The World Economy and the Chinese Economy

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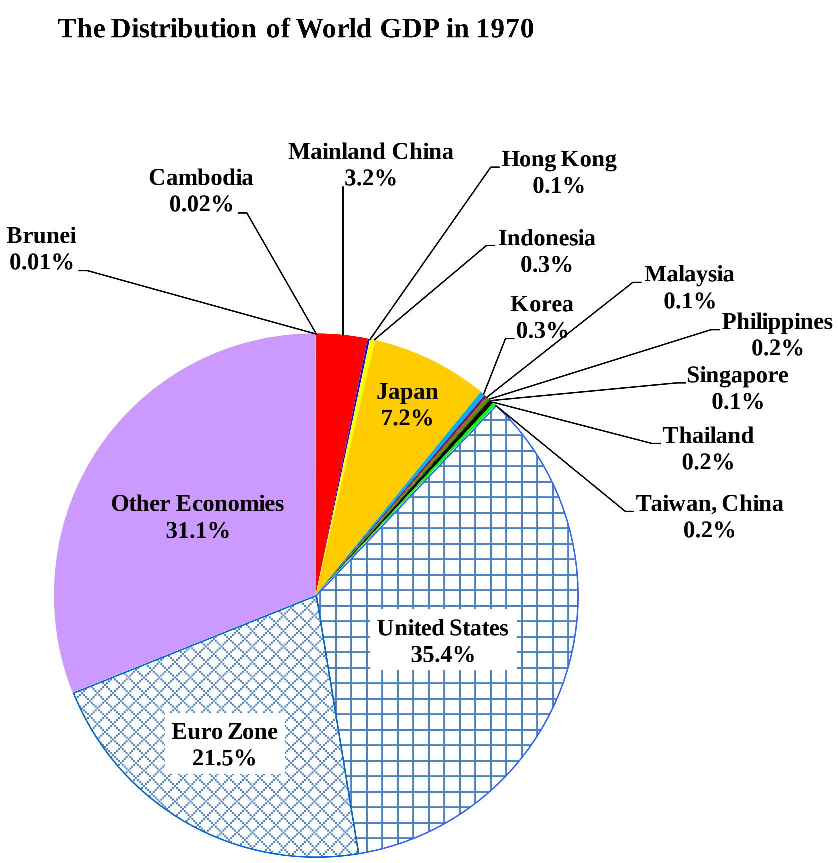
Introduction

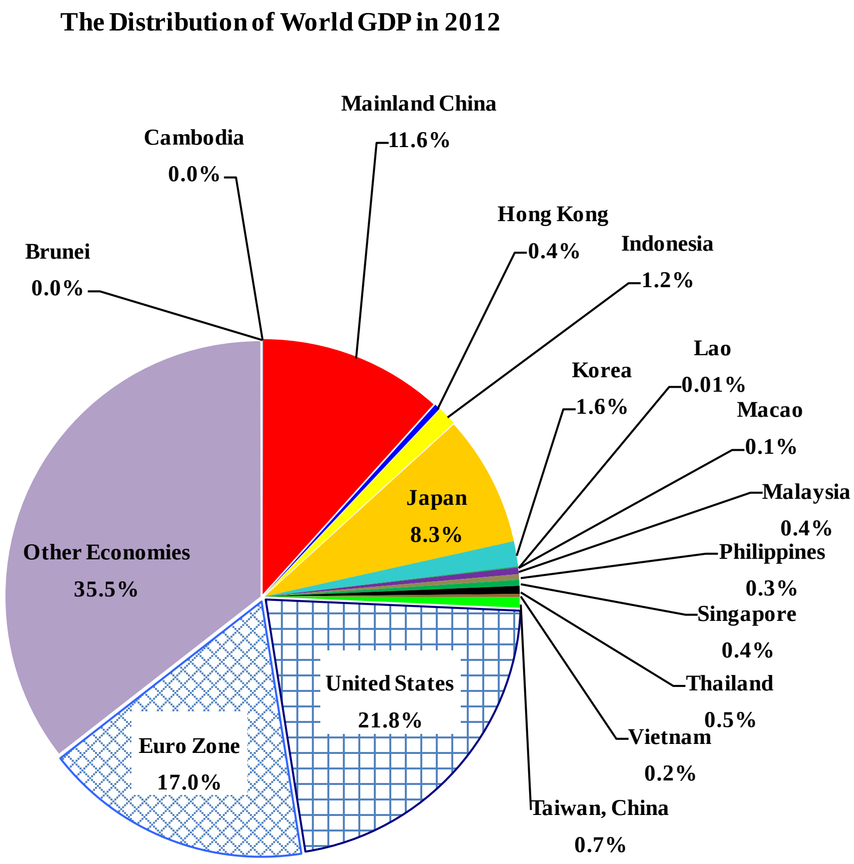
- The centre of gravity of the World economy, in terms of both GDP and international trade, has been gradually shifting from North America and Western Europe to East Asia, and within East Asia from Japan to China, over the past couple of decades.
- China has become the second largest economy by GDP as well as the second largest trading nation in the World.
- The Chinese economy has also been growing and continues to grow at much higher rates than North American and European economies and Japan.
- China, with a saving rate in excess of 40%, is a potential large foreign direct and portfolio investor to the rest of the World.

The Chinese Economy in the Global Context: GDP

- China has made tremendous progress in its economic development since it began its economic reform and opened to the World in 1978. China is currently the fastest growing economy in the World—averaging 9.8% per annum over the past 36 years. It is historically unprecedented for an economy to grow at such a high rate over such a long period of time.
- Between 1978 and 2013, Chinese real GDP grew more than 26 times, from US$356.5 billion to US$9.32 trillion (in 2013 prices), overtaking Japan and becoming the second largest economy in the World, after the U.S., in 2010.
- By comparison, the U.S. GDP (approx. US$16.8 trillion) was less than 2 times Chinese GDP in 2013.

The Distribution of World GDP, 1970 and 2012, US$

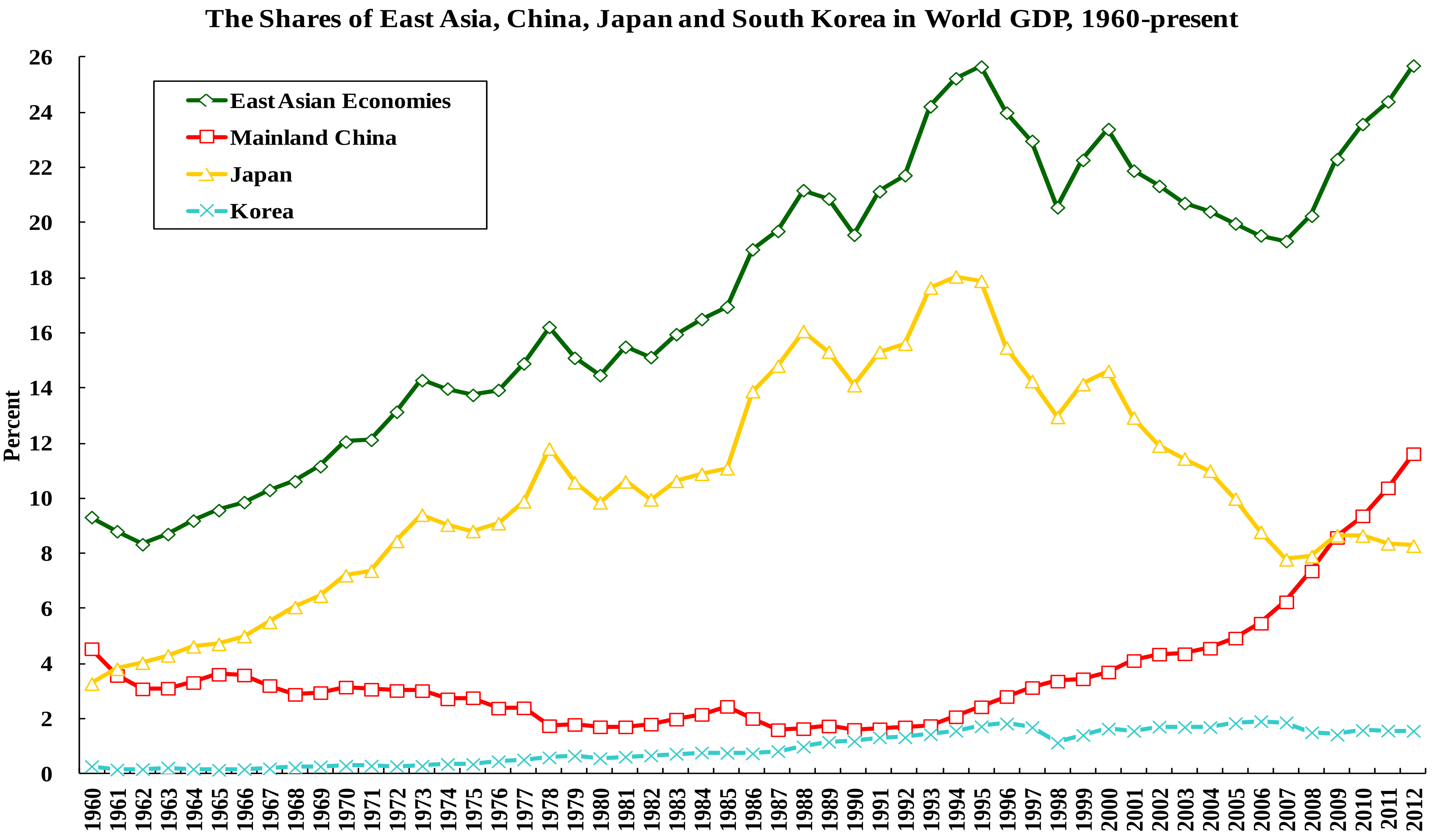




The Chinese Economy in the Global Context: GDP

- The East Asian (defined as the 10 Association of Southeast Asian Nations (ASEAN) + 3 (China, Japan and the Republic of Korea) share of World GDP rose from just above 10% in 1970 to approximately 25% in 2012.
- The Japanese share of World GDP declined from a peak of 18% in the mid-1990s to 8% in 2012.
- The (Mainland) Chinese share of World GDP rose from 3% in 1970 and only 4% in 2000 to over 11% in 2012.

The Shares of East Asia, China, Japan and South Korea in World GDP, 1960-present



The Chinese Economy in the Global Context: International Trade

- Chinese international trade has grown very rapidly, especially after it acceded to the World Trade Organisation (WTO) in 2001.
- China has also grown into the second largest trading nation in the World in terms of the total value of international trade in goods and services, just after the U.S.
- While China is the largest exporting nation in terms of goods and services, followed by the U.S., the U.S. is the largest importing nation in terms of goods and services, followed by China. China is also the largest exporting nation in terms of goods alone, followed by the U.S. The U.S. is the largest exporting as well as importing nation in terms of services, followed by respectively the United Kingdom and Germany.

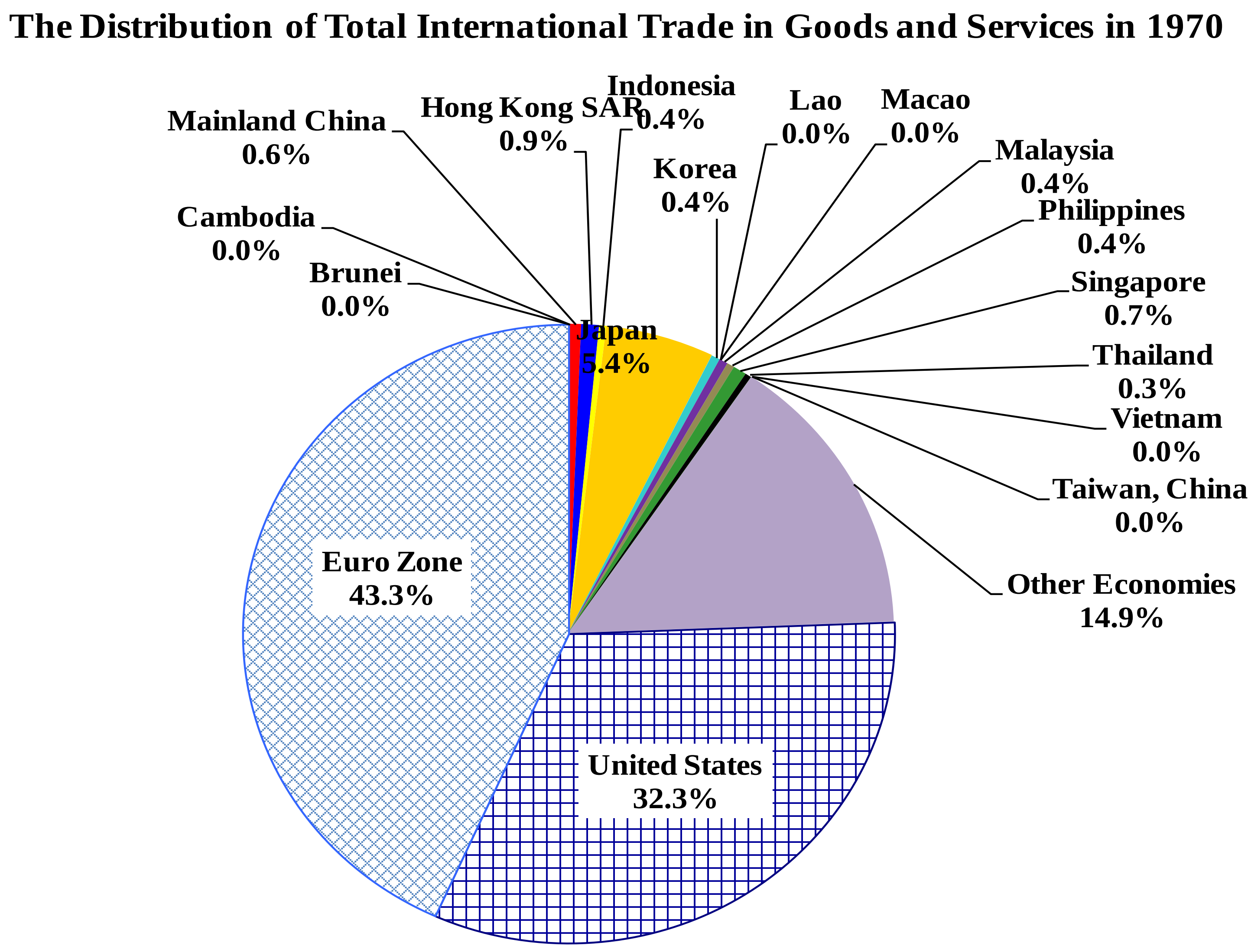
The Chinese Economy in the Global Context: International Trade

- In 1970, the United States and Western Europe together accounted for over 60% of World trade. By comparison, East Asia and South Asia combined accounted for less than 10% of World trade.
- In 1990, the United States and Western Europe together still accounted for approximately 55% of World trade while East Asia and South Asia combined accounted for just over 10% of World trade.
- By 2012, the share of United States and Western Europe in World trade has declined to below 45% whereas the share of East Asia and South Asia has risen to 30%.
- The regional distribution of international trade parallels approximately the regional distribution of GDP.

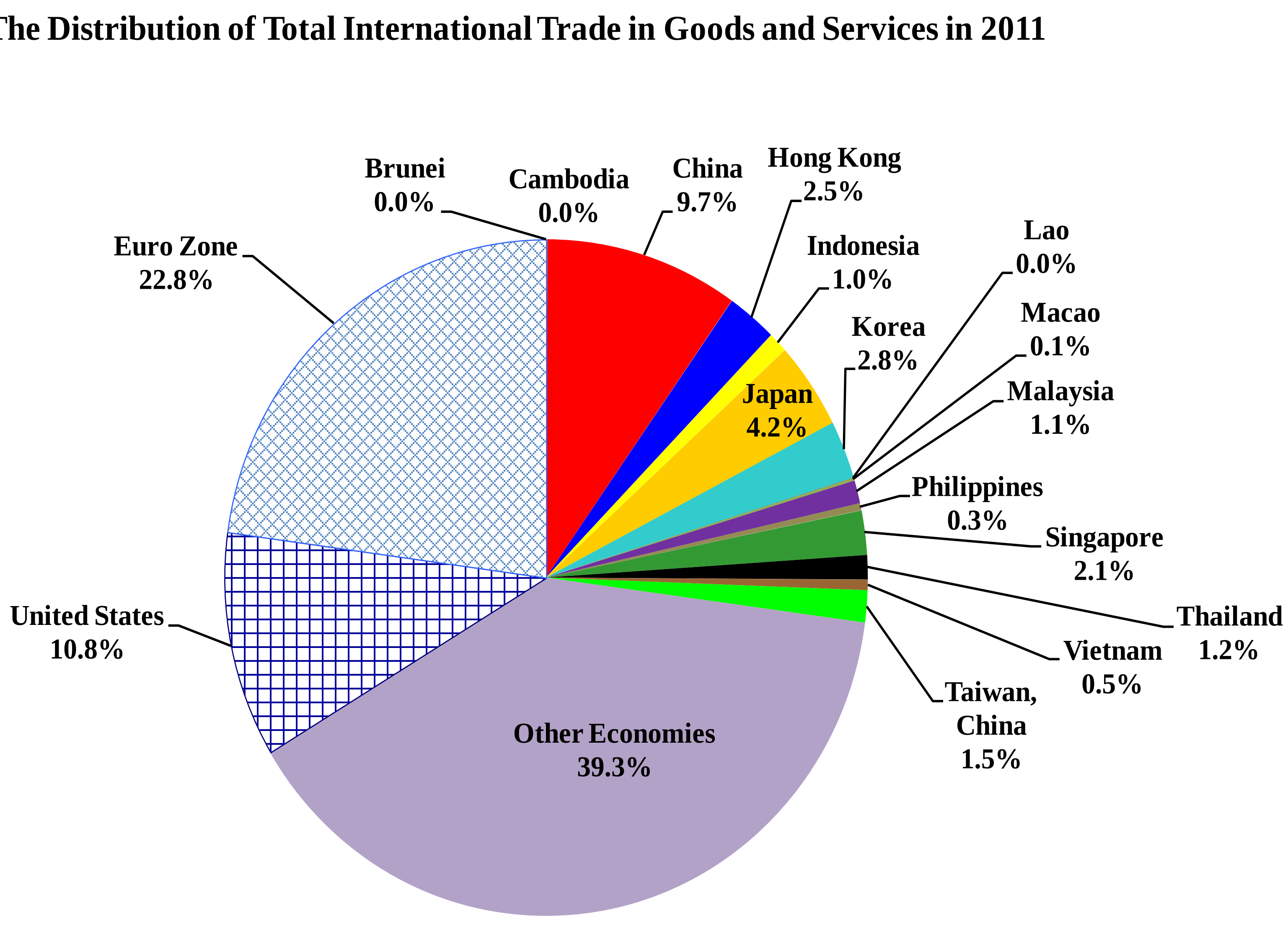
The Chinese Economy in the Global Context: International Trade

- The East Asian (defined as the 10 Association of Southeast Asian Nations (ASEAN) + 3 (China, Japan and the Republic of Korea) share of World trade rose from 9.9% in 1970 to 25.8% in 2012.
- The Chinese share of World trade rose from 0.7% in 1970 to 10.7% in 2012.
- Chinese international trade accounted for 41.2% of East Asian international trade in 2012.
- China runs a trade deficit with almost every East Asian economy.

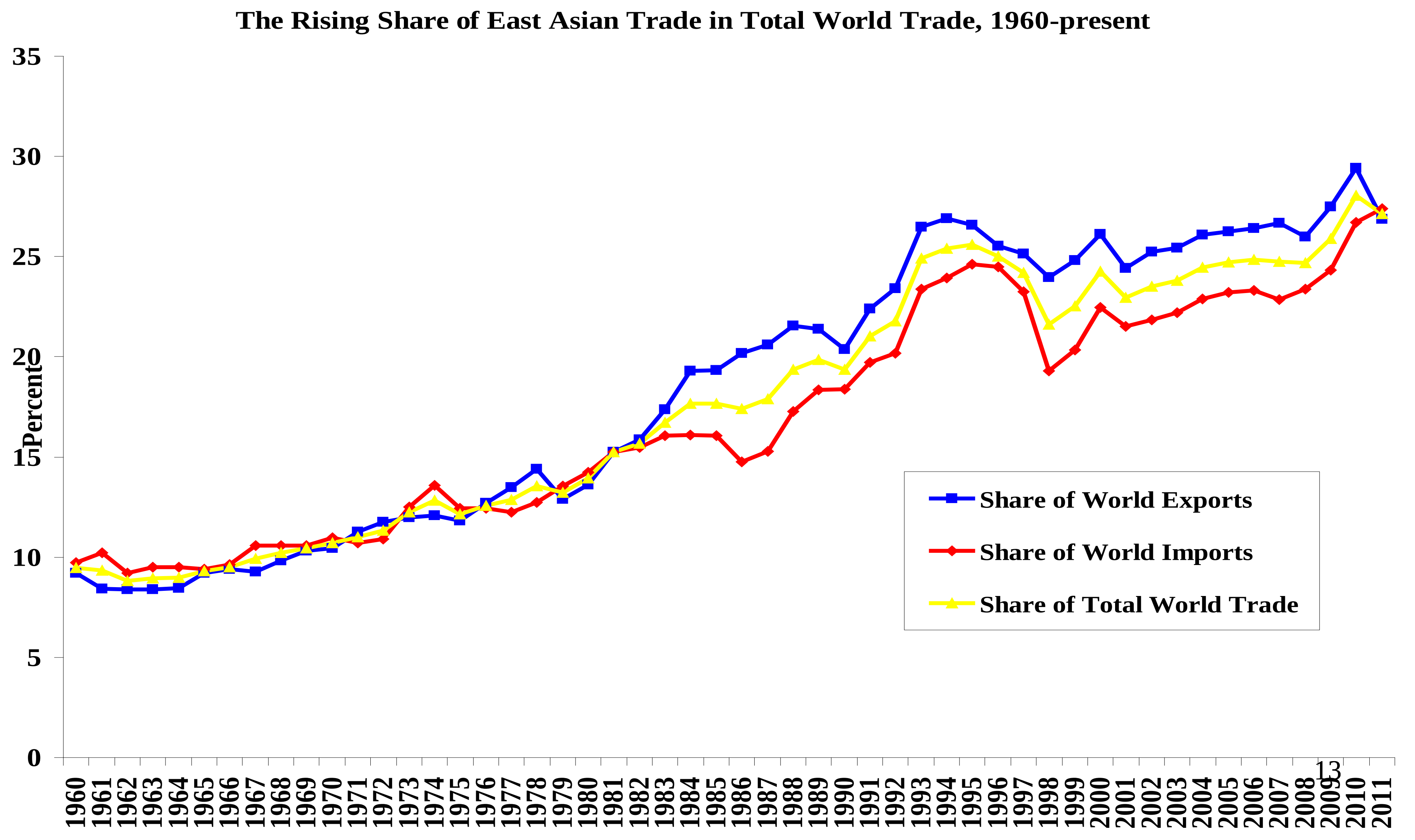
The Distribution of Total International Trade in Goods and Services, 1970



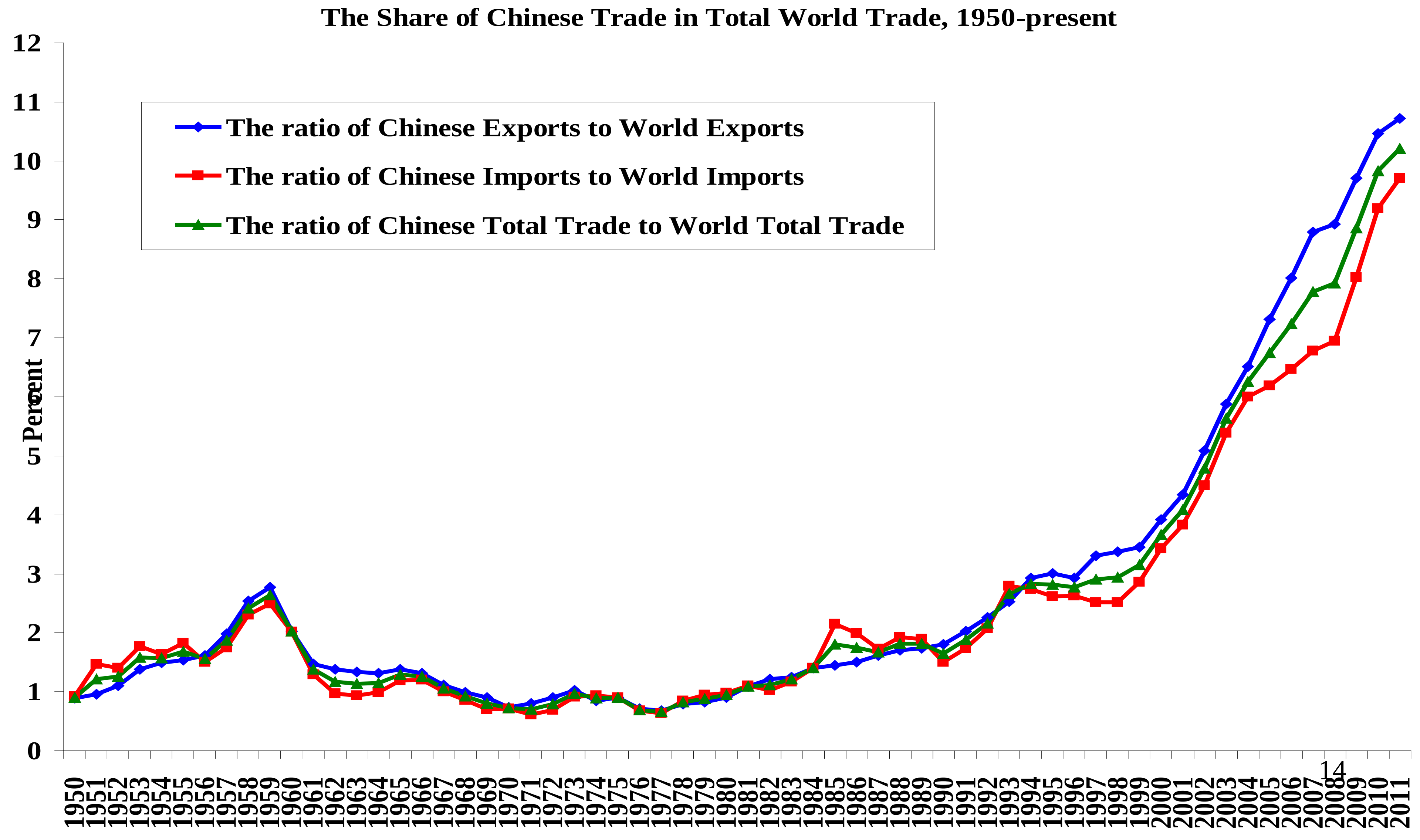
The Distribution of Total International Trade in Goods and Services, 2011



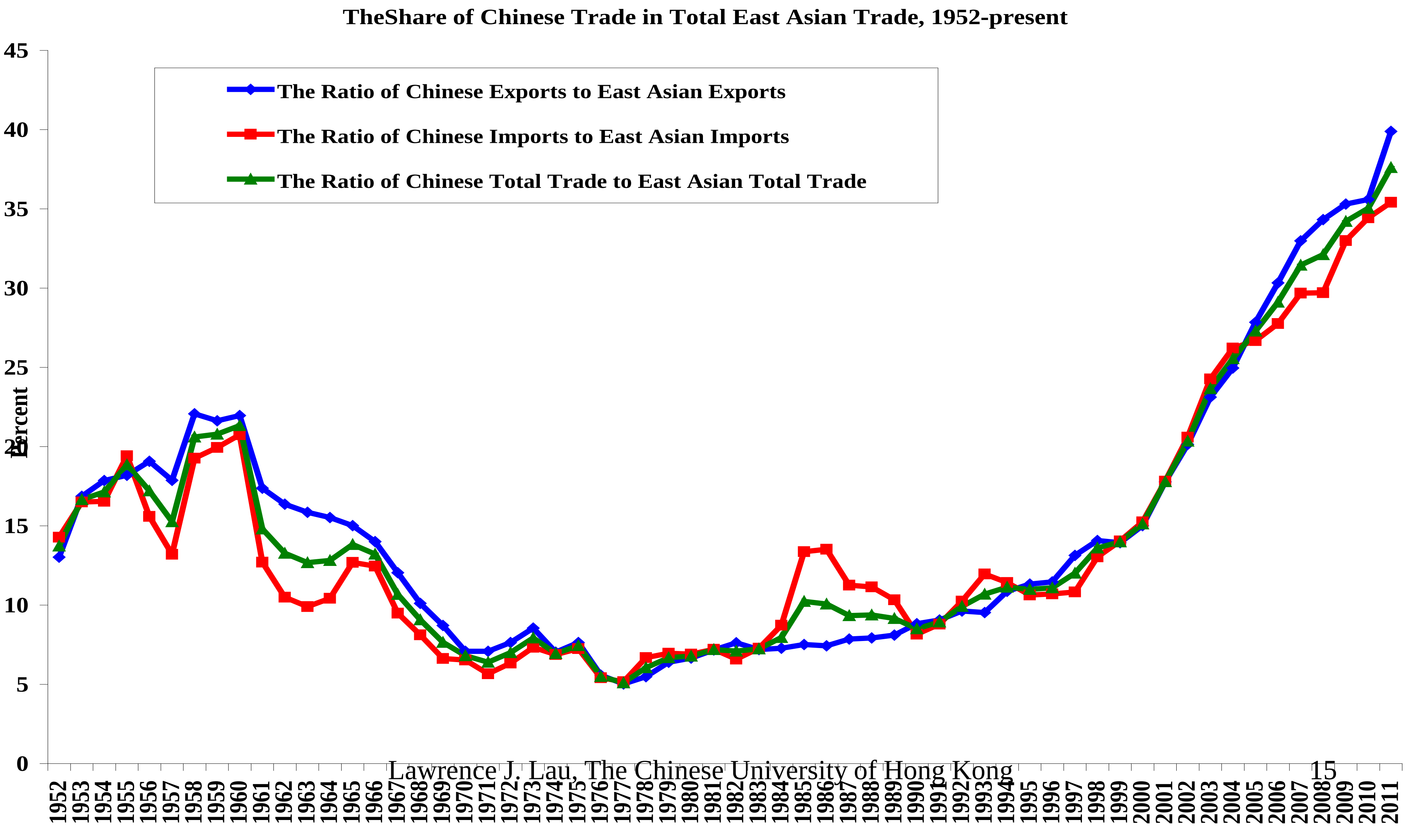
The Rising Share of East Asian Trade in Total World Trade, 1960-present



The Share of China in Total World Trade, 1950-present



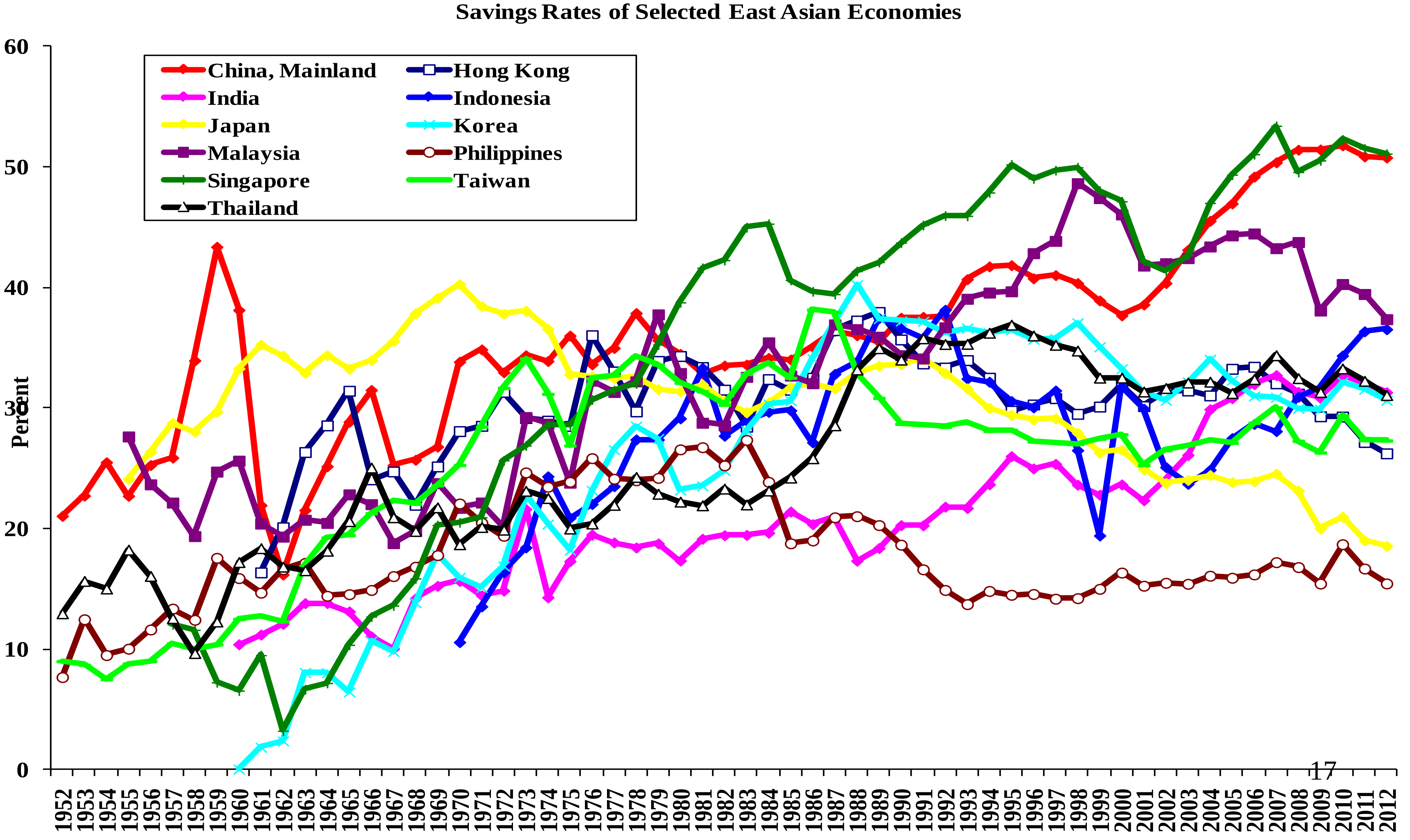
The Share of China in Total East Asian Trade, 1952-present



The Chinese Economy in the Global Context: High Saving Rate

- Economic growth in East Asia has been under-pinned by a high domestic saving rate (see the following chart), with the Philippines being a notable exception.
- A high domestic saving rate means, among other things, that most of the East Asian economies can finance all of their domestic investment needs from their own domestic savings alone. Thus, they can achieve a high rate of growth of their tangible capital stocks without having to depend on the more fickle foreign capital inflows (including foreign direct investment, foreign portfolio investment, foreign loans or foreign aid).
- Chinese economic growth since 1978 has been supported by a high domestic saving rate, on the order of 30% and above, enabling a consistently high domestic investment rate. The Chinese saving rate has fluctuated around 40% since the early 1990s and has at times approached or even exceeded 50% in more recent years.

Saving Rates of Selected Asian Economies (1952-present)



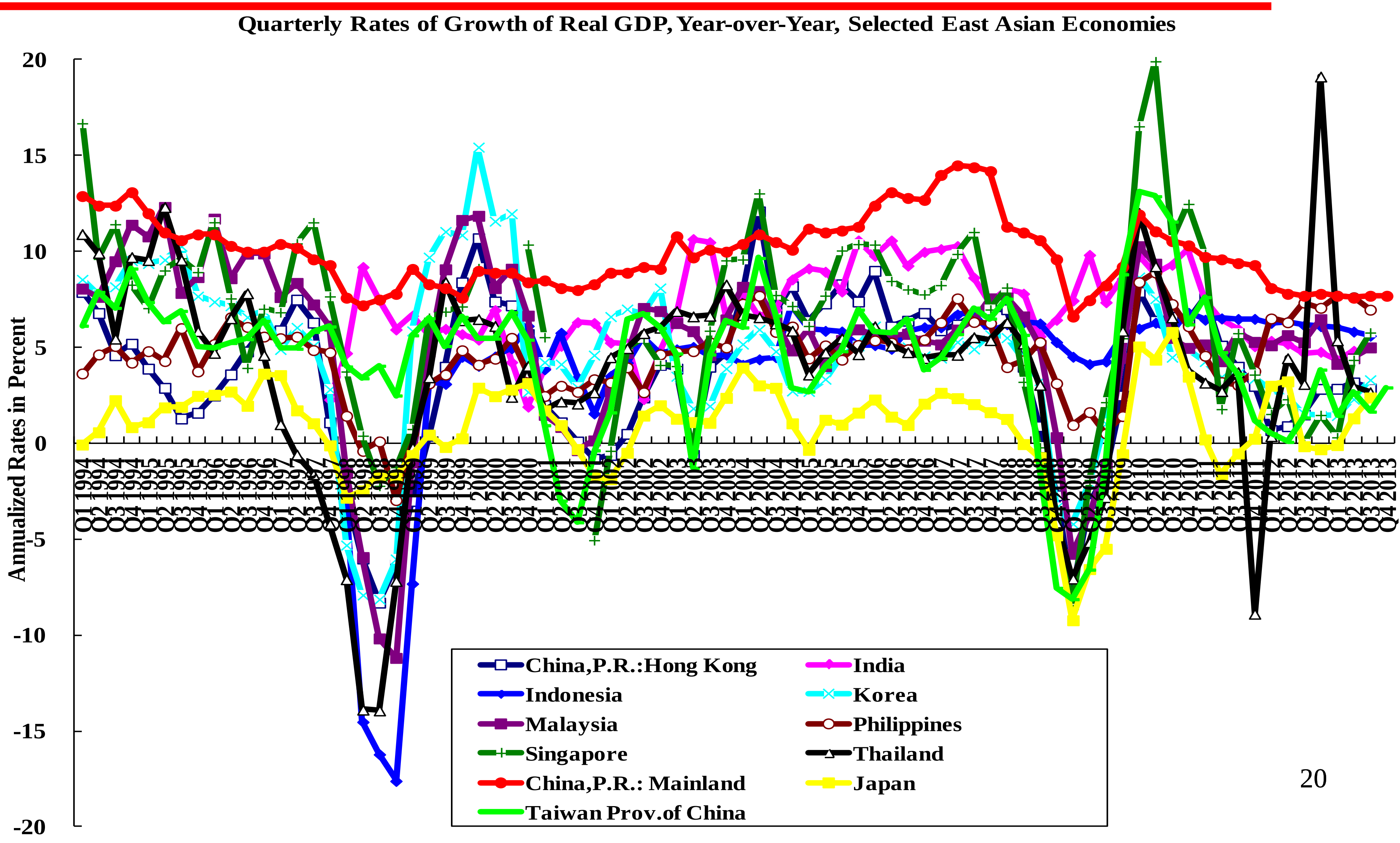
A Market Economy with Chinese Characteristics: Government and Market

- The proper functioning of a modern economic system requires the visible hand of the government working with the invisible hand of the market.
- Ultimately, the division of labour between the invisible hand and the visible hand depends on the efficacy of the respective hands in achieving economic efficiency, which in turn depends on the pre-existing economic environment.
- Economies of scale are common in many industries and given the huge market in China, monopolies, especially local monopolies, must be appropriately regulated by the central government and not left solely to the market or to the local government.
- The role of state-owned enterprises depends on the initial conditions of the economy and on the stage of economic development. For example, the China Development Bank could not have accomplished what it accomplished if it were not wholly state-owned.

A Market Economy with Chinese Characteristics: Maintaining Separability

- Why was the Chinese economy able to survive successive financial crises, beginning with the 1997-1998 East Asian currency crisis, as well as quantitative easing (QEI, II and III) relatively unscathed?
- China has been relatively insulated from the financial disturbances in the World economy. This is because it has capital control and does not have to depend on foreign capital due to its high domestic saving rates. Potential contagion was therefore minimised. (It was even spared the Bernard Madoff swindle which actually caught quite a few wealthy European investors.)

Quarterly Rates of Growth of Real GDP, Y-o-Y: Selected East Asian Economies



A Market Economy with Chinese Characteristics: Maintaining Separability

- Going forward, China should enhance its inter-connectedness with the World economy while maintaining the ability to be differentiated, in accordance with its own best interests, and potentially separable. It should strive to achieve harmony with the rest of the World without becoming identical with the developed economies in every aspect.
- Capital account convertibility does not imply that China has to approve all of the new financial products invented by Wall Street.
- For example, China should be careful in introducing financial derivatives such as credit-default-swaps (CDSs) indiscriminately. CDSs purchased by investors who do not own the underlying debt securities are really an instrument of gambling (or insurance without insurable interest which creates moral hazard).

Preserving Diversity and Independence

- The importance of limiting the risks of financial institutions and their propagation has been recognised in the aftermath of the 2008 global financial crisis.
- The concept of "Systematically Important Financial Institutions (SIFIs)" leads to the requirement that financial institutions that are too big to fail should be limited in size. In addition, the concept of "Globally Systematically Important Financial Institutions (GSIFIs)" also means that these financial institutions should be subject to additional regulations.
- However, the current regulations in place do not go far enough to reduce systemic risks. These GSIFIs should be prevented form doing too much business with one another, so that if one GSIFI gets into trouble, it will not automatically bring down other GSIFIs. An attempt should be made to reduce the correlation of risks among the largest financial institutions.

Preserving Diversity and Independence

- Diversification yields a benefit only if the underlying risks are really independent and dispersed. True diversification requires some degree of differentiation, some degree of non-correlation.
- Thus, as China integrates with the rest of the World, it should emphasise inter-operability but also maintain some degree of differentiation and potential separability. It protects not only China but also the rest of the World, so that the cross-border effects of disturbances will be attenuated.

A Market Economy with Chinese Characteristics: Enhancing Survivability

- Systems fail from time to time. Some systemic diversity among countries and regions can hence overall survivability.
- For example, the current internet system, if it fails, can bring the entire world to a halt. What is needed is not only more redundancy, but some differentiation, so that the entire internet will not fail all at once.
- This is the same argument for genetic diversity to ensure survival of the particular species.
- Economic, political and social systems are no different. Some differentiation is not only locally necessary and useful, but also potentially globally beneficial.

Enhancing Inter-Connectedness and Maintaining Potential Separability

- We consider for the case of the Renminbi how inter-connectedness with the World economy can be enhanced but at the same time potential separability, for example, in the event of an economic or geo-political crisis, can be maintained.

The Internationalisation of the Renminbi: The Different Meanings

- The internationalisation of the Renminbi can mean different things to different people. It basically implies the use of the Renminbi for various purposes outside of Mainland China.
- (1) The Renminbi as a "Unit of Account" in cross-border trade transactions. This means that the prices and values are denominated or quoted in terms of the Renminbi (however, they do not necessarily imply settlement in Renminbi).
- (2) The Renminbi as a "Medium of Exchange". This means the use of the Renminbi for actual settlement of transactions, including cross-border trade transactions between China and its trading partner countries and regions, and eventually possibly between and among its trading partner countries and regions themselves, on a voluntary basis.

The Internationalisation of the Renminbi: The Different Meanings

- (3) The Renminbi as a "Store of Value". This means the holding of Renminbi and Renminbi-denominated assets long term by individuals and institutions. When Renminbi is held by central banks and monetary authorities of other countries and regions, it serves as a foreign exchange reserve currency.
- (4) The Renminbi as an "International Funding Currency". This means money is raised by non-Chinese entities through the issuance of financial instruments such as bonds and stocks denominated and if appropriate traded in Renminbi.
- (5) The Renminbi as a "Major International Reserve Currency" like the U.S. Dollar and the Euro, widely held in the form of Renminbi or Renminbi-denominated assets by central banks and monetary authorities of other countries and regions as part of their foreign exchange reserves.

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

- Even though the Renminbi is not de jure fully or freely convertible, it has gradually become de facto convertible in some economies in East Asia because of its wide general voluntary acceptance. The Renminbi is today widely accepted and used in Hong Kong, Macau, Laos, Myanmar, and other border areas at the retail level as a medium of exchange and a store of value even though it is not legal tender in these places.
- Chinese visitors to Hong Kong use the Renminbi freely in the streets to pay for goods and services. The Renminbi can also be exchanged for Hong Kong Dollar freely in the streets and through the Hong Kong Dollar into other "hard" foreign currency such as the US Dollar and the Euro.

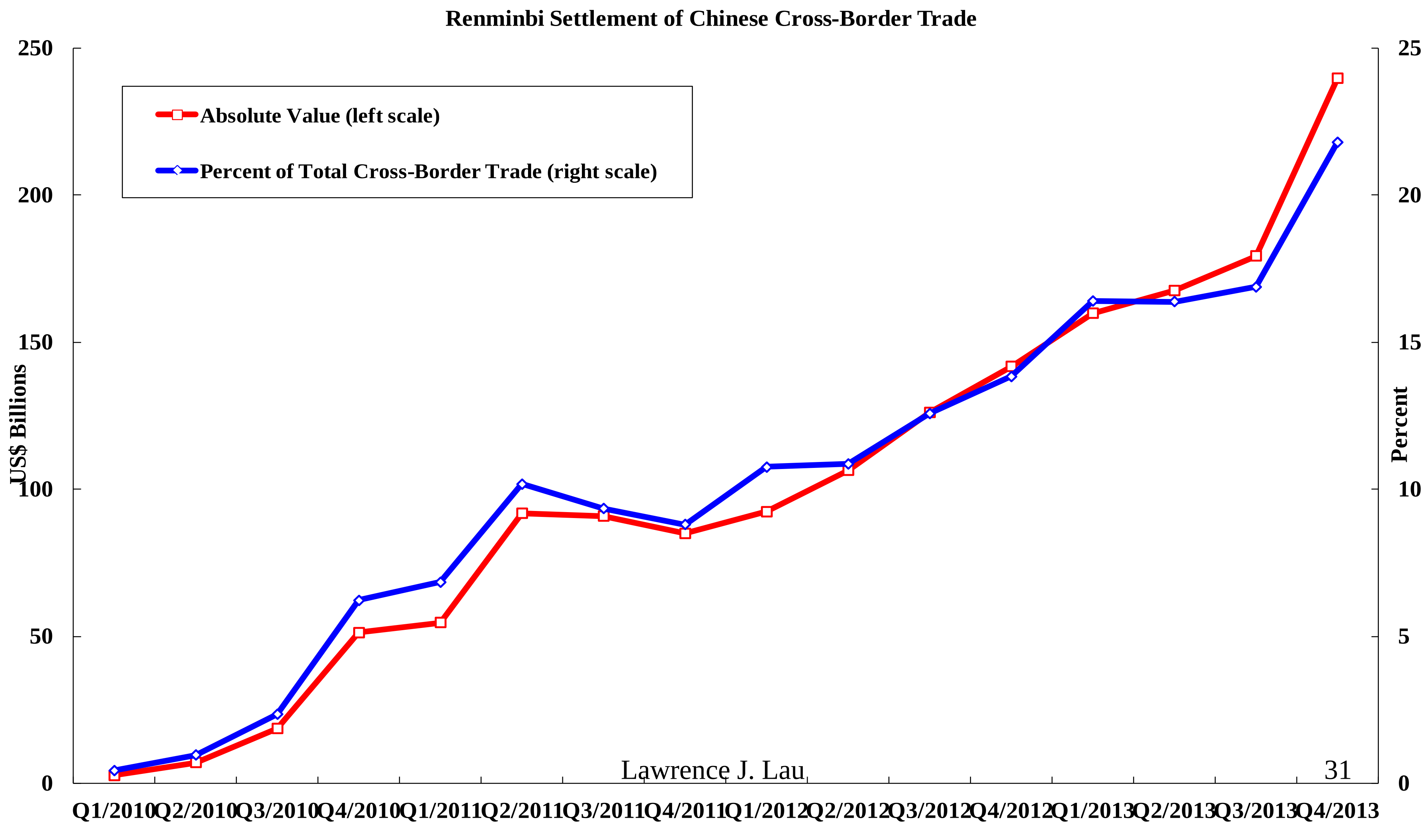
The Internationalisation of the Renminbi: As an International Medium of Exchange

- Chinese exporters and importers in selected provinces, municipalities and regions have been permitted to settle their cross-border trade transactions in Renminbi in Hong Kong since 2009 on a voluntary basis, by mutual agreement between the exporter and the importer in each case.
- The practice was extended to the whole of Mainland China at the end of 2011 and settlement was allowed to take place in locations other than Hong Kong such as Singapore and Taipei.
- The Renminbi is increasingly used as an invoicing and settlement currency for cross-border transactions, especially those involving Chinese enterprises as transacting parties.

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

- The proportion of Mainland Chinese international trade settled in Renminbi has grown rapidly, from almost nothing in 2010Q1 to US$240 billion in 2013Q4 or 21.8% of the total value of trade in goods and services. In absolute value, some US$960 billion of Chinese international trade is now settled in Renminbi annually.
- The Renminbi is also used for foreign direct investment and portfolio investment both inbound and outbound, but its use can be further liberalised.
- The central banks and monetary authorities of many countries and regions have entered into swap agreements with the People's Bank of China, the central bank of China, which facilitates the use of Renminbi as an invoicing and settlement currency.

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



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

- In the following chart, the share of each major country in world trade is compared to the share of its currency used in world trade settlement in 2010. Even though China accounted for more than 10% of world trade, Renminbi accounted for less than 1% of world trade settlement; while the U.S. had a similar share of world trade as China, the U. S. Dollar accounted for more than 35% of world trade settlement. There is plenty of room for the expansion of the use of Renminbi for cross-border trade settlement.

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

- The benefits to Chinese exporters and importers and their trading partners in the importing and exporting countries and regions of using either the Renminbi or the latter's own respective local currencies as the invoicing and settlement currency for cross-border transactions, instead of a third currency such as the U.S. Dollar or the Euro, include:
- (1) Reduction of the transactions costs of cross-border transactions (one currency conversion rather than two);
- (2) Reduction of foreign exchange risk for exporters and importers of goods and services (one less currency risk);

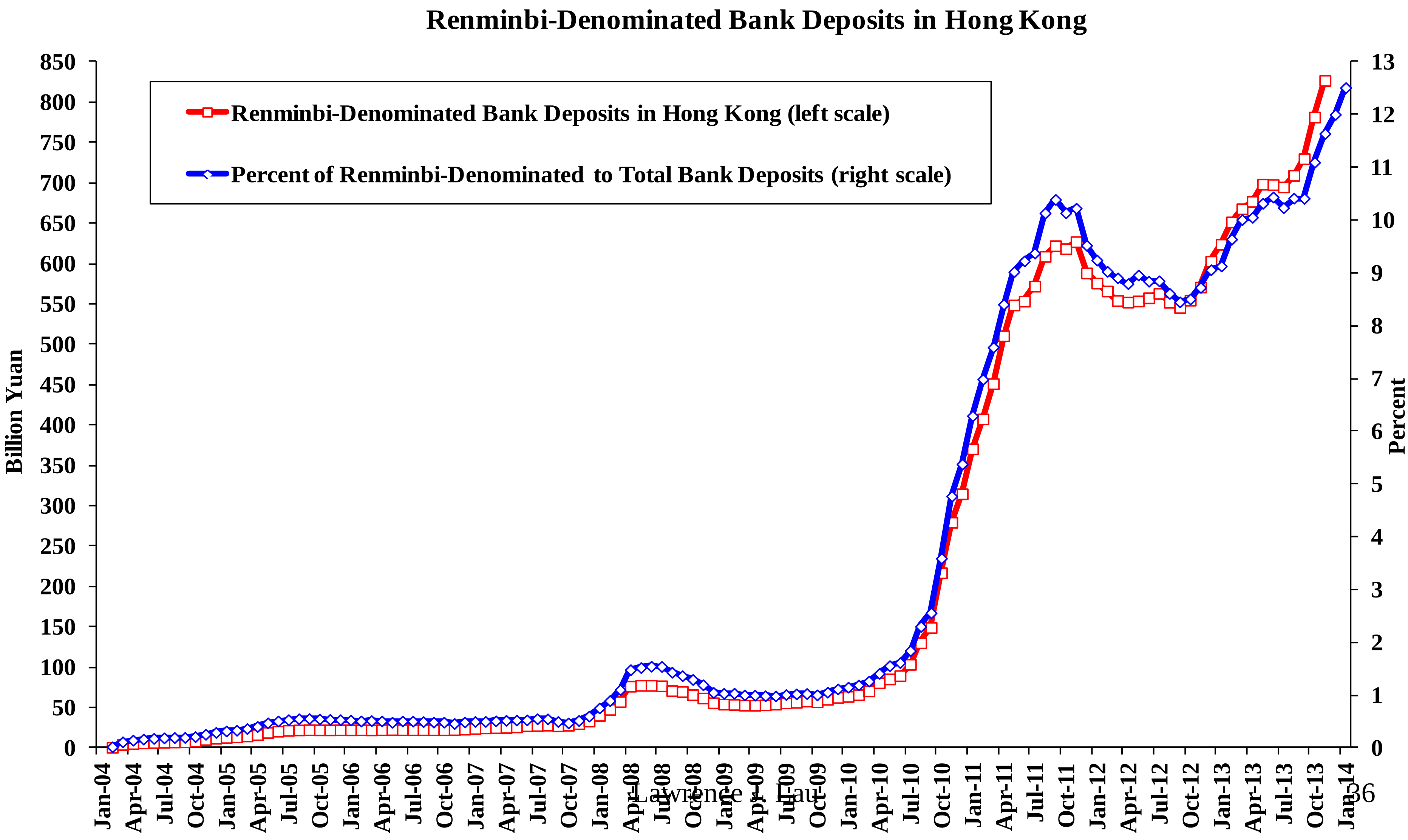
The Internationalisation of the Renminbi: As an International Medium of Exchange

- (3) Reduction of foreign exchange reserves needed to be held for liquidity and transactions demand purposes by the respective central banks or monetary authorities.
- The Yen and the Renminbi and some other East Asian currencies have come of age, just as the Western European currencies recovered in the aftermath of World War II—it is no longer necessary to rely on a third currency for invoicing and settlement purposes.

The Internationalisation of the Renminbi: As a Store of Value

- The Renminbi is increasingly used a store of value outside of the Mainland. In Hong Kong, Renminbi bank deposits held by its residents, including both individuals and firms, have grown rapidly in the past couple of years to slightly more than 12.5% (in January 2014) of total bank deposits in all currencies, attesting to the willingness of Hong Kong residents to accept and to hold the Renminbi.
- Commercial banks in Taiwan have also recently begun to offer Renminbi deposit accounts. Renminbi deposits at the end of January 2014 accounted for 21% of foreign currency deposits and 3% of total deposits.
- Thus, the elimination of all forms of capital controls has not been necessary for the Renminbi to be used as a medium of exchange or a store of value outside Mainland China. There can be wide general acceptance of the Renminbi even in the absence of its full convertibility.

Renminbi-Denominated Bank Deposits in Hong Kong



The Internationalisation of the Renminbi: As an International Funding Currency

- However, the expansion of the offshore Renminbi market may be constrained by a number of factors.
- First, since the Renminbi is expected to appreciate relative to the U.S. (and hence Hong Kong) Dollar in the long run, it is risky for a borrower to borrow in Renminbi unless it has or expects to have a stable source of revenue denominated in Renminbi, such as direct investors on the Mainland.
- Second, the Renminbi funds raised offshore do not automatically qualify to be repatriated to the Mainland to be used there.
- Third, the pool of Renminbi deposits in Hong Kong is less than 1% of the total Renminbi deposits on the Mainland.

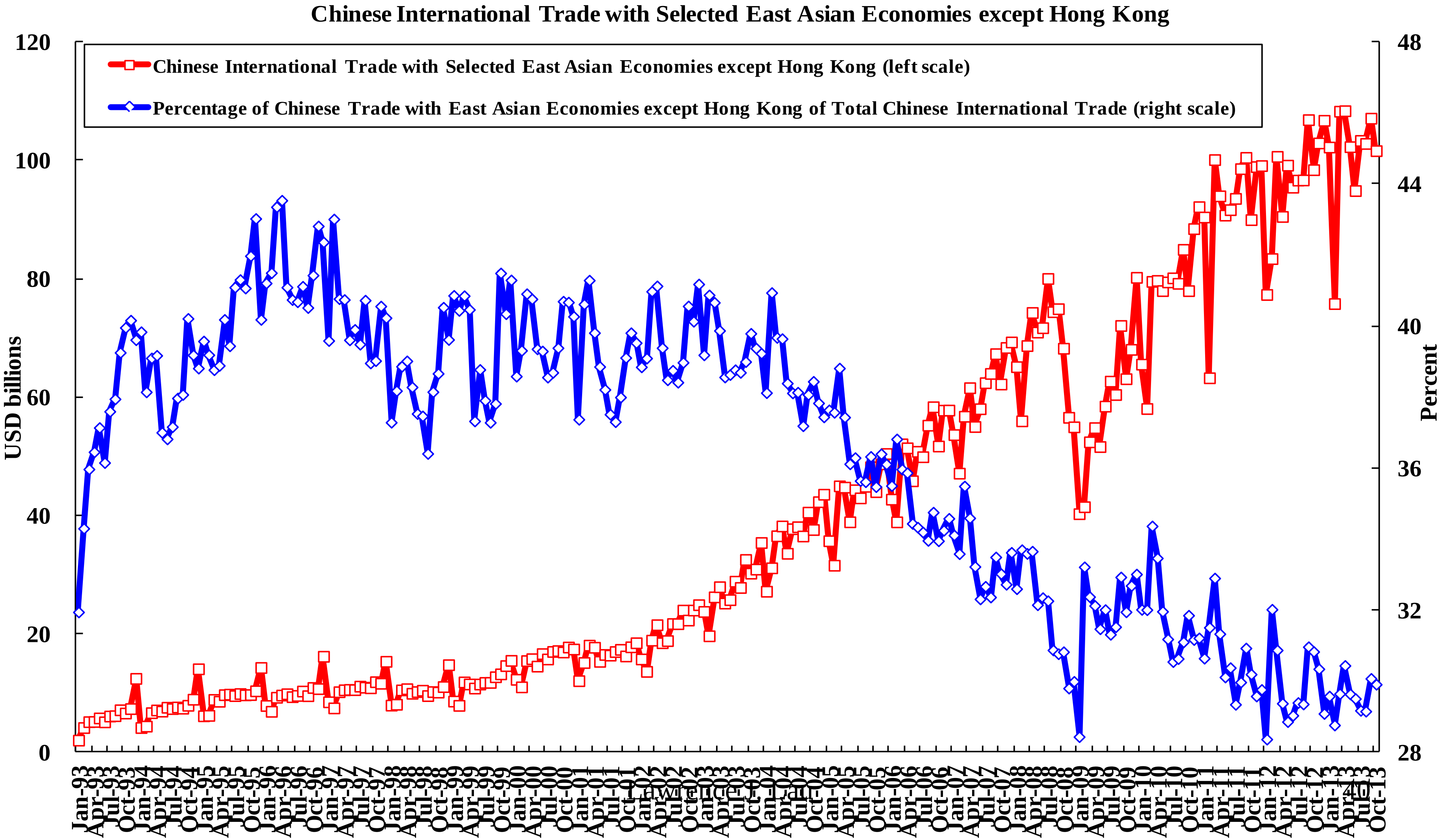
The Future Role of the Renminbi: As an International Medium of Exchange

- It the future, it is possible that the Renminbi can be used directly in the trading of Renminbi-denominated securities, for example, on the Hong Kong Stock Exchange. If realised, this will allow (Mainland) Chinese investors to buy and sell these securities abroad even in the absence of capital accounts convertibility.
- The Renminbi can also be used by other countries and regions to settle cross-border trade among themselves if they are not willing to accept one another's currency for whatever reason as long as they have access to Renminbi (and especially if one of the trading partners has limited access to the U.S. Dollar and/or the Euro, e.g., Iran and possibly Russia).

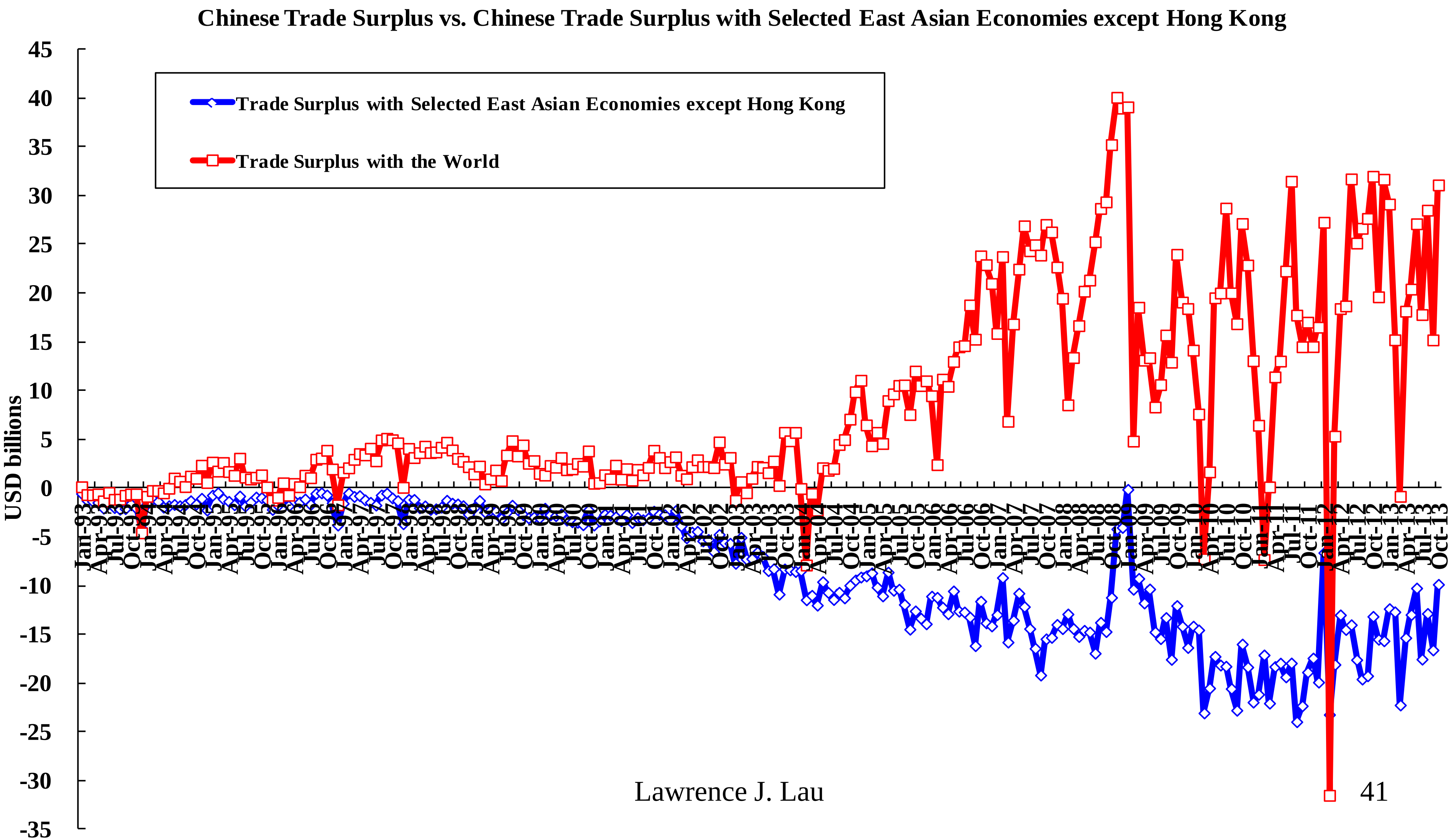
The Future Role of the Renminbi: As an International Medium of Exchange

- In 2012, approximately US$1.15 trillion, or 30%, of Chinese international trade is conducted with East Asian economies other than Hong Kong. (Hong Kong is a major export destination of Mainland China; however, a large proportion of its imports from China is re-exported from Hong Kong to other destinations, including the U.S. and Europe, around the World.)
- Moreover, while China runs a small trade surplus vis-a-vis the World as a whole, it runs a large trade deficit with East Asian economies other than Hong Kong. What this means is that the East Asian economies will have ample room to earn and accumulate Renminbi balances if they wish to do so.
- Thus, potentially, the Renminbi can not only be used as a settlement currency instead of the U.S. Dollar by Chinese exporters and importers with their trading partners in East Asia, but also by other East Asian economies in the settlement of trade transactions among themselves on a voluntary basis as they all have the ability to earn large quantities of Renminbi through their respective trade surpluses vis-a-vis China.

Chinese International Trade with East Asian Economies except Hong Kong



Chinese Trade Surplus with the World and East Asian Economies except Hong Kong



The Future Role of the Renminbi: As an International Medium of Exchange

- Eventually, it is possible that the East Asian economies may even issue bonds denominated in Renminbi because they all have a trade surplus vis-a-vis China and hence will have the ability to service the Renminbi-denominated debt and the pool of Chinese savings is huge and Chinese investors are natural customers for Renminbi-denominated assets.

The Future Role of the Renminbi: Towards Capital Accounts Convertibility

- The long-term trend of the exchange rate of the Renminbi relative to U.S. Dollar is likely to hold steady or appreciate modestly over the next few years although there may well be fluctuations in the short term caused by speculative inflows and outflows. A stable or modestly appreciating exchange rate of the Renminbi should facilitate its further internationalisation.
- Capital account convertibility of the Renminbi is expected to be achieved before 2020. It can occur sooner if short-term capital flows, both outbound and inbound, can be appropriately "discouraged".

The Future Role of the Renminbi: Towards Capital Accounts Convertibility

- A Tobin tax, originally proposed by the late Prof. James Tobin, Nobel Laureate in Economic Sciences, can be an effective means of distinguishing between short- and long-term capital flows. It may be defined as a tax of say 1% on all spot conversions of a foreign currency into Renminbi or vice versa that are not related to underlying current-account transactions.
- Thus, foreign currency transactions related to the exports or imports of goods and services will be exempted from such a tax. In practice, even capital account transactions below a certain threshold level, say 2 million Yuan (approximately US$320,000 at current exchange rate), should probably also be exempted.
- Such a Tobin tax is intended to impose a penalty on short-term purely financial round-trip excursions from a foreign currency into the Renminbi or vice versa, and thereby discourage short-term cross-currency capital flows.

The Future Role of the Renminbi: Towards Capital Accounts Convertibility

- If every time a foreign currency is converted into Renminbi or vice versa, a tax of say 1% is levied, then a round-trip within a month would amount to an effective cost of more than 24% per annum, whereas for a direct investment with a long time horizon of say 5 years, the tax will amount to only 0.4% per annum, virtually nothing.
- In February, 2013, the European Commission published proposals for a financial transaction tax (FTT), which is also a form of Tobin tax. Only 11 of the 27 member states of the European Union (EU) will participate in the FTT, including France, Germany, Italy and Spain.

The Future Role of the Renminbi: Not As an Object of Gambling and Speculation

- China should avoid having the Renminbi exchange rate become an object of gambling and speculation by the hedge funds of the World.
- The daily volume of foreign exchange transactions worldwide amounts to approximately US$5.3 trillion. This is equivalent to approximately US$1.5 quadrillion per year. The total annual volume of international trade, including trade among countries and regions that do not require currency conversion such as within the Euro Zone, is approximately US$20 trillion, or only 1.3% of the total volume of foreign exchange transactions. Are all these transactions necessary?

The Future Role of the Renminbi: Not As an Object of Gambling and Speculation

- This shows that the bulk of foreign exchange transactions consists of short-term gambling and speculation, causing unnecessary fluctuations in the currency exchange rates, which generate no benefits to real economies but create large profits for bankers handling these transactions (operating the casinos, so to speak, even though there have also been allegations of price-fixing in foreign exchange markets by the major banks.
- The volatility of the exchange rates, caused by such speculation also benefits the U.S. Dollar as the dominant and only safe haven currency.

The Future Role of the Renminbi: Enabling Settlement in Own Currencies

- 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.
- However, one cannot, in general, expect international trade to be bilaterally balanced for every pair of trading partner countries. Under own-currency settlement, some countries may wind up with an excess amount of another country's currency while others may have an insufficient amount of another country's currency. Thus pooled settlement makes sense, so that within a given group of countries, the excess foreign currency held by one country can be used to offset the shortfall of another country.

Settlement of International Transactions in Own Currencies in Western Europe (1950s)

- This netting out should work well within a group, especially if every country in the group has more or less balanced trade with the rest of the group as a whole.
- The Bank for International Settlements in Basel performed this group settlement function for the Western European countries in the 1950s and early 1960s as they recovered from World War II but had not yet developed the confidence in one another's national currencies. U.S. aid under the Marshall Plan underpinned the operation of the settlement system by providing U.S. Dollars to settle any remaining balance after netting out amongst the Western European countries.

The Future Role of the Renminbi: Enabling Settlement in Own Currencies

- A similar Bank for Intra-Asia Settlements can be established to perform the same function for Asian economies on a voluntary basis, enabling them, if they so choose, to settle in their own currencies. China, and perhaps also Japan, with their large official foreign exchange reserves, can provide any remaining settlements necessary in terms of either the Yuan (or the Yen) or another major international reserve currency such as the U.S.$ or the Euro.

The Future Role of the Renminbi: Real Exchange Rate Coordination

- The real exchange rate between two currencies is the exchange rate after adjusting for the relative rates of inflation between the two economies.
- Stable real exchange rates are beneficial to the real economy. Exporters, importers, direct investors and long-term portfolio investors all prefer stable real exchange rates.

The Future Role of the Renminbi: Real Exchange Rate Coordination

- Real exchange rate coordination among a group of consenting countries and regions, in response to their current account surpluses and deficits and relative rates of inflation, can help to avoid the adoption of "beggar thy neighbour" policies by and potentially ruinous competitive devaluation among them.
- Moreover, if there were effective real exchange rate coordination among the group, it will facilitate the adjustment of the exchange rates en bloc vis-a-vis a major international reserve currency because then no one economy within the group will be relatively advantaged or disadvantaged.

The Future Role of the Renminbi: Real Exchange Rate Coordination

- Such real exchange rate coordination is best carried out among a group of countries with extensive trade and investment relations among themselves such as the ASEAN + 3 on a voluntary basis.
- With effective real exchange coordination among a group of economies, any currency within the group is as good as any other currency within the group, including the Renminbi.
- If real exchange rate coordination is successful among East Asian economies—or the most important trading countries among them, it will result in an East Asian "Currency Snake".
- Under real exchange coordination, the relative exchange rate parities within the coordinated group of economies will return to Bretton-Woods-like stability, but without the use of gold.

The Future Role of the Renminbi: As a Major International Reserve Currency

- It is not at all clear whether it is in China’s best interests to have the Renminbi become a major international reserve currency like the U.S. Dollar and the Euro. To benefit from the seigneurage of being a major international reserve currency that is widely held by central banks elsewhere in the World, China will likely have to run a significant trade deficit which it may not be willing to do. Moreover, there is also the risk of other central banks deciding to dump the currency and assets denominated in the currency at inopportune times.

Concluding Remarks

- The centre of gravity of the global economy has been gradually shifting to East and South Asia from North America and Europe. The centre of gravity of the East Asian economy has been gradually shifting to China from Japan.
- In integrating with the World economy, the Chinese economy should try to maintain potential separability so as to avoid having its economic and financial system dragged down by a global crisis.
- It should also maintain its own characteristics so as to enhance survivability in the event of unforeseen adverse developments.

Concluding Remarks

- Paradoxically, the global financial crisis of 2007-2009 has accelerated the pace of internationalisation of the Renminbi. China will be internationalising the Renminbi gradually and in a planned and orderly manner. It has already made a beginning by allowing the Renminbi to be used on a voluntary basis as an invoicing and settlement currency in its international trade transactions.
- The use of the Renminbi for the denominating, invoicing, clearing and settlement of Chinese international transactions will continue to rise over time, especially in its trade with East Asian economies.
- Chinese trade with the U.S. and Europe will probably continue to be denominated and settled in U.S. Dollar and Euro respectively.

Concluding Remarks

- The Renminbi may perhaps even be used in the settlement of trade among East Asian economies themselves, on a voluntary basis. This is because almost all East Asian economies have a trade surplus vis-a-vis China and hence can have a ready supply of Renminbi to be used for settlement of trade among themselves if they so wish.
- To the extent the East Asian economies may potentially have an excess of Renminbi it may be more economically and efficient for them to settle in Renminbi than in U.S. Dollars because it will involve one fewer currency conversion.

Concluding Remarks

- Capital account convertibility of the Renminbi, in the sense that both inbound and outbound capital controls will be effectively lifted, is expected to be achieved before 2020.
- It can occur sooner if short-term speculative capital flows (hot money), both outbound and inbound, which do not do the real economy any good, can be appropriately "discouraged". The imposition of a Tobin tax on cross-border capital flows, which effectively differentiates between short-term and long-term capital flows, may be useful in controlling the inflow and outflow of hot money.

Concluding Remarks

- It is important to note that full convertibility of the Renminbi does not necessarily imply that its exchange rate will be freely determined in the foreign exchange market. The Renminbi will probably continue to be determined under a managed floating rate system.
- The Hong Kong Dollar is an example of a fully convertible currency that does not have a freely fluctuating exchange rate.

Concluding Remarks

- The Renminbi does not and should not aim to replace the U.S. Dollar as a major international reserve currency. Instead, it should play a supporting role in the evolution of the international monetary order to a more stable and sustainable set-up, for example, in enabling own-currency settlement by the individual economies.
- China can take the lead in promoting and enabling own currency settlement among East Asian countries and regions by supporting the establishment of a Bank for Intra-Asian Settlements, which will provide services similar to those provided by the Bank for International Settlements to Western European economies in the 1950s to participating East Asian economies.
- A further initiative that China can also lead and promote is real exchange rate coordination among East Asian economies.

Concluding Remarks

- China Development Bank should remain wholly state-owned and focus exclusively on financing projects that are too long-term or too risky or have sufficiently large externalities to be financed by commercial banks.
- China Development Bank should remain a wholesale bank, making use of its quasi-sovereign credit to secure its funding through the issuance of bonds, and should not enter into the ordinary commercial bank business, for example, it should not accept retail deposits.
- Precisely because it does not take retail deposits, it can and should be treated differently from other commercial banks in terms of regulatory requirements.

Concluding Remarks

- And because CDB does not compete with the commercial banks, the Chinese Government should have no problem in guaranteeing the debt of China Development Bank enabling its quasi-sovereign credit rating.
- And given that CDB does not have any retail customers and does not compete with commercial banks, it is also reasonable to consider exempting CDB from income taxes and dividend payments (bear in mind that it is wholly state-owned).

Concluding Remarks

- China Development Bank should enable the availability of long-term (up to 35 years) owner-occupied residential mortgage loans by committing to purchase qualified mortgage loans from commercial banks, using proceeds from long-term bonds issued directly by CDB. This will greatly enhance the affordability of residential housing to the lower income households in China.

Concluding Remarks

- For lending overseas, China Development Bank should try to match the currency of the revenue of the borrower. For example, for an infrastructural project in Brazil, if the potential revenue is in Real, then China Development Bank can make use of its quasi-sovereign credit rating to borrow Real in Brazil, and lend the proceeds to the Brazilian borrower. This enables CDB to match its liabilities with its assets, thus protecting itself from future exchange rate changes, and it will also make it much easier for the borrower to service the debt in Real in the future and greatly reduce the probability of default.