Internationalizing the RMB: Pros and Cons

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What Is the RMB Internationalization

- The renminbi (RMB) internationalization here refers to the process that the RMB becomes an invoice, settlement and reserve currency in international economic and financial transactions.
Why Some Chinese Economists Support the RMB Internationalization (Pros)

- The current financial crisis can be viewed as an opportunity
- China needs a financial position proportionate to its economic power
- Domestic market-oriented reform can be deepened
- The financial cooperation in Asia has stagnated
- The global monetary system could be more balanced
- The process of the RMB internationalization has already begun
- China’s financial system has been improved smoothly
Pros: 1. Opportunities

- The developed world has suffered because of the financial crisis
- A multi-polar monetary system becomes more necessary than ever
- China’s economic influence has elevated significantly
- China can make contribution to the necessary reform of the global monetary system
Pros: 2. Changing Economic Status

- China’s GDP based on market exchange rate accounts for 10% of the world total in 2011
- China’s exports and imports account for 12% and 10% of the world total respectively in 2011
- China’s trade dependence is around 60% in 2011
- 90% of China’s trade are invoiced and settled in USD
- The share of the RMB as a reserve currency is nearly zero
Estimates of China’s Economic Output in the Future

• In market exchange rate China has become the second biggest economy in the world in 2010

• In PPP China will probably surpass the U.S. in 2020 and become the largest economy in the world
  
  (Justin Lin, 2009)

• In PPP China will exceed the U.S. in 2015 and become the largest economy in the world

  (Angus Maddison, 2009)
Pros: 3. A Driving Force for China’s Domestic Reform

- Making the exchange rate policy more flexible
- Establishing a market-based interest rate setting mechanism step by step
- Accelerating the pace to make the RMB fully convertible
- Engaging in financial liberalization in order to expand its financial market size
- Improving financial regulation
Pros: 4. Limited Progresses Resulted from Asian Financial Cooperation

- Lack of political trust among the Asian big economies
- Negative reaction of the US towards Asian financial cooperation (AMF)
- Reluctance for most Asian countries to concede the monetary sovereignty
- Difficulties in allocating weights to various economies with contrasting economic size and growth momentum
- Low expectation of the Asian economies for monetary cooperation: Rapidly increased foreign exchange reserves since the Asian financial crisis
- Bitter lessons from the debt crisis in the Eurozone
Pros: 5. An Internationalized RMB Could Be Conducive to Global Financial Stability

- Providing a new investment tool
- Constraining the global dominant currency from acting irresponsibly
- Incorporating the RMB into the SDR reserve basket
- Strengthening financial collaboration in Asia
Pros: 6. Growing Acceptance of the RMB in Asia

- The RMB has already circulated in HK and other neighboring economies
- The RMB saving accounts are available in Chinese Taiwan, Bangladesh, Malaysia, Indonesia, the Philippines, Singapore and Korea
- China’s central bank has signed currency swap agreements with the financial authorities of Korea, HK, Belarus, Malaysia, Argentina, Indonesia, etc.
- Some Asian economies have more or less used the RMB as an invisible currency anchor (e.g., Malaysia)
- China has greatly enlarged the use of the RMB in the cross-border trade
Pros: 7: Substantial Improvements Made in China’s Financial System

- Meeting the requirements of capital adequacy by Chinese commercial banks
- Low non-performing loans
- Introduction of QFII and QDII
- More flexible and sizable treasury bonds market as well as stock markets
- Sound budgetary position
- Huge foreign exchange reserves (maybe too much)
Why Some Chinese Economists Oppose the RMB Internationalization (Cons)

- Conditions are far from mature
- It runs in the opposite direction with regional cooperation
- The experiences of the Yen internationalization are not supportive
- It may probably give rise to some unfavorable consequences
Cons: 1. Premature Conditions

- China’s economic aggregate is not big enough compared to the U.S. and the EU
- There are many obstacles that may hinder China’s long-term growth
- China has a long way to go to entirely open up its capital account
- It remains unknown when China will establish a market-based exchange rate regime
- It will take decades to substantially narrow the gap between China and the developed economies in terms of financial sophistication and size
- The Financial regulation and macro monetary management are not perfect
Cons: 2. Incompatible with Regional Cooperation

- Regional cooperation becomes trendy in today’s world
- Only a united Asia can survive the fierce competition and eventually turn to be the third pillar of the future tri-polar world
- The successful experiences of the Euro provide Asia with a good roadmap
- The Asian peoples are smart enough to find a win-win way to collaborate financially
- Asian financial cooperation has already made headways in many ways
Asian Financial Cooperation

- Asian Currency Unit (ACU)
- Asian Bond Fund (ABF)
- Chiang Mai Initiative (CMI)
- Reserve Pool
- Various discussions regarding exchange rate regimes
- Potential Asian Monetary Fund (AMF)
- An ultimate goal: An Asian single currency (ASIRO?)
Cons: 3. Unsuccessful Efforts of the Yen Internationalization

- High level of the dollarization in Asia
- Japan’s huge trade surplus with its trade partners
- Dramatic fluctuation of exchange rate between the yen and the dollar
- Backlash from the US
Cons: 4. Unwanted Aftermath Caused by the RMB Internationalization

- Triffin Dilemma
- Trilemma: exchange rate, capital movement, independent monetary policy
- Counteraction resulted from the domestic vested interest groups
- More fluctuation in exchange rate and assets prices
- Long-term pressure on the RMB to appreciate due to increasing demand
- Potential social-political instability generated by much more exposure of financial sector
A Possible Tri-polar International Currency System in 2010-2030

- The USD will remain as the most important key currency
- The EURO will play a bigger role despite of the European sovereign debt crisis
- An Asian united currency or one of the Asian economies’ currency would become a key currency? The RMB?
Thank You