

Internationalization of RMB

China officially started the process of internationalization of RMB in 2009, the year was marked by dramatic financial crisis. China launched a pilot program to allow trade between 5 Chinese mainland cities and Hong Kong, Macau and ASEAN to be settled in RMB. This decision was a response to the crisis, try to ward off the disruption of the trade by expected volatile exchange rate of dollar and dry of dollar liquidity. The impact of crisis on China's trade is big. China recorded a 16% decline of exports in 2009, contrasting stellar growth, usually 20% strong, prior to the crisis. so, the internationalization of RMB was firstly motivated by the need of stabilizing the trade. On the other side, the move to internationalization of RMB also carried the strategic meaning, say, to change the marginal role of RMB in the shift of international monetary system. Clearly, the crisis has shaken the existing IMS and weakened the dominance of incumbent dollar and euro. The call for reforming IMS is strong. it is seen by many as a good opportunity to change China's position in IMS, which has long been not matched its weight in world economy. Looking history, a country's position in IMS was more or less be commensurate to its economic clout. The rising position of RMB will give China a freer hand to finance and investment. It is perceived that China enter new stage characterized by two way flow of goods and capital. The years after 2009 witness the rapid increase of the import and oversea investment of China. it makes the internationalization of RMB even more meaningful. On the other hand, there are also concerns voiced on the cost of being an international currency and the incompatibility between international currency and under-developed financial market, and closed capital account.

The way China chose to internationalize the RMB is very much shaped by the three things, reaction to the crisis, strategic consideration and concern of the cost. Basically, China took a gradual and cautious approach, like many other reforms China took. China does not set the specific target, but rather feeling stone to cross river, say, to follow the market needs. What China do is to gradually remove the obstacle and Do not pursue specific target at any cost. to respond to market need, China has adopted an

array of measure to facilitate the internationalization process. First, to expand initial trade settlement pilot scheme to cover almost all trade. The initial scheme was for trade settlement between 5 mainland cities and Hong Kong, Macau and ASEAN. Now it covers 20 provinces and their trade partners all around the world. Second, the to expand the bilateral currency swap agreement to support central bank in other countries to provide the RMB liquidity. Third, to support offshore RMB market development, the size and scope of offshore market grow rapidly. New offshore markets emerge besides that in Hong Kong and beyond the Asia. The City of London launched an initiative to make London a centre for RMB business. Forth, the capital account has been further liberalized to cater for the internationalization of RMB, which serve as catalyst. For outward flow, RMB Overseas Direct Investment trial launched, the RMB loan offered to other countries expanded. For inward flow, R-QFII scheme launched, and RMB inter-bank bond market opened to selected offshore RMB holders. the latest move is that China will let companies in Qianhai, an area of Shenzhen, take out RMB loans from banks in Hong Kong, with tenors and interest rates to be set independently. In conclusion, up to now, the main policy on internationalization of RMB is a response to the market needs, by the way of gradual deregulation on previous highly regulated system. China dose not very actively promote the process. China's basic attitude is to let it run it own course with gradual removal of impediments. It is noted that in 18th party congress report, the internationalization of RMB was not mentioned at all while the financial reform has been addressed, demonstrating the domestic agenda is still be far more important priority of the consideration. Internationalization of RMB could assist this process, but itself not the center of the strategy.

Up to now, the internationalization of RMB goes well and smoothly. It is welcomed by the market. As the result, the speed of the internationalization is fast, to some extent, faster than expected. Today, more than 10,000 financial institutions are doing business in RMB, up from 900 in June 2011. The pool of offshore RMB, non-existent three years ago, now tops nearly RMB900bn (USD143bn). The proportion of China's exports and imports settled in RMB has increased nearly six-fold in three years to nearly 12%. But, still, how far the internationalization of RMB will go is

unknown. we are aware of that the appetite of outside world for RMB is partly driven by the appreciation expectation of RMB. When China's trade is moving to more balanced, as evidenced by latest figure that shows in first quarter this year China recorded a deficit, the scope for further appreciation has quickly diminish. The oversea demand for RMB may also change. The prospect of internationalization of RMB is also very much dependent on the how far the financial liberalization which are mostly dominated by domestic needs. So, among the different use of RMB, the trade use of RMB will advance most, some expect it will quickly be third one after dollar and euro. The use for financing and investment will also go some ways, as China's own needs go up. The use for hedge and storage of value will be more problematic before substantial reform be done.

No matter what ambitions China has on the internationalization of RMB, the impacts of internationalization of RMB on IMS are potentially big. This it because the size of China's economy. China is well on the track to dethrone US as the largest economy in the world in 10 years. And China's economy is not only big, but also grow fast. Our estimation shows at 2020, the potential growth rate of China is still above 7%. The international use of the currency of a fast growing big economy will bring world lots of benefits. First, it helps fully tap the potential of trade growth as traditional driver of trade, developed countries' growth stalled. Second, It allows more engagement of China and rest of the world . with an internationalized RMB, the investment in and out of China would be much easier and beyond the limit of stock of dollar. As the result, the fruit of China's growth could be shared more widely. Third, it provides more options for asset diversification and value storage, better for more efficient asset allocation and hedging. Last, not least, it may intensify the competition between major currencies, help strengthen the discipline of IMS and in turn provide the higher quality public goods.