

The Internacionalization of the Chinese Currency

Hegemonic Dispute or Defensive Strategy

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Currency internationalization is part of the financial globalization process

1. End of capital account controls after 1980's: UK, Australia, NZ, Europe, Mexico, Peripherals Asia and LA. (partial after 1998), China and Russia (in progress)
2. Renminbi internationalization is the most important process going on and has aroused a lot of interest
3. Threat to the American hegemony or defensive strategy
 - 3.1 "Change of Guard Vision": Market competition among currencies. Transition from the pound sterling to the dollar.
 - 3.2. "Hegemonic Dispute": Strategy of the Chinese State to increase its political leverage in the world and against the hegemonic power of the US

2008 Financial Crisis accelerated measures for the internationalization of the Yuan

The Economist 11/20/2011: “This house believes that the yuan will be the world's main reserve currency within ten years”

Against the motion. Stephen Jen While the rise of China's economy and the growing international role of the yuan are compelling generational trends, it would be a mistake to underestimate the durability of the dollar as the dominant reserve currency and overestimate the speed with which the yuan could become a dominant reserve currency

Defending the motion: Arvind Subramanian

The yuan will be the world's main reserve currency because the fundamentals are moving strongly in China's favour. The historical experience of the sterling-dollar transition suggests that once a country becomes economically dominant in this broad sense, currency ascendancy follows within

China has fueled these expectations

Hu Jintao: G-20 Meeting (November, 2008)

Demands a “new international financial order that is fair, just, inclusive and orderly”

Zhou Xiaochuan: Reform the international monetary system (March e 2009) “The outbreak of the crisis and its spillover to the entire world reflect the inherent vulnerabilities and systemic risks in the existing international monetary system”

Yuan internationalization: where are we?

Table 3: Currency distribution on global foreign exchange market turnover
Net-net basis, percentage shares of average daily turnover in April of each year

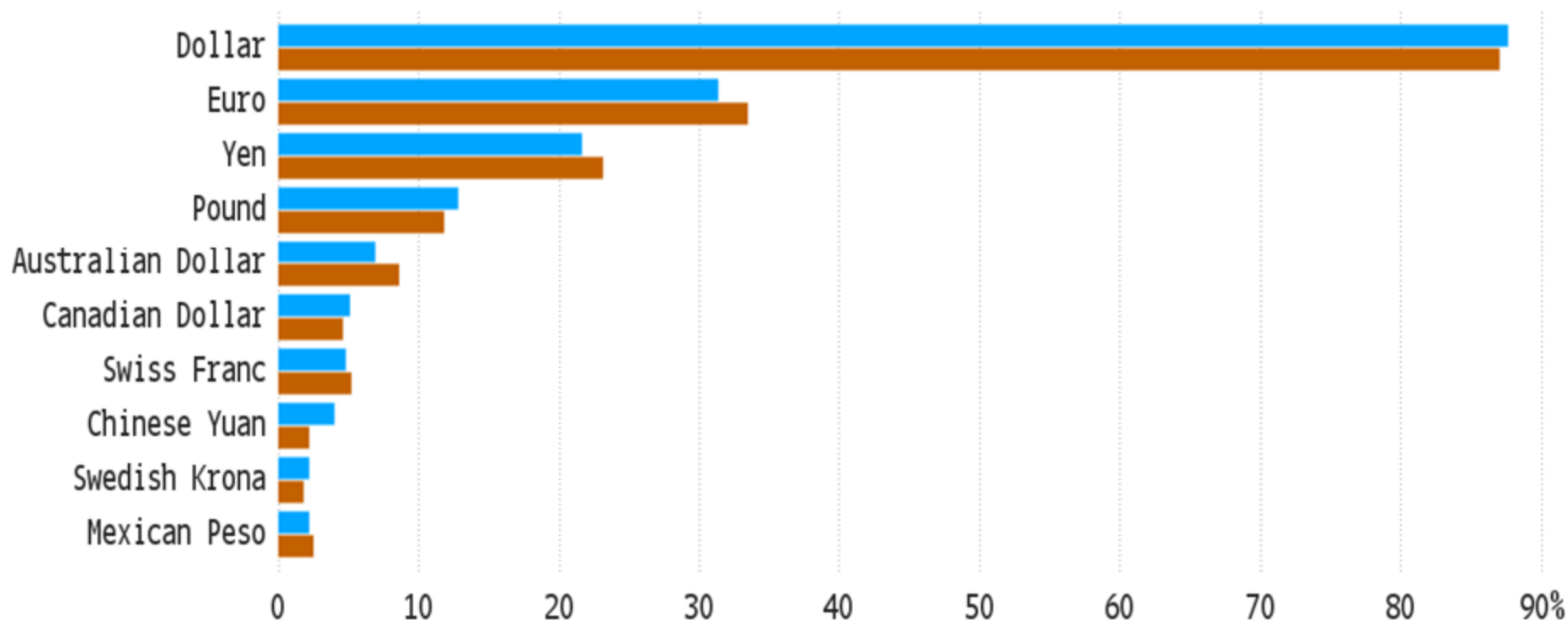
Currency	2001	2004	2007	2010	2013	2016
US dollar	89.9	88	85.6	84.9	87	87.6
Euro	37.9	37.4	37	39.1	33.4	31.3
Yen	23.5	20.8	17.2	19	23	21.6
Sterling pound	13	16.5	14.9	12.9	11.8	12.8
Australian dollar	4.3	6	6.6	7.6	8.6	6.9
Canadian dollar	4.5	4.2	4.3	5.3	4.6	5.1
Swiss franc	6	6	6.8	6.3	5.2	4.8
Chinese yuan	0	0.1	0.5	0.9	2.2	4
Mexican peso	0.8	1.1	1.3	1.3	2.5	2.2
Swedish krona	2.5	2.2	2.7	2.2	1.8	2.2
NZ dollar	0.6	1.1	1.9	1.6	2	2.1
Singapore dollar	1.1	0.9	1.2	1.4	1.4	1.8
HK dollar	2.2	1.8	2.7	2.4	1.4	1.7
Norwegian krone	1.5	1.4	2.1	1.3	1.4	1.7
Korean won	0.8	1.1	1.2	1.5	1.2	1.6
Turkish lira	0	0.1	0.2	0.7	1.3	1.4
Russian rouble	0.3	0.6	0.7	0.9	1.6	1.1
Indian rupee	0.2	0.3	0.7	1	1	1.1
South African rand	0.9	0.7	0.9	0.7	1.1	1
Brazilian real	0.5	0.3	0.4	0.7	1.1	1

International currencies: settlements

Top 10 Currencies by Market Share

Chinese yuan climbs further up the overall ranking

■ 2016 Market Share ■ 2013 Market Share




Source: Bank for International Settlements

Yuan is still an exotic currency: low liquidity

The world's top ten traded exotic currencies

(Data obtained from the 2013 [BIS survey](#))

The following table shows the top 10 traded exotic currencies in global FX. Even the most popularly traded exotics are traded infrequently and make up only a tiny fraction of global FX. 

Currency Ranking Among Exotics Only	Currency	Globally Traded Currency Ranking Among All Currencies	Global FX Market % (Involved in one side of global FX trades)
1	Mexican peso (MXN)	8	2.50%
2	Chinese yuan (CNY)	9	2.20%
3	Russian ruble (RUB)	12	1.60%
4	Hong Kong dollar (HKD)	13	1.40%
5	Singapore dollar (SGD)	15	1.40%
6	Turkish lira (TRY)	16	1.30%
7	South Korean won (KRW)	16	1.20%
8	South African rand (ZAR)	17	1.10%
9	Brazilian real (BRL)	19	1.10%
10	Indian rupee (INR)	20	1.00%

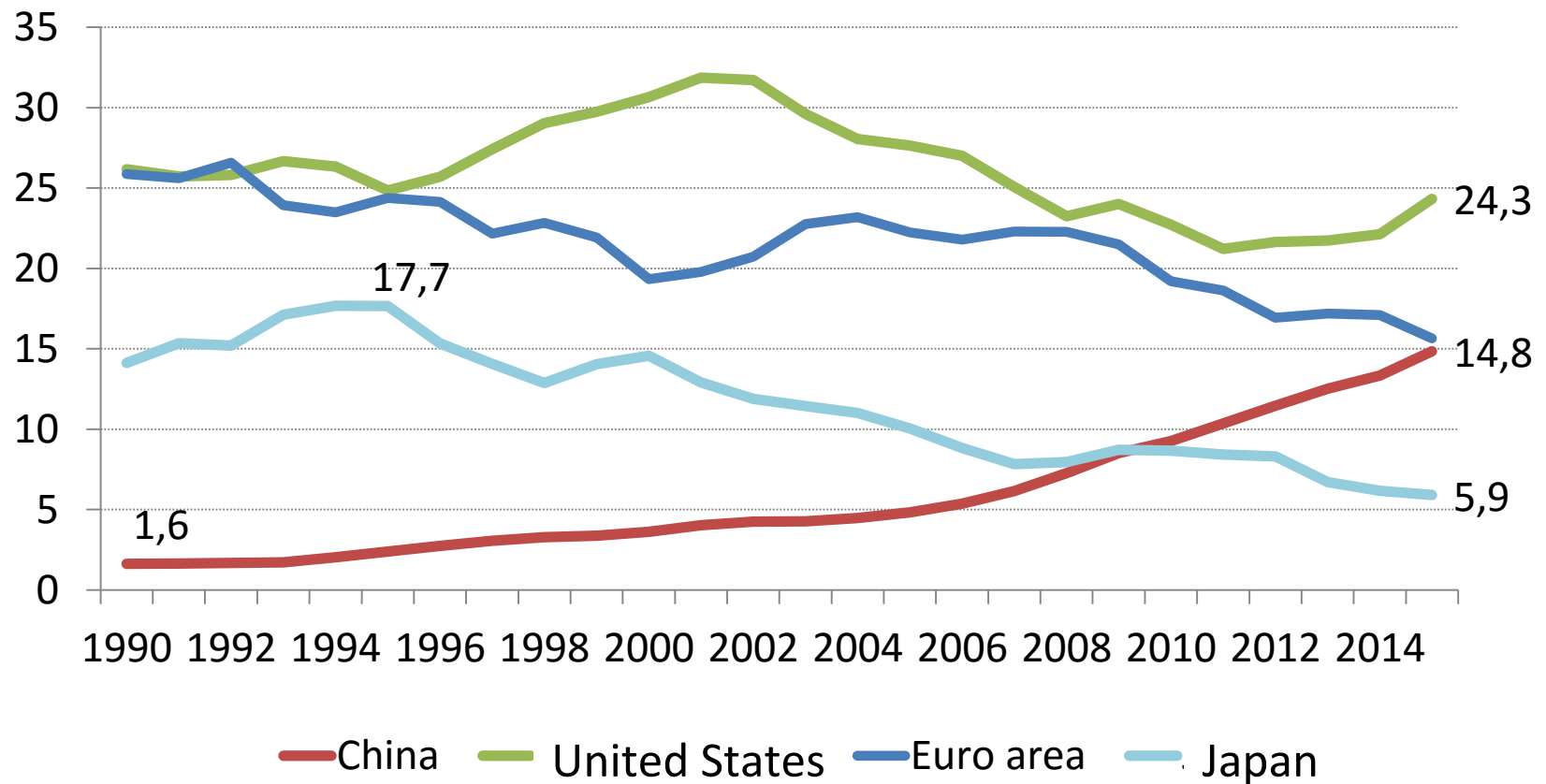
Figures based on 2013 data compiled by the [BIS survey](#).

China has conditions increase the international role of its currency?

- ✓ Basic conditions:
 - ✓ size of the domestic economy in international trade and finance;
 - ✓ stability of the value of the currency;
 - ✓ open and developed financial markets

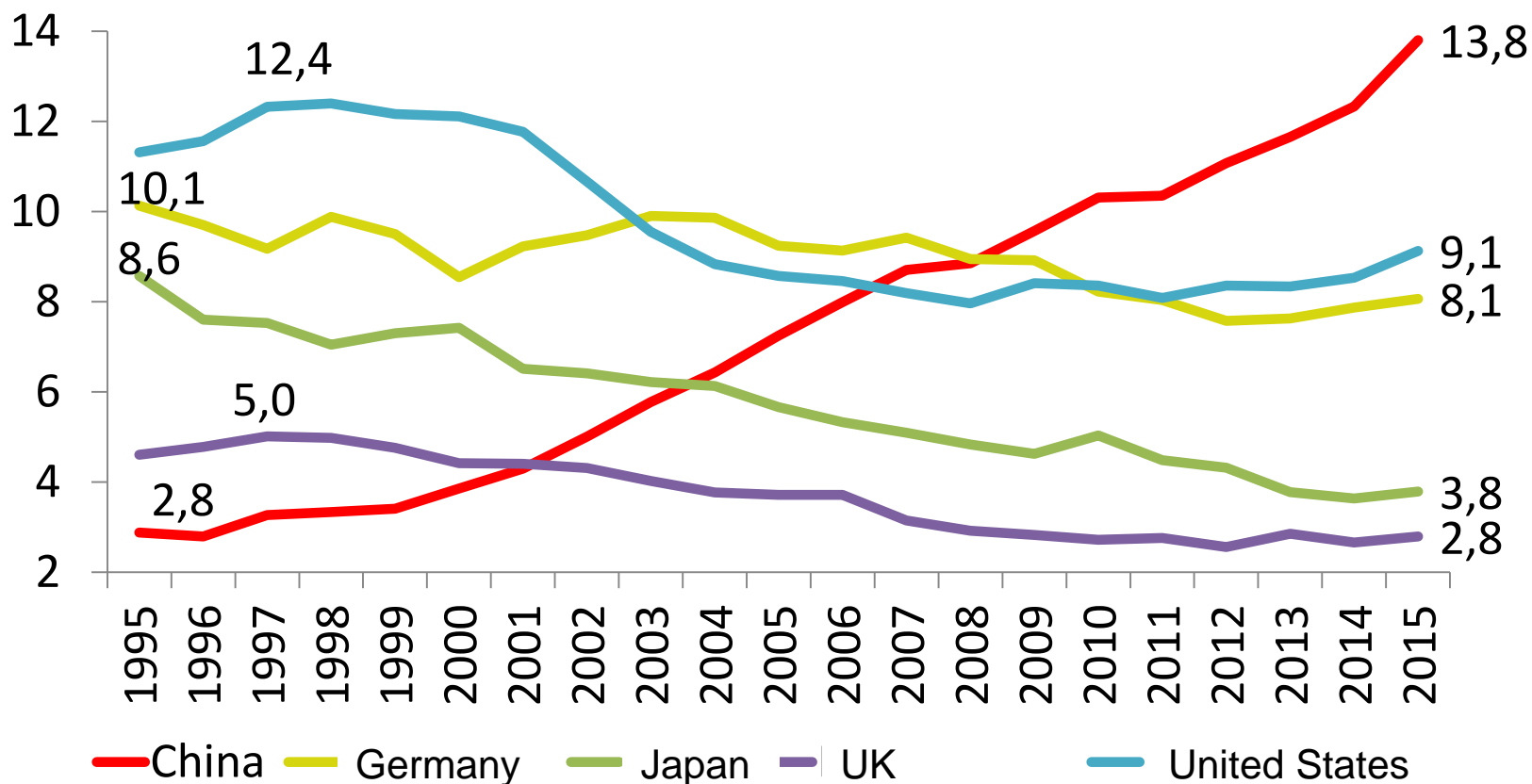
China is already a very large economy

Share of the World GDP (%)



China is the world's main exporter

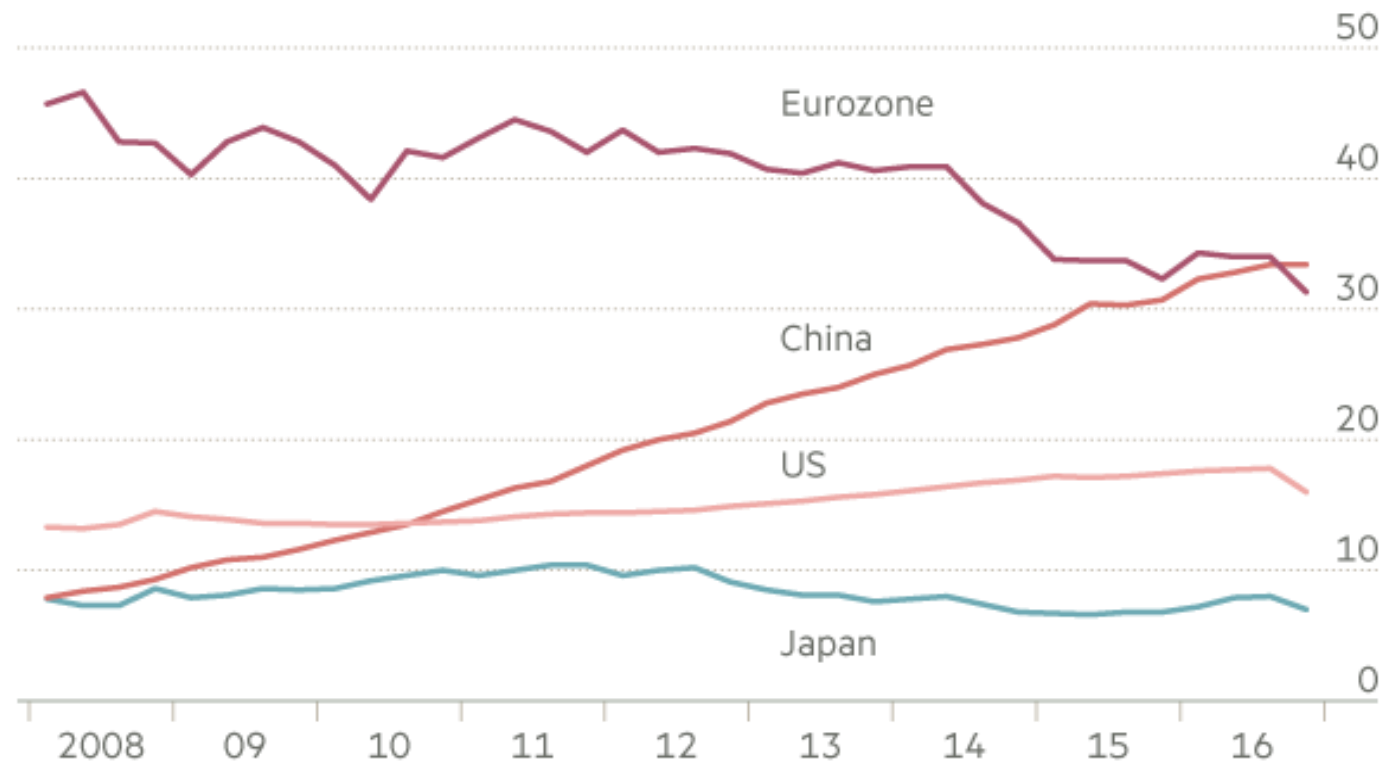
Share of the world's exports(%)



China has the largest banking system of the world

China's banks overtake rivals

Assets (\$tn)



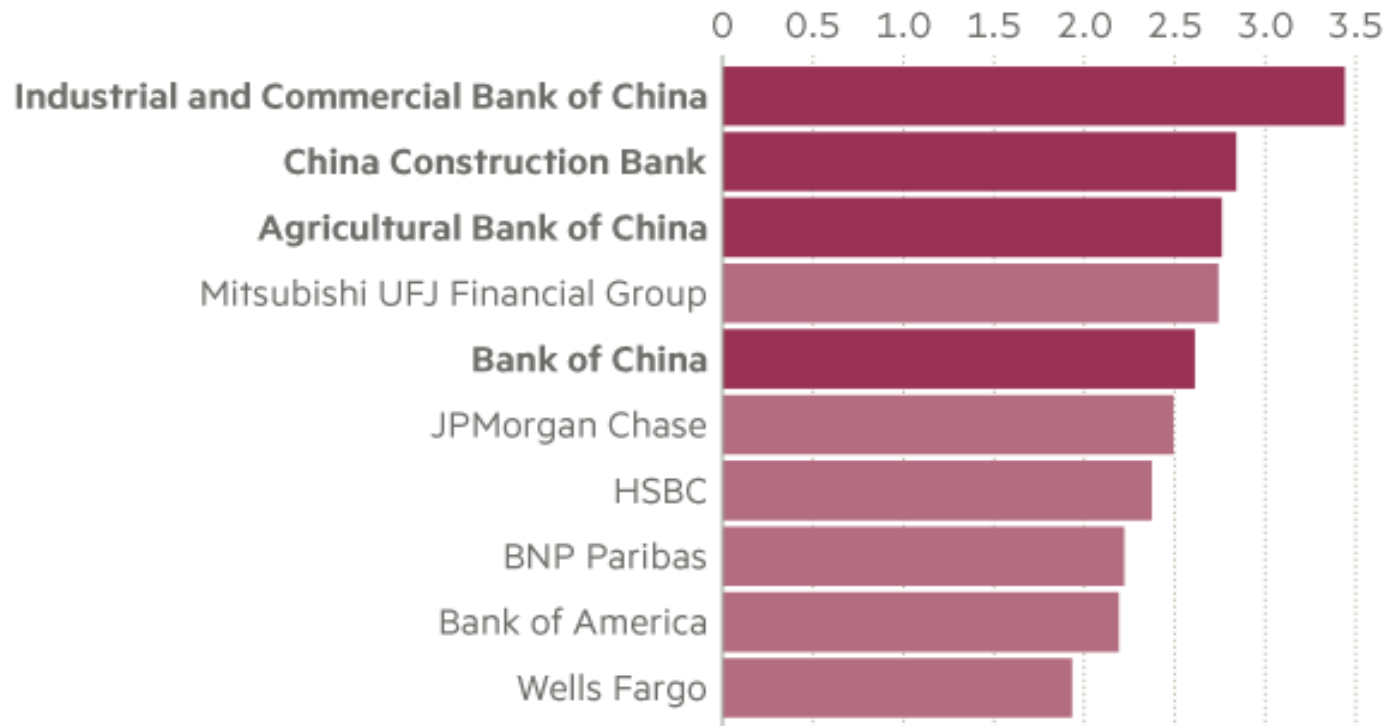
Sources: European Central Bank; Federal Reserve; China Banking Regulatory Commission; Bank of Japan; Thomson Reuters Eikon; CEIC

FT

4 among the 5 largest banks of the world are chinese

World's three largest banks are Chinese

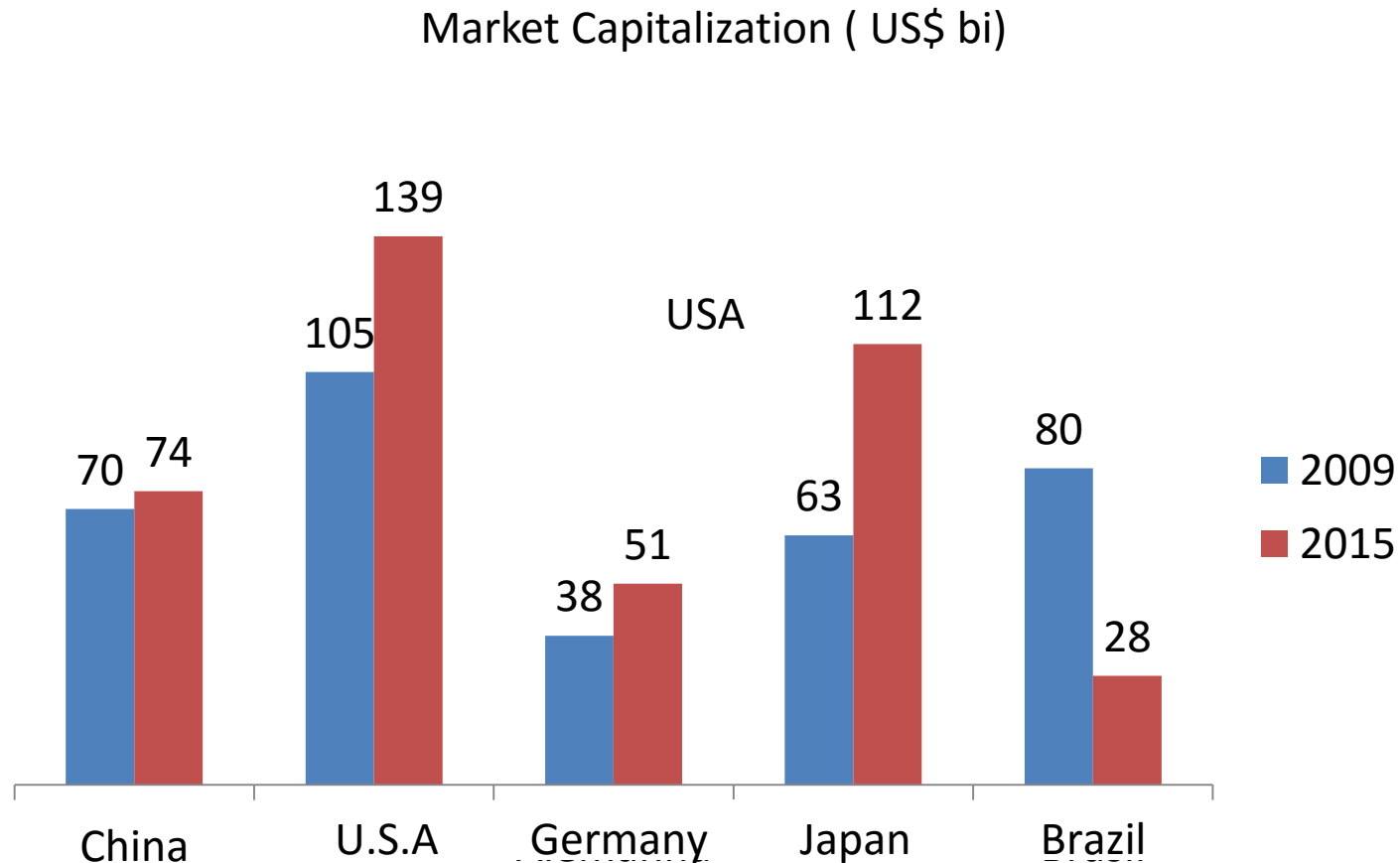
Total assets (\$tn)



Source: Thomson Reuters Eikon

FT

Stock exchange operations are among the largest in the world

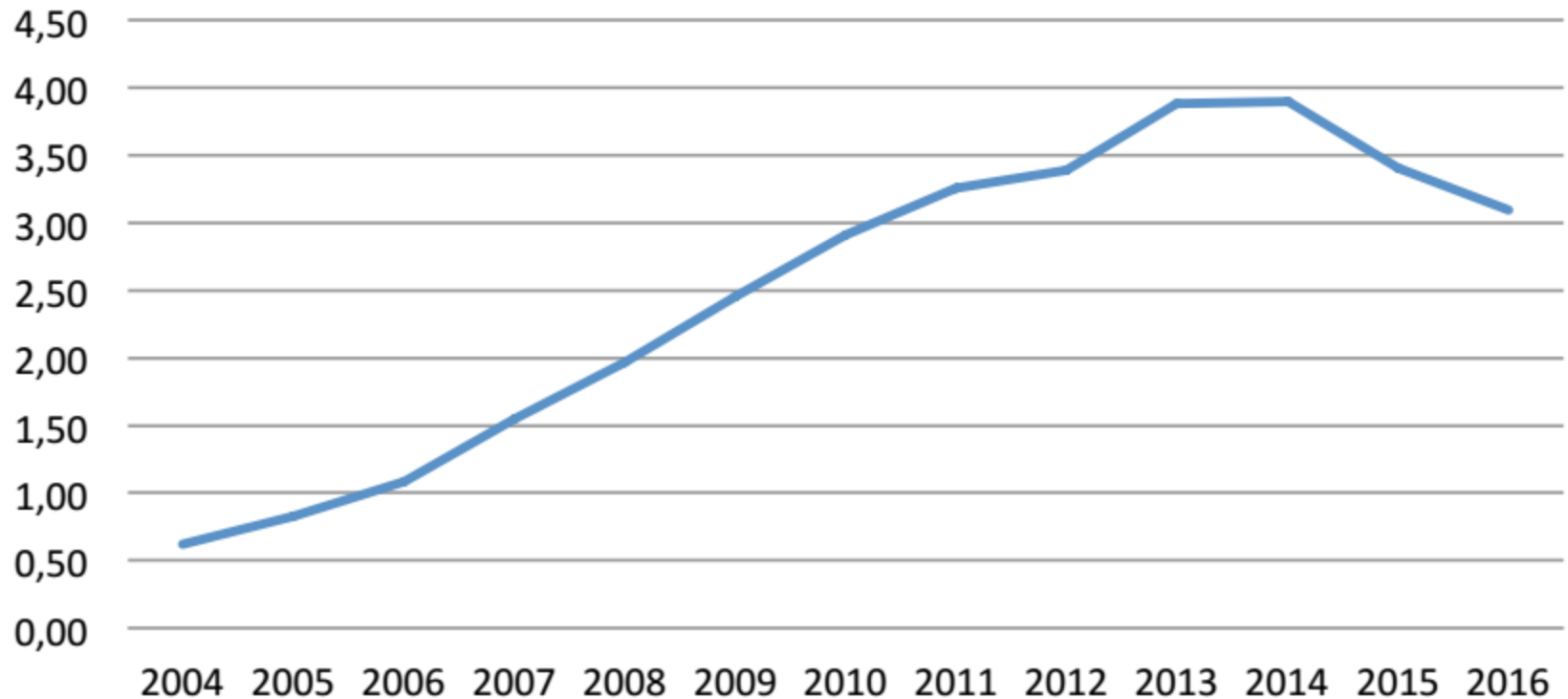


... but chinese capital accounts are not open
and there are large financial imbalances

- ✓ Government control of exchange and interest rates
- ✓ State-owned banks dominate (6 banks)
- ✓ Credit Allocation guided by central planning and investment policy
- ✓ Interest rates ceilings for deposits and lending
- ✓ Shadow banking
- ✓ 10 to 40 million vacant properties.
- ✓ Capital controls

Very high reserves are a consequence of Chinese imbalances

China: International Reserve Assets
US\$ trillions (End of the year)



Source: State Administrator of Foreign Exchange.

Internationalization is a very risky road

✓ Benefits:

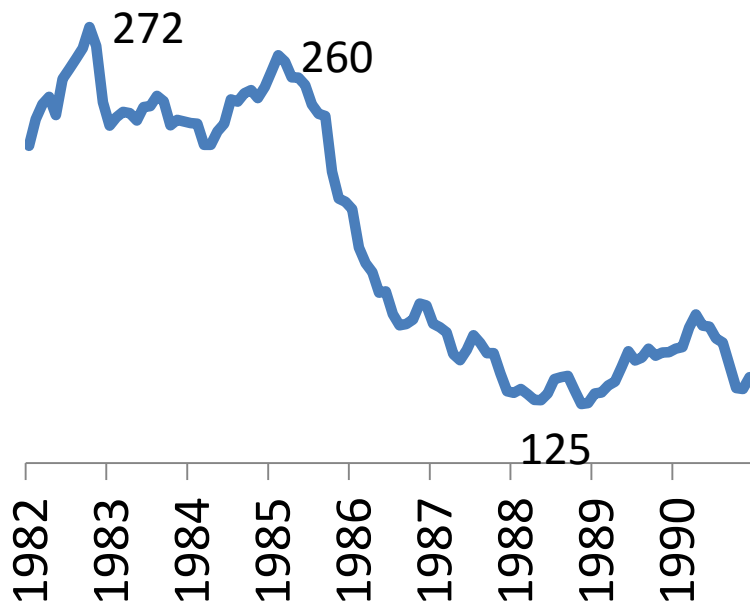
- Lower the cost of hedging (companies),
- Reduction of financial intermediation costs (liquidity),
- Easier management of reserves
- Increase external competitiveness of local banks

✓ Disadvantages:

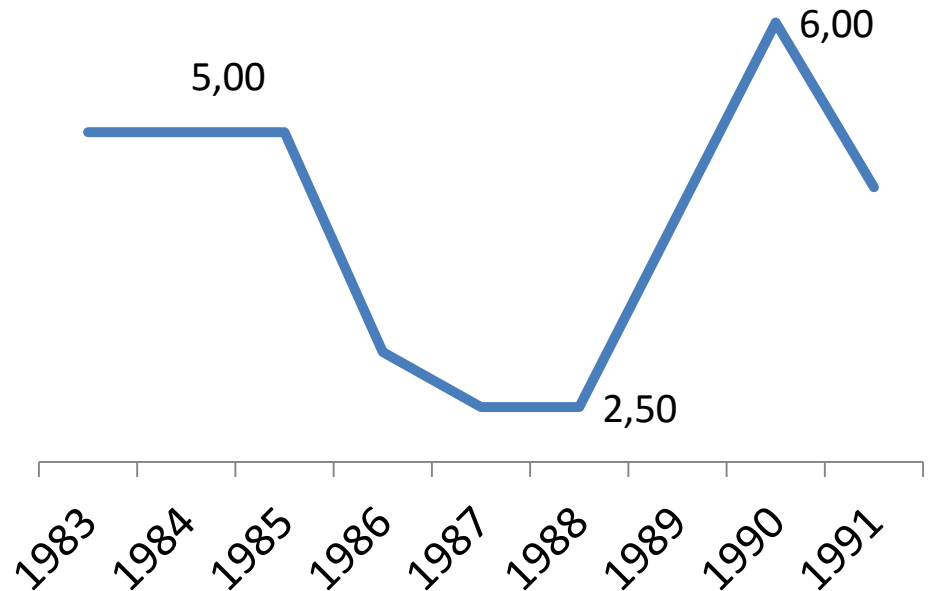
- Loss of control over macro variables
- More exposure to financial risk (Japan 1989, UK 1992, France 1981, ASIA 1998)

Japan is an example to be avoided

Exchange Rate: Yen-Dollar



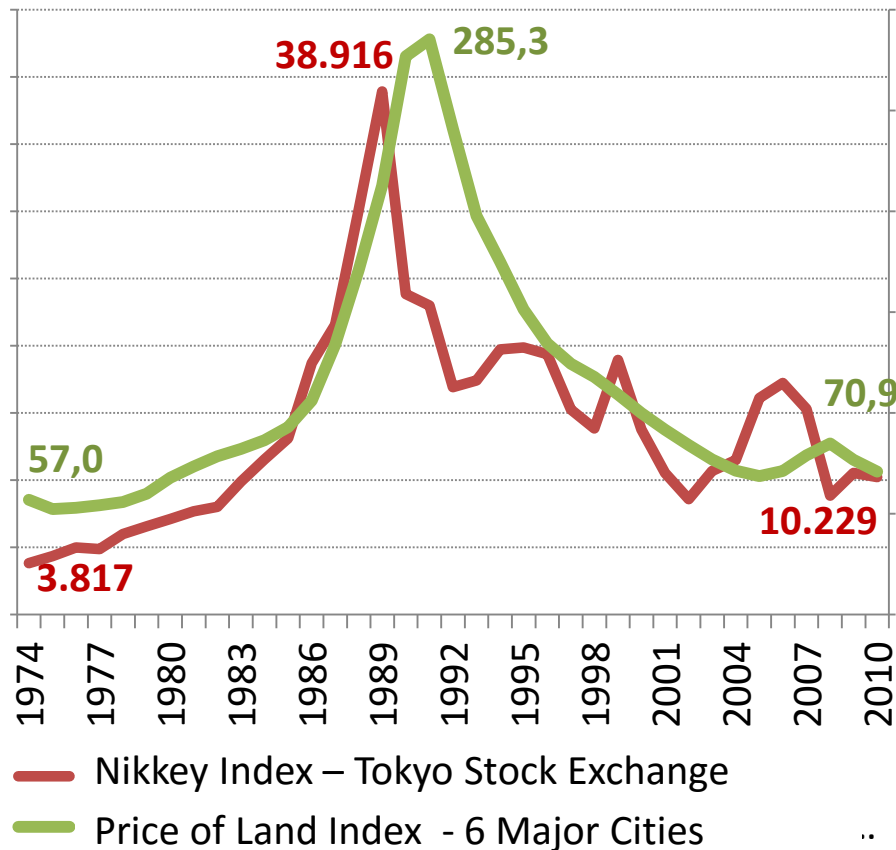
Basic Interest Rate (% y/y)



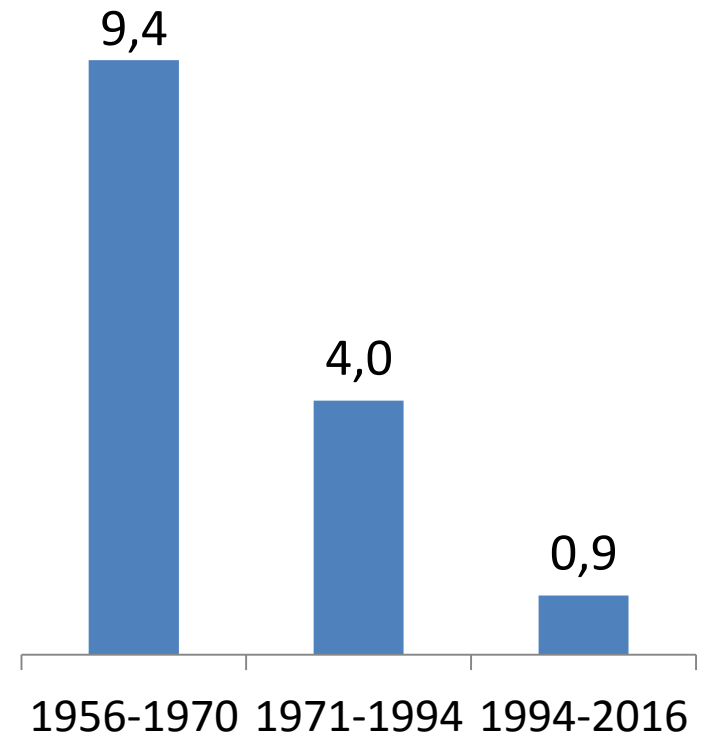
Souce: Bank of Japan

Long Term Asset Deflation and Stagnation was a consequence of Japanese currency internationalization

Japan: Index of Stock Exchange and the Price of Land



Japan: GDP Growth Rate (%y)

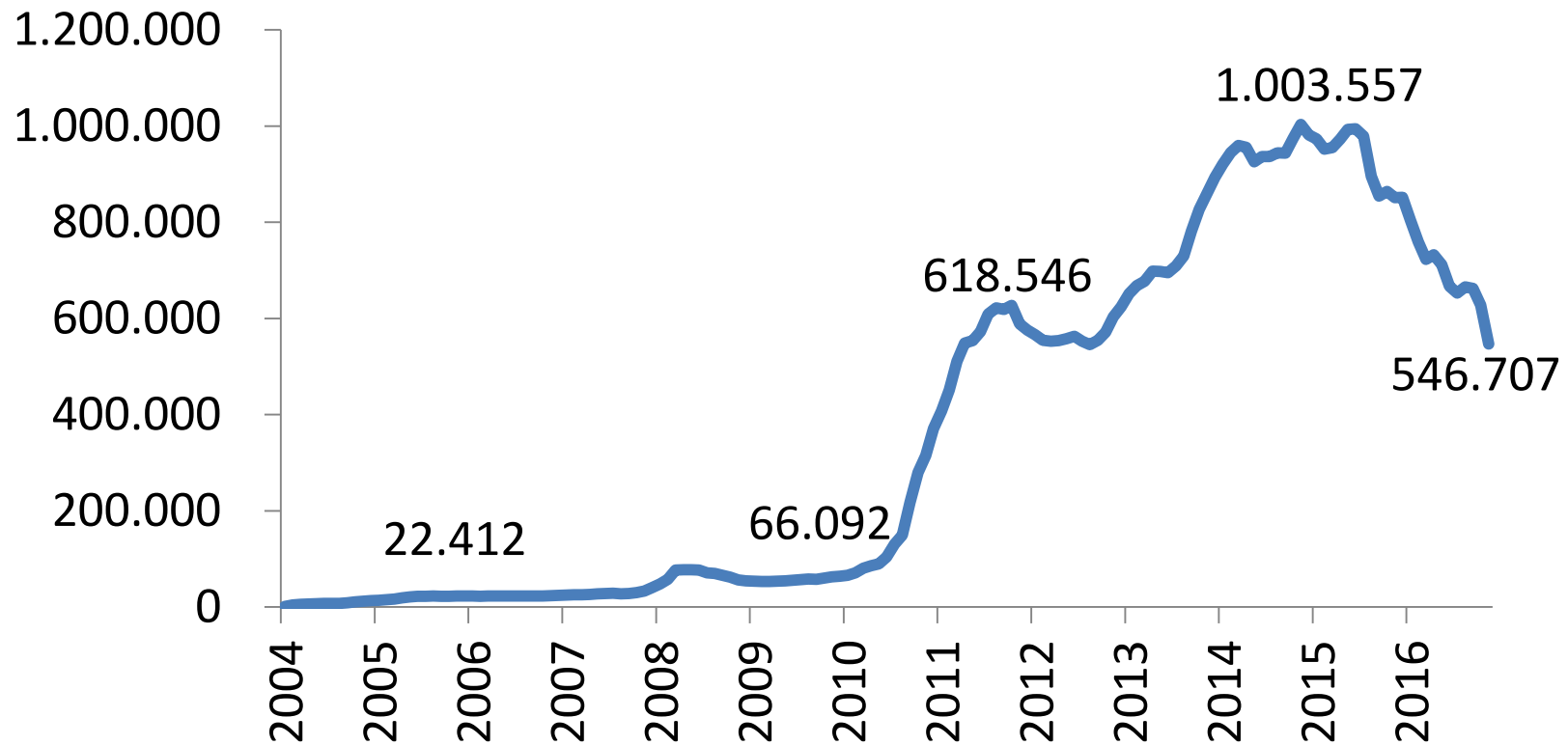


Steps towards internationalization

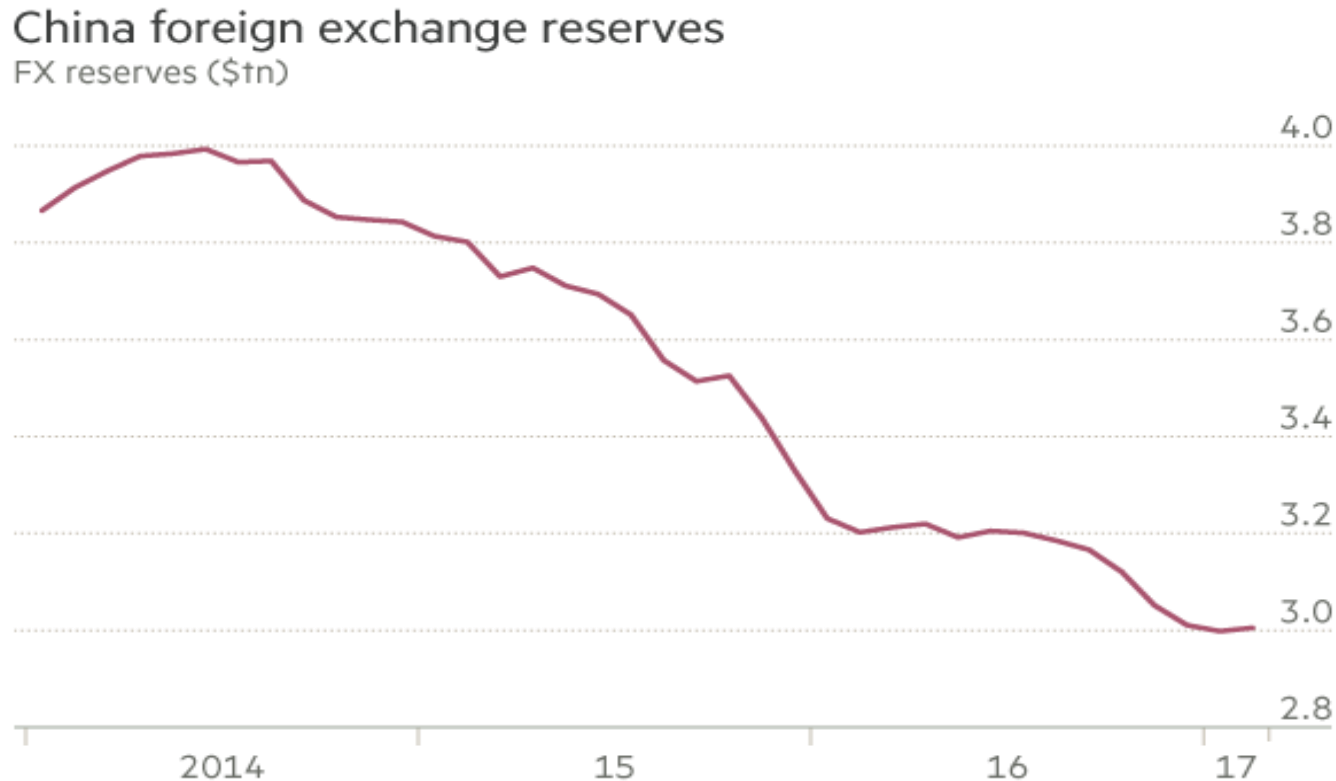
- ✓ Foreign exchange market in HK (CNH). Future futures on CNH were authorized at the end of 2010
- ✓ Public securities were launched as of 2007 (interest rates in HK are lower) and later corporate
- ✓ "Holes" in capital controls between HK and the "mainland" were opened: Limited purchase of authorized Yuan in 2003 (external liabilities in yuan); payment of exports and imports as of 2009
- ✓ Created the yuan market in London (2013), in addition to other parts of the world – Santiago, Buenos Aires in South America

Deposits in Yuan in HK exploded after 2010, but were cut by half

Deposit In Yuan in Hong Kong (Million)



... as international reserves shrank due to speculative operations

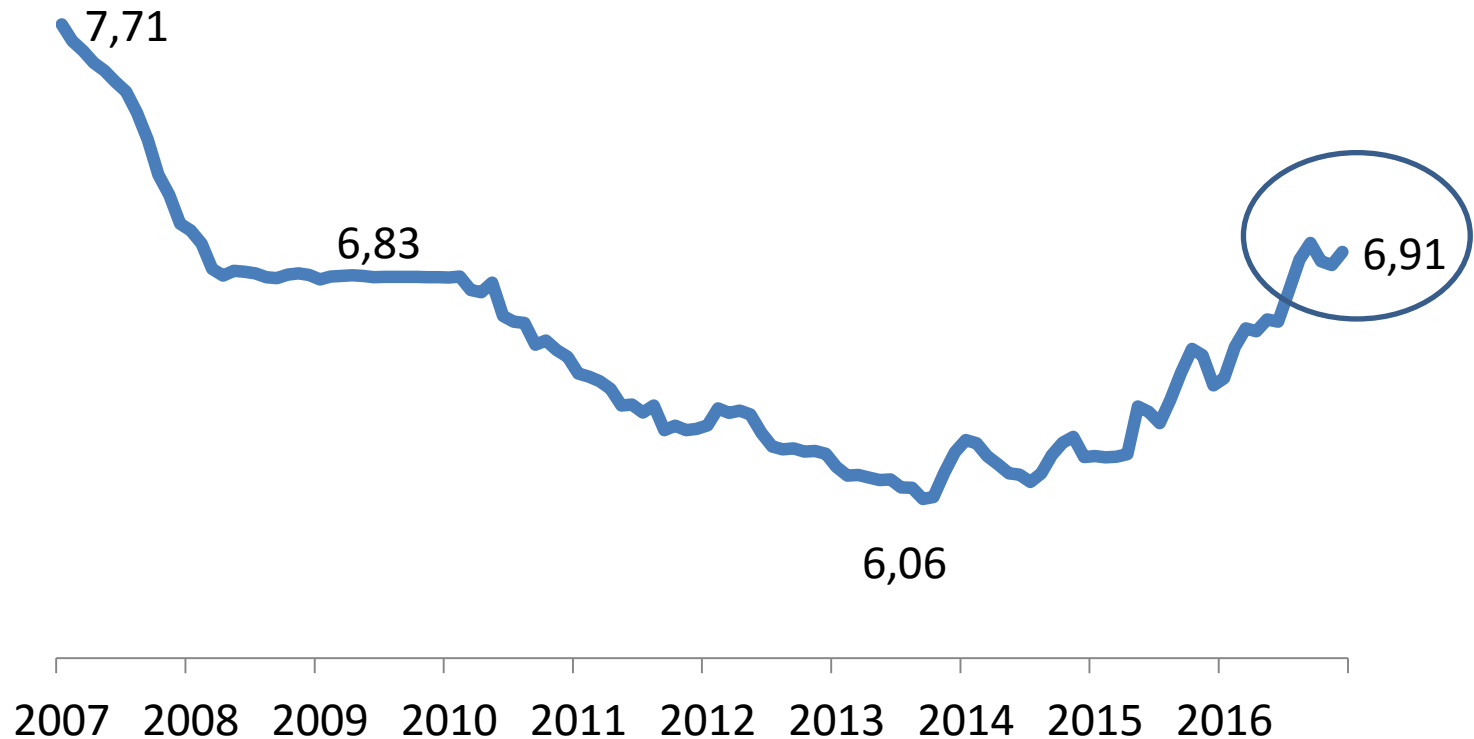


Sources: People's Bank of China; CEIC

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... and to exchange rate devaluation before
11/26/2016

TAXA DE CâMBIO YUAN/DÓLAR (Média mensal)



Trump attacked China's exchange rate policy and this had consequences for the internationalization of the yuan

“I think they’re (China) grand champions at manipulation of currency. So I haven’t held back. We’ll see what happens,” Trump ,
The Guardian, 24/1/17



What are the main objectives of the Internationalization of the Yuan

- ✓ Replace the US dollar as the central currency of the international monetary system?
- ✓ Bilateral adjustment mechanism with US: current account surplus, reserve volume
- ✓ Instrument to support the internationalization of Chinese enterprises and trade?
- ✓ Instrument to accommodate the imbalances of the Chinese economy?

How to understand the internationalization of the Yuan

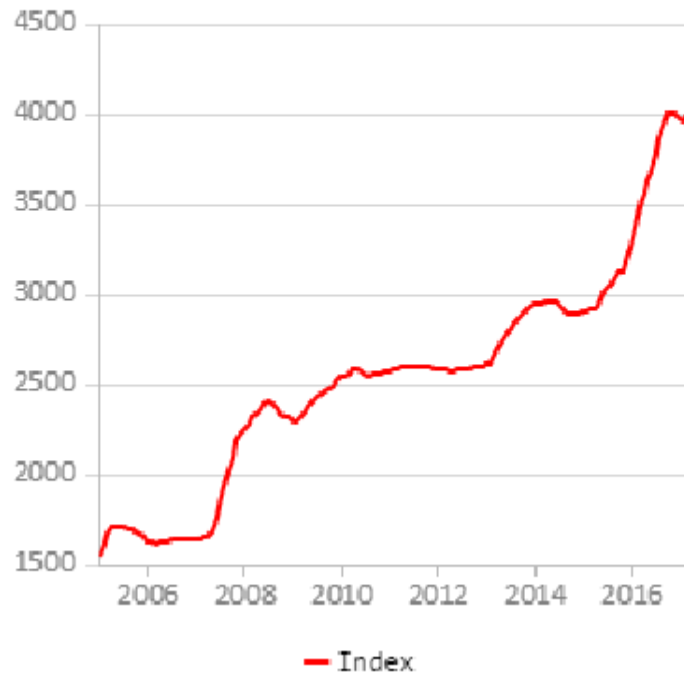
- ✓ It is an experiment in a controlled space
- ✓ Can be adjusted or reversed
- ✓ It may serve as a marginal adjustment and information mechanism for the Chinese government.
- ✓ It is not a “road” towards a rapid internationalization: full liberalization of the capital account
- ✓ Reversion in 2016/17: increased control of outflow and capital inflows: "one step backwards, two forward?" (Lenin / Mao)

Risks involved in the process

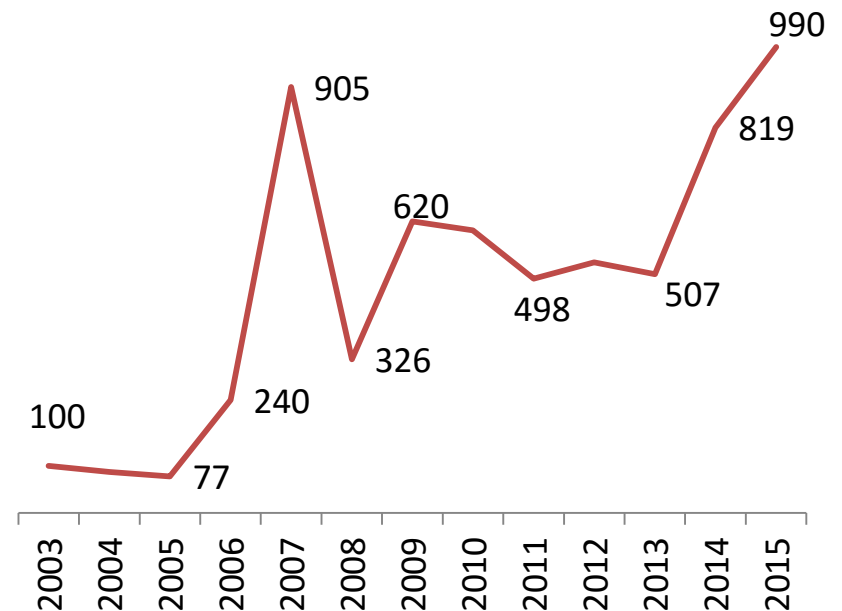
- ✓ Loss of autonomy in domestic exchange and interest policy
- ✓ Generation of new types of domestic imbalances
- ✓ Loss of control of the domestic "speculative bubble".

Is there a financial bubble in China?

Second-hand House Price Index, Shanghai
(2003=1000)



Shanghai Stock Exchange
Market Capitalization in RMB (2003=100)



Conclusions

- ✓ Hegemonic currency is a question of power (interest and capacity) and not having anyone to interfere against
- ✓ Internationalization of currency as a response to external adjustment can be very destabilizing (Japan, 1980s and 1990s)
- ✓ It is possible to create a limited mechanism for the internationalization of companies and trade, as well as recycling of excess foreign currency
- ✓ Financial market reform is essential and complicated



CENTRO BRASILEIRO DE
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A GEOPOLÍTICA DA INTERNACIONALIZAÇÃO DA MOEDA CHINESA

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Mirko Pose

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http://midias.cebri.org/arquivo/Dossie_Ed1.pdf

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A Internacionalização do Yuan

Disputa hegemônica ou estratégia defensiva

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Seminário Economia Política do Desenvolvimento da China

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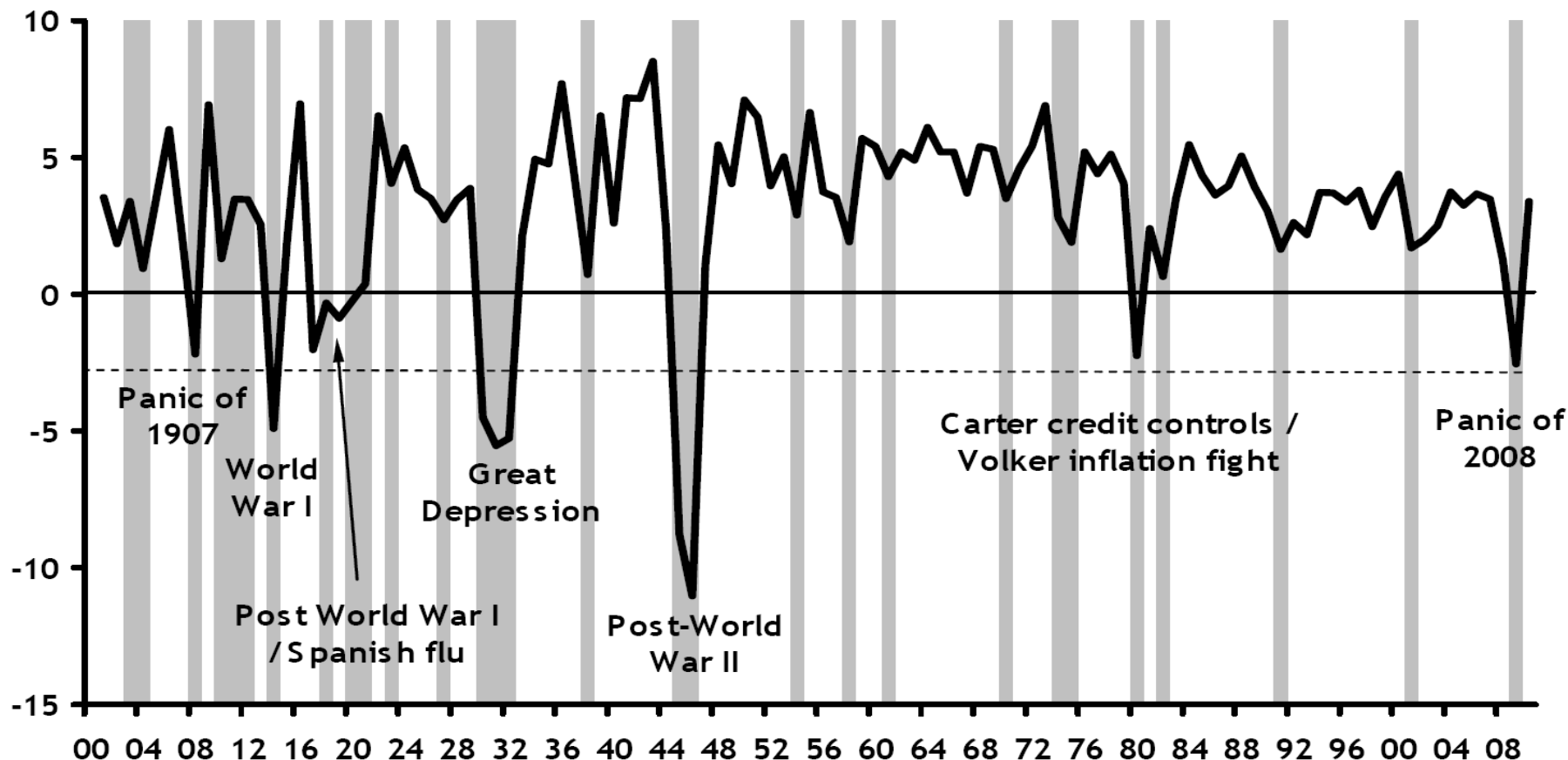
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Changes in the International Monetary System are related with international financial crisis

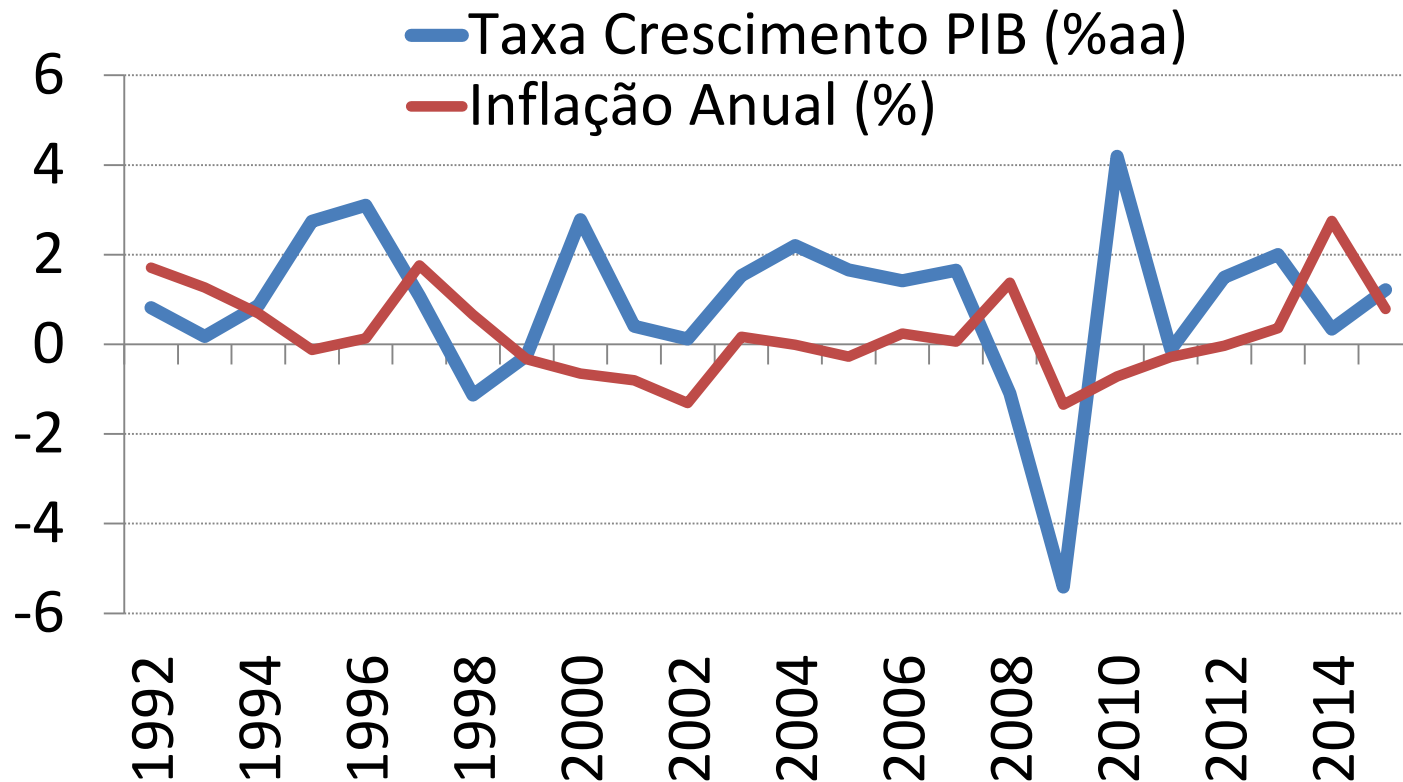
Global real GDP: The seven global recessions

% yoy; US recession bars shown in grey (latest 2009), J.P.Morgan fcast 2009-10



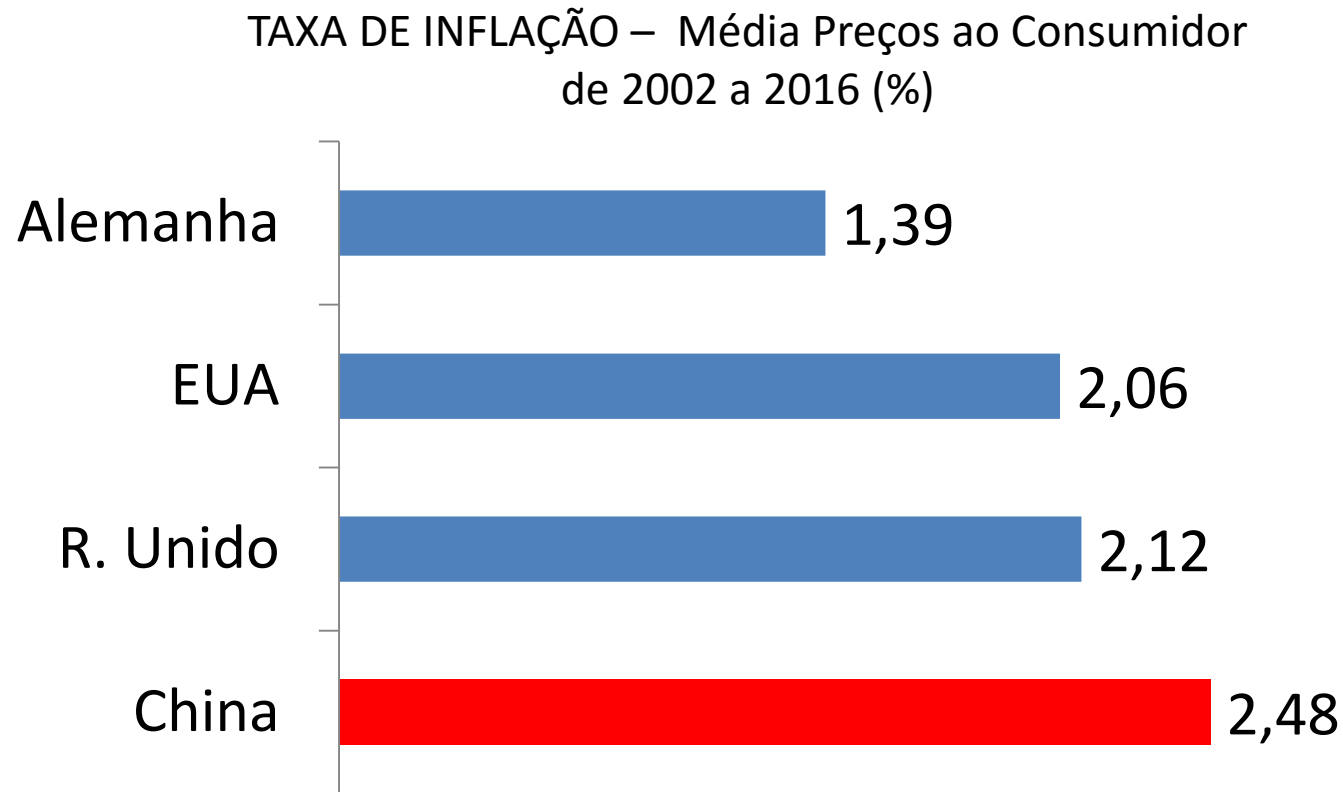
VALORIZAÇÃO DEMASIADA DO IENE LEVOU O GOVERNO A REDUZIR JUROS PARA ESTIMULAR ECONOMIA ...

✓ Crescimento Médio foi 0,9 % aa e Inflação 0,25% aa entre 1992-2015

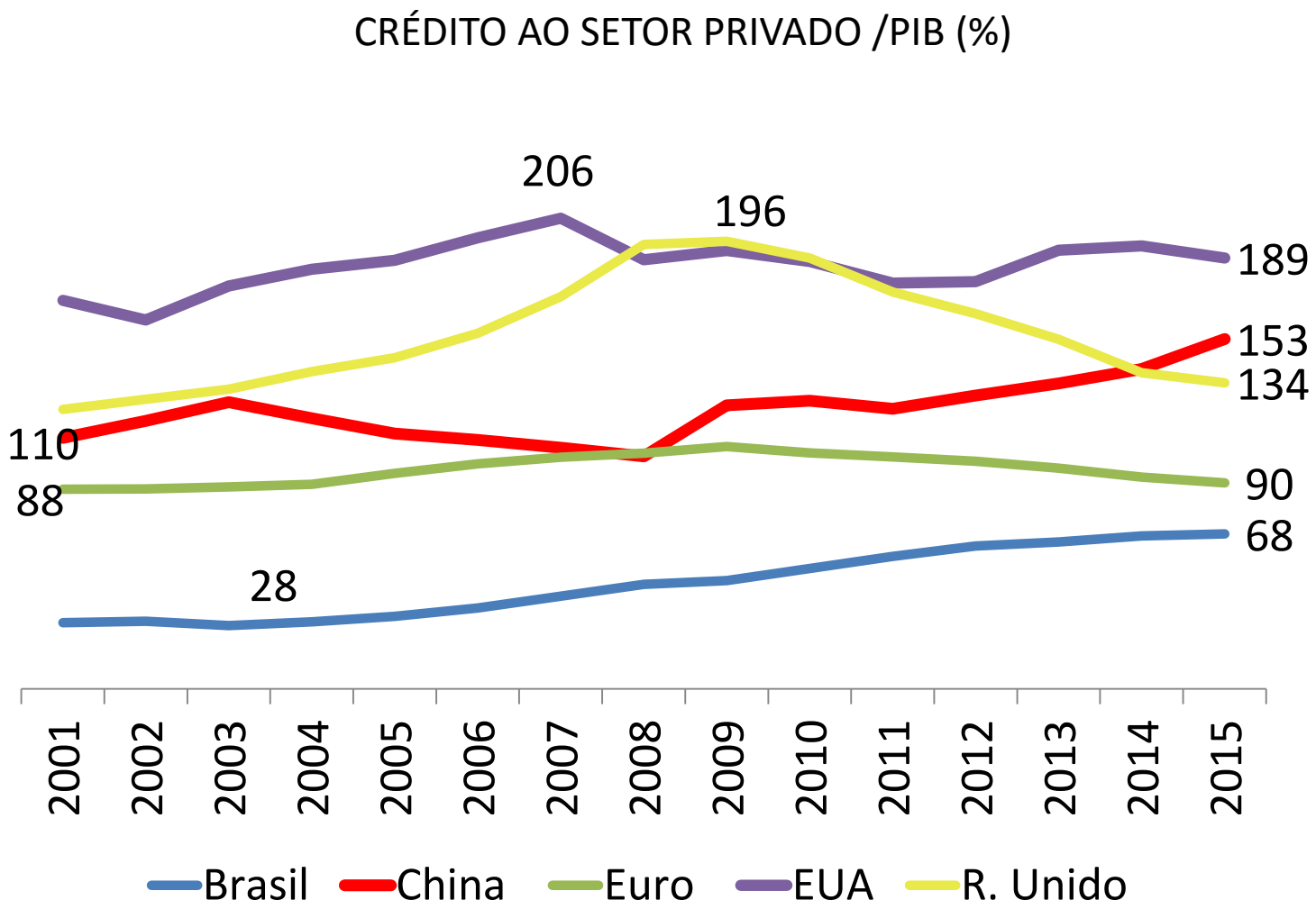


Fonte: Banco Mundial

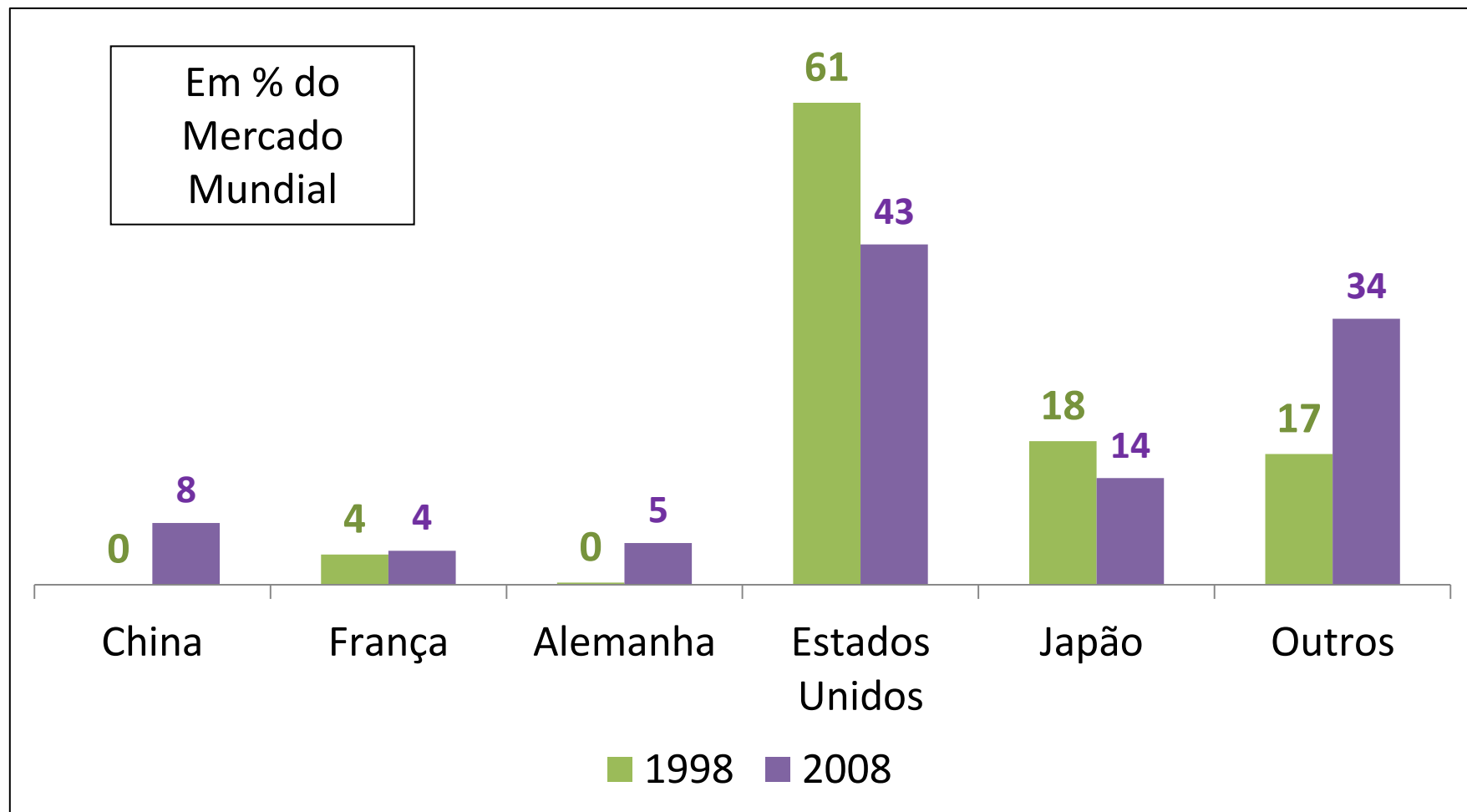
Inflação não elevada, mas mais volátil frente ao padrão dos países emissores de moeda reserva



Crédito ao Setor Privado é bastante alto para país emergente



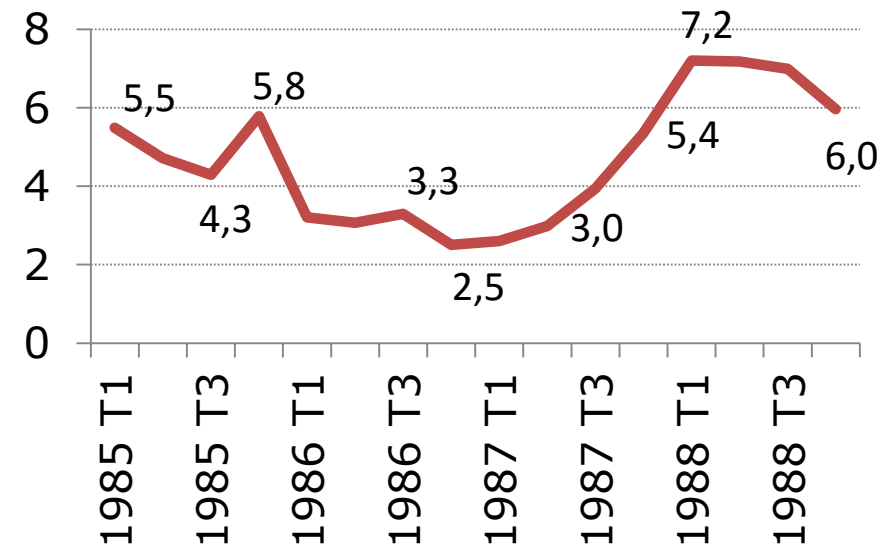
Mercado chinês de títulos corporativos ainda é pequeno no mundo



VALORIZAÇÃO DEMASIADA DO IENE LEVOU O GOVERNO A REDUZIR JUROS PARA ESTIMULAR ECONOMIA ...

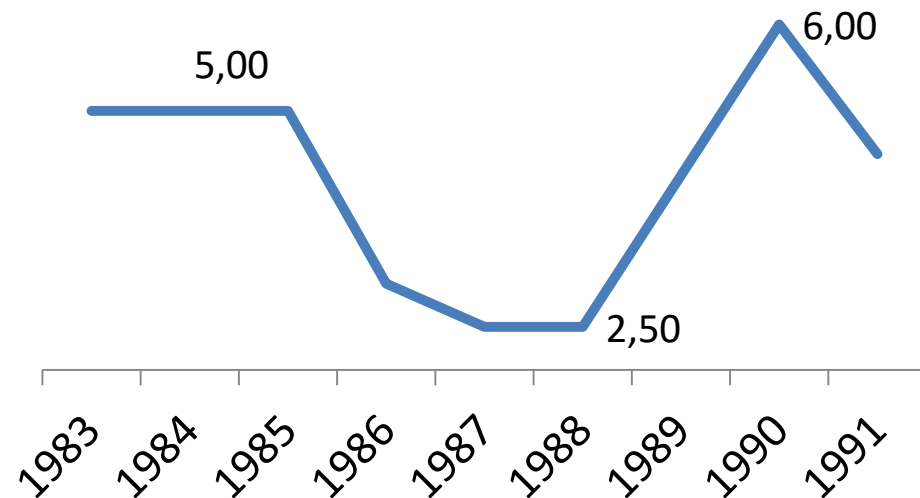
- ✓ Para fazer frente à perspectiva deflacionária (preços e atividade) do Endaka, BoJ reduziu taxa de desconto

Taxa de Cresc. do PIB (% aa)



Fonte: FMI

Taxa de Juros Básica (% aa)



Fonte: BoJ

China has conditions increase the international role of its currency?

- ✓ Condições básicas:
 - ✓ tamanho da economia doméstica no comércio e nas finanças internacionais;
 - ✓ estabilidade do valor internacional da moeda;
 - ✓ mercado financeiros desenvolvidos
- ✓ Vantagens e Desvantagens:
 - ✓ Perda de controle sobre variáveis macro e risco de crise (Japão-1989, RU 1992, FR 1981, ÁSIA 1998)
 - ✓ Hedge (empresas), redução de custos financeiros, administração de reservas, competitividade externa dos bancos locais

Mesmo assim, o uso do Yuan é muito restrito

Table 1: China's International Investment Position (quarterly), 2014-16

US\$ Billion (End of period)

Item	dec/14	mar/15	jun/15	set/15	dec/15	mar/16	jun/16	set/16	dec/16
International Investment Position	1603	1469	1397	1538	1673	1715	1818	1874	1801
Assets	6438	6290	6351	6197	6156	6196	6283	6464	6467
Direct investment	883	904	919	965	1096	1161	1221	1280	1317
Portfolio investment	263	249	276	257	261	297	307	341	365
Other investment	1394	1334	1381	1378	1389	1427	1446	1575	1681
Reserve assets	3899	3785	3771	3590	3406	3305	3303	3264	3098
Liabilities	4836	4821	4954	4659	4483	4481	4465	4589	4666
Direct investment	2599	2676	2742	2770	2696	2752	2775	2806	2866
Portfolio investment	796	888	969	788	817	790	734	795	809
Other investment	1440	1242	1232	1090	964	930	944	983	985

Source: State Administrator of Foreign Exchange.