

The Use of RMB in International Transactions:

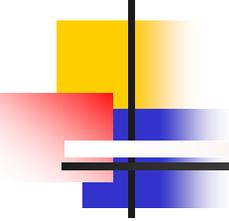
-Background, Development and Prospect

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The early stage of cross-border RMB usage

- **RMB as settlement currency for border trade has long existed**
 - In 1980s, RMB has been widely used to settle the border trade between China with Vietnam, Myanmar, Mongolia and Russia.
 - Since 1993, China signed a number of Bilateral Currency Border-trade Settlement Agreements with neighboring countries.
 - 2010 and 2011, China signed Bilateral Currency Trade Settlement Agreements with Russia and Belarus, respectively.

Emerging offshore RMB business

■ Offshore RMB Business

2004

- Personal RMB business

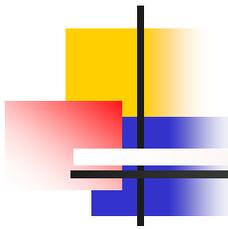
2007

- RMB bonds

2009

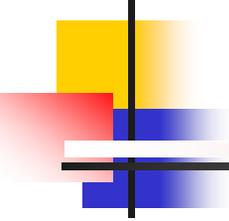
- RMB Trade Settlement Pilot Scheme

- In Nov 2003, PBoC announced to provide clearing service for HK personal RMB business. Bank of China HK branch was designated as the RMB clearing bank in HK.
- In 2007, Ministry of Finance and Mainland bank started to issue RMB bond in HK.



A wake-up call during financial crisis

- A wake-up call was heard during the financial crisis in 2008.
 - Under Executive Meeting of East Asia Pacific(EMEAP) framework.
 - Working group study the currency swap between major central banks.
 - teleconference discussing the way of cooperation in Oct. 2008.
 - Agreements were reached in Dec. 2008 that include the use of local currency in supporting financial institutions and trade.
- The last point regarding trade financing in local currencies was new:
 - RMB had never been used in non-border international trade before.
 - Institutional arrangement has to be adjusted to implement the agreements.



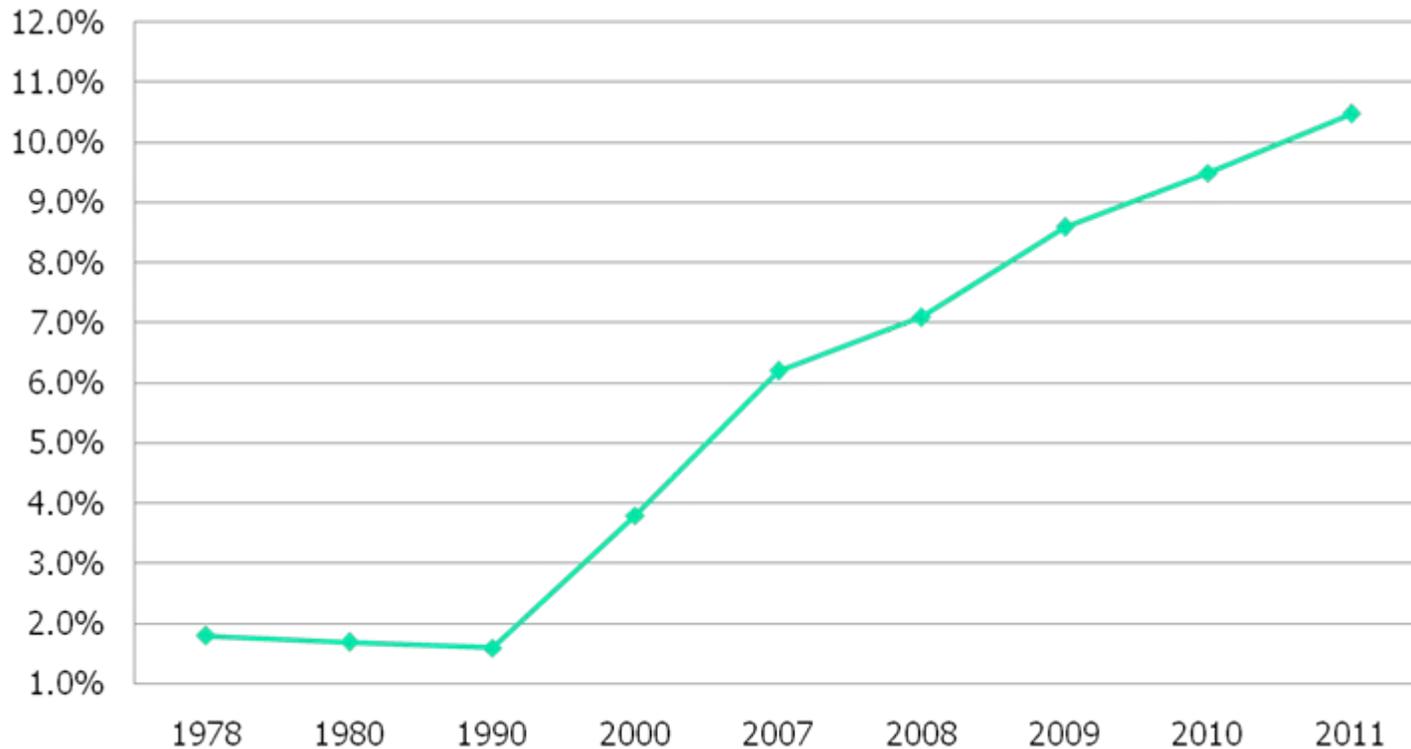
Launch of Pilot Program for Cross-border Trade Settlement using RMB

- More foreign central banks approached PBoC for currency swap.
- In July 2009, State Council decided to introduce pilot scheme for RMB trade settlement.

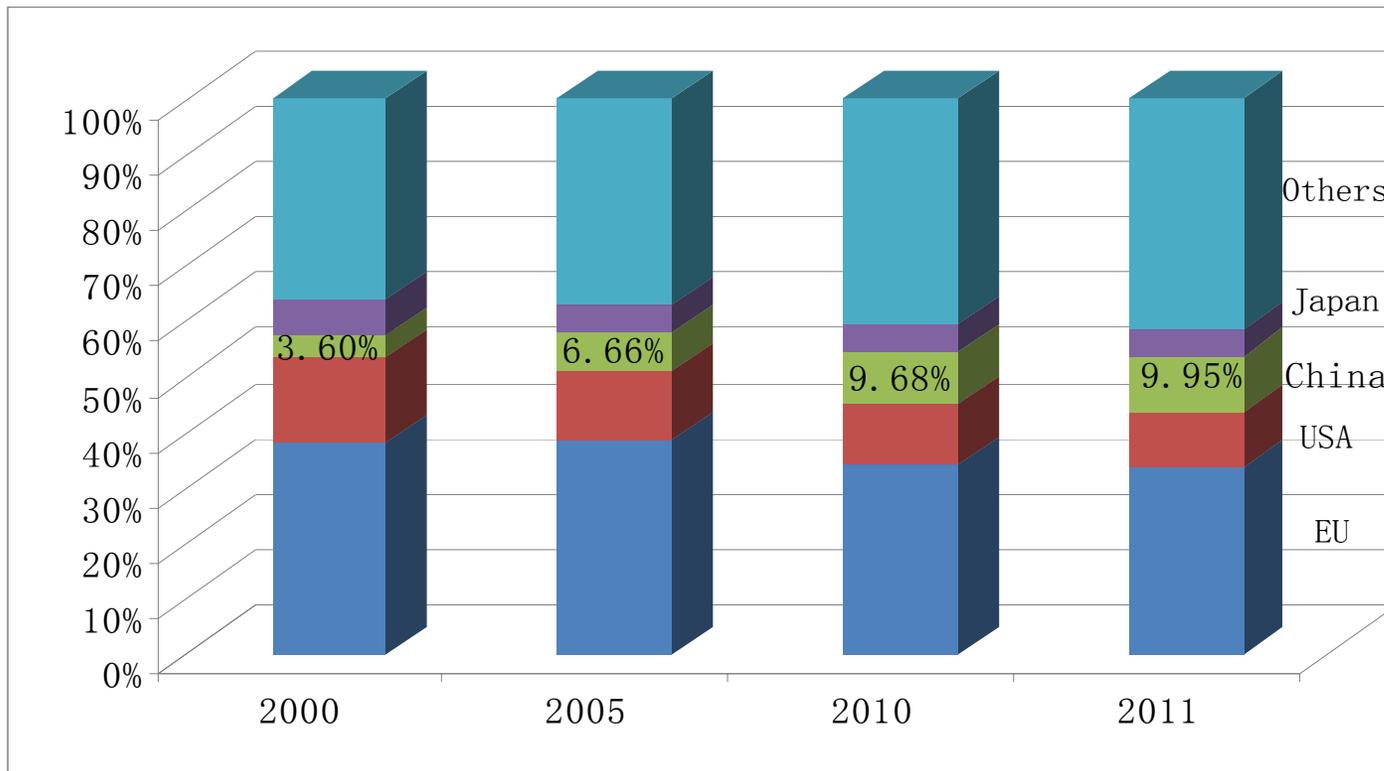
The Expansion of Pilot Program

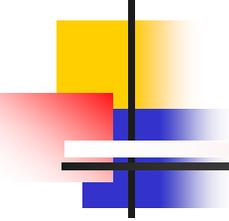
	July 2009	June 2010	August 2011
Domestic geographical coverage	Shanghai, and four cities in Guangdong	Extends to other 18 provinces (autonomous regions, municipalities), such as Beijing, Tianjin, Xinjiang and so on	Entire China
Enterprises engaging in RMB settlement of export trade in goods	365 designated enterprises	67724 designed enterprises <small>Note: announced at Dec. 2010</small>	<ul style="list-style-type: none"> Enterprises with the qualification may carry out RMB settlement of export trade in goods A list of enterprises shall be subject to focused supervision
Transactions in-scope	Goods Trade	All current account transactions	All current account transactions and some capital account business (FDI, ODI, RMB loan)
Counter-party Regions	Hong Kong, Macau and ASEAN	No restrictions	No restrictions

China's share of World GDP has increased from <2% in 1978 to 10.4% in 2011



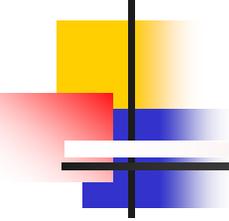
China's share of World Trade has increased from 3.6% in 2000 to almost 10% in 2011





Major principals of the cross-border RMB related regulations

- Serve for real economy, being responsive to market needs
- Trade related transactions first, then direct investment, followed by portfolio investment
- Dismantle obstacles to use RMB as pricing and settlement currency. Enable Chinese exporters and importers to choose currency freely.

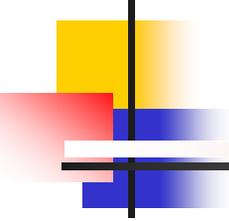


Regulations on Use of RMB in Current Account Transactions

- **For Enterprises:** No restrictions on importers. For merchandise exporters, After Feb, 2012, all eligible enterprises can use RMB except for enterprises on a short negative list, their transactions are subject to careful monitoring and supervision.
- **For Banks:** All eligible domestic or foreign banks, with installation of RMB Cross-border Payment Management Information System(RCPMIS), are eligible for cross-border RMB settlement business.

Regulations on Capital/Financial Account Transactions

Capital and Financial Account	FX	Aug 2010 and before	Jan 2011	Oct 2011	Dec 2011
B. Financial Account					
1. Direct Investment					
1.1 ODI	YES		ODI		
1.2 FDI	YES			FDI	
2. Portfolio Investment					
2.1 Asset					
2.1.1 Equity securities	QDII				
2.1.2 Debt Security	QDII	Panda bond			
2.2 Liabilities					
2.2.1 Equity securities	QFII				
2.2.2 Debt Security	YES	Inter-bank Dim Sum			RQFII
3. Other investment					
3.1 Asset					
3.1.1 Trade Credit	YES	yes			
3.1.2 Loan	YES		Loan w/ODI	Loan	
3.2 Liability					
3.2.1 Trade Credit	YES	yes			
3.2.2 Loan	YES				



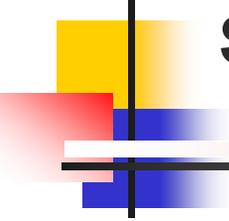
Related infrastructure development: China International Payment System (CIPS)

- **Objectives for CIPS:**

Secure, Stable, Efficient and able to handle all different kinds of RMB cross-border business

- **Principles to develop CIPS:**

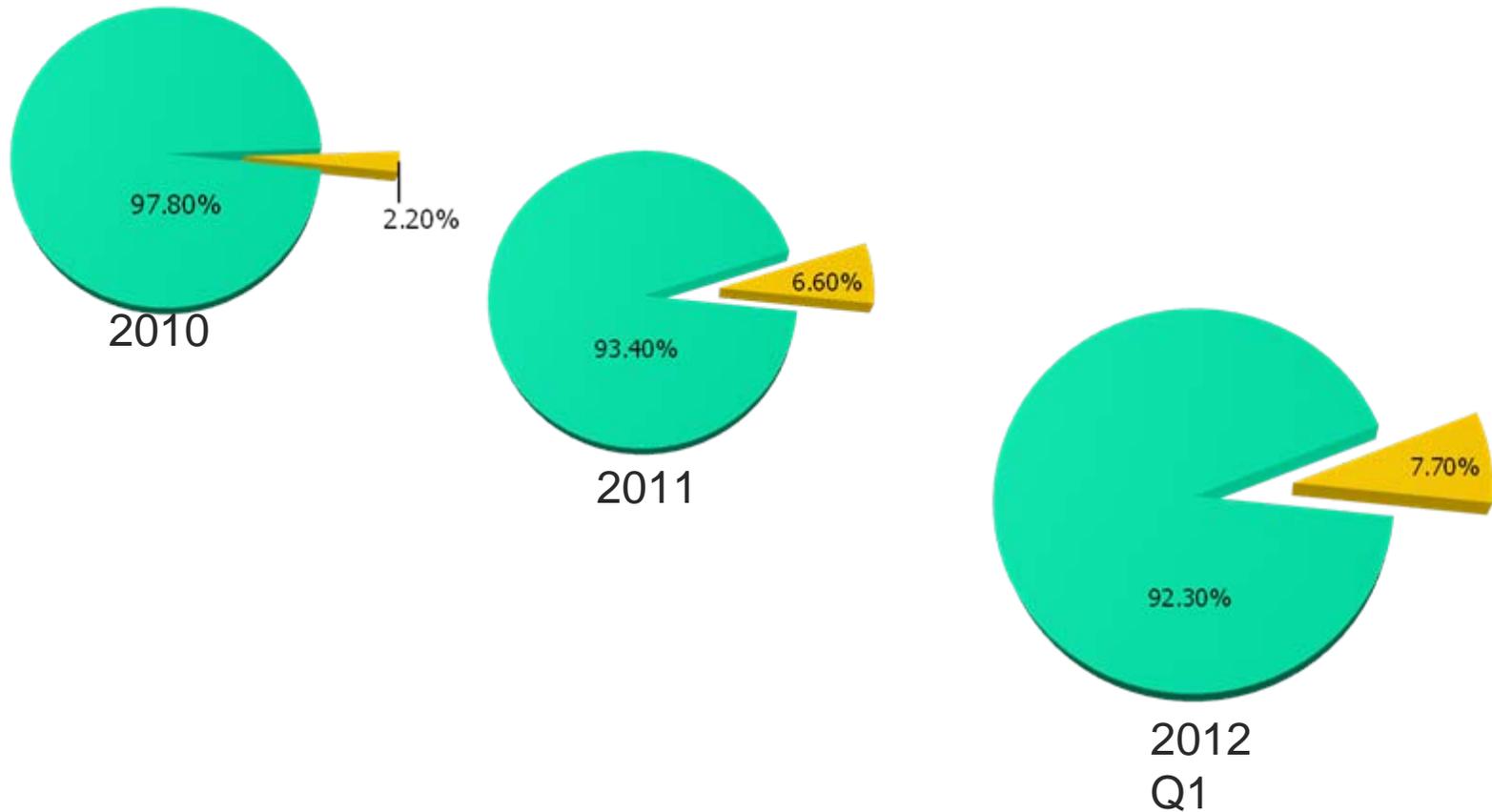
1. Support further development of RMB cross-border use;
2. Ensure CNAPS run in stable and secure environment;
3. Prevent and eliminate potential risks;
4. Create fair environment for competition



Support HK to develop as an offshore RMB center

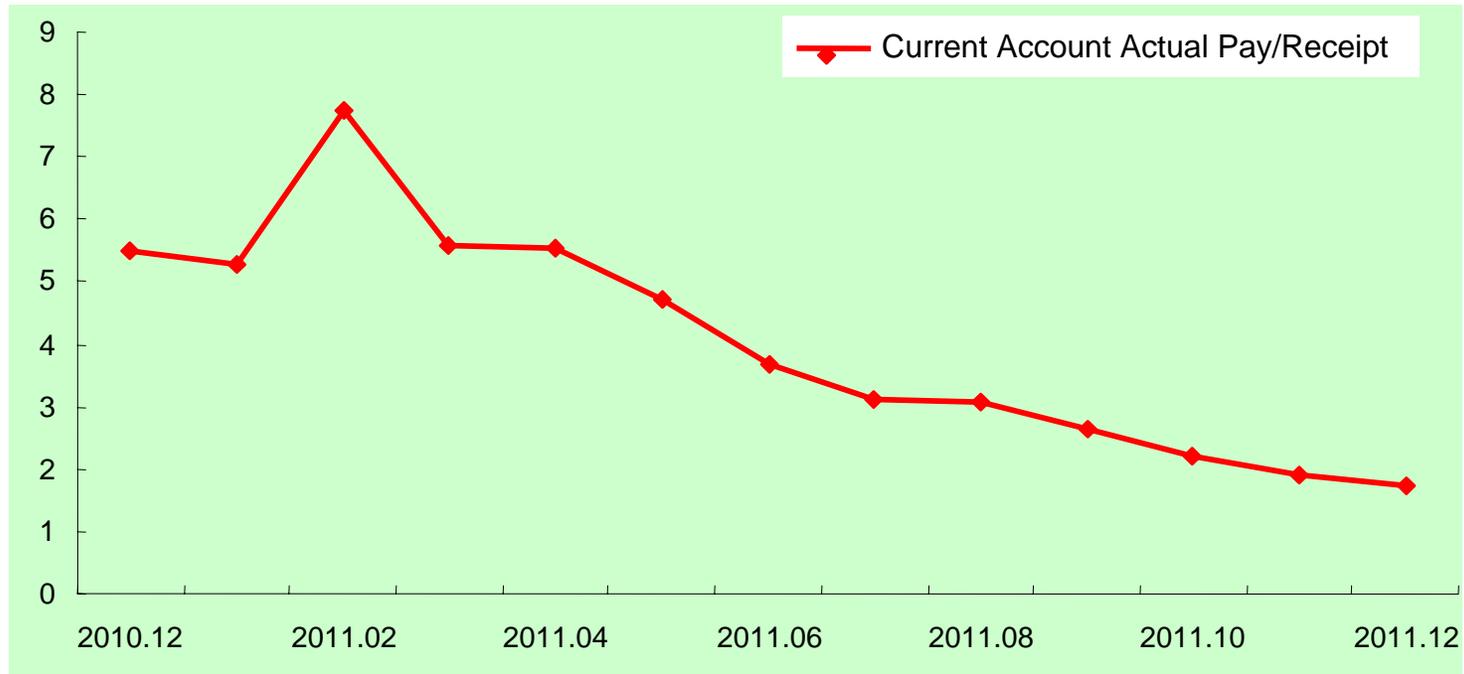
- China's 12th Five-Year Plan (2011-2015) states that "Support HK develop as Offshore RMB business center and International asset management center"
- In July 2010, after consulting with HKMA, PBoC signed the modified RMB Clearing Agreement with Bank of China HK branch and its understanding with with HKMA specified that HK financial institutes should follow the local regulatory requirements and market factors to develop RMB business

RMB's share in goods trade has been rising steadily



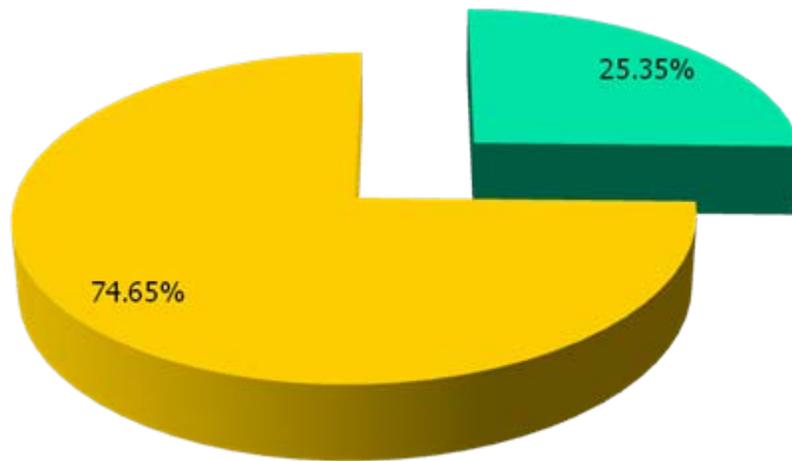
RMB current account payment and receipt has become more balanced:

the payment/receipt ratio declined steadily since 2011Q2



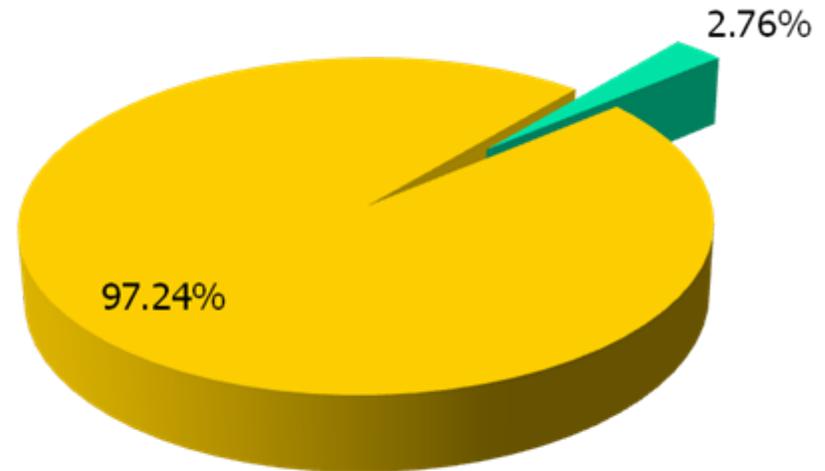
A quarter of newly invested FDI is settled in RMB, while the share of RMB for ODI is much smaller

In **2012 Q1**, the value of Foreign Direct Investment(FDI) settled with RMB is **47 billion RMB**

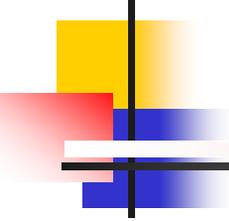


■ Value of FDI Settled with RMB

In **2012 Q1**, the value of Outbound Direct Investment(ODI) settled with RMB is **2.87 billion RMB**

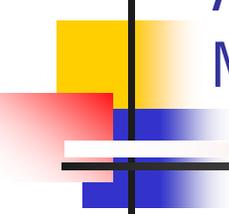


■ Value of ODI Settled with RMB



Emerging RMB offshore markets

- Hong Kong
 - The largest RMB offshore center with many products
- Singapore
 - RMB NDF was first emerged in 1996, RMB deposits
- London
 - Larger than expected in terms of deposits, spots trading
- Tokyo
 - NDF, Recently introduced Yuan-Yen direct trading,
- Chicago
 - Lunched RMB NDF in 2006

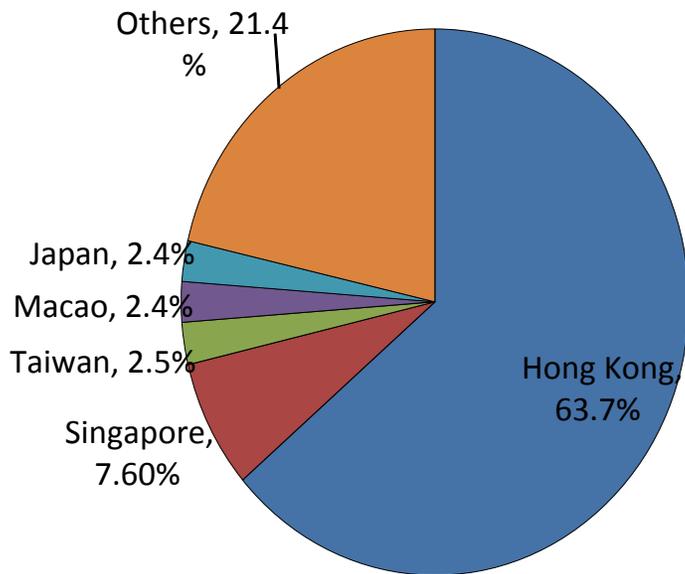


A closer look at cross-border RMB settlement: Mainly a regional development

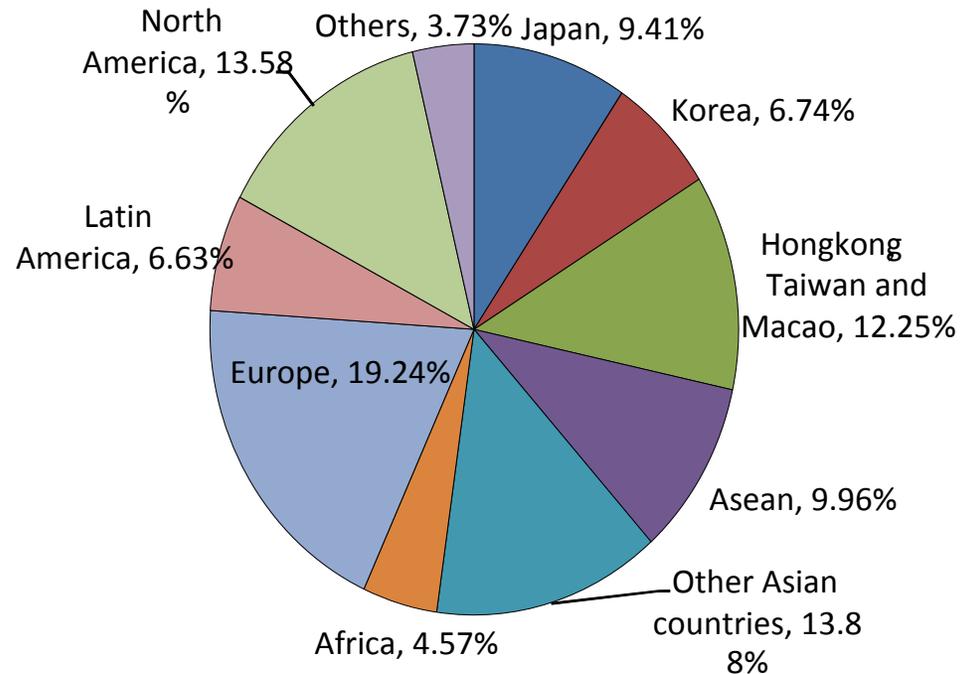
- 52% of China's trade occurred in neighboring Asia
- Asia accounts for 78.6% of cross-border RMB settlement
- The above higher RMB settlement ratio reflects the fact that mainland China is the largest trade partner for all its major neighboring economies in Asia

Geographical Distribution of China's RMB cross-border settlement and foreign trade

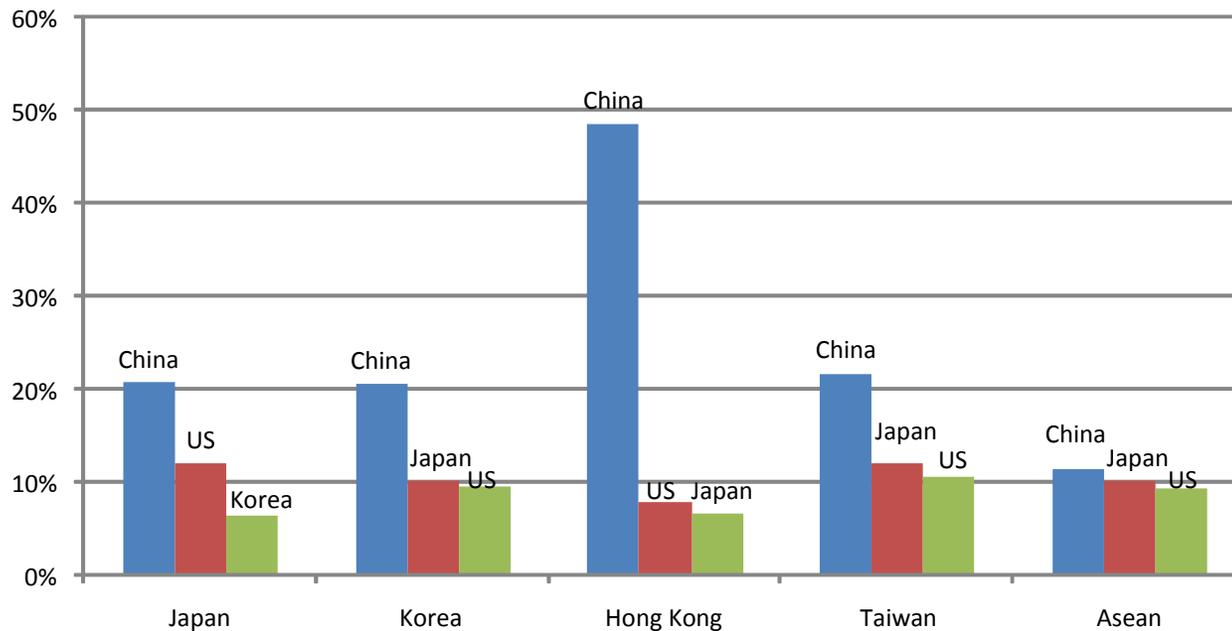
Geographical distribution of offshore RMB settlement



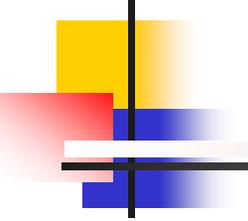
Geographical distribution of China's trade



Mainland China is the largest trade partner of its major economic neighbors

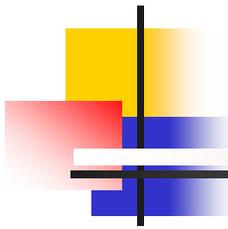


Source: Asean Statistics, CEIC



In spite of the above progress, RMB Internationalization still has a long way to go

- The economic size is large but still only half of that of the USA and EU.
- Exports ranked No.2, but can be discounted by a quarter if we only consider the value-added part, ranking will be No.3.
- The pricing power of China's exporters is relatively weak.

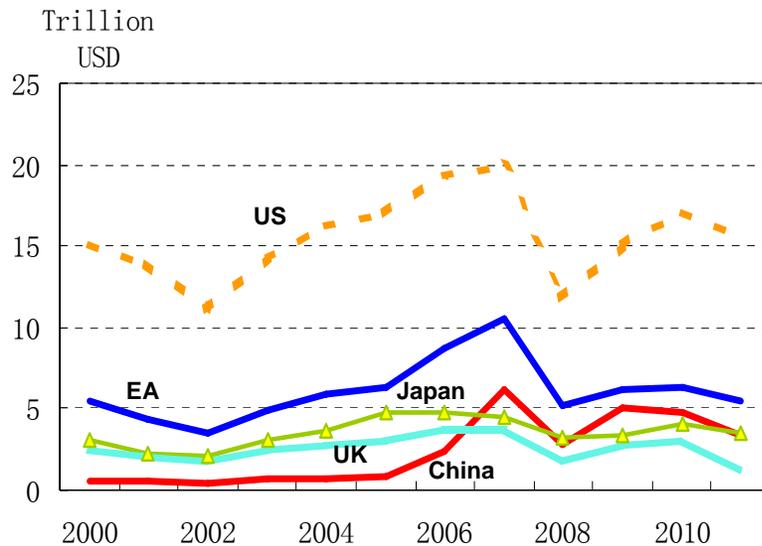


However, China's major constrain for increasing usage of RMB in international transaction is:

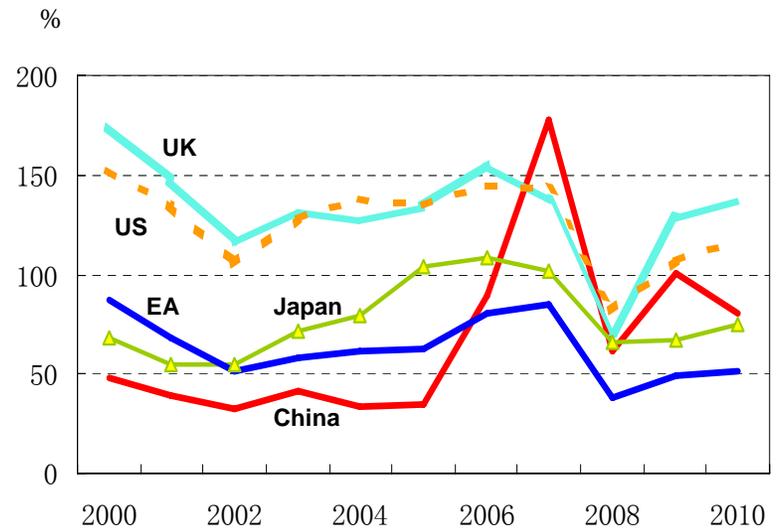
- Underdeveloped financial market
- Capital account convertibility incompatible to the need of a large open economy.

Stock market is relatively small in market capitalization

Market capitalization of listed companies



as percent of GDP



Source: World Development Indicators, World Bank

In addition, the stock market is closed to foreign companies, a sharp contrast to major developed economies and even some emerging market economies

Number of listed companies in selected stock exchanges

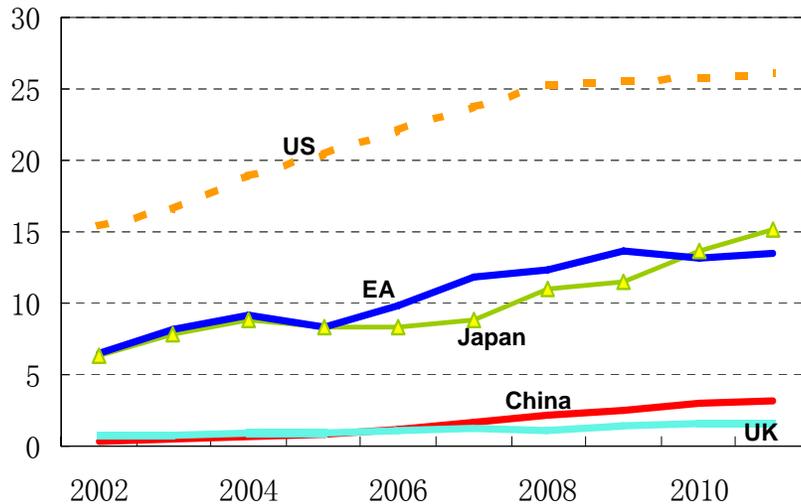
Country/area	Exchange	Total	Domestic Companies	Foreign Companies	Foreign Companies as percent of Total
China	Shanghai SE	931	931	0	0
	Shenzhen SE	1,411	1,411	0	0
US	NASDAQ OMX	2,680	2,383	297	11.1%
	NYSE Euronext (US)	2,308	1,788	520	22.5%
Japan	Osaka Securities Exchange	1,229	1,228	1	0.1%
	Tokyo SE Group	2,291	2,280	11	0.5%
Europe	NYSE Euronext (Europe)	1,112	969	143	12.9%
UK	London SE Group	2,886	2,288	598	20.7%
Germany	Deutsche Börse	746	670	76	10.2%
Russia	RTS Stock Exchange	252	251	1	0.4%

Source: World Federation of Exchanges (2011)

Bond market underdeveloped in terms of outstanding issues & almost closed in terms of international issues

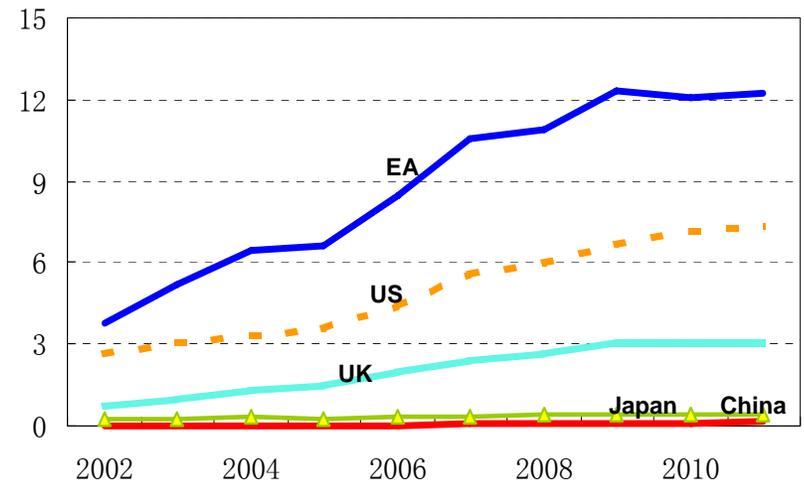
Domestic issued outstanding debt securities

Trillion USD



Internationally issued outstanding debt securities

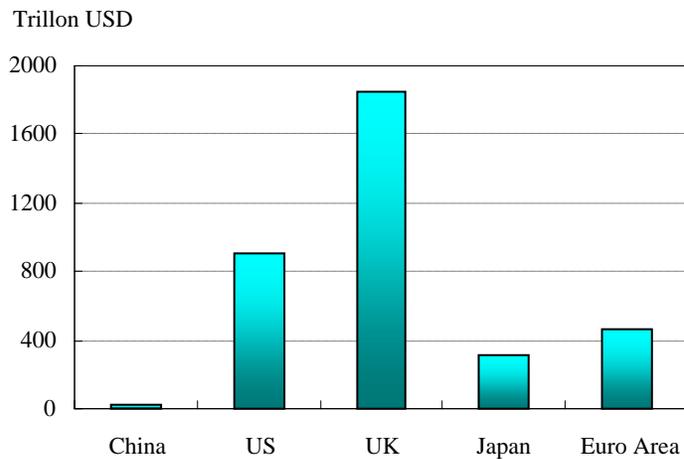
Trillion USD



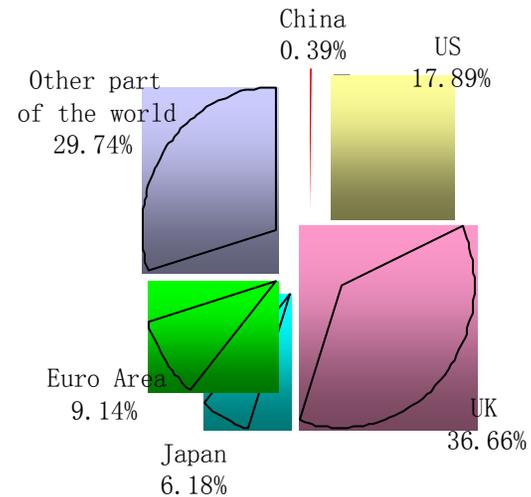
Source: BIS, Securities Statistics

And China's onshore FX market is miniscule, its global share in FX turnover is less than 1%.

FX turnover--Daily averages
(April,2010)

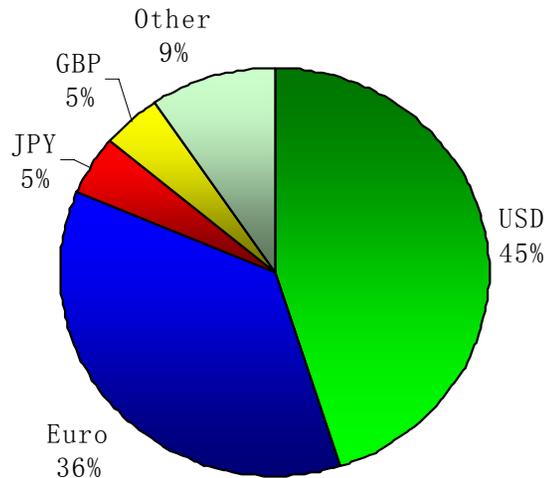


FX turnover--Share of the world
(April,2010)

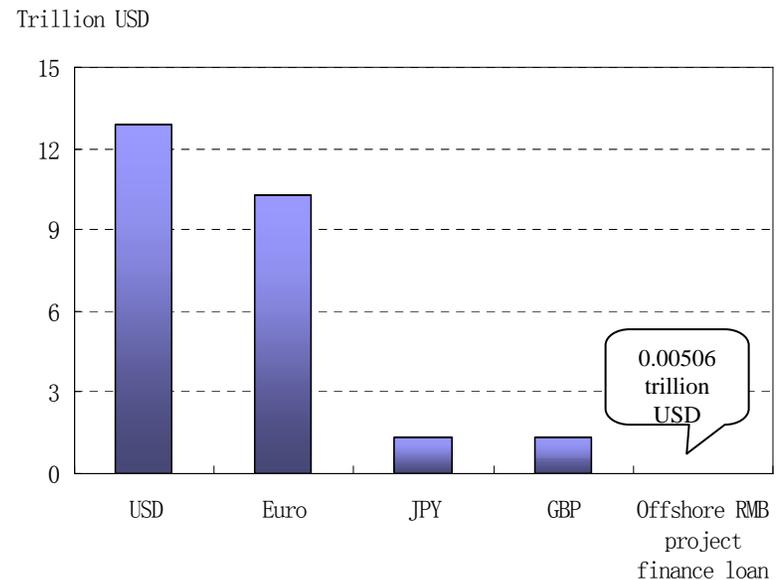


China's Banking sector's cross-border assets denominated in RMB is almost negligible

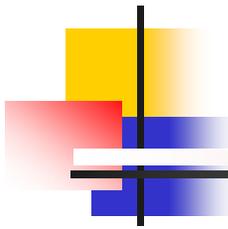
Currency composition of cross-border assets
(BIS reporting banks--end 2011)



Cross-border assets and RMB loan
(end-2011)



Source: BIS, PBC



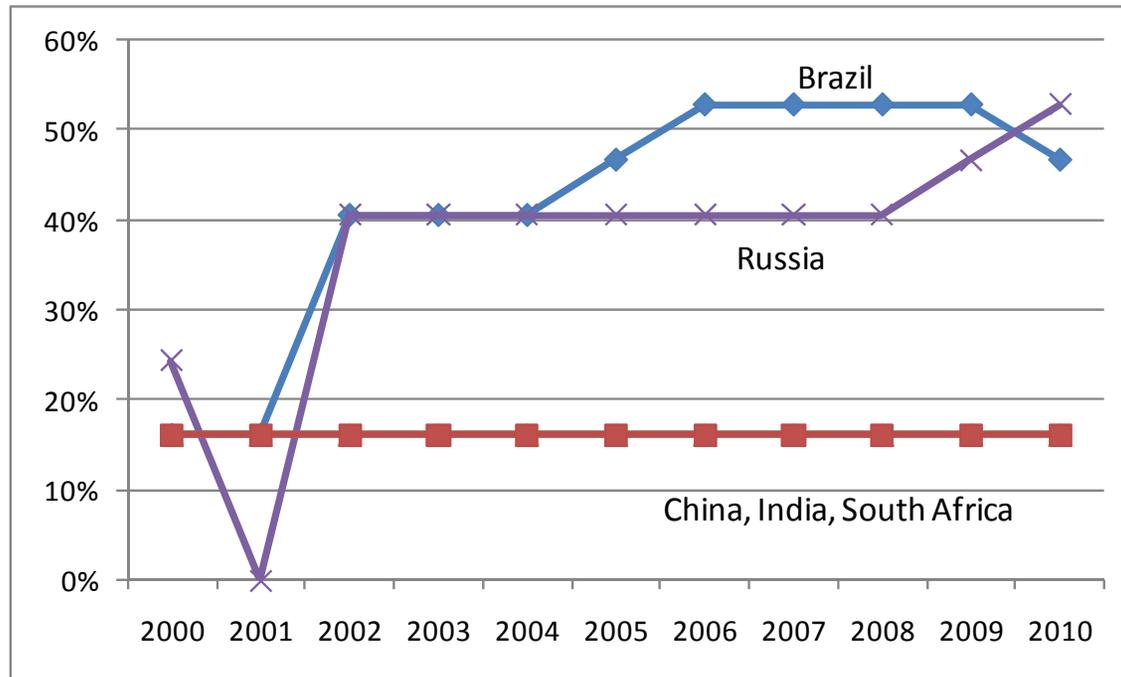
Financial derivatives market is just emerging

- **China is the largest commodity futures market across the globe.**
The trading volume of commodity futures in China exceeded half of the world's total in 2010 and 38% in 2011.
- **but the financial derivatives market is in its early stage**
 - **Stork index futures:** The number of contracts accounted for 1.1% of the world's total.
 - **Interest-rate derivatives:** Trading of RMB interest-rate swaps accounts for less than 0.1% of the world's total.
 - **Foreign exchange derivatives:** The turnover of RMB foreign exchange swap and forward transactions accounts for 3% of the world's total.
 - **Stock options and stock futures, are not yet traded in China.**

Capital Account openness need to be increased

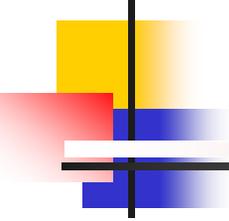
Capital Account Openness Index

Relative to United States, US=100



Also 100 for United Kingdom, Euro Area and Japan

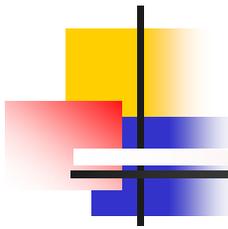
Source: Chinn and Ito (2011)



Prospects:

RMB internationalization is dependent on financial development and reform

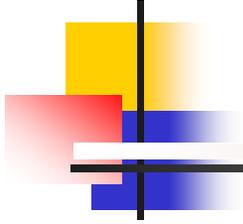
- The potential of RMB is rooted in the expansion of China's real economy and its integration with the world economy.
- Its further growth calls for deepening reform and further opening up, particularly in financial market and capital account management.
- There is huge opportunity associated with the resulted development for both China and its partners around the world.



Prospects:

Benefits of expanded RMB usage in cross-border transactions

- Reduce the risk of currency mismatch in the Chinese economy.
- Make a more flexible RMB exchange rate less costly to China's real economy and therefore facilitate adjustment in external imbalance.
- Increased flexibility in exchange rate will in turn increase the maneuvering space of China's monetary policy.
- As a side effect, it will also improve the effectiveness of monetary policy in major advanced economies.
- It will contribute to a more resilient and stable IMS.



Thank You