The Use of RMB in International Transactions:

- Background, Development and Prospect

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People’s Bank of China
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

- 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.

Timeline:
- 2004: Personal RMB business
- 2007: RMB bonds
- 2009: RMB Trade Settlement Pilot Scheme
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.
- 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

<table>
<thead>
<tr>
<th></th>
<th>July 2009</th>
<th>June 2010</th>
<th>August 2011</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Domestic geographical coverage</strong></td>
<td>Shanghai, and four cities in Guangdong</td>
<td>Extends to other 18 provinces (autonomous regions, municipalities), such as Beijing, Tianjin, Xinjiang and so on</td>
<td>Entire China</td>
</tr>
<tr>
<td><strong>Enterprises engaging in RMB settlement of export trade in goods</strong></td>
<td>365 designated enterprises</td>
<td>67724 designed enterprises</td>
<td>Enterprises with the qualification may carry out RMB settlement of export trade in goods</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Note: announced at Dec. 2010</td>
<td>A list of enterprises shall be subject to focused supervision</td>
</tr>
<tr>
<td><strong>Transactions in-scope</strong></td>
<td>Goods Trade</td>
<td>All current account transactions</td>
<td>All current account transactions and some capital account business (FDI, ODI, RMB loan)</td>
</tr>
<tr>
<td><strong>Counter-party Regions</strong></td>
<td>Hong Kong, Macau and ASEAN</td>
<td>No restrictions</td>
<td>No restrictions</td>
</tr>
</tbody>
</table>

announced at Feb 2012
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

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<tbody>
<tr>
<td><strong>B. Financial Account</strong></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>1. Direct Investment</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.1 ODI</td>
<td>YES</td>
<td></td>
<td>ODI</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.2 FDI</td>
<td>YES</td>
<td></td>
<td>FDI</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Portfolio Investment</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.1 Asset</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.1.1 Equity securities</td>
<td>QDII</td>
<td></td>
<td>Panda</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.1.2 Debt Security</td>
<td>QDII</td>
<td></td>
<td>bond</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.2 Liabilities</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.2.1 Equity securities</td>
<td>QFII</td>
<td></td>
<td>Inter-bank Dim Sum</td>
<td>RQFII</td>
<td></td>
</tr>
<tr>
<td>2.2.2 Debt Security</td>
<td>YES</td>
<td></td>
<td>Dim Sum</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Other investment</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3.1 Asset</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3.1.1 Trade Credit</td>
<td>YES</td>
<td></td>
<td>yes</td>
<td>Loan w/ODI</td>
<td>Loan</td>
</tr>
<tr>
<td>3.1.2 Loan</td>
<td>YES</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3.2 Liability</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3.2.1 Trade Credit</td>
<td>YES</td>
<td></td>
<td>yes</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3.2.2 Loan</td>
<td>YES</td>
<td></td>
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</table>
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
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 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.

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

- Hong Kong, 63.7%
- Singapore, 7.60%
- Japan, 2.4%
- Macao, 2.4%
- Taiwan, 2.5%
- Others, 21.4%

Geographical distribution of China's trade

- Europe, 19.24%
- Asean, 9.96%
- Other Asian countries, 13.8%
- Africa, 4.57%
- Latin America, 6.63%
- North America, 13.58%
- Others, 3.73%
- Japan, 9.41%
- Korea, 6.74%
- Hong Kong, Taiwan and Macao, 12.25%
Mainland China is the largest trade partner of its major economic neighbors.
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

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

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

Domestic issued outstanding debt securities

Internationally issued outstanding debt securities

Source: BIS, Securities Statistics
And China’s onshore FX market is miniscule, its global share in FX turnover is less than 1%.

Source: BIS, Triennial Central Bank Survey: Report on global foreign exchange market activity in 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.