RENMINBI INTERNATIONALISATION (I): A HISTORICAL REVIEW AND CHINA'S POLICY MEASURES

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Executive Summary

1. In line with its stature as the world's second-largest economy in nominal terms and the largest in purchasing power parity (PPP) terms, China has had ambitious plans for a greater international role for its currency, the Renminbi (RMB), since the beginning of the century.

2. China began to internationalise the RMB in the early 2000s, particularly after the 2008-09 global financial crisis which adversely impacted many countries, including China, due to the dominance of US dollar as the world's reserve currency. China's policymakers argued for an international currency, such as the International Monetary Fund's (IMF) Special Drawing Rights (SDR), to reduce this dependence.

3. While China recognised that such a shift in roles would take considerable amount of time, it has also begun to ramp up public policies to internationalise its own currency, the RMB.

4. China has liberalised its regimes for a two-way flow of RMB into and out of China since 2006, though outflows continue to be heavily controlled. The exchange rate regime was also reformed in 2005 and has been liberalised since. Offshore bond issuances were first permitted in 2007 and direct links for foreigners to invest in onshore securities have since been established.

5. Bilateral currency swap agreements have been signed with many countries since 2009. Offshore RMB trading is now possible in all time zones. The IMF has included the RMB in the basket of currencies that determine the value of its SDR in 2016. Several other steps have also been taken by the Chinese authorities to promote the greater international role of the RMB.

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Background

1.1 China's major public policy push to internationalise the Renminbi (RMB) began in 2009. The global financial crisis and US domestic policy actions to deal with the crisis resulted in global spillovers, including China. Countries around the world found themselves dealing with a crisis whose impact reverberated through their own economies due to the dominance of the US dollar as the world's most international currency and largest reserve currency.

1.2 In an essay for the Bank for International Settlements (BIS), former Governor of People's Bank of China, Dr Zhou Xiaochuan, asked: "….what kind of international reserve currency do we need to secure global financial stability and facilitate world economic growth..?"[1] In his view, "The above question, as the ongoing financial crisis demonstrates, is far from being solved, and has become even more severe due to the inherent weaknesses of the current international monetary system".

1.3 Zhou called for a reform of the existing international monetary system moving from using a national currency (for example, the US dollar) towards using International Monetary Fund's (IMF) Special Drawing Rights (SDR) as a centrally managed global reserve currency for a more stable value, rule-based issuance and manageable supply. This would safeguard global economic and financial stability.

1.4 The global financial crisis, in his view, reflected the inherent vulnerabilities and systemic risks in the existing international monetary system as reserve currency-

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1 Zhou, X. (2009). Reform the international monetary system. *BIS Review,* 41.

issuing countries faced a dilemma between trying to achieve domestic monetary policy goals and meeting demand for reserve currencies from other countries simultaneously. While he argued specifically for a larger role for the IMF's SDR as a global reserve currency and as a means of payment in international trade and financial transactions, he also recognised that "this will require political cooperation among member countries".

1.5 This line of thinking was the articulation of recognition among Chinese policymakers of the need to reduce their dependence on the US dollar. This resulted in a strong impetus to promote the international role of the RMB. Since 2009, China has made significant progress in its stated policy goal. Some initially argued that the RMB would soon replace the US dollar as the world's premier currency or at least give the US dollar a strong challenge for its primacy as an international currency. Others were much more circumspect.[2]

A Brief History of International Currencies

2.1 Three currencies rose to international status in the 20th century – the US Dollar, the Deutsche Mark (which subsequently formed the core of the Euro) and the Japanese

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[2] See Chen, H and Peng, W (2010). The Potential of the Renminbi as an International Currency. In W Peng and C Shu (eds.), *Currency Internationalization: Global Experiences and Implications for the Renminbi* (pp. 115–138). Palgrave Macmillan UK. https://doi.org/10.1057/9780230245785_5, accessed 3 July 2021.

Dobson, W and Masson, P R (2009). Will the renminbi become a world currency? *China Economic Review*, *20*(1), 124–135. https://doi.org/10.1016/j.chieco.2008.05.005, accessed 3 July 2021.

Subramanian, A (2011a). Eclipse: Living in the Shadow of China's Economic Dominance. In *Peterson Institute Press: All Books*. Peterson Institute for International Economics. https://ideas.repec.org/b/iie/ppress/6062.html, accessed 3 July 2021.

Subramanian, A (2011b). Renminbi Rules: The Conditional Imminence of the Reserve Currency Transition. *SSRN Electronic Journal*. https://doi.org/10.2139/ssrn.1928138, accessed 3 July 2021.

Eichengreen, B (2011a). *Exorbitant Privilege: The Rise and Fall of the Dollar and the Future of the International Monetary System*. Oxford University Press.

Eichengreen, B (2011b). The renminbi as an international currency. *Journal of Policy Modeling*, *33*(5), 723–730. https://doi.org/10.1016/j.jpolmod.2011.07.004, accessed 3 July 2021.

Kroeber, A R (2011). The Renminbi: The Political Economy of a Currency. *Brookings*. https://www.brookings.edu/research/the-renminbi-the-political-economy-of-a-currency/, accessed July 2021.

Prasad, E and Ye, L (2012). The Renminbi's Role in the Global Monetary System. *Brookings*. https://www.brookings.edu/research/the-renminbis-role-in-the-global-monetary-system/, accessed 3 July 2021.

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. *Journal of Economic Integration*, 27(3), 329–365.

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/RePEc:cth:wpaper:gru_2020_024, accessed 3 July 2021.

Yen.[3] The rise of these three as international currencies significantly reduced the role that the UK Pound Sterling had played as the world's dominant international currency till the early 20th century. At the dawn of the 20th century, 60% of world trade was invoiced in Pound Sterling. Nearly two-thirds of the world's foreign currency reserves were denominated in Pound Sterling – more than twice the total held in Deutsche Mark and Japanese Yen. The US dollar hardly played a role either as a reserve currency or as a unit of account for international trade at the time.

2.2 In 1872, the US economy had overtaken the UK economy as the world's largest. Between 1913, when the United States established the Federal Reserve and began the process of establishing deep and liquid financial markets, and 1917, a short span of four years, the US Dollar had emerged as a major international currency. During the First World War, the United States lent large sums to the UK to finance the war, leading to the perception that the US dollar was a good store of value and hence, a strong currency. These three factors – economic size, deep and liquid financial markets, and role as strong currency, contributed to US Dollar's internationalisation.

2.3 By the end of the Second World War in 1945, liquid assets held in US dollars were twice that of the Pound Sterling. The US dollar was also the only currency still convertible into gold, which made it the de-facto basis for the Bretton Woods system. The transformation of the US dollar into the world's leading international currency was complete and has largely remained so since. While there are differing opinions on the speed of the US dollar's transformation, estimates range from 10 years to nearly 80 years.[4]

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

Eichengreen, B and Kawai, M (2014). Issues for Renminbi Internationalization: An Overview. In *ADBI Working Papers* (No. 454; ADBI Working Papers). Asian Development Bank Institute. https://ideas.repec.org/p/ris/adbiwp/0454.html, accessed 3 July 2021.

4 See Broz, J L (1999). Origins of the Federal Reserve System: International Incentives and the Domestic Free-Rider Problem. *International Organization*, 53(1), 39–70.

Schenk, C R (2010). *The Decline of Sterling: Managing the Retreat of an International Currency, 1945–1992*. Cambridge University Press. https://doi.org/10.1017/CBO9780511676499, accessed 3 July 2021.

Lindert, P H (1969). *Key Currencies and Gold, 1900-1913*. Princeton University International Finance Section, Department of Economics.

Krugman, P R (1984). *The International Role of the Dollar: Theory and Prospect* (No. c6838). National Bureau of Economic Research. https://www.nber.org/books-and-chapters/exchange-rate-theory-and-practice/international-role-dollar-theory-and-prospect, accessed 3 July 2021.

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

2.4 The Deutsche Mark's rise began in 1973 after the United States suspended the dollar's convertibility into gold, which ended the Bretton Woods system. Periodic bouts of high inflation in the United States and depreciation over four decades had begun to erode global confidence in the US dollar as a store of value.

2.5 The share of international reserves held in dollars declined significantly after the late 1970s, with the Mark and the Yen gaining in share. In contrast, Germany's strong and growing economy and sound economic management contributed to Mark's strength and growing internationalisation. By 1989, nearly a fifth of global reserves were held in Deutsche Mark.

2.6 Subsequently, this share declined as Germany, along with the rest of Europe, focused on the creation of the Euro, and Germany also faced slowing economic growth, partly due to the strength of the Mark. The share of reserves held in the US dollar began to rise again, as economic management in the United States improved in the 1990s after the cold war ended.

2.7 The Japanese Yen also began to take on the role of an international currency after the break-up of the Bretton Woods system in 1973.[5] Even though central banks began to hold reserves in Yen, as it was seen as a strong currency and international use gradually increased in the 1980s, neither much of global trade was invoiced in yen nor was much cross-border debt held in yen.

Eichengreen, B and Flandreau, M (2009). The rise and fall of the dollar (or when did the dollar replace sterling as the leading reserve currency?). *European Review of Economic History*, 13(3), 377–411. https://doi.org/10.1017/S1361491609990153, accessed 3 July 2021.

Subramanian, A (2011a). Eclipse: Living in the Shadow of China's Economic Dominance.

Subramanian, A (2011b). Renminbi Rules: The Conditional Imminence of the Reserve Currency Transition.

[5] Takagi, S (2011). Internationalizing the yen, 1984–2003: Unfinished agenda or mission impossible? In *Asia and China in the Global Economy* (Vol. 1–0, pp. 219–244). World Scientific. https://doi.org/10.1142/9789814335270_0008, accessed 3 July 2021.

Frankel, J A (1984). *The yen/dollar agreement, liberalizing Japanese capital markets*. Institute for International Economics; distributed by MIT Press.

Kennedy, P P (1989). *The Rise and Fall of the Great Powers: Economic Change and Military Conflict from 1500 to 2000*. Harper Collins.

Fingleton, E (1995). *Blindside: Why Japan Is Still on Track to Overtake the U.S. By the Year 2000* (1st edition). Houghton Mifflin Harcourt.

2.8 By 1991, the share of the Japanese Yen in international reserves reached a peak of 9%; it declined subsequently as the US dollar regained its primacy. Japan's efforts at liberalising its financial markets in the late 1990s and early 2000s remained an unfinished task. By that time, Japan's real economy began its long period of stagnation and further internationalisation of the Yen suffered as a result.

2.9 Some common elements among the experiences of these three currencies provide relevant context for examining China's current push to internationalise the RMB. In the United States, it was the actions of the young Federal Reserve, particularly its role in establishing deep and liquid financial markets beginning with the establishment of a market for US dollar-denominated trade acceptances that drove the internationalisation of the currency.[6] Another is the financial sector in the United States as it stood to profit from the internationalisation directly.[7] The leading post-war role of the United States at the Bretton Woods conference that established the IMF and the World Bank also helped internationalise the US Dollar.

2.10 However, there was limited popular support among the majority of the public and politicians for the US dollar's internationalisation; several important legislations that could have possibly supported a larger international role for the US dollar stalled in the US Congress.

2.11 Likewise for the Mark, there was active opposition in Germany, among both economic policymakers and foreign policymakers, for a large international role for the Mark.[8] The powerful manufacturing sector in Germany feared the loss of competitiveness if a greater international role for the Mark led to an appreciation of the currency.

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6 Eichengreen, B (2011a). *Exorbitant Privilege: The Rise and Fall of the Dollar and the Future of the International Monetary System*.
Frankel, J (2012). Internationalization of the RMB and Historical Precedents.

7 Broz, J L (1999). Origins of the Federal Reserve System: International Incentives and the Domestic Free-Rider Problem. *International Organization*, 53(1), 39–70.
Karmin, C (2008). *Biography of the dollar: How the mighty buck conquered the world and why it's under siege* (1st ed). Crown Business.
Frankel, J (2012). Internationalization of the RMB and Historical Precedents.

8 Eichengreen, B (2011a). *Exorbitant Privilege: The Rise and Fall of the Dollar and the Future of the International Monetary System*.
Eichengreen, B (2011b). The renminbi as an international currency.

2.12 In Japan, till the 1990s, the attitudes towards internationalisation among policymakers and the manufacturing sector were similar to those in the United States and Germany, either indifference or active opposition. Although the financial sectors in Germany and Japan arguably stood to gain from the process, just as that in the United States, this sector in the two countries was relatively small or had a smaller voice than the manufacturing sector.

2.13 After an initial period of indifference, Japanese official policy began to actively promote greater internationalisation of the Yen in the 1990s.[9] Some of the objectives of this shift were similar to what China's objectives are today – reduce exchange rate risk for domestic firms and promote Japan as an international financial centre. Recognising the role of a more liberalised financial sector in the internationalisation process, the "big-bang" reforms of 1998 were introduced. While these and other efforts continued over the following decade, they have been largely ineffective due chiefly to the "lost decades" in the Japanese economy after the bursting of the stock market and real estate bubbles. As the Japanese economy stagnated, so did the international role of the Yen.

2.14 China's efforts at internationalising the RMB, which involve the government's explicit policy objective to do so, therefore stand somewhat in contrast to the experiences of the United States and Germany, and to a more limited extent, Japan, where internationalidation happened almost as a by-product of the growth of their economies and, at least in the United States, the depth of its financial markets.[10]

2.15 Another important message relevant to China from the experience of the US dollar, in particular, is the amount of time it took for it to become the world's dominant international currency by displacing the British Pound Sterling. Estimates range from 10 years to nearly 80 years, depending on the measurement metrics used.[11]

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

[10] Interestingly, China led the establishment of two new multilateral development banks in 2015 – the Asian Infrastructure Investment Bank and the New Development Bank. Both banks are based in China – the former in Beijing and the latter in Shanghai. The US dollar is the operating currency of both banks, despite the two banks being based in China and established at a time when China had already been pushing for a larger international role for the RMB for several years.

[11] Eichengreen, B (2011a). *Exorbitant Privilege: The Rise and Fall of the Dollar and the Future of the International Monetary System*.

While global financial markets and technology have changed significantly since the US dollar became the world's dominant currency, this experience indicates that the time frame over which the RMB could possibly become a major international currency is unpredictable and would depend on a number of factors beyond government policy.

China's Policy Steps at Internationalising the RMB

3.1 China's efforts to internationalise the RMB started in early 2002 and proceeded gradually with incremental measures. Policies prior to 2009 included the introduction of the Qualified Foreign Institutional Investor (QFII) programme, launch of offshore RMB market in Hong Kong and reform of the exchange rate regime, while more comprehensive measures have been implemented since the global financial crisis, and policy steps to internationalise the RMB have accelerated since (see Annex 1).[12]

Eichengreen, B and Flandreau, M (2009). The rise and fall of the dollar (or when did the dollar replace sterling as the leading reserve currency?).

Eichengreen, B and Flandreau, M (2010). The Federal Reserve, the Bank of England and the rise of the dollar as an international currency, 1914-39. In *BIS Working Papers* (No. 328; BIS Working Papers). Bank for International Settlements. https://ideas.repec.org/p/bis/biswps/328.html , accessed 3 July 2021.

Subramanian, A (2011a). Eclipse: Living in the Shadow of China's Economic Dominance.

Subramanian, A (2011b). Renminbi Rules: The Conditional Imminence of the Reserve Currency Transition.

Krugman, P R (1984). *The International Role of the Dollar: Theory and Prospect*.

12 See Prasad, E (2016). China's efforts to expand the international use of the renminbi.

Eichengreen, B (2011a). *Exorbitant Privilege: The Rise and Fall of the Dollar and the Future of the International Monetary System*.

Eichengreen, B (2011b). The renminbi as an international currency.

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

Xinhua (2015). *Chronology of RMB going global*. http://english.www.gov.cn/news/top_news/2015/12/03/content_281475246990434.htm, accessed 3 July 2021.

Deutsche Bank (2015). *Harnessing the RMB opportunity: A brief guide to China's global currency*. Deutsche Bank. https://www.deutschebank.nl/nl/docs/Deutsche_Bank_A_brief_guide_to_China_s_global_currency.pdf, accessed 3 July 2021.

HKMA (2014). *Hong Kong Monetary Authority—Hong Kong as Offshore Renminbi Centre – Past and Prospects*. http://www.hkma.gov.hk/eng/news-and-media/insight/2014/02/20140218/, accessed 3 July 2021.

PBOC (2020). *2020 RMB Internationalization Report*. https://www.caixinglobal.com/upload/PBOC-2020-RMB-International-Report.pdf, accessed 3 July 2021.

Key policy steps pre-2009

3.2 The very first efforts to relax the tight controls on RMB started in the early 2000s. In November 2002, China introduced the QFII programme, which allowed licensed international institutional investors to convert foreign currencies into RMB and invest and trade in RMB-denominated securities on China's stock markets.

3.3 The following year, the People's Bank of China (PBOC) appointed the Bank of China (Hong Kong) as the clearing bank for the RMB business in Hong Kong.[13] In early 2004, 40 participating banks in Hong Kong began to offer personal banking services in RMB including deposit-taking, currency exchange, remittances, and debit and credit card services.

3.4 In July 2005, China reformed its exchange rate regime, which directly impacted the process of the internationalisation of the RMB. China moved from a fixed exchange rate system pegged to the US dollar to a managed floating exchange rate regime based on market supply and demand with reference to a basket of currencies. This allowed the RMB to fluctuate within a narrow band (subsequently, the band has been periodically changed and widened). China initiated steps towards a greater degree of exchange rate flexibility, while the PBOC still carefully managed the exchange rate to avoid excessive volatility.

3.5 In 2007, the first offshore RMB denominated bonds, known as "dim sum" bonds, were issued by the China Development Bank in Hong Kong.

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[13] The scope of the business of the Bank of China (Hong Kong) included deposit-taking, exchange, remittances and RMB cards. The clearing bank would open RMB settlement accounts for participating banks for the acceptance and withdrawal of RMB funds, open a settlement account with the PBOC's Shenzhen sub-branch to centralise the acceptance and withdrawal of RMB funds of the clearing and participating banks, collect and distribute RMB banknotes; provide clearing services for RMB remittances and RMB cards issued by Hong Kong banks; and provide services for participating banks to square their RMB open positions from the exchange of RMB into Hong Kong dollars and vice versa. Source: https://www.info.gov.hk/gia/general/brandhk/1224072.htm, accessed 3 July 2021.

Key policy steps post-2009

Offshore payment and clearance systems

3.6 Expanding from its initial steps in Hong Kong, there were RMB clearing banks in 25 countries and regions around the world including in London and New York by the end of 2019,[14] with Hong Kong remaining as the single largest offshore market for the RMB.

3.7 The Cross-Border Interbank Payment System (CIPS) was launched in October 2015. The CIPS is a wholesale payment system, authorised by the PBOC, that provides cross-border payment clearing services to participating financial institutions. CIPS is based on international standards and permits the acceptance and usage of communications from SWIFT. The adoption of such international standards permits CIPS to be useful in the further internationalisation of the RMB.[15] CIPS reduces the need to use clearing banks and hence provides an alternative and more direct route available to satisfy the demand for cross-border payments and clearance services in the RMB by financial institutions.

3.8 The scope and coverage of CIPS have gradually expanded. As of April 2021, CIPS had 1,171 participants with 44 as direct participants and 1,127 as indirect participants. Among indirect participants, 876 were from Asia (including 525 from mainland China), 148 from Europe, 39 from Africa, 26 from North America, 21 from Oceania and 17 from South America, covering 100 countries and regions around the world. CIPS could play an increasing role in RMB payments and clearing services as the international demand for RMB-based transactions continues to grow.

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14 PBOC (2020). *2020 RMB Internationalization Report*.

15 SWIFT is an international system of communication between financial institutions. It is not a fund transfer system. Therefore, payment systems such as CIPS do not substitute for SWIFT (see Prasad, E (2016). China's efforts to expand the international use of the renminbi).

Trade settlement

3.9 As the world's largest trading nation, it was only natural that initial steps at internationalisation would cover the RMB being used in trade settlement. An exporter to China would receive RMB and be permitted to hold those RMB funds in banks in Hong Kong (now also in other clearing centres). The banks and firms could use these RMB funds for investments in the Mainland. As part of the pilot scheme launched in July 2009, a total of 365 Mainland Designated Enterprises (MDEs) from five approved cities – Shanghai, Guangzhou, Shenzhen, Zhuhai and Dongguan – could settle merchandise exports in RMB. Hong Kong, Macau and ASEAN member countries were specified as areas outside mainland China covered by the pilot.

3.10 This development marked a shift from serving personal customers to institutions and enterprises and from one-way RMB repatriation to two-way flows of RMB. It deepened the use of RMB in cross-border trade and investment activities. Hong Kong also experienced a maturing growth into an offshore RMB business centre with the world's largest pool of offshore RMB liquidity. The RMB cross-border trade settlement programme has subsequently been expanded several times. In 2011, it was expanded nationwide and to all countries and regions abroad.

3.11 Since 2012, the RMB cross-border trade settlement programme became applicable to all current account transactions and some capital account businesses. All China-based enterprises with import and export licences were allowed to settle their goods exports in RMB. In 2018, PBOC permitted all cross-border business that was earlier allowed to be settled in foreign exchange to also be settled in RMB.[16]

Investments

3.12 In 2011, China launched the RMB Qualified Foreign Institutional Investors (RQFII) pilot scheme. The scheme allowed qualified foreign institutional investors to establish RMB accounts in Hong Kong (up to a specified limit) and invest RMB

16 PBOC (2018). *Notice on Further Improving Policies for Cross-border RMB Business to Facilitate Trade and Investment*. https://rmb.bk.mufg.jp/files/topics/700_ext_02_en_0.pdf, accessed 3 July 2021.

assets onshore. The pilot programme granted 21 institutions with a total quota of RMB20 billion. Over time, the scheme was gradually expanded.

3.13 As of 2020, there have been no limits to the amounts that can be invested through this scheme and QFII and RQFII schemes have also been merged. Procedures to allow repatriation of profits from the investments made through the scheme have been simplified over time. Other modalities for onshore investments in RMB-denominated securities such as the Shanghai-Hong Kong Stock Connect (2014) and Shenzhen-Hong Kong Stock Connect (2016) and Bond Connect (2017) enable foreign investors to invest in securities through Hong Kong. RMB-denominated bond issuances in onshore and offshore markets have grown significantly since 2010.

3.14 In July 2015, the PBOC simplified the procedures for foreign central banks, international financial institutions and sovereign wealth funds to access the onshore interbank market and removed the investment quota limit on these entities.

3.15 While all these steps cover inflows of investment to China, steps have also been taken to liberalise the outflow of investments from China. From 2006, the Chinese government has introduced the qualified domestic institutional investor (QDII) scheme to allow qualified Chinese enterprises to invest in financial products overseas within allowable quotas.

3.16 In November 2014, RMB QDII (RQDII) programme was first introduced. An institution with a QDII licence may invest in overseas financial products denominated in RMB as long as these products are within the permissible investment scope under the QDII scheme. As of end-March 2021, the accumulated approved investments under the QDII programme were reported at US$134.6 billion, having increased from US$9.4 billion in April 2006 when the scheme started. The number of institutions for total approved investment fund increased from six in July 2006 to 173 as of March 2021.[17]

[17] The data is sourced from the CEIC database, originally from the State Administration of Foreign Exchange.

Currency swap agreements

3.17 China began signing bilateral and multilateral currency swap agreements with several countries to provide them with guaranteed RMB liquidity. 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.[18] Such swap agreements help the internationalisation of the RMB as it can now be used as a currency to support bilateral trade and investment.

3.18 In 2010, the Chiang Mai Initiative Multilateralisation (CMIM) agreement came into effect. It is a single-contractual multilateral currency swap arrangement set at US$120 billion for liquidity support among ASEAN+3 members (China, Japan, the Republic of Korea and 10 ASEAN countries). Its core objectives are to address the balance of payment and short-term liquidity difficulties in the ASEAN+3 region, and to supplement other existing international financial arrangements. In May 2012, the CMIM agreement doubled the size of swaps to US$240 billion.

Exchange rate regime

3.19 Greater exchange rate flexibility has been a central element of China's efforts to internationalise the RMB. Several steps have been taken since 2005 when the regime ended its peg to the US dollar and reverted to a basket of currencies as the basis for the RMB exchange rate. The RMB's trading band is currently 2% around the central parity rate each trading day. The RMB is currently the world's eighth most traded currency, with an average daily trading volume of about US$284 billion and a global trading share of about 4.3%.[19]

3.20 However, this greater flexibility has not been without its costs. In August 2015, the PBOC widened the exchange rate band within which the RMB would be allowed to float. This resulted in the depreciation of the RMB and market turmoil, and led the government to announce a series of measures during 2015-16 to curb depreciation

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18 PBOC (2020). *2020 RMB Internationalization Report*.

19 BIS (2019). *Triennial Central Bank Survey of Foreign Exchange and Over-the-counter (OTC) Derivatives Markets in 2019*. https://www.bis.org/statistics/rpfx19.htm, accessed 3 July 2021.

expectations by restricting Chinese investment overseas through the tighter implementation of existing capital controls and encouraging financial deleveraging. These steps achieved domestic policy objectives at the cost of creating concerns on the process of RMB internationalisation in the minds of global investors. On almost every measure, RMB internationalisation suffered a setback during 2015-16. While it has begun to recover since, the levels achieved before 2015-16 have yet to be achieved.

Inclusion in the SDR

3.21 A major step forward in the internationalisation of the RMB was its inclusion in the basket of currencies underlying the SDR of the IMF. In November 2015, the IMF announced that the RMB would be one of the five currencies in the SDR basket; the RMB officially joined the basket on 1 October 2016, with a weight of 10.9%. The other four SDR currencies and their weights were US Dollar (41.7%), Euro (30.9%), Japanese Yen (9%) and British pound (8.1%).

3.22 The inclusion of RMB in the SDR is an official recognition of the steps taken by China in the further opening up of its capital account, liberalising its financial markets and moving to a more market-determined exchange rate for the RMB. It also officially recognised the RMB as an international reserve currency, thereby allowing holdings of RMB assets by global central banks as part of their own reserves.[20]

3.23 The IMF also stated that the inclusion of the RMB in the SDR basket would be good both for China and for the world. It "recognizes and reinforces China's continued reform progress..." and could "..bring about a more robust international monetary and financial system, which in turn would support the growth and stability of the global economy".[21]

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20 Prasad, E (2016). China's efforts to expand the international use of the renminbi.

21 IMF (2015). *Q and A on 2015 SDR Review.* https://www.imf.org/external/np/exr/faq/sdrfaq.htm, accessed 3 July 2021.

Steps Taken Thus Far

4.1 China has taken a number of policy steps to internationalise the RMB. Capital inflows to China are now much more open. A variety of avenues for cross-border clearance and payment systems have been put in place, along with the reform of the exchange rate regime. China has made it easier for foreign investors to participate in China's onshore financial markets and for China's global trade to be settled in RMB. It has signed bilateral currency swaps with several countries to provide them with access to RMB liquidity in case of emergencies. As the RMB is now part of the SDR basket of the IMF, it is an official reserve currency.[22]

[22] The government has clearly taken several steps to provide the necessary policy underpinnings for the internationalisation of the RMB. How successful have these efforts been and how has the process of RMB internationalisation evolved thus far? *EAI Background Brief*, No. 1598, Renminbi Internationalisation (II): Progress and Prospects, provides data and discusses these issues.

Annex 1

The progress of the RMB internationalisation

Year	Content	Themes
November 2002	Introduction of Qualified Foreign Institutional Investor (QFII) programme[23]	QFII/RQFII
November 2003	Introduction of personal RMB business in Hong Kong[24]	Offshore RMB market
February 2004	The start of personal RMB banking business[25]	Offshore RMB market
July 2005	The RMB exchange rate regime reform[26]	Exchange rate regime
May 2007	Greater RMB fluctuation band[27]	Exchange rate regime
July 2007	Creation of offshore RMB bond market[28]	Offshore RMB market
July 2009	Introduction of the pilot scheme for RMB cross-border trade settlement	Trade settlement
March 2010	The Chiang Mai Initiative Multilateralisation (CMIM) agreement came into effect[29]	Currency swaps
January 2011	Qualified Chinese enterprises are allowed to invest in foreign countries directly in RMB	Offshore RMB market
August 2011	Expansion of the RMB cross-border trade settlement programme	Trade settlement

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[23] The qualified foreign institutional investor programme allowed licensed international institutional investors to convert foreign currencies into RMB and trade RMB-denominated stock exchanges in China's stock markets.

[24] PBOC announced the provision of clearing service for Hong Kong personal RMB business. Bank of China (Hong Kong) was appointed by the PBOC as the clearing bank for RMB business in Hong Kong in December.

[25] Some participating banks in Hong Kong started to offer personal account RMB business including deposit-taking, currency exchange, remittance and debit and credit card services. Bank of China (Hong Kong) announced the launch of RMB clearing services.

[26] China reformed the exchange rate regime and moved from a fixed exchange rate system pegged to the US dollar to a managed floating exchange rate regime based on market supply and demand with reference to a basket of currencies, which allowed RMB to fluctuate within a narrow band. China started to work towards greater degree of exchange rate flexibility, while the central bank still carefully managed the exchange rate to avoid excessive volatility.

[27] RMB's value was allowed to rise or fall within a 0.5% band around the central parity rate each trading day, greater than the previous limit of 0.3%.

[28] The first offshore RMB denominated bonds (also known as "dim sum" bonds) are issued by the Chinese Development Bank. The "dim sum" bonds generally refer to RMB-denominated bonds issued in Hong Kong.

[29] The CMIM is a multilateral currency swap arrangement of US$120 billion for liquidity support among ASEAN+3 members (China, Japan, the Republic of Korea and 10 ASEAN countries), with the core objectives of addressing balance of payment and short-term liquidity difficulties in the ASEAN+3 region, and supplementing other existing international financial arrangements.

December 2011	Launch of the RMB Qualified Foreign Institutional Investor (RQFII) pilot scheme	QFII/RQFII
March 2012	Further expansion of RMB cross-border trade settlement	Trade settlement
April 2012	Greater RMB fluctuation band	Exchange rate regime
May 2012	The CMIM agreement doubled the size of swaps to US$240 billion	Currency swaps
December 2012	The RQFII quota was expanded to RMB270 billion	QFII/RQFII
March 2014	Greater RMB fluctuation band	Exchange rate regime
November 2015	The Executive Board of IMF decided to include RMB into the currency basket of the SDR as a fifth currency along with the US dollar, euro, Japanese yen and British pound	Offshore RMB market
July 2017	The RQFII quota was expanded to RMB500 billion	QFII/RQFII
September 2019	Limitations on investment quotas of the QFII and RQFII were removed	QFII/RQFII
September 2020	QFII and RQFII were combined	QFII/RQFII

Source: Xinhua (2015), Deutsche Bank (2015), HKMA (2014) and PBOC (2020).