

# Opportunities and Challenges of Renminbi Internationalization

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**Abstract.** Current international situation provides a golden chance for Renminbi Internationalization. China has undertaken some important methods to promote Renminbi Internationalization including the pilot program of international trade settlement, the bilateral currency swap agreements and other uses in financial markets. However, there're still some challenges from both the international conditions and the domestic economy. The objective of this study is to discuss some feasible means to overcome the challenges and to provide a promising future of Renminbi Internationalization.

**Keywords.** Renminbi, internationalization, trade settlements, finance, regionalization

## 1. New Opportunities for Renminbi Internationalization

The world has provided new opportunities for Renminbi to become an international currency in the recent years. The financial crisis in 2008 caused a severe global recession and also changed the global economic structure. Firstly, it has weakened the leading role of developed economies and led to the consequent discrediting of the U.S. and European financial models.

The crisis revealed the underlying problems of the current international monetary system which is characterized with USD as the leading international currency. Problems are caused mainly by the failure of countries experiencing fundamental balance of payments problems to devalue or revalue their currencies as well as being "awash with dollars". The world has called for reform of the monetary system by using various international currencies.

China, the second largest economy and the second largest trading partner in the world, has a promising outlook of the internationalization of Renminbi for several reasons: the large size of economy, the stability of Renminbi, the developing financial market and the network externalities. (Hongyi Chen and Wensheng Peng, 2007) Chinese governments have undertaken some strategic moves to internationalize Renminbi.

Renminbi Internationalization is not only an opportunity for China but also an opportunity for Asian countries and the world. Renminbi Internationalization is a response to the reform of current monetary system to avoid global financial risks for all the countries. Those smaller in economic sizes, with less developed financial markets, or low levels of foreign exchange reserves are willing to hold various currencies. Those with strong trade and investment ties to China can cut down the costs in trading. In conclusion, the current situation provides a golden chance for Renminbi Internationalization.

## 2. The International Use of Renminbi

An international currency is one that is used outside its home country. The classical three functions of money domestically – medium of exchange, store of value and unit of account – can be transferred to the level of international money. (Chinn and Frankel 2005) Based on the previous researches, the international use

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of Renminbi can be divided into two major sectors: international trade settlements and international financial markets.

## 2.1. The Renminbi Use in International Trade Settlements

In the recent years, China has maintained the rapid development in international trade transactions with many other countries. The increasing amount of trade with China grants the facility of using Renminbi in settlements.

The history of Renminbi use in international trade settlements could date back to early 21st century, between China and some Asian countries which are mostly adjacent to China with close trading relations with China. For examples, based on the statistics of Yunnan Province, from 2001 to 2003, the bilateral trades between China and Vietnam, Laos and Myanmar through Yunnan Province have been using Renminbi in settlements. (See Table1)

Table 1 The Percentage of Renminbi Use in Trade Settlements

Country	Import (%)			Export (%)		
	2001	2002	2003	2001	2002	2003
Vietnam	28.33	48.00	51.52	21.81	11.81	10.42
Laos	29.14	37.42	54.59	5.91	3.50	6.18
Myanmar	49.59	59.88	78.65	16.07	12.28	10.7

Source: "Understanding Renminbi Internationalization", Liu Lizhen, XuQiyuan,2003, p142-143,

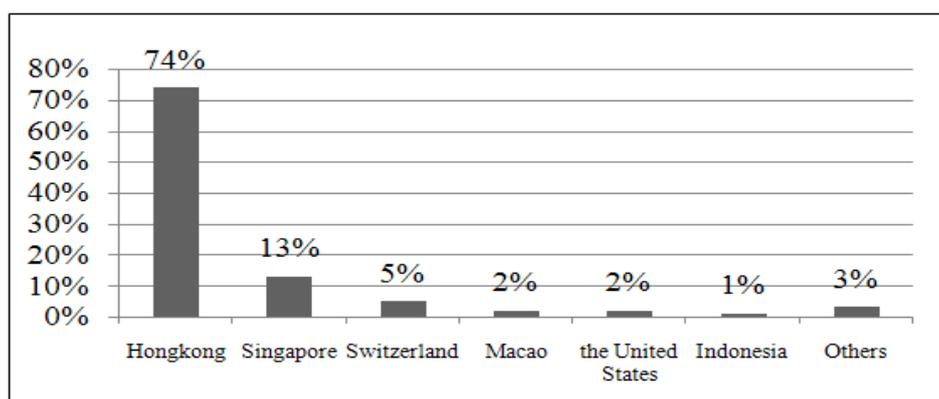
The percentage of Renminbi use in those countries was quite large in import. After almost a decade, it could be predicted that the percentage would be larger than before. Because Renminbi has gained its reputation in surviving from the past financial crisis, these countries should be confident in Renminbi and are willing to hold it as their foreign exchange.

In 2009, Chinese government launched a so-called Pilot Program for Renminbi settlement, starting from Shanghai, Guangzhou, Shenzhen, Zhuhai and Dongguan. Up to the end of 2009, there had been 409 transactions using Renminbi in settlements. The total amount was 3.58 billion Yuan.

Since June 2010, the areas which could conduct the trade settlements with Renminbi, expanded from the five cities to 20 provinces/municipalities. Under the Pilot Program, any foreign trading firm can receive RMB as the settlement currency when it exports to a Chinese enterprise in the pilot region. And if a foreign firm wishes to pay in RMB for imports from China, its Chinese trading partner must be among the designated enterprises in one of the pilot regions. (BBVA research, 2011) The number of companies using Renminbi in trade settlements has increased from 365 companies to 67,724. At the end of 2010, there had been more than 500 billion Yuan conducted in trade settlements, estimated 2% in the total amount of international trade. It was 48 times more than the amount in the previous year.

Even though the use of Renminbi in international trade settlements has a stunning increase within a year, the regions using Renminbi are mostly limited to those geographically close to China, especially East Asia. (See Figure 1)

Figure 1 The Distribution of Renminbi Trading Settlements



Source: "The strategy of Renminbi Internationalization in Renminbi Settlement aboard", Lijing, 2010

The limitation is caused by many reasons. One of the reasons is that the original areas conducting the Renminbi international trade settlements are largely located to south of China. These areas are having intensive business with East Asian areas.(Liu Zhenlin, 2011)Another reason is that the total amount of Renminbi used in trade settlements still remains at a low percentage in some countries. For example, from January to April, 2009, during the trade settlements with Russia, the percentage of USD was about 89%, and the percentage of Renminbi was only about 0.1%. (GuoCuirong and Li Haiyan,2011)Even though the use of Renminbi has made some progress, Renminbi is still to some extent lack of attraction to many countries.

## 2.2. The Renminbi Use in Financial Markets

Hong Kong, the only RMB offshore center, is one of the key for us to understand the development of Renminbi use in financial market. And also, we will focus on the strategic relations or special agreements made with China.

The use of Renminbi in Hong Kong is noticeable.Banks in Hong Kong have started Renminbi transactions since 2004, including deposits, exchange and remittances, transactions of Renminbi bonds. Since then, Renminbi flows in Hong Kong have increased speedily. The deposits of Renminbi have increased 50% from 2004 to 2008. Up to the end of 2009, there have been 40 banks having Renminbi deposits, which are in total 62.7 billion Yuan. At the end of 2010, Renminbi deposits in Hong Kong increased to 314.94 billion Yuan. It's about five times more than the total amount in 2009. The percentage of Renminbi among foreign currencies deposits has continually increased.

China Development Bank launched about 5 billion Yuan bonds in Hong Kong in 2007. In the following two years, China's financial institutions including the Export-Import Bank of China, Bank of China, China Construction Bank and Bank of Communications have sold more than 20 billion Yuan bonds. In 2009, the Bank of East Asia (China) and HSBC (China) launched 5 billion Yuan bonds in Hong Kong. The Ministry of Finance also launched 6 billion national debts in Hong Kong in the same year. In 2010, various institutions have launched 35.86 billion Yuan bonds in Hong Kong, which are about 50% of the grand total circulation of Renminbi bonds since 2007. Except for the banks in mainland China and Hong Kong as the main bodies, the international financial institutions like Asian Development Bank and companies like McDonald's Cooperate also raise funds by launching Renminbi bonds.

Hong Kong plays a primary role in practicing RenminbiInternationalization. Hong Kong has developed a well-operated Renminbi settlements system.It has the most percentage of Renminbi amount abroad and the most various functions of Renminbi. Moreover, using the official data may underestimate the actual size of Renminbi circulation in Hong Kong because there is a significant gap between the flows through bank business and other means of exchange of the Renminbi. (HaihongGao and Yongding Yu, 2009) The circulation could be larger than what we have got here.

Another aspect to understand Renminbi Internationalization is the international monetary cooperation. China and some Asian countries have developed strategic relations for long. In 2000, one of the most significant works is the Chiang Mai Initiative, which provides fundamental agreements on exchanging currencies among China, Japan, Korean and ASEAN. Up to April 2009, Asian countries have reached 26 bilateral currency swap agreements involving 90 billion dollars. China has reached agreements involving 16.5 billion dollars. (See Table 2)

Table 1 Bilateral Currency Swap Agreements under the Framework of CMI (unit: billion USD)

	Japan	South Korea	Indonesia	Malaysia	Philippines	Thailand
China	3.9	4.0	4.0	1.5	2.0	2.0
Total:						16.5

Source: Marahiro Kawai, 2010, "From the Chiang Mai Initiative to an Asian Monetary Fund", <http://www.mof.go.jp/english/index.htm>.

Moreover, China becomes more active since 2008 to accelerate the pace of international monetary cooperation of Renminbi. China has signed agreements with many countries in these three years. (See Table 3)

Table 3 Bilateral Currency Swap Agreements between China and Some Major Countries

Treaty Parties	Time	Monetary Amount	Treaty Parties	Time	Monetary Amount
South Korea	2008	180 billion CNY/0.38 million KRW	Indonesia	2009	100 billion CNY/175 trillion IDR
Hong Kong	2009	200 billion CNY/227 billion HKD	Argentina	2009	70 billion CNY/38 billion ARP
Malaysia	2009	80 billion CNY/40 billion MYR	Iceland	2010	3.5 billion CNY/66 billion ISK
Belarus	2009	20 billion CNY/ 8 trillion RUR	Singapore	2010	150 billion CNY/30 billion SEK

Source: "The strategy of Renminbi Internationalization in Renminbi Settlement abroad", Lijing, 2010

The bilateral currency swap agreements allow the parties of treaties to swap foreign currency with own currency within a certain amount. If more amount of Renminbi being available to exchange with other currencies, it's more efficiency in using it in international transactions.

Another milestone of the development of Renminbi financial market is Renminbi being listed in MICEX in Russian on 15th December, 2010. This is the first time for Renminbi directly being listed and traded abroad.

### 3. Challenges of Renminbi Internationalization

Though Renminbi has a huge potential to become an international currency and the pace of internationalization is speeding up, the international use of Renminbi still remains limited. (See Table 4)

Table 2 the international use of major currencies

Currency	2004	2007	2010
USD	88.0%	85.6%	84.9%
EUR	37.4%	37.0%	39.1%
JPY	20.8%	17.2%	19.0%
GBD	16.5%	14.9%	12.9%
CHF	6%	6.8%	6.4%
HKD	1.8%	2.7%	2.4%
CNY	0.1%	0.5%	0.9%

Note 1 bilateral statistics, 200% in total; Only some currencies are included.

Source: BIS, Triennial Central Bank Survey. Report on global foreign exchange market activity

The world still relies on USD, Euro and Japanese Yen. And Renminbi has a long way to go before it finally achieves its position. The US Dollar is still at the leading position among all the currencies in the world. Even though the percentage of USD uses has declined a little bit, it is still far more beyond other currencies. Euro also plays an important role. But it's facing a serious crisis recently and at the risk to be cancelled. Japanese Yen, as the most international currency in Asia, is a major competitor with Renminbi. Japan is also working on promoting Japanese Yen. Yet it hasn't achieved any significant improvement. The internationalization of Renminbi could provide another alternative for other countries. Also, it could promote the currency cooperation in Asia to some extent.

Moreover, Renminbi Internationalization is facing some internal challenges. Monetary economists agree that three key economic pillars are required to support the internationalization of a currency: the size of an economy and its trade volume; the breadth, depth, and liquidity of its capital markets; and the stability and convertibility of its currency. (Friedrich Wu, 2009) Despite the large GDP, China still remains far behind the other leading economies in average per capita income level. And its economy is still beset by numerous imbalances and risks. Beside, China's capital markets are still at early stage. Renminbi could only be exchanged freely in trades but not in financial market. In international trade settlements, the scale of Renminbi is small and the fees are high. More than 70% of international trade transactions still use USD in settlements. So how to maintain the domestic economy and to decrease the costs and risks of international use of Renminbi is still the key issue for Chinese government to work for.

## 4. Conclusions and Proposals

As the responses to the challenges, there are some measures that could be taken to reduce the barriers in the pace of internationalizing Renminbi. The measures as followed:

### 4.1. The first step of Renminbi Internationalization is to realize regionalization in Asia.

Regionalization should be the first step of Renminbi internationalization which will obtain experiences of practices and build up the reputation. It could start from cooperation between China and South-East Asia, South Asia and North-East Asia. As one of the biggest partners of ASEAN, China has a good relation with ASEAN. There have been some practices of Renminbi in the international transactions for long. It's possible and beneficial to promote better use of Renminbi in transactions between China and ASEAN. Considering the cooperation between China and South Asia, it's a little complicated between China and India. The international trades between China and India are developing slowly because of the political problems. However, the trading amounts have still increased to 6.17 billion dollars in 2010. The other countries in South Asia like Laos, Vietnam and Myanmar always have good trading relations with China. There're a lot of potential for China and South Asia countries to work together. China has adopted some strategies to unclog the path. For example, one of the most important strategies is the "Bridgehead", which is to promote better trade settlements with Renminbi abroad. In addition, working with North-East Asia is also important. We should focus on the relations with Japan and South Korea. China is the biggest trading partner with South Korea and the second big trading partner with Japan. The volumes of international trades between these countries are huge. China has already had monetary cooperation with South Korea and it's going on well. Since Japan and South Korea have similar economic models as Europe and North America, the practice of Renminbi in these two countries would provide reference for the future practice in Europe and North America.

### 4.2. Secondly, another means is to lower the costs and to promote Renminbi's efficiency.

One of the challenges coming from Renminbi itself is low efficiency and high costs. In the short term, China should continue the bilateral or multilateral agreements with other countries and try to cooperate with more countries around the world and larger amount of currencies should be accessible in agreements. In addition, China should continue to encourage other countries to use Renminbi in trade settlements. The goals are to make Renminbi more efficient in the trade settlements and more amount of Renminbi being used abroad. In the long term, China could establish off-shore banks to develop Renminbi transactions and open more Renminbi transactions abroad.

### 4.3. At last, China should make full use of Hong Kong and build up economic cooperation areas with other regions.

To strengthen the connection between Hong Kong and mainland China, Hong Kong, Macau and Pearl River Delta area could work as a cooperation unit. And then China could use Hong Kong, the off-shore financial center to realize the integration of HKU and CNY, which could reduce the trading costs and improve the international competency for both Hong Kong and mainland China. Additionally, China can also work with Japan and South Korea to establish the North-East Asia economic cooperation area. The cooperation area would decrease the obstacles in the use of Renminbi in Japan and South Korea. Also, it will connect the three countries better to realize the integration of economy. The currency policies in these three countries are expected to be mutually beneficial.

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