

The Renminbi: Now in the Basket of Special Drawing Rights (SDR)

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Introduction

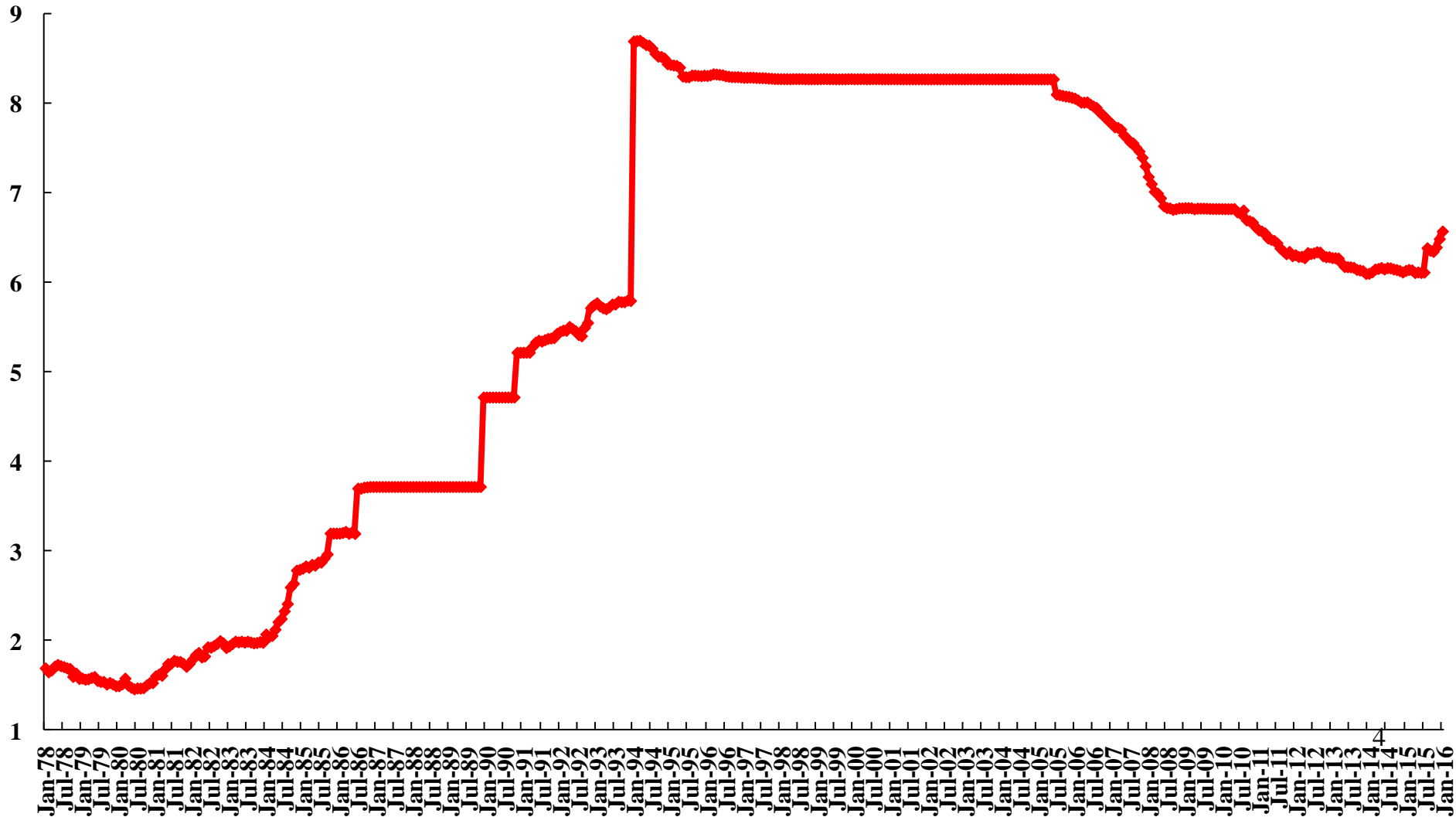
- ◆ The inclusion of the Renminbi in the Special Drawing Right (SDR) Basket with a weight of 10.92%, greater than those of the British Pound and the Japanese Yen, announced towards the end of 2015, is a milestone in the internationalization of the Renminbi (even though it will not become effective until October 2016).
- ◆ The Renminbi is already used in the invoicing, clearing and settlement of international transactions, especially by Chinese exporters and importers.
- ◆ Free usability, relative stability and reduced volatility is the key for its further more widespread use.
- ◆ The Renminbi exchange rate since the announcement of its inclusion in the SDR basket has held fairly steady with a ² devaluation to date of less than 2% against the U.S. Dollar.

The Internationalization of the Renminbi

- ◆ The Chinese Yuan devalued steadily from 1980 until the beginning of 1994, when it became current-account convertible.
- ◆ Since 1994, it has been appreciating with respect to the U.S. Dollar in both nominal and real terms, until August, 2015.
- ◆ In August, the abrupt devaluation of the RMB by 4%, the biggest drop of its exchange rate in the last 20 years, affected the global capital markets and even contributed to the delay by the U.S. Federal Reserve Board on raising the U.S. interest rate.
- ◆ In December, China Foreign Exchange Trade System (CFETS) began to release a Yuan exchange rate composite index that measures the currency's strength relative to a basket of 13 currencies, including the U.S. Dollar, the Euro, and the Japanese Yen.
- ◆ In January 2016, there was a further devaluation of more than 1% against the U.S. Dollar.
- ◆ In terms of its value relative to the CFETS basket of currencies, the Renminbi exchange rate is at the present time in approximately the same position as it was at the beginning of 2015.

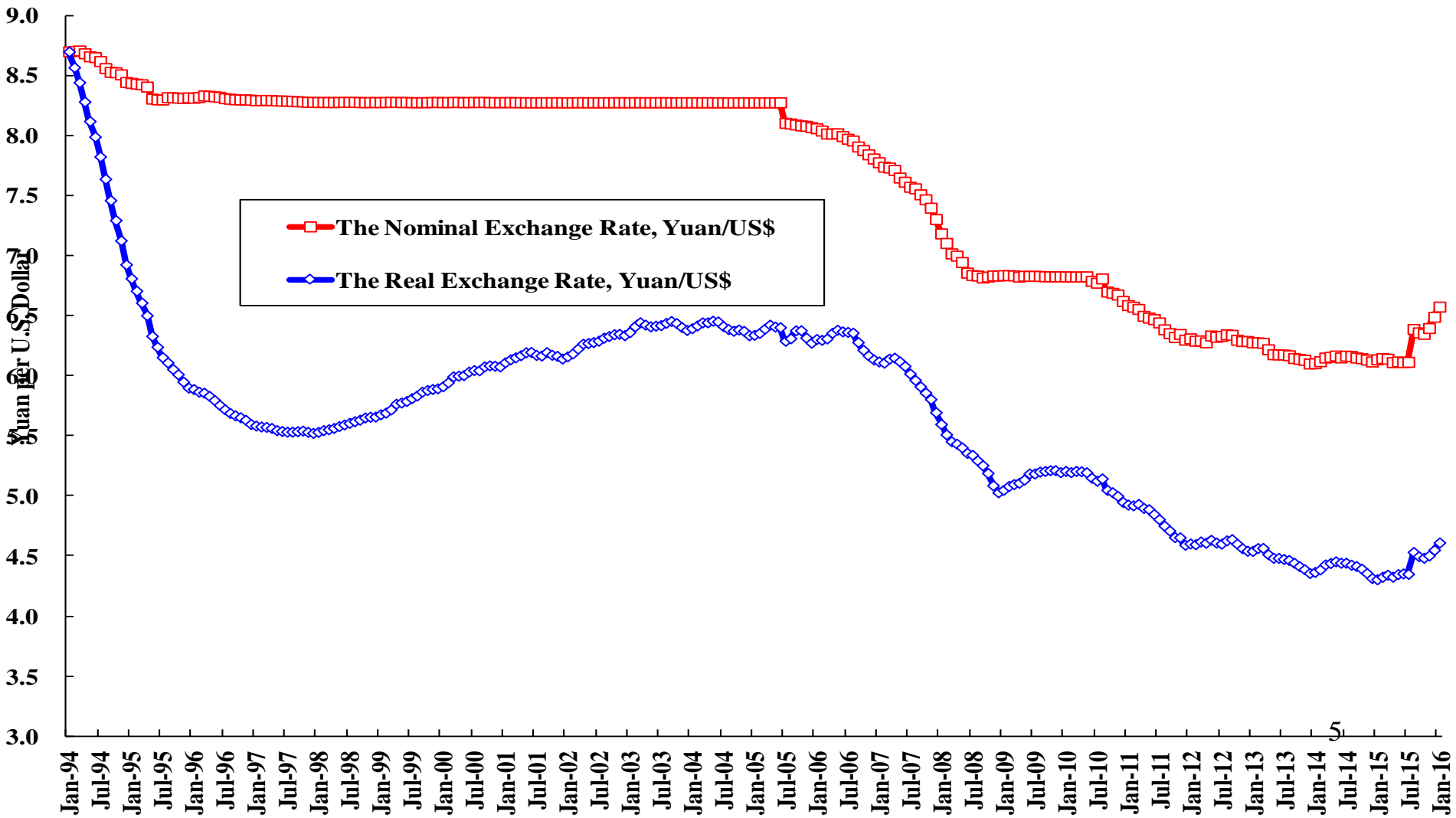
Nominal Exchange Rate of the Renminbi, Yuan/US\$, 1978-present

Nominal Exchange Rate of the Renminbi, Yuan/US\$, 1978-present



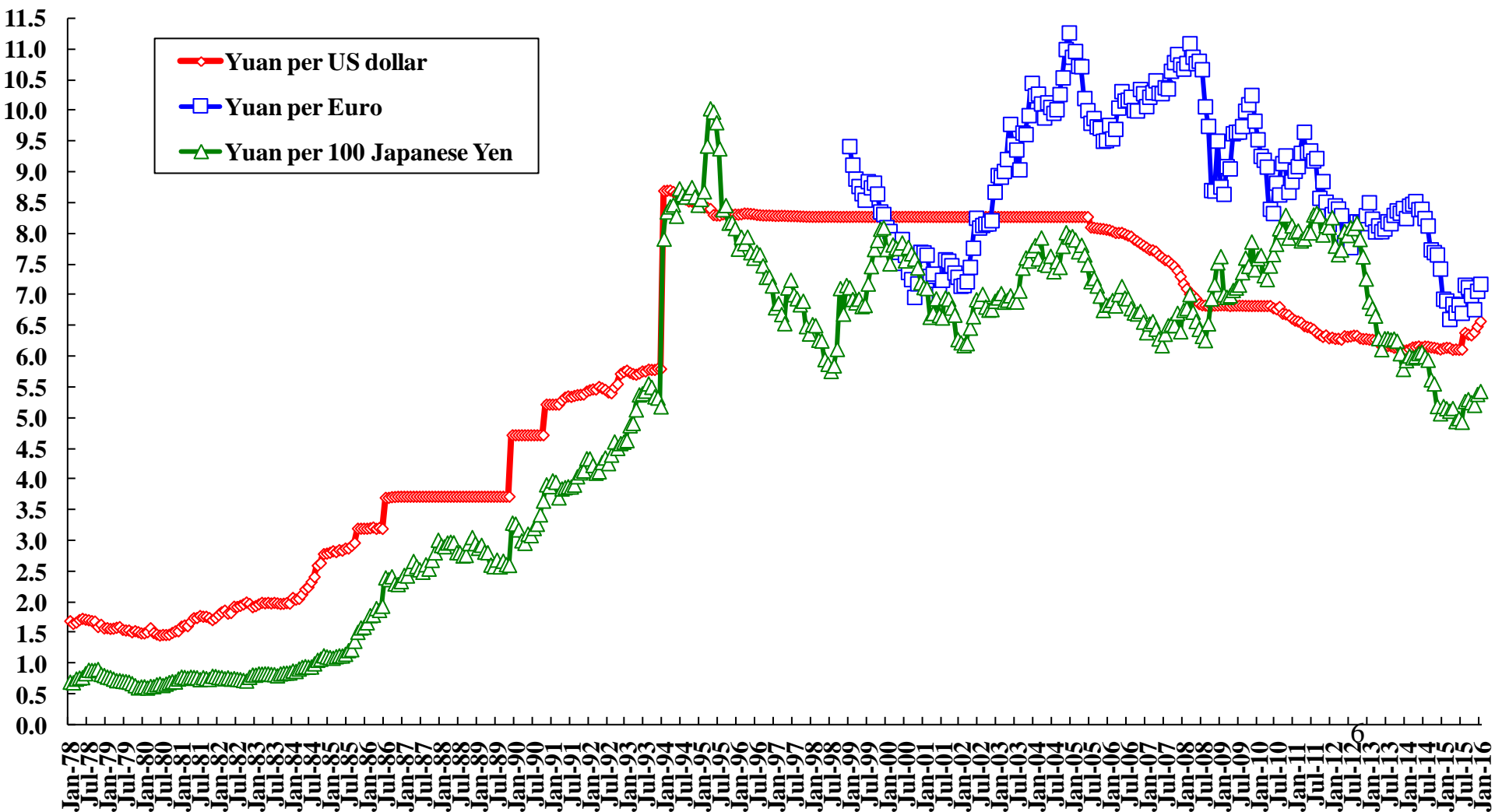
The Nominal and Real Yuan/US\$ Exchange Rates since 1994

The Nominal and Real Yuan/US\$ Exchange Rates (1994 prices)



Nominal Exchange Rate of the Renminbi, Yuan/US\$ and Yuan/Euro, 1978-present

Nominal Exchange Rate of the Renminbi, Yuan/US\$, Yuan/Euro and Yuan/100Yen, 1978-present

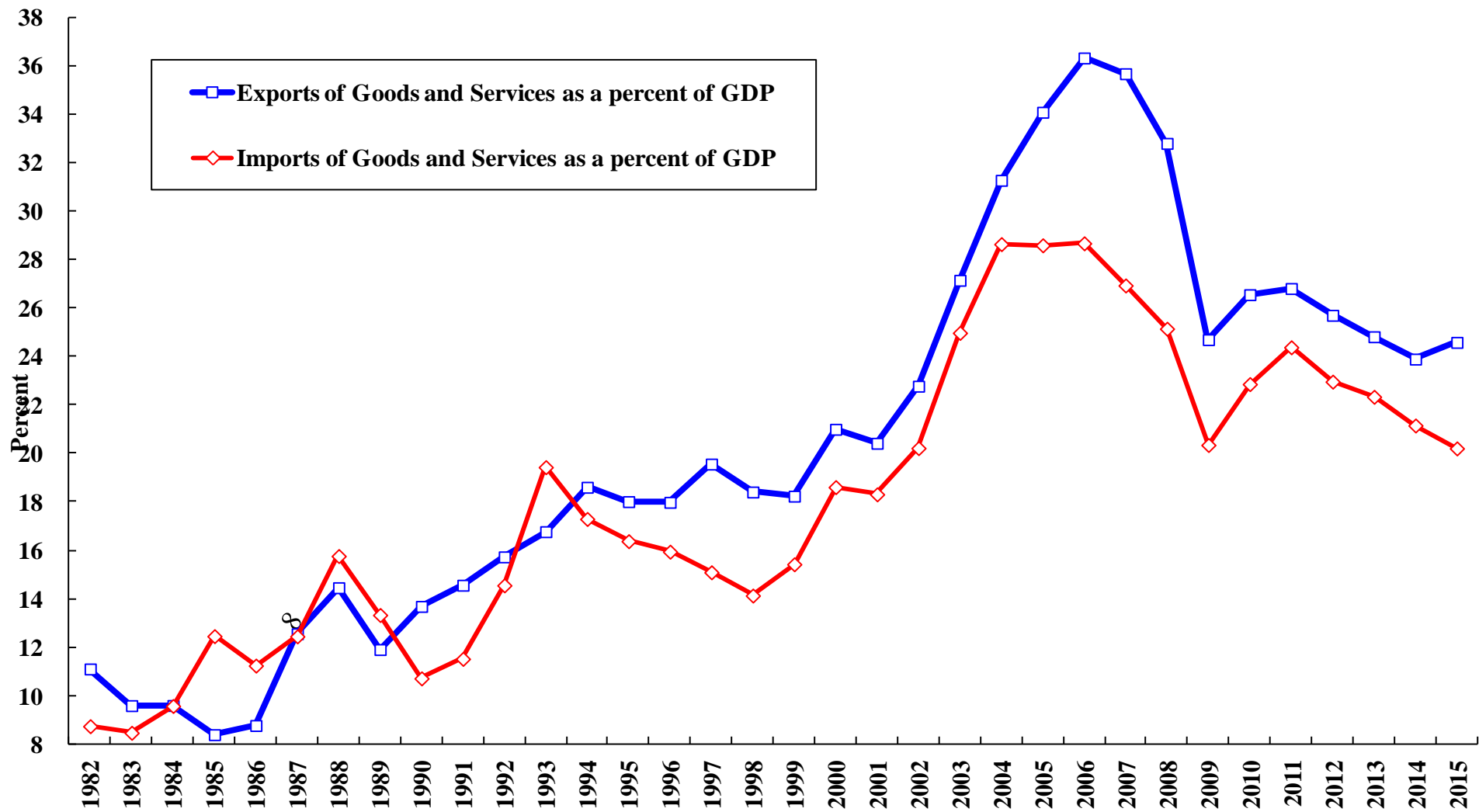


The Internationalization of the Renminbi

- ◆ There has been a great deal of speculation on a further devaluation of the Renminbi.
- ◆ However, China still has a substantial trade surplus on the order of 4% of its GDP, or US\$450 billion, a year.
- ◆ Moreover, since 2010, China has increasingly used Renminbi as an invoicing, clearing and settlement currency for its international transactions. As of year-end 2015, 26.4% of Chinese trade, equivalent to an annual rate of US\$1.1 trillion, was settled in Renminbi. This has reduced substantially the need for foreign exchange for the purposes of conducting international transactions.
- ◆ China still has the largest foreign exchange reserves in the World at US\$3.20 trillion at the end of February 2016.

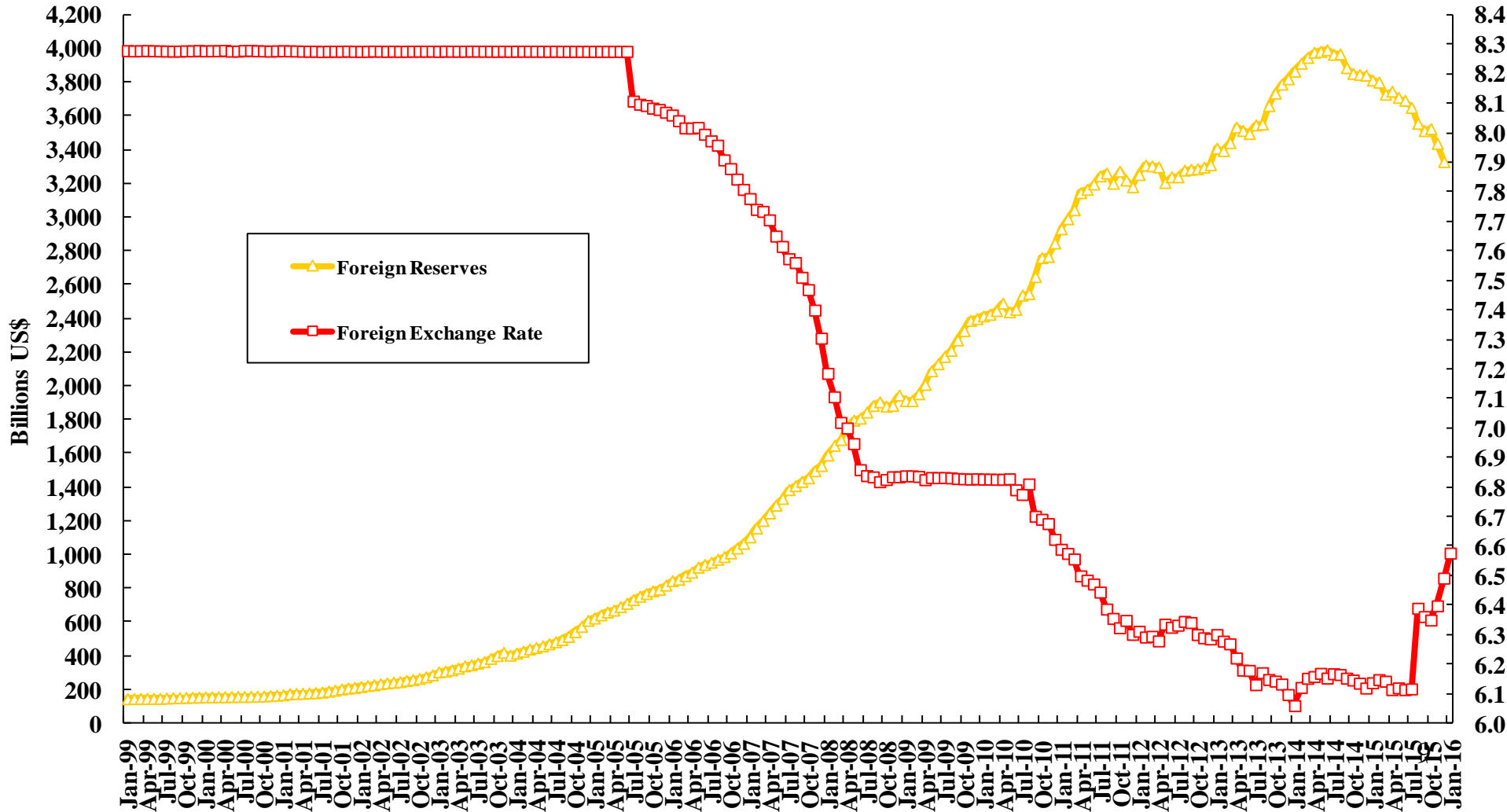
Exports and Imports of Goods and Services as a Percent of Chinese GDP, 1982-present

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Chinese Foreign Exchange Reserves and the Yuan/US\$ Exchange Rate

Chinese Foreign Exchange Reserves and the Yuan/US\$ Exchange Rate at the End of the Month

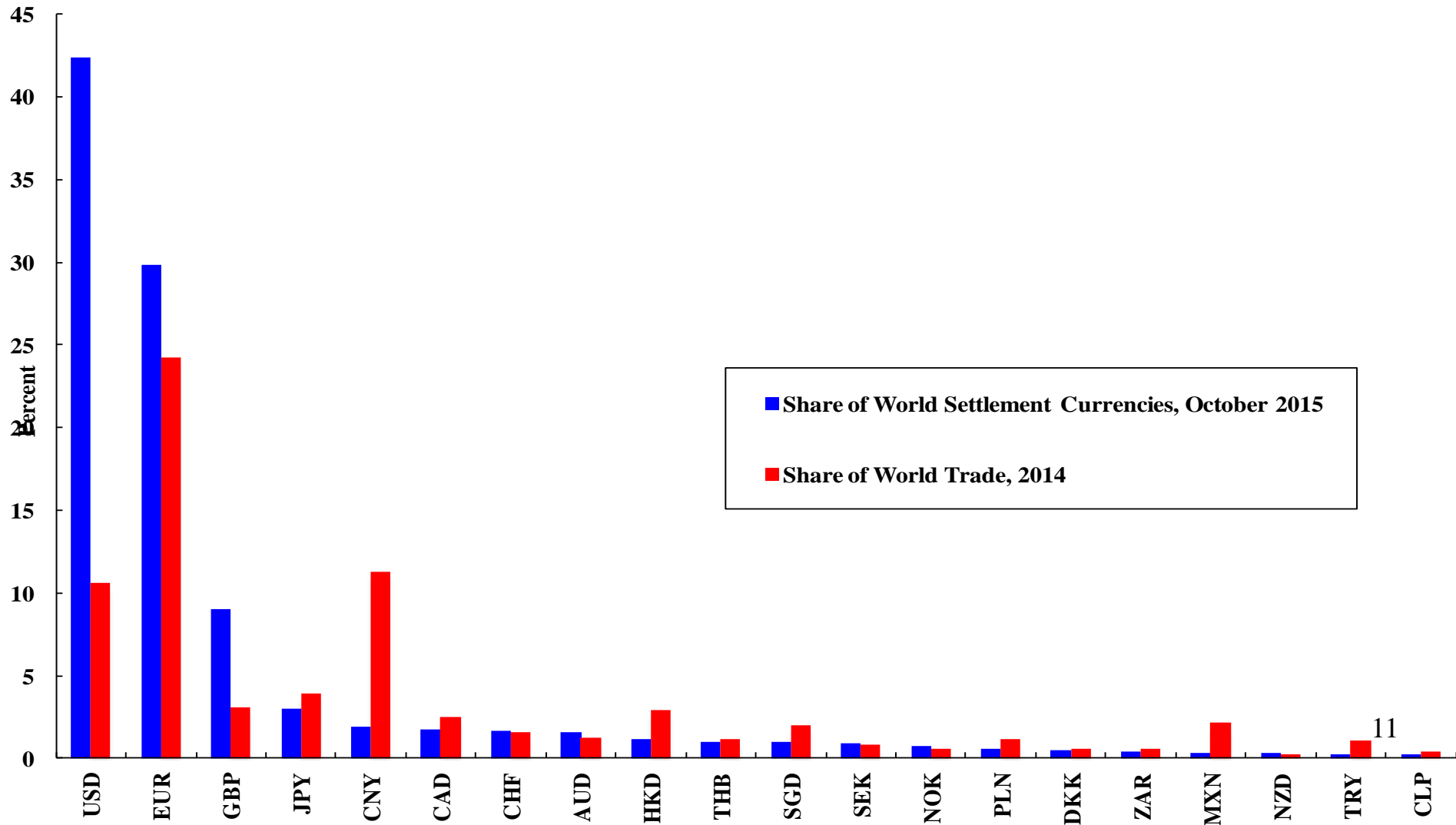


The Internationalization of the Renminbi: The Settlement in Own Currency

- ◆ Own currency settlement between trading partner countries is preferred by both exporters and importers because it reduces transactions costs and exchange rate risks. It also makes it less necessary to maintain large official foreign exchange reserves for international transaction purposes.
- ◆ Two trading partner countries use a third currency for invoicing, clearing and settlement only because they do not trust each other's currency.
- ◆ For this reason, the U.S. Dollar has remained the currency of choice in international settlements.
- ◆ Since 2010, a proportion of the Chinese international transactions has begun to be settled in Renminbi (amounting to 26.4% of Chinese international trade as of the end of 2015).

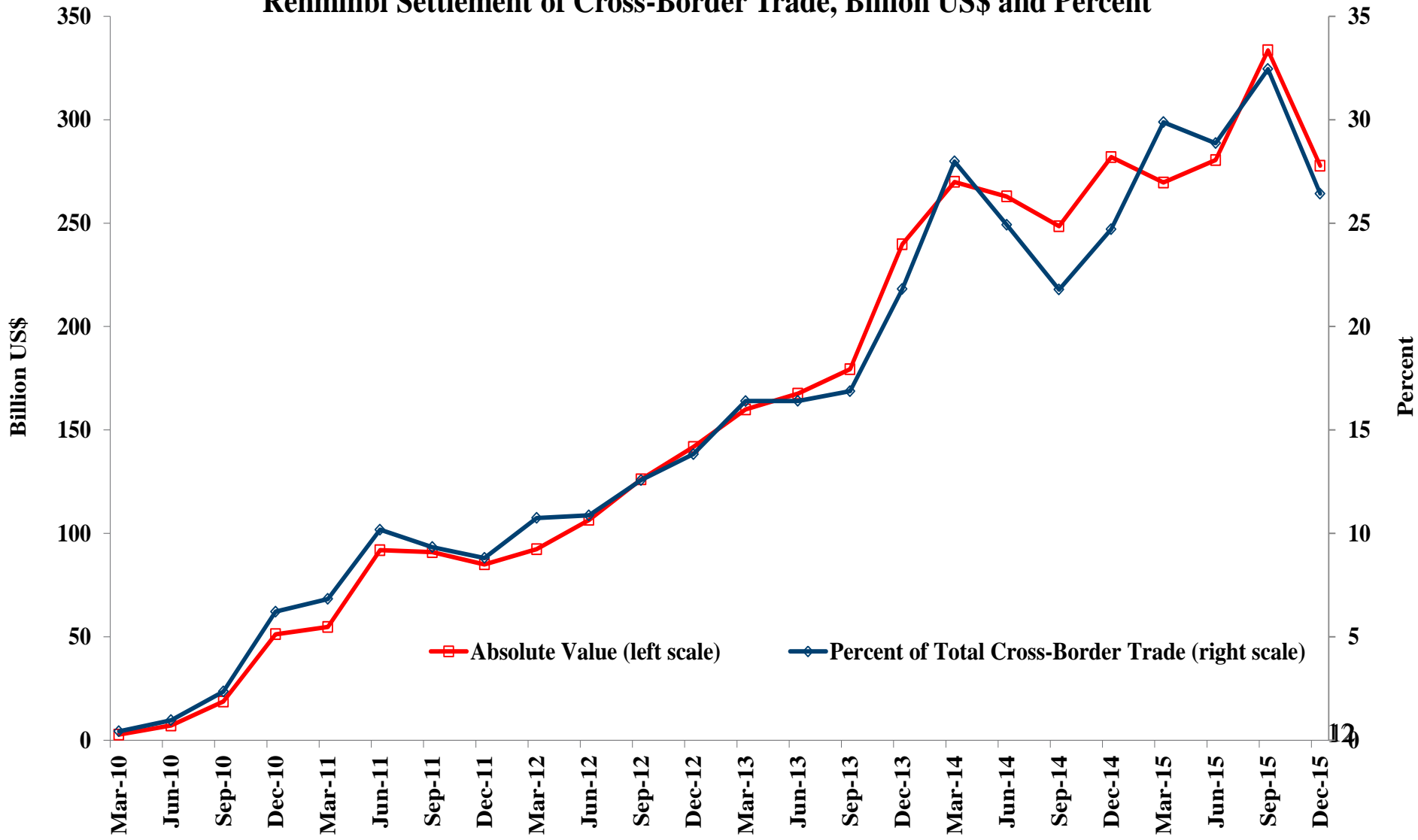
Distribution of World Trade Settlement Currencies versus World Trade, Oct. 2015

Share of World Settlement Currencies, October 2015



Renminbi Settlement of Chinese Cross-Border Trade, Billion US\$ and Percent

Renminbi Settlement of Cross-Border Trade, Billion US\$ and Percent



The Internationalization of the Renminbi: As an International Medium of Exchange

- ◆ The Renminbi can also be used as an invoicing, clearing and settlement currency for trade between other economies. This is most natural for economies with large trade surpluses with respect to China, but not with respect to the U.S., since they will then have a ready source of Renminbi balances that can be used for the settlement of their international transactions.
- ◆ In the Thirteenth Five-Year Plan for the Economic and Social Development of China, there is a commitment to making orderly progress towards capital account convertibility but without a specified date. One issue is how to allow free movement of capital while at the same time discourage short-term speculative inflows and outflows. A Tobin tax is a possibility.

The Internationalization of the Renminbi: As a Major International Reserve Currency

- ◆ One benefit of a currency being a major international reserve currency is seigneurage, that is, the country issuing the currency can pay for its imports with the currency, which it can print at close to zero marginal cost, without having to export anything in return.
- ◆ Thus, a country with seigneurage does not need to balance its trade, as other countries are willing to accept its currency and bonds as payment for their exports.
- ◆ However, in order for an economy to benefit from seigneurage, it must be prepared to run a large trade deficit vis-a-vis the rest of the World as a whole. Otherwise, it derives little real benefit.

The Internationalization of the Renminbi: As a Major International Reserve Currency

- ◆ Thus, for a country that is unwilling to run a large trade deficit, the potential real benefit from its currency being a major international reserve currency is small. In fact, other countries may have difficulties acquiring and holding that country's currency even if they want to do so.
- ◆ Another potential cost is the risk of other central banks and monetary authorities holding a country's currency and bonds deciding to sell them en masse all of a sudden. This can greatly de-stabilize not only the exchange rate but also the domestic credit and financial markets and the capital market in general.
- ◆ So unless a country is too big to fail, such as the U.S., it is risky to have large amounts of its currency and bonds widely held by other central banks and monetary authorities.

The Internationalization of the Renminbi: The Future

- ◆ I believe the Renminbi is on course to become a major international currency for transaction purposes. What it needs to do is hold its exchange rate steady and not to adjust its value abruptly. By reducing its volatility relative to the U.S. Dollar, it can become the preferred currency for international transactions purposes.
- ◆ Other countries with significant trade with China, such as Russia, Iran and the Shanghai Organization countries, may find it convenient to use Renminbi for their international transactions.
- ◆ But the most important thing is for the Renminbi to avoid losing the confidence of the Chinese people. This means it must maintain its purchasing power, both domestically and abroad.