**The RMB: A Resistible Internationalization?**

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**The RMB: A Resistible Internationalization?**

* Facts
* Challenges
* How does a currency become international?
* Modes and mechanisms of internationalization of the Chinese Yuan
* Resistible internationalization?
  + External and internal factors that limit (today) its extension
  + Difficult arbitration between internationalization and social stability

**What future for the RMB?**

* Current context: an “upset evolution” of globalization:
  + Rise of protectionism, especially US
  + Context of the “trade war”, China-US negotiations: what compromise, impact on trade, on capital movements
  + Slow economic growth in China, debt/GDP increase
* What consequences of RMB internationalization?
  + A new global financial architecture with multiple reserve currencies including Yuan / RMB
  + A sino-centric international system in competition or in parallel with the International Monetary System with the aim of weakening the US $ (and the €)?
  + Past attempts or no internationalization attempts: Japanese Yen, DM..
* Contradictions
  + Trade, Investments: contribute to the growth and expansion of RMB
  + Domestic economic policy priorities: a brake to its expansion.

**Openness, growth but dependence on US $**

* China's strong export-led economic growth since opening
* Mercantilist strategy, relying on undervalued RMB. Rapid development of financial surpluses, questions of its recycling
* High dependence on US $ (trade, capital)
* Underdeveloped financial system, fragmented, protected from competition and disconnected from domestic market forces (interest rate policies, soft budget constraint, financial repression, misallocation of capital, shadow banking)
* WTO accession, accelerator of trade, export of capital (FDI), protecting many sectors to the entry of foreign competitors
* Impact of the 2008 financial crisis: reaction (injection of liquidities) + reflection on how to reduce dependency on the US $
* 2000s & 2010s: Continuing internationalization of RMB, many filters, from pegging to the US $ to managed floating

**Still predominance of US $ and €**

* RMB not yet attractive despite strong growth: no RMB currency yet
* Most non-performing economies still tied to $
* In 2015, 62% of countries have their currency pegged to $, 60% of developing countries borrow in this currency. > 30% of countries have their currency pegged to the euro, while 13% of countries have their currency pegged to the euro.
* Global currency reserves: central banks hold more than 60% of their reserves in $

**Internationalization and RMB growth**

* 2nd largest world economy; GDP + 15% of world GDP (at market exchange rates) and 12% of world trade:
* RMB has become a reference currency, today one of the components of IMF Special Drawing Rights
* Lifting restrictions on cross-border inflows and outflows of financial capital has led to rapid growth in the use of RMB.
* One of the main currencies in denomination and settlement of cross-border trades and financial transactions
* De facto RMB has become a reserve currency even if China has neither an open capital account nor a flexible exchange rate
* RMB today:
  + commercial currency (billing of exchanges), investment currency (capital invested for acquisition of assets: Chinese OFDI, FDI in China).
  + Step 3: Become a reserve currency

**Internationalization and RMB growth**

* Many central banks around the world are acquiring modest amounts of RMB in their foreign exchange reserves portofolios. Many swaps signed over the world with China
* The ambitious project of new silk roads should contribute to increase the international role of the RMB: invoicing of exports, bank loans in RMB.
* Specific mechanisms to channel inbound and outbound capital from China, with HK as the main hub to issue bonds denominated in RMB (Dim Sum Bonds), to invest in China (non-residents), export capital (residents). Other hubs set up (Singapour, London..)

**What is an international currency?**

* Several factors (Tresor Eco)
  + Size of the country issuing the currency, its role in world trade, the volume of its financial markets
  + Financial, economic and political stability of the currency area where the currency is issued
  + Liquidity and depth of financial markets that reduce transaction costs
  + Convertibility for current and financial transactions with a high degree of openness of the capital account (Doesn’t mean total opening but but make it sensible to market forces)
* Historical comparisons, experiences
  + £ / $: rapid emergence of U$ but cohabitation for nearly half a century (-> Bretton Woods)
  + Gowth of the currency without willingness to internationalization: DM..

**Progressive activation of the RMB at the international level**

* Monetary policy: unchanged from 1991 to 2005: exchange rate fixed at 8.18 RMB / $
* Introduction of an extended daily fluctuation band: start of revaluation of the RMB / $
* 2010: partial opening of the capital account through a window in HK: a twin of the domestic currency by creating an offshore market
* At the same time, expansion of the use of the yuan as a currency of trade, bilateral and international trade, both for Chinese exports and for imports excluding raw materials
* Swap agreements with many countries, including developed. 5th world currency but still far from the USA (40%) and € (10%), with around 5%
* Attempt to federate the BRICS, NDB, Asian countries (AIIB): to amortize and avoid crises, even to create a new international monetary system
* The New Silk Roads Project: A vector for increasing the RMB's international role: loans settle up in RMB

**A « dirty float »? From pegging to « managed floating »**

* China’ current managed floating exchange rate system is a BBC regime:
* Fluctuation range (Band), a currency basket (Basket) , incremental adjustment (Crawling)
* Band: +/- 0,5% (2007), +/- 1 % (2012),

+/- 2 % (2014)

* 2016: joining the IMF’s SDR basket

**A resistible growth: Has RMB growth reached its pick?**

* RMB share in global payments declined over the last 3 years. Its use in global bonds market fell by 45% compared to its 2015 peak; also declining of deposits in HK banks, also drops cross-border trade in RMB (from 35% in 2015 to 12% in 2017)
* Many reasons:
  + Since 2014, the RMB exchange rate has fallen against the $ despite interventions by the central bank. Slowing of China's debt-fueled economic growth and the accumulation of default risks: -> capital outflows by residents and companies.
  + Choice of economic stability versus exchange flexibility
  + China has exhausted its export potential: new growth model, middle income trap.
  + Last reason: contraction of globalization
  + Decline in capital flows (equities, bonds, IDF, credits) from $ 11.9 trillion to $ 3.3 trillion between 2007 and 2015
  + Trade and non-trade barriers on the rise
  + Discriminatory measures grow faster than liberalization policies
  + China loses market share in shrinking global market

**Reform of the monetary system or social stability**

* What credibility of the Chinese financial system?
  + Capital outflow, stock accumulation of foreign exchange related to the export and not by the attractiveness of the financial market
  + Spoliation of savers in general and the middle classes in particular. Risk of increasing with a slowdown in growth and the fragility of the banking system.
  + Difficult to consider the total opening of the capital account
* What monetary policy?
  + Control the financial bubbles created by the real estate market financed by cash hidden or channeled by the absence of any investment alternative
  + Avoid a hard landing: relaxation of the constraint on banks, increase liquidity, launch again major infrastructure works
  + Partial opening of the capital account through sophisticated mechanisms to invest more easily in the Shanghai and Shenzhen stock exchanges

**What perspectives?**

* Ambiguity of China
  + Progressive integration into the Bretton Wood system
  + Creation of a new regional, inter-regional system with other countries (Russia?) Centered around China around trade, commodities, derivatives (future): -> move away from US $
* Several problems
  + Chinese growth: future role of foreign trade if model of domestic growth develops (urbanization, services, etc.), if GDP groth continue to decline?
  + Ability to transform the domestic financial system and introduce reforms, especially in the financial area: openness, competition, increasing liberalization of the capital account, end of financial repression.

**Conclusion**

* International RMB growth fueled by strong growth in China's foreign trade in the last decades
* Accumulation of financial resources and the problem of their recycling
* Internationalization and role of the RMB as international currency: 2 steps achieved (commercial currency, investment currency)
* 3rd step, reserve currency still limited
* External factors: contraction of the world market, greater confidence in other currencies ($, €)
* Internal factors: opacity, fragmentation of the financial system, lack of trust from foreign investors
* The trade off between growth, imbalance, social order.