
The Renminbi's Ascendance in Global Finance

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Two Perspectives

- A. Implications for China's domestic development
- B. Implications for global monetary system

Other Issues

1. Sequencing: Capital account liberalization, exchange rate flexibility, financial market development
 2. Benefit-risk tradeoffs during transition
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Key Concepts

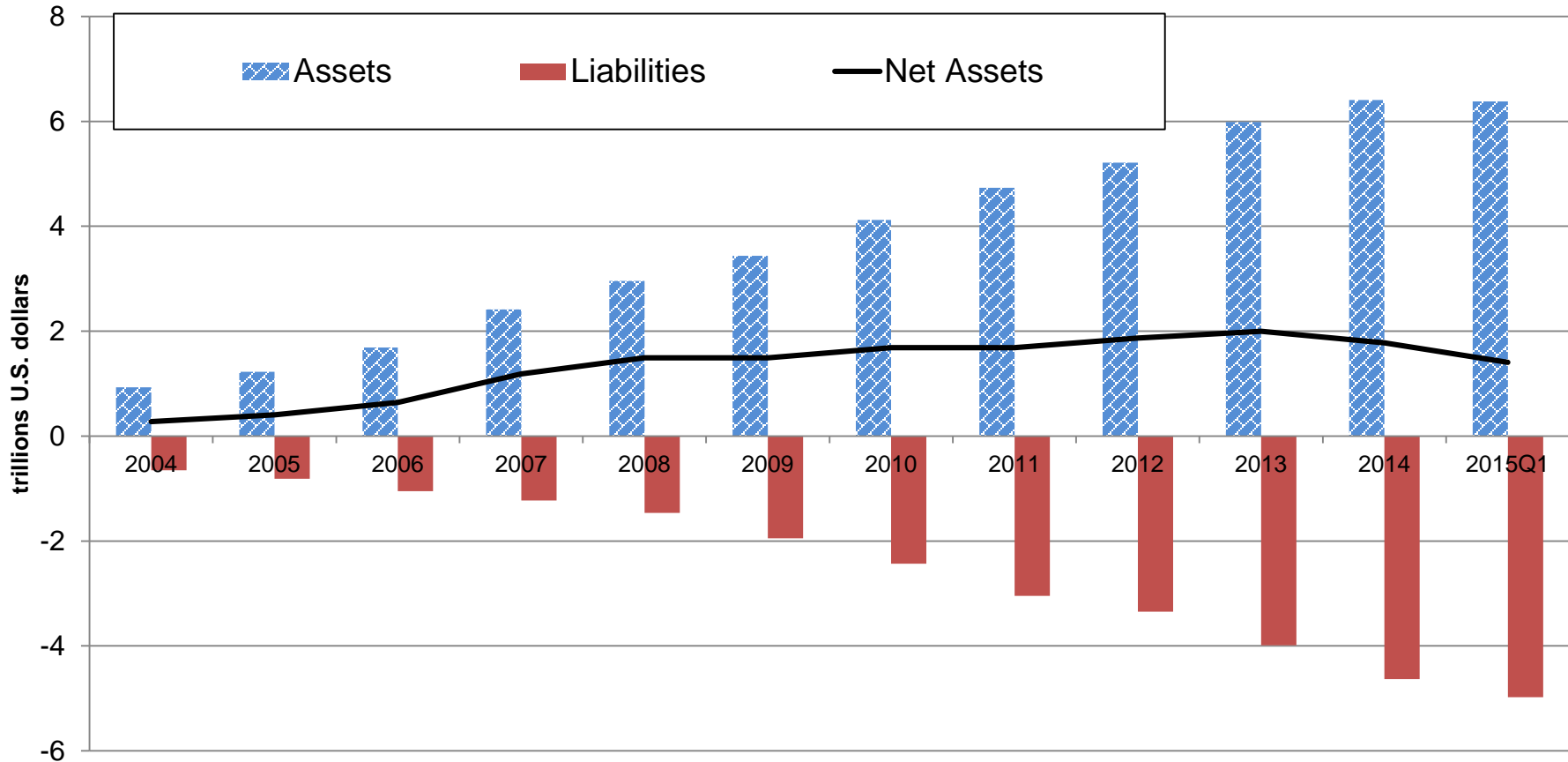
- A. Open capital account** (convertible currency): No controls on capital inflows, outflows
 - B. International currency:** Widely used in trade settlement, cross-border financial transactions
 - C. Reserve currency:** Held as central banks' reserves
- A** not synonymous with freely floating exchange rate
- A** and **B** neither necessary nor sufficient for each other
- A** and **B** necessary for **C**
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Benefits of CAL

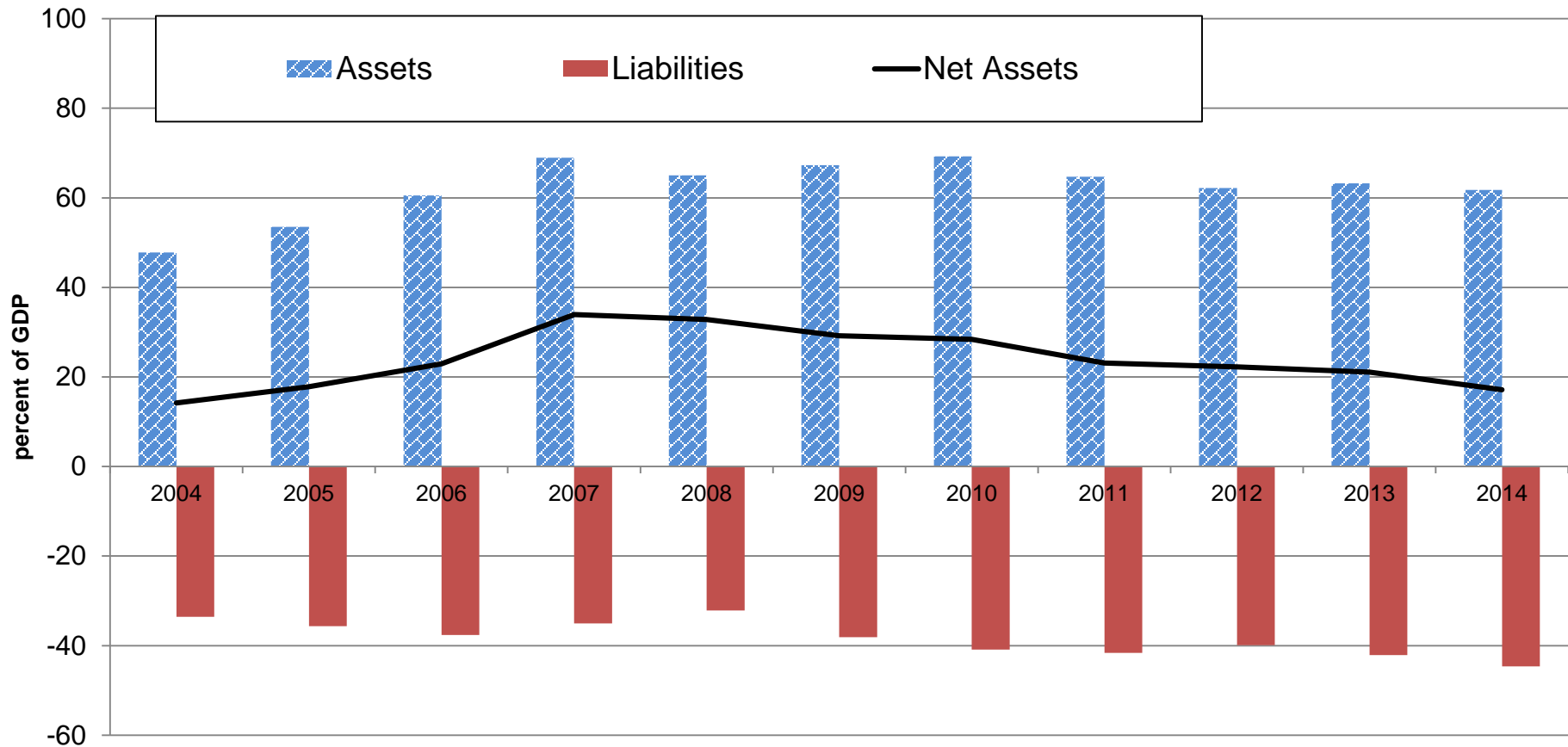
- Collateral (indirect) benefits of financial integration
 - Development of financial markets
 - Regulatory, technical expertise comes with inflows
 - Diversification opportunities for domestic investors
 - Catalyst for financial sector reforms
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External Assets and Liabilities

(in trillions of dollars)



External Assets and Liabilities (in percent of GDP)



Risks of Premature CAL

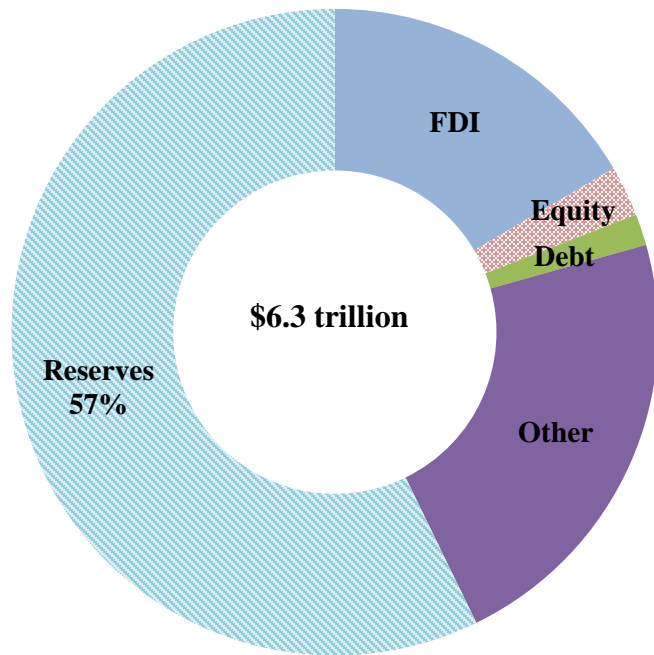
- Putting the cart before the horse: CAL before greater exchange rate flexibility, reform of financial system risky
 - Difficult to control currency value if capital account open
 - Risks to financial system if outflows unrestricted
 - High ratio of bank deposits to GDP; capital flight?
 - Are these major risks? \$3.2 trillion of forex reserves buys some protection; low level of foreign-currency external debt
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Organizing Framework for Domestic Reforms

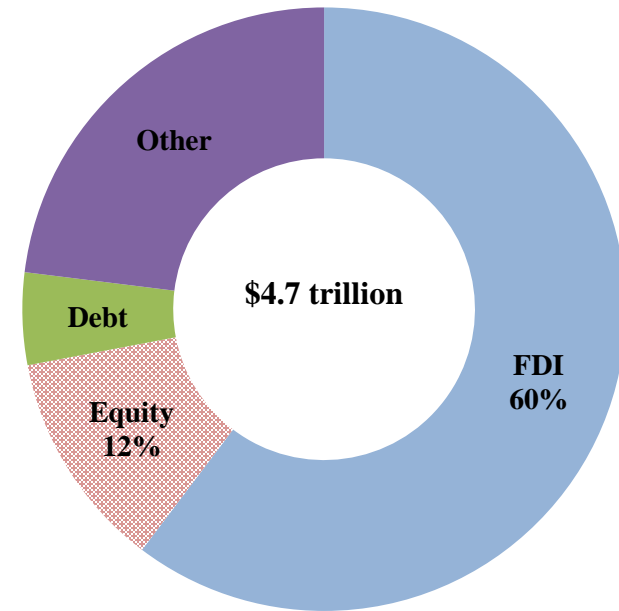
- Consensus around objective of making RMB global reserve currency could drive domestic reform agenda
 - Achieving objective while mitigating risks requires:
 - Better, deeper, well-regulated financial markets
 - Fx flexibility
 - Better macro policy framework
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External Assets and Liabilities

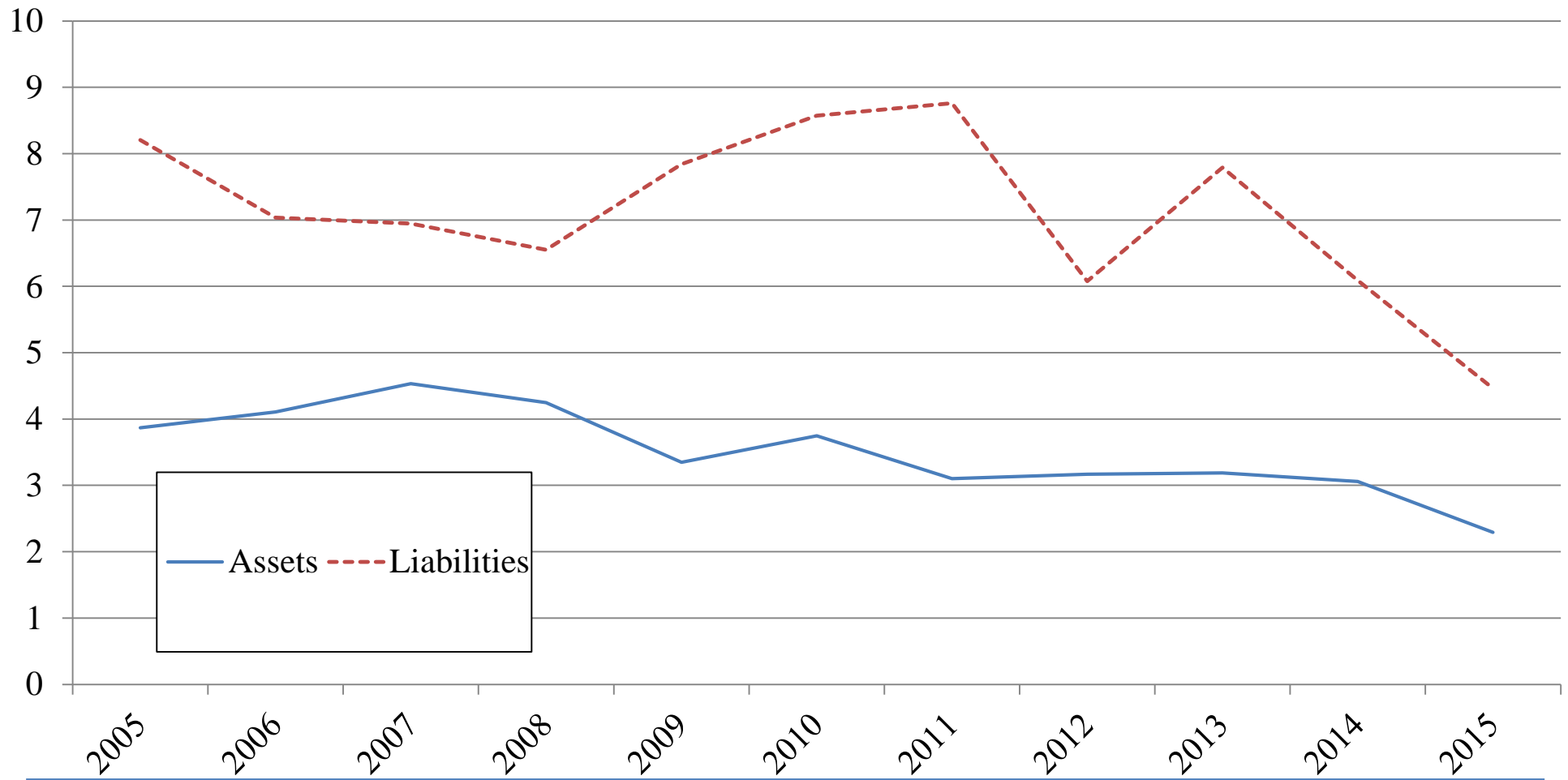
External Assets



External Liabilities



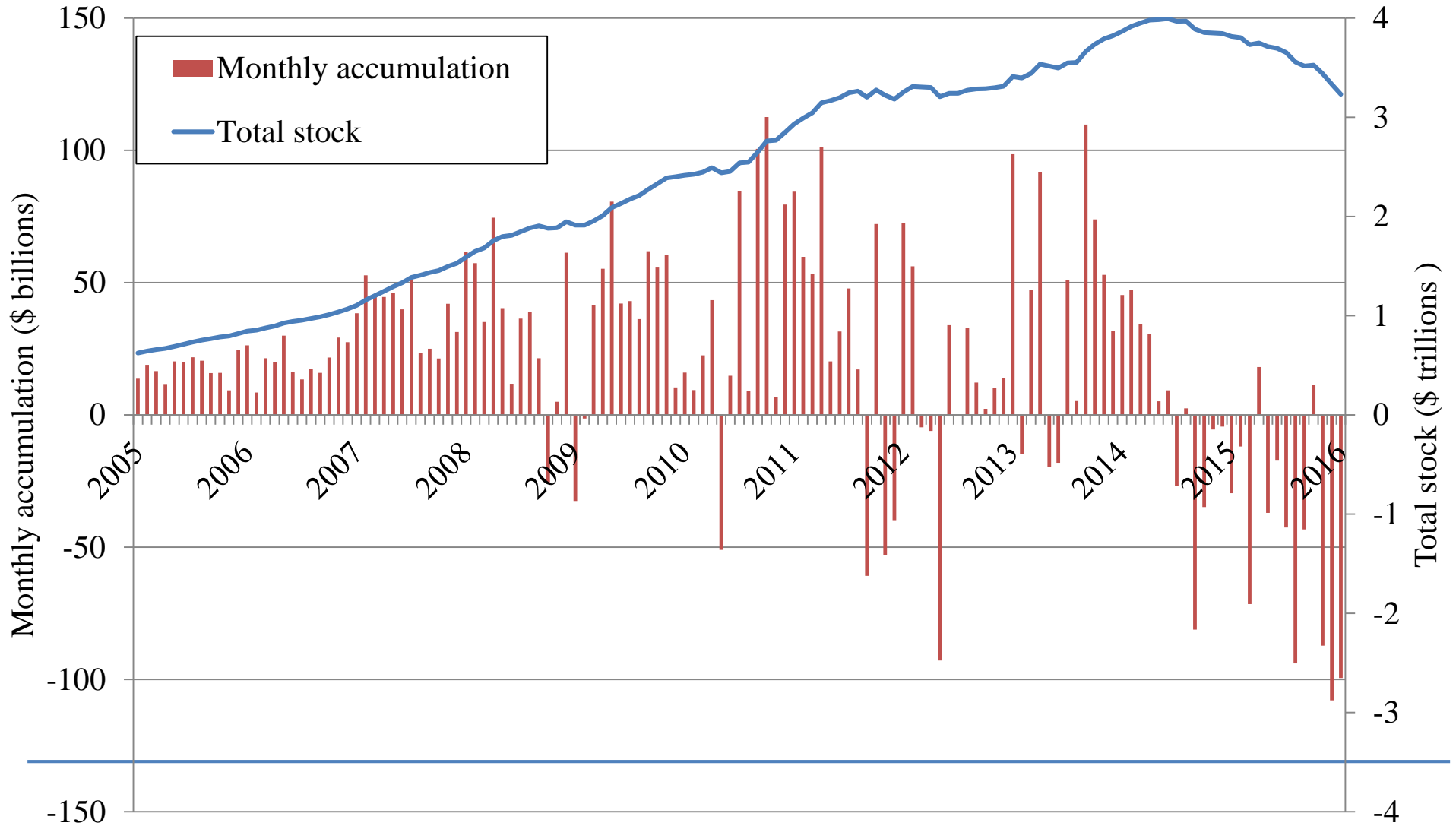
Returns on External Assets and Liabilities (in percent)



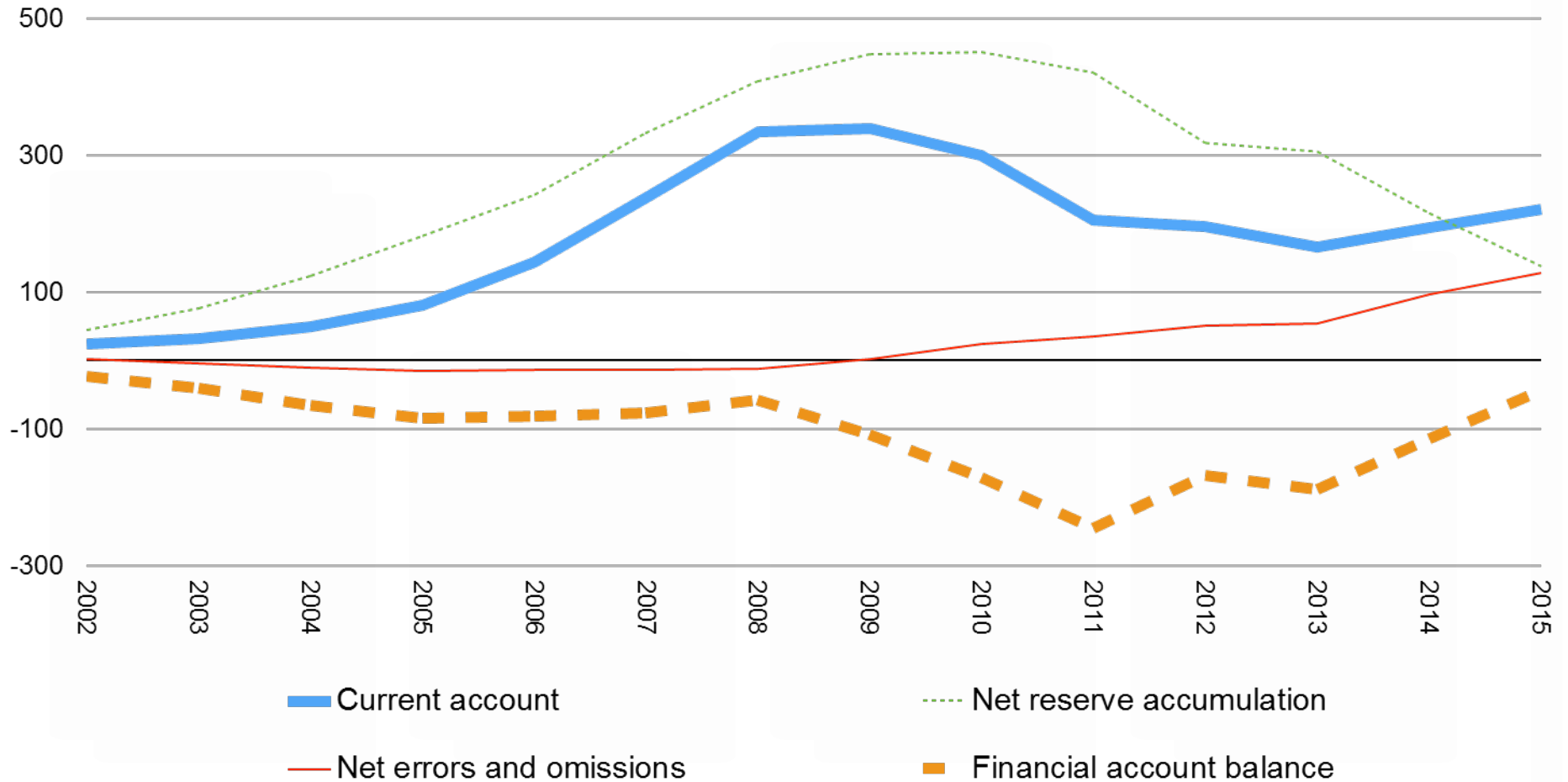
Returns on External Investment Positions

| | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
|---|------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Net income (bns USD) | -6 | -18 | -7 | 4 | 22 | -16 | -38 | -85 | -35 | -95 | -60 |
| Inward | 19 | 36 | 50 | 77 | 103 | 99 | 129 | 128 | 150 | 166 | 183 |
| Outward | 24 | 54 | 57 | 73 | 80 | 115 | 167 | 213 | 185 | 261 | 243 |
| Net external position (bns USD) | 276 | 408 | 640 | 1188 | 1494 | 1491 | 1688 | 1688 | 1866 | 1996 | 1776 |
| Stock of assets | 929 | 1223 | 1690 | 2416 | 2957 | 3437 | 4119 | 4735 | 5213 | 5986 | 6409 |
| Stock of liabilities | 653 | 816 | 1050 | 1228 | 1463 | 1946 | 2431 | 3046 | 3347 | 3990 | 4632 |
| Net return (%) | | -6.4 | -1.7 | 0.6 | 1.9 | -1.1 | -2.6 | -5.1 | -2.1 | -5.1 | -3.0 |
| Return on assets (t/t-1) | | 3.9 | 4.1 | 4.5 | 4.2 | 3.3 | 3.7 | 3.1 | 3.2 | 3.2 | 3.1 |
| Return on liabilities (t/t-1) | | 8.2 | 7.0 | 6.9 | 6.6 | 7.8 | 8.6 | 8.8 | 6.1 | 7.8 | 6.1 |

Foreign Exchange Reserves

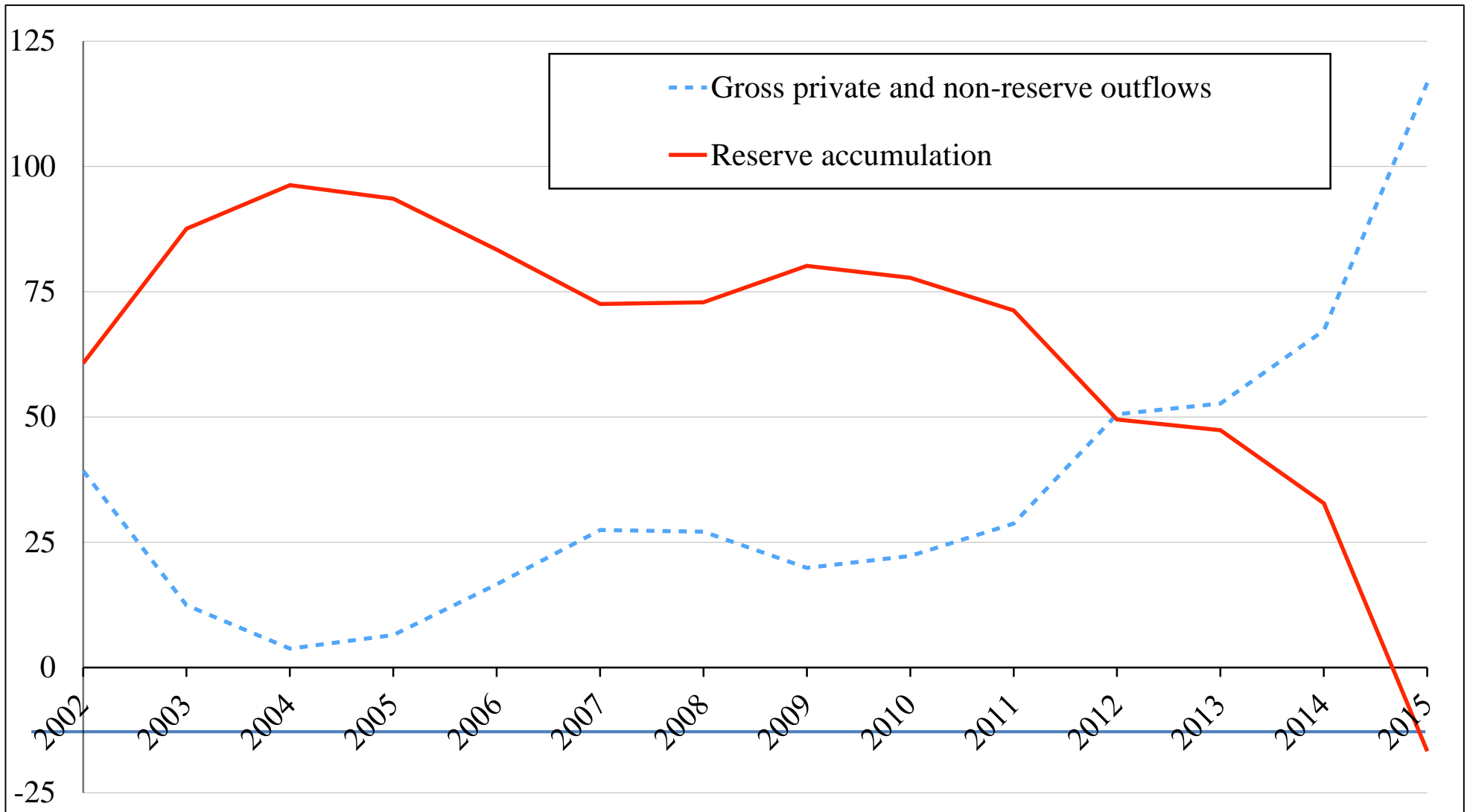


Decomposition of Current Account Balance (in billions of dollars)



Structure of Capital Outflows

(in percent)

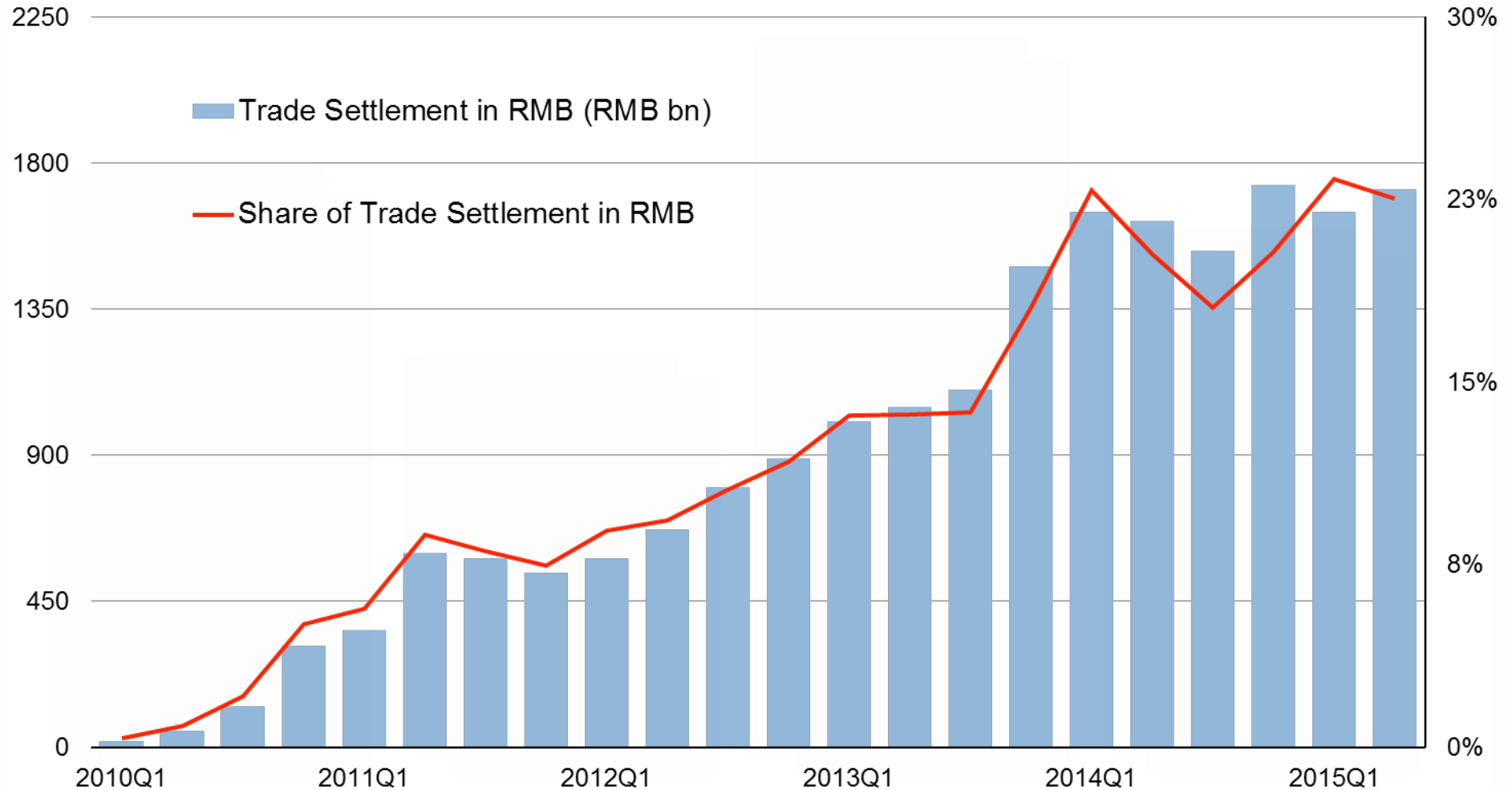


Internationalization of Renminbi

- Offshore yuan deposits
- Trade settlements in yuan
- Yuan denominated bonds
- Currency swaps with other central banks

*Is renminbi on its way to becoming
true global currency?*

Settlement of Foreign Trade in Renminbi



Dim Sum (Renminbi-Denominated) Bonds



RMB as World Payments Currency by Value (in percent)



RMB as World Payments Currency by Rank



The RMB in International Financial Markets

- Share of fx market turnover (2013): 2.2%
 - Share of international bonds and notes (2015) : 0.5%
 - Interest rate derivatives (contracts, volume; 2013): < 1%
-

RMB's International Use Requires:

- More financial centers (15), fin. institutions authorized to conduct RMB transactions
 - Payment system (CIPS)
 - More renminbi liquidity offshore
 - Integration of offshore, onshore markets
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Key Concepts

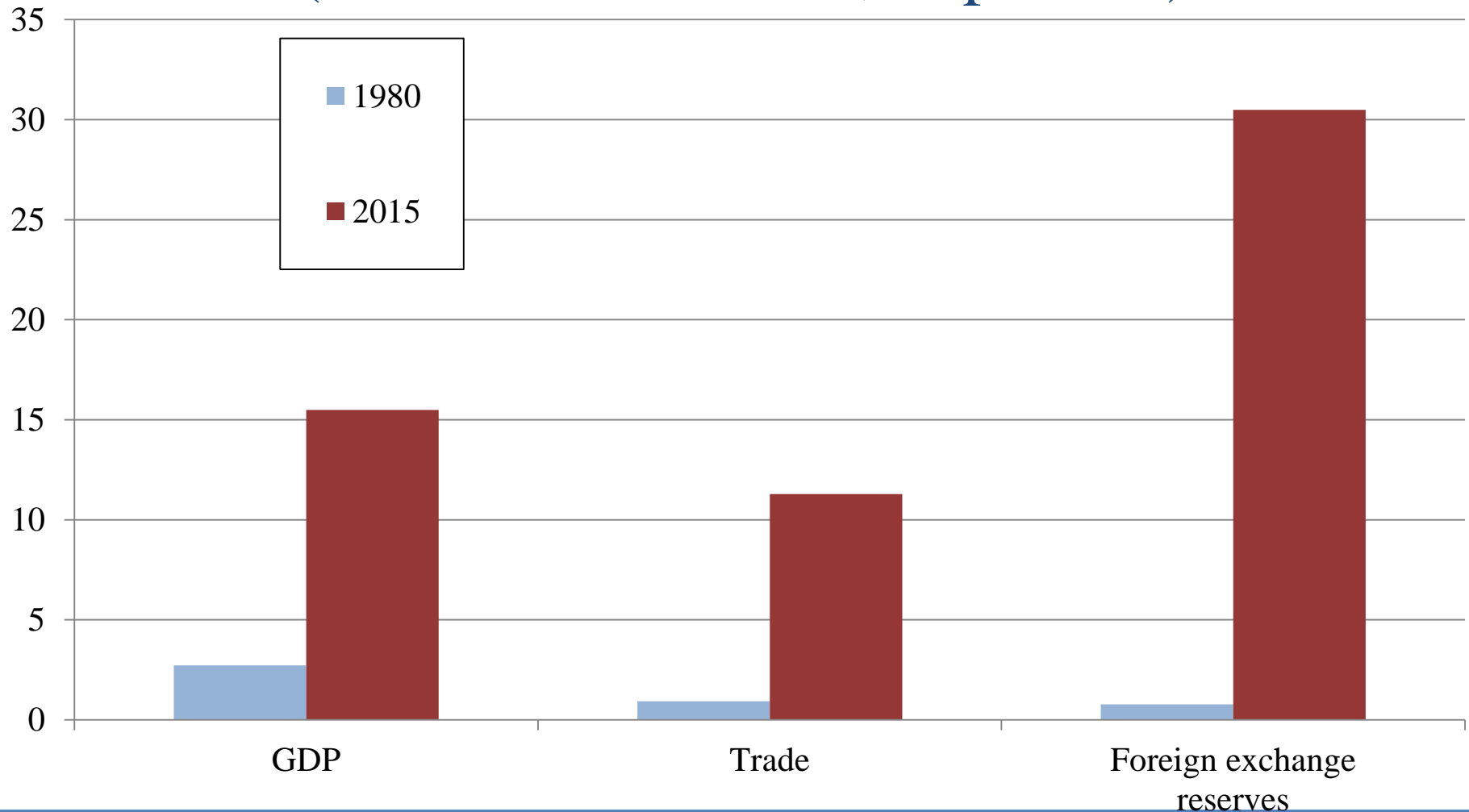
A. International currency: RMB on its way

B. Reserve currency: Held in central bank reserve portfolios. Basic criteria:

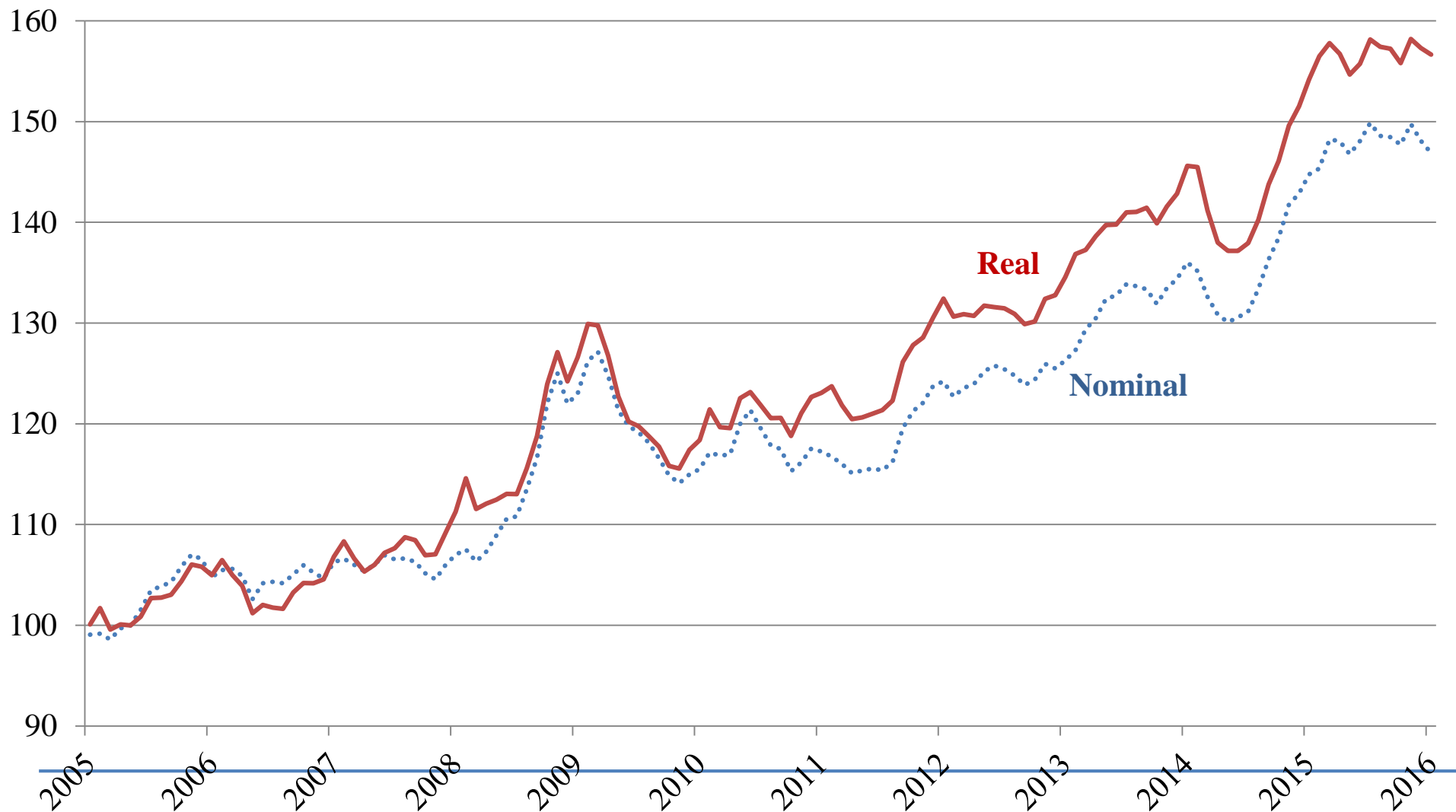
- Size
 - Open capital account
 - Flexible exchange rate
 - Well-developed financial markets
 - Macroeconomic stability
-

China and the World

(share of world total, in percent)



Trade-Weighted Effective Exchange Rates



Bond Markets: Stocks and Turnover

| | Government | | | Corporate | | |
|-----------|--------------------|----------|----------------|--------------------|----------|----------------|
| | Amount Outstanding | Turnover | Turnover Ratio | Amount Outstanding | Turnover | Turnover Ratio |
| U.S. | 14,495 | 123,505 | 8.5 | 8,047 | 6,703 | 0.8 |
| Japan | 8,341 | 10,376 | 1.2 | 656 | 37 | 0.1 |
| Euro area | 8,132 | - | - | 3,671 | - | - |
| China | 3,694 | 2,339 | 0.6 | 1,543 | 445 | 0.3 |
| Germany | 1,262 | 5,919 | 4.7 | 282 | - | - |

Financial Markets for a Reserve Currency

- Financial market characteristics:
 - ❑ Breadth: Broad range of financial instruments
 - ❑ Depth: Large stock of those instruments
 - ❑ Liquidity: High level of turnover
 - High-quality renminbi assets backed by:
 - ❑ Technical infrastructure for trading and settlement
 - ❑ Regulatory framework—focus on systemic financial stability, adequate capacity, political will
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Will China Stumble?

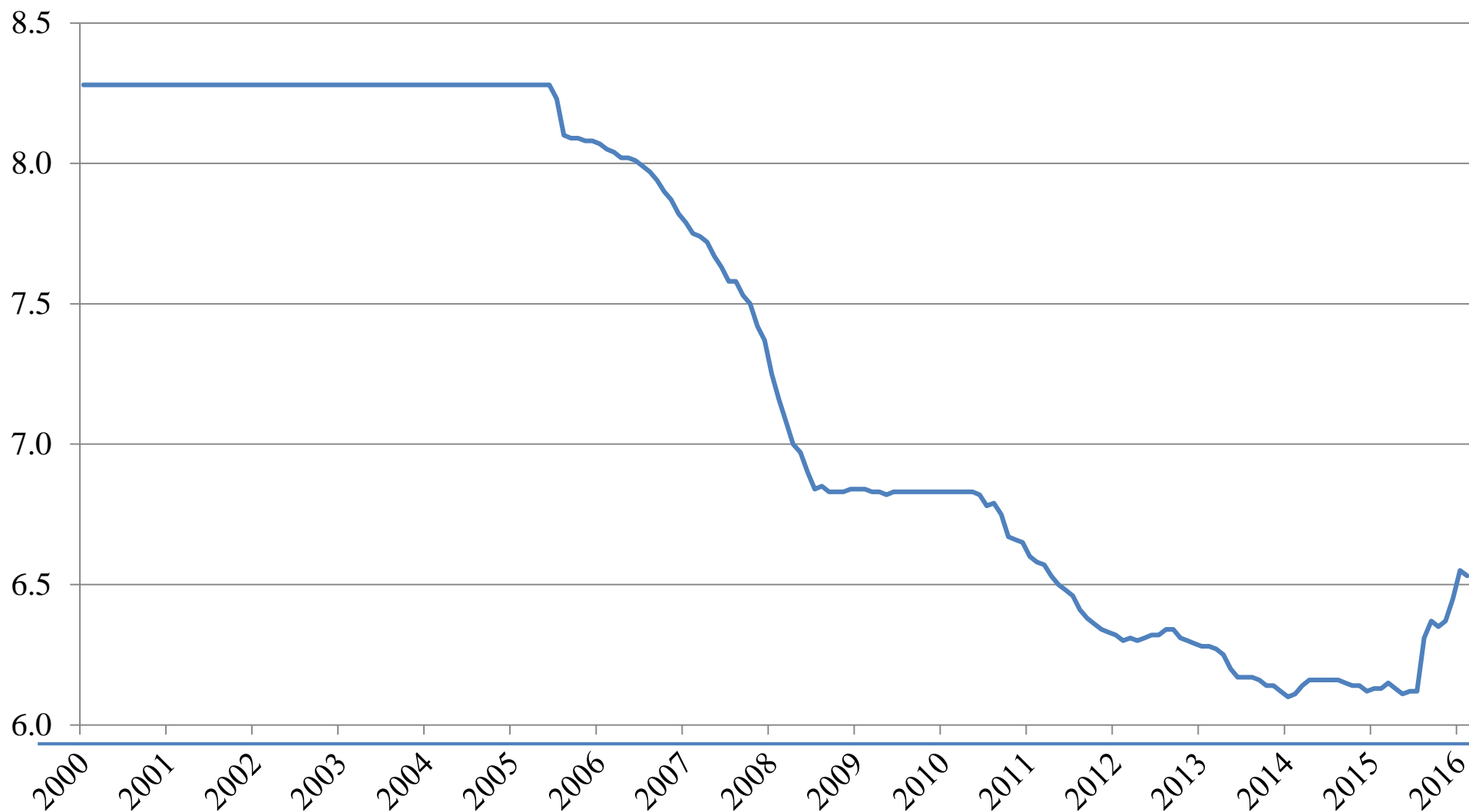
- Financial system risks
 - Capital flight
 - Policy missteps
 - Political, social instability
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Stock Market Indices

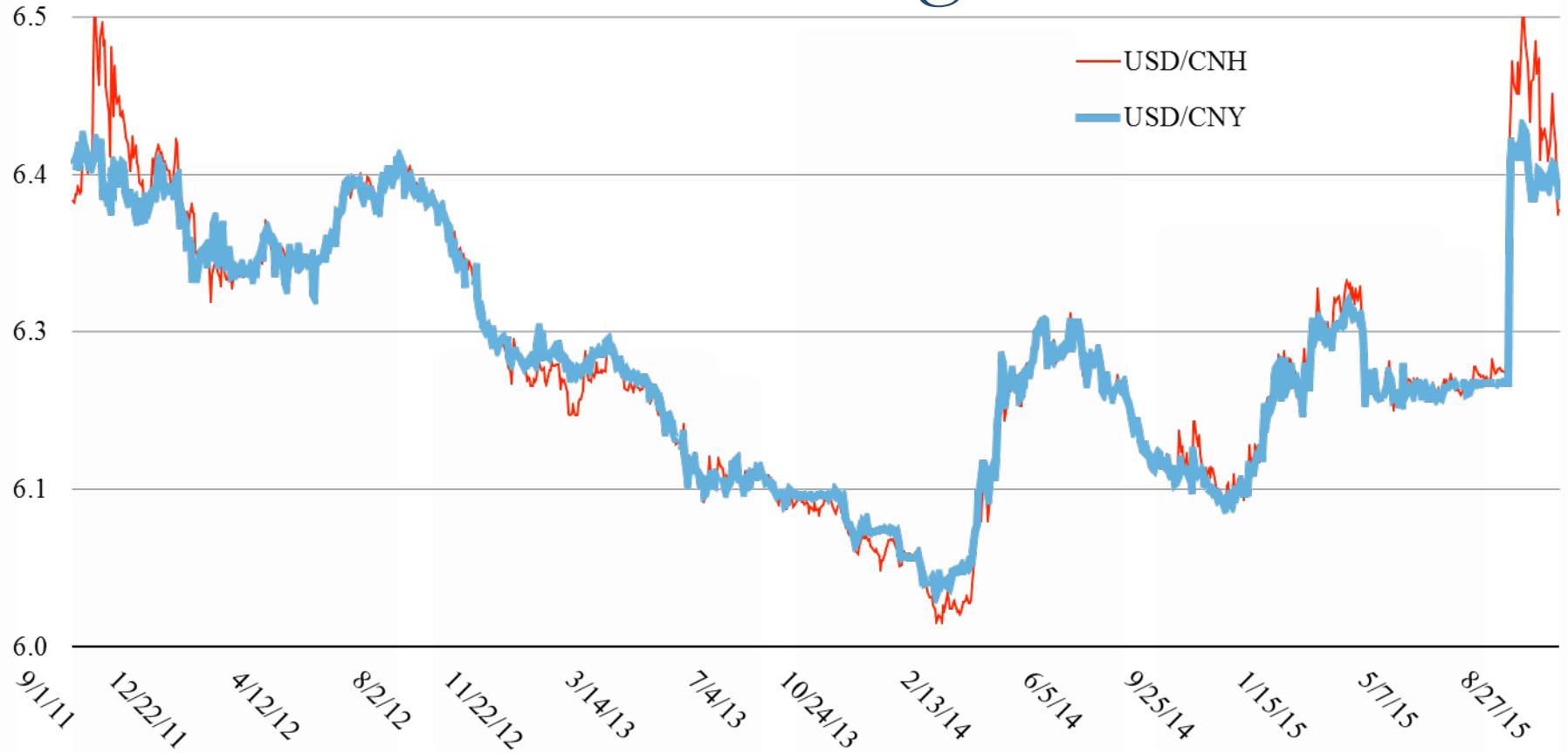


RMB-dollar exchange rate

(Jan. 2000 – Feb. 2016)

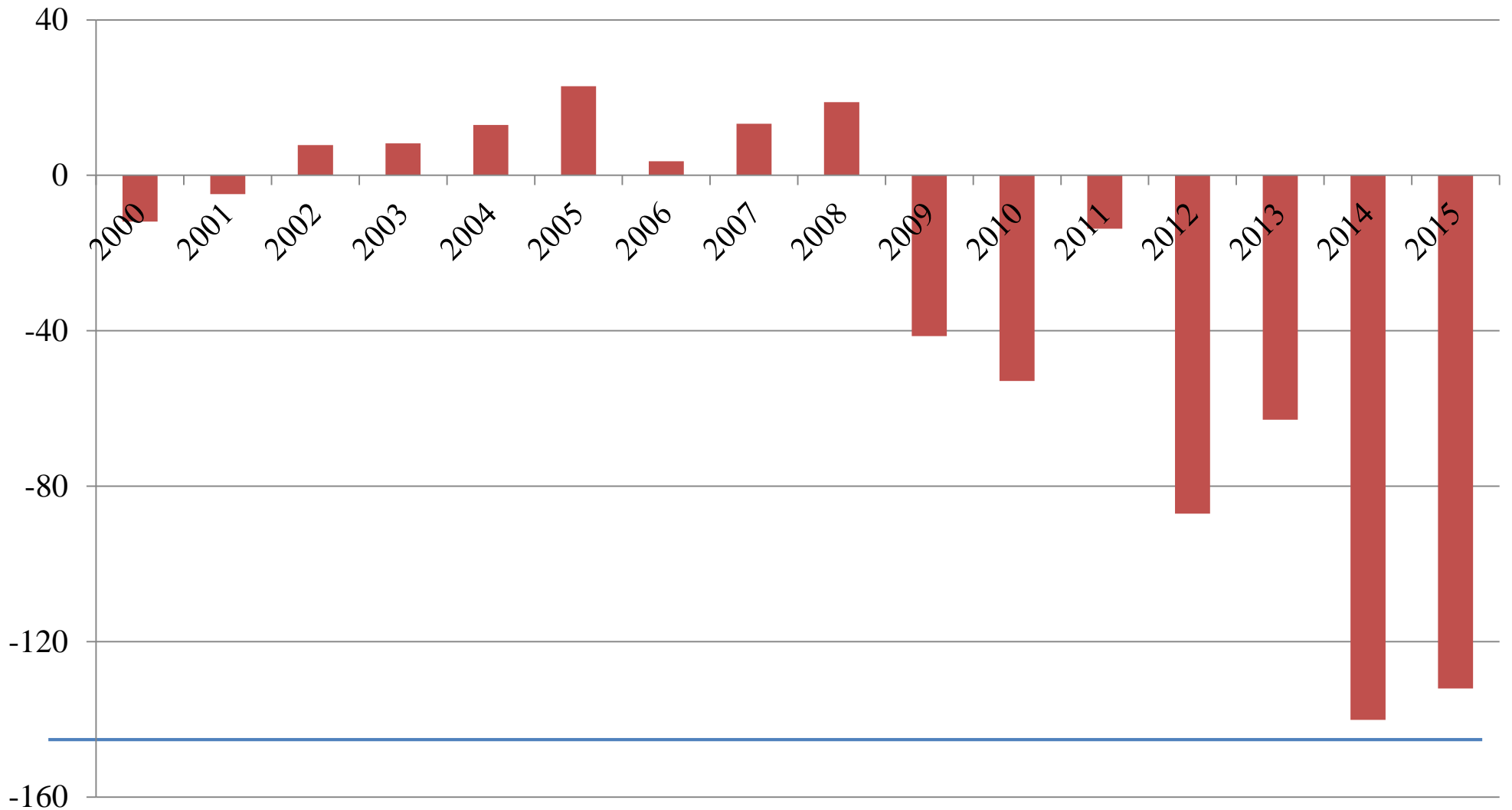


Onshore and Offshore Spot Renminbi-Dollar Exchange Rates



Net Errors and Omissions

(in billions of U.S. dollars)



Key Concepts

A. International currency

B. Reserve currency

C. Safe haven currency: Quality of institutions crucial

- Open, transparent democratic government
 - Trusted, independent central bank
 - Independent judiciary
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Prognosis

- Renminbi likely to become widely-used international currency in next 5 years
 - RMB could become significant reserve currency if financial market, currency reforms continue + capital account becomes more open
 - Will erode but not displace dollar's dominant role in global finance
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China's Investment Position in the U.S.

(in billions of U.S. dollars)

