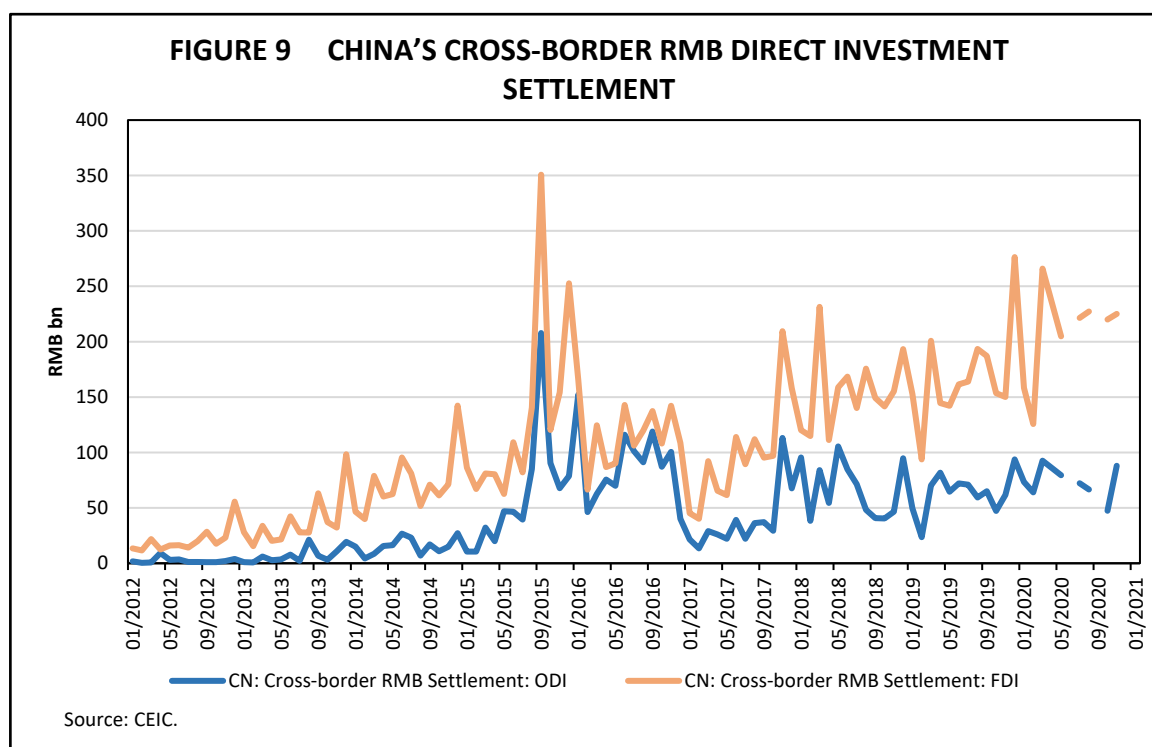
3.11 The use of RMB for cross-border trade invoicing and payment has grown rapidly since 2012 (Figure 7). China's goods trade and other current account transactions—services, income, and dividend payments settled in RMB reached their historical highs in 2015 and early 2016; more recently they are gradually recovering to their previous highs. In 2015 the RMB settled share of China's goods trade rose by more than 30% over the previous year, while that of other current account transactions rose over 10%. Though cross-border RMB trade settlement fell in 2016 and 2017, it has begun to grow again since 2018.

3.12 Figure 8 shows China's cross-border RMB trade settlement as a share of total trade value. During historical highs of RMB trade settlement in 2015 and 2016, its share of total trade value reached over 35% for trade and other current account, over 30% for trade in goods, and less than 5% for service trade and other current account.⁴

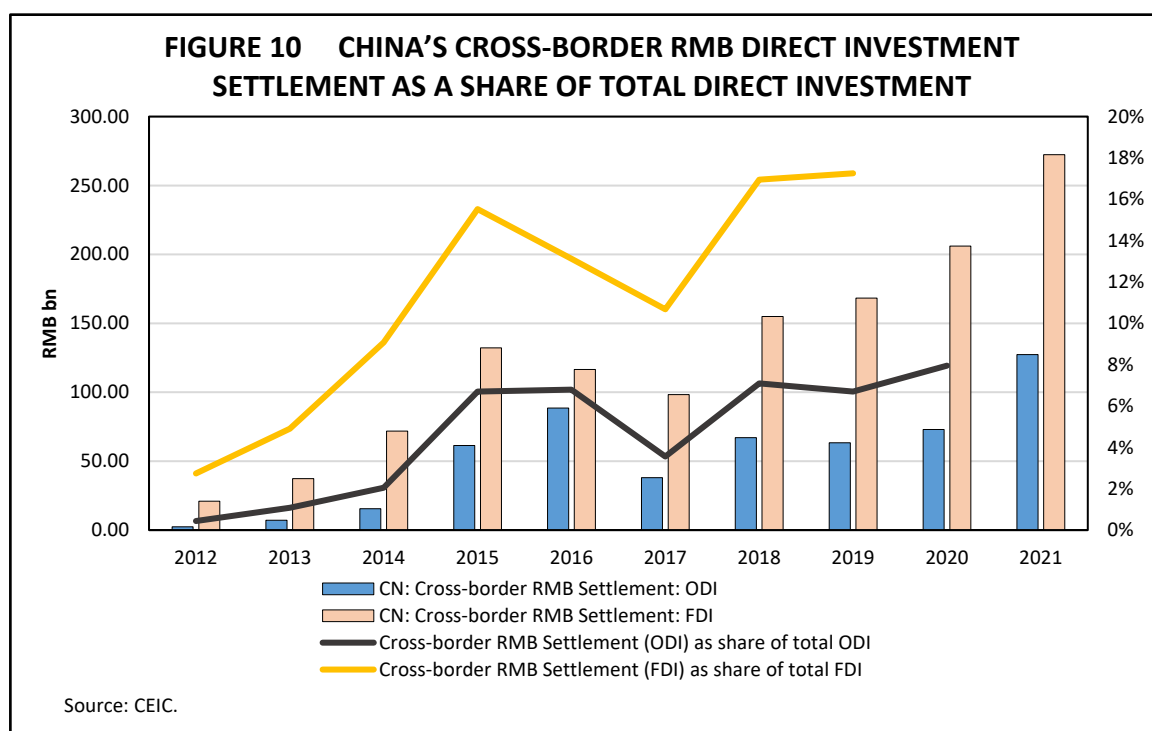
⁴ Cross-border RMB trade settlement in service trade and other current account as a share of total trade value and RMB trade settlement in goods as a share of total trade value should add up to RMB trade settlement in all trade and other current account as a share of total trade value.



3.13 Since 2011, inward foreign direct investment (FDI) and outward direct investment (ODI) have been allowed to be settled in RMB. Since then, the currency has been developing as the choice for settling direct investment payments inward and outward (Figure 9).

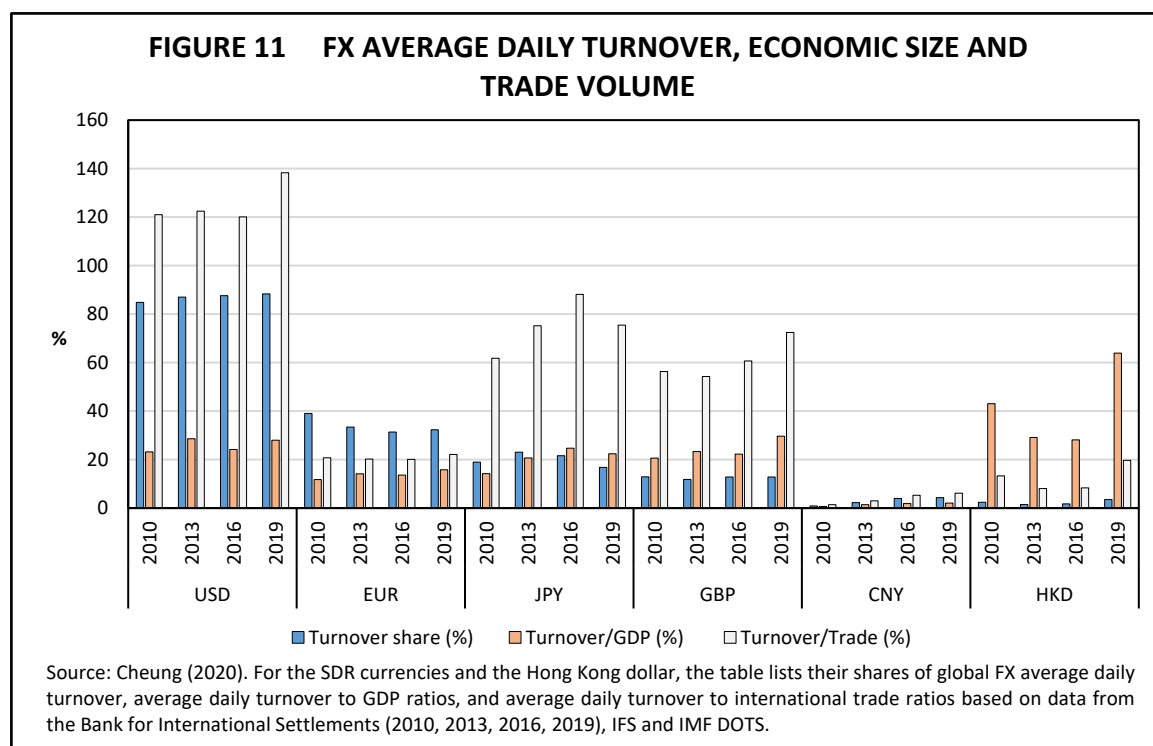


3.14 After the conversion from monthly data to annual data, Figure 10 shows that cross-border RMB FDI settlement as a share of total FDI was around 15% in 2015, fell in 2016 and 2017 before recovering to the previous high levels at over 15% after 2018. For RMB ODI settlement, its share of total ODI was around 7% in 2015 and 2016, fell in 2017 before growing again since 2018 in more recent years.⁵

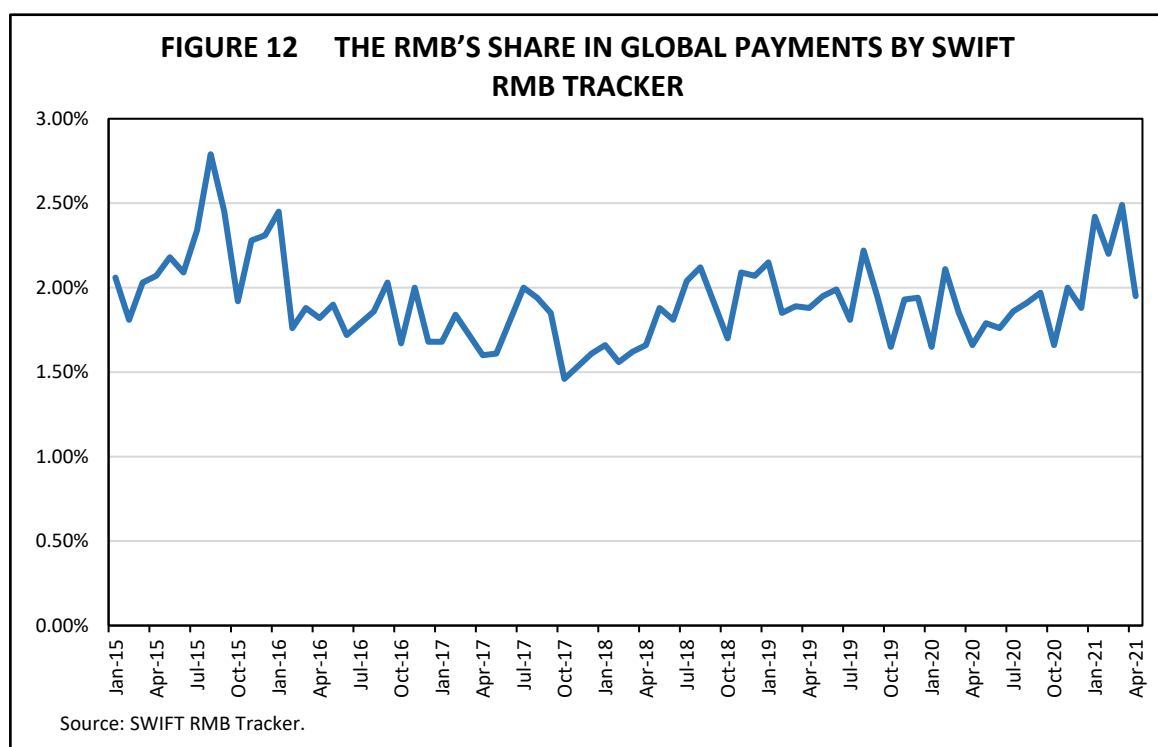


⁵ Data for total FDI and total ODI is only available till 2019 and 2020 respectively.

3.15 Another measure of the RMB's international role as a means of exchange can be gauged from the global foreign exchange trading market. As discussed in Cheung (2020) (Figure 11), the average daily RMB trading turnover has been growing – from around RMB30 billion in 2010 to RMB285 billion in 2019. As a share of the overall global foreign exchange market, however, the RMB remains small – at around 4.3% (the US dollar's share was more than 88%).



3.16 Yet another measure of RMB's use as a medium of exchange can be assessed from SWIFT data on international payments. The RMB's share in global payments rose from 0.31% in 2011 to 2.27% in 2021. The share has fluctuated at around 2% since 2015 (Figure 12) as compared to the US dollar's share in global payments at around 40%, the EUR's share at around 36%, GBP's share at 6% and JPY's share at around 3.5% as of April 2021.



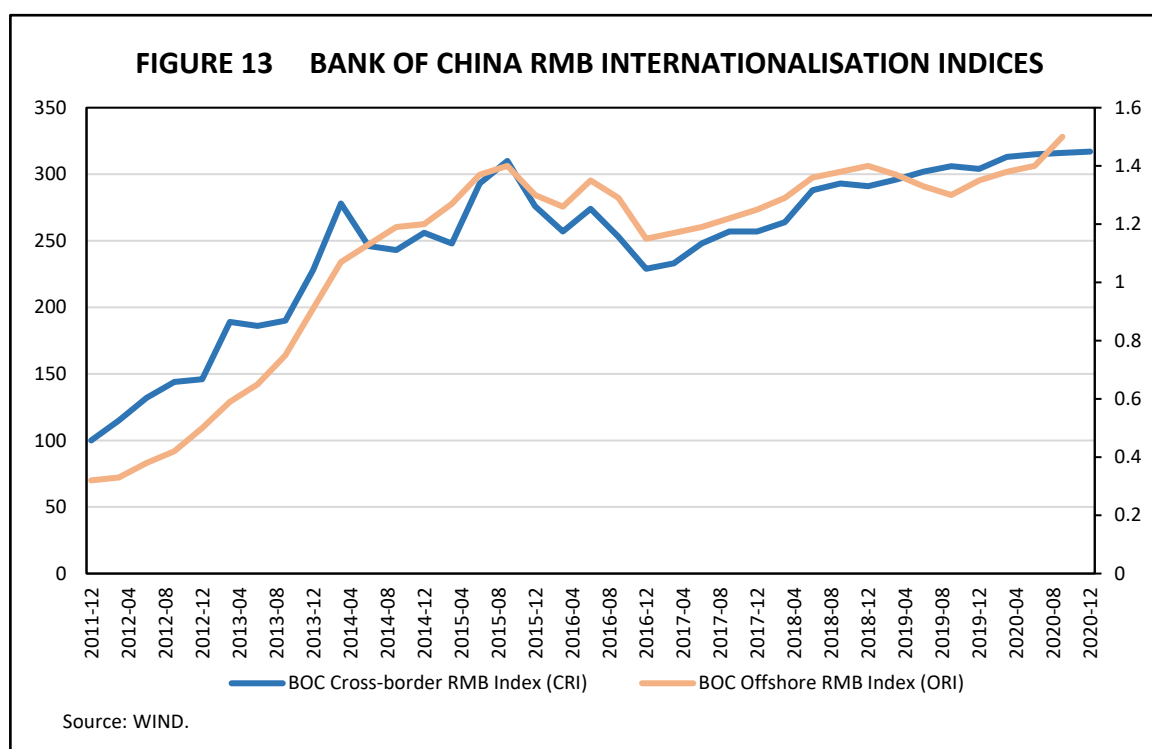
The RMB's role as a unit of account

- 3.17 The US dollar continues to be the unit for pricing the vast majority of global commodities such as oil, gold and many other commodities in international markets. China is well aware that the RMB's international role would also depend on the extent to which it is used in global commodity markets. Pricing in RMB would also reduce currency for China as the world's largest consumer of many commodities.
- 3.18 China first introduced RMB-denominated gold contracts in 2014. Currently, RMB-denominated contracts are available for global investors in oil and iron ore, in addition to gold. In 2016, the Shanghai International Gold Exchange launched the RMB-denominated Shanghai Gold Benchmark Price, futures contracts, which are now traded at the exchanges in Chicago and Dubai.
- 3.19 RMB-denominated futures in oil and crude oil were opened to international investors in 2018. The RMB-denominated Shanghai oil contracts have formed about 10% of the global trading volume in such contracts since their launch. More recently

in June 2020, China launched RMB-denominated PTA (purified terephthalic acid), natural rubber and low-sulphur fuel futures contracts.⁶

Indices Tracking RMB Internationalisation

- 4.1 A few commercial banks such as the Bank of China (BOC) have developed proprietary indices to track RMB internationalisation (Figure 13). The BOC indices show that RMB globalisation has made progress since 2012. Both cross-border and offshore RMB indices show a rapid upward trend from 2012 to 2015. There has been downward movement between 2015 and 2016 before a gradual increase resumed since 2017.



Prospects

- 5.1 The RMB's international role is growing gradually, so is its roles as a reserve currency and as a medium of exchange. Its role in other functions of money, however, is still small. Some of the early predictions that the RMB would rapidly challenge the dominance of the US dollar have not been realised. The more

⁶ Cheung, Y W (2020). *A Decade of RMB Internationalization*.

circumspect view that continued internationalisation would depend on continued policy actions and reforms has been borne out.

- 5.2 Given China's status as the world's second-largest economy and largest trading nation, the RMB is favourably positioned to continue to make further gains as an international currency. However, the RMB still has some way to go before attaining the status of a major international currency. China's policy steps in this area have thus far been gradual. Given the continuing pronouncements from the policymakers, such policy steps are likely to continue. However, a more international RMB will mainly depend on the trust and confidence in China's policies, deeper financial markets, and the further liberalisation of the capital account and exchange rate regimes.

Annex 1

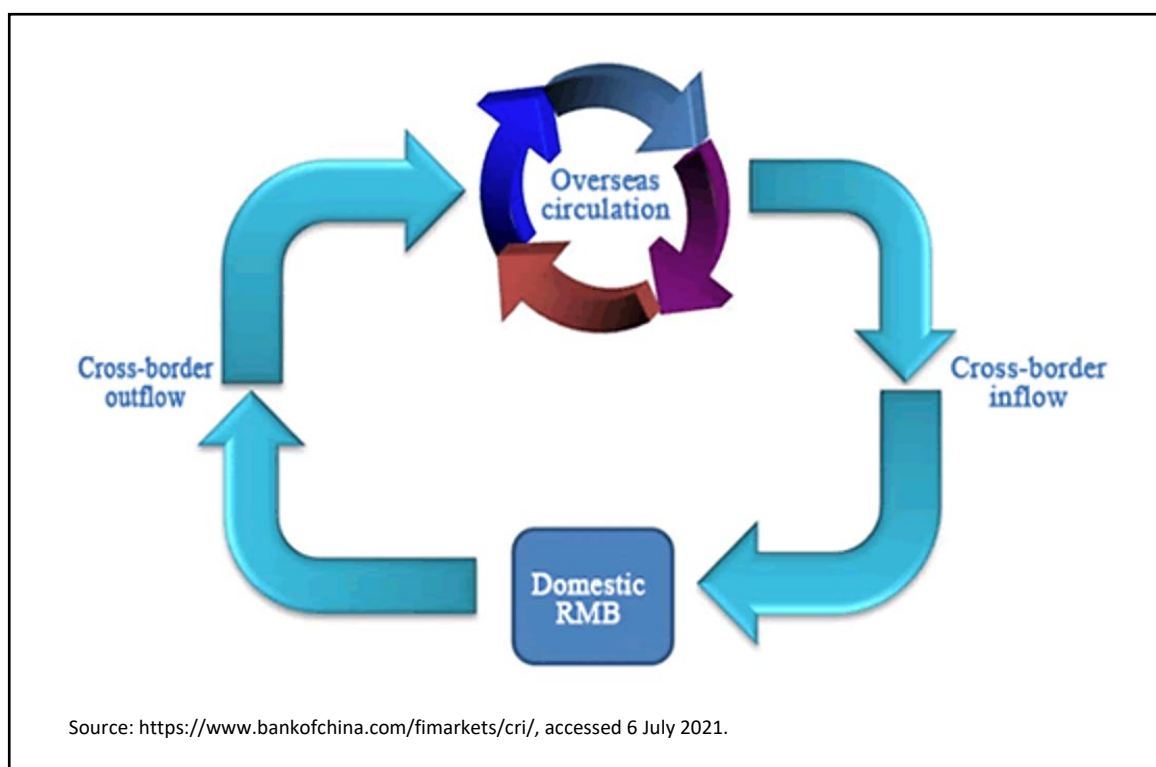
Bank of China RMB Internationalisation Index

Following the release of the Bank of China (BOC) Cross-border RMB Business White Paper (2013) in July 2013, the Bank officially launched the BOC Cross-border RMB Index (CRI) worldwide on 20 September, providing an authoritative measure to comprehensively reflect the degree of RMB activity in cross-border and overseas transactions.

Cross-border RMB Index (CRI)

CRI is a comprehensive index that reflects the degree of RMB activity in cross-border transactions and the development situation of RMB internationalisation.

The index composed of three well-knit parts to reflect the degree of RMB activity in cross-border outflow, overseas circulation and cross-border inflow.



The index with wide coverage covers all items under the current account and typical items under the capital account, reflecting RMB circulation and utilisation abroad by clearing status, which reveals the degree of activity of cross-border and overseas RMB circulation and utilisation.

Offshore RMB Index (ORI)

BOC Offshore RMB Index or ORI is an index to reflect the RMB development in the international financial market and the progress of RMB internationalisation.

Five indicators are set and calculated on a weighting basis, including the percentage of offshore RMB deposits and loans, percentage of RMB in global foreign exchange reserves, and percentage of RMB-denominated international bonds and equity investments in such bonds and investments denominated in all currencies, which represent the exercise of five international currency functions with RMB, namely, value store currency, financing currency, investment currency, reserve currency and trading currency.

Focusing on offshore markets, ORI aims to comprehensively evaluate RMB development in offshore financial markets in terms of size of existing funds, use of funds and use of financial instruments.

ORI measures and presents the progress of RMB internationalisation at the end of the reporting period based on existing indicators, that is, the balance of various assets and liabilities at the end of the reporting period.

ORI calculates the percentage of RMB in all currencies on a weighting basis in terms of various offshore financial market activities to intuitively reflect RMB development in the international financial market.