

RMB internationalization:

Recent Development and headwinds

Alicia Garcia-Herrero

Chief Economist for Emerging Markets, BBVA

Key points

- 1 Why is China pushing to internationalize the RMB?
- 2 Recent development and headwinds?
- 3 Policy Suggestions

1. Why is China pushing to internationalize the RMB?

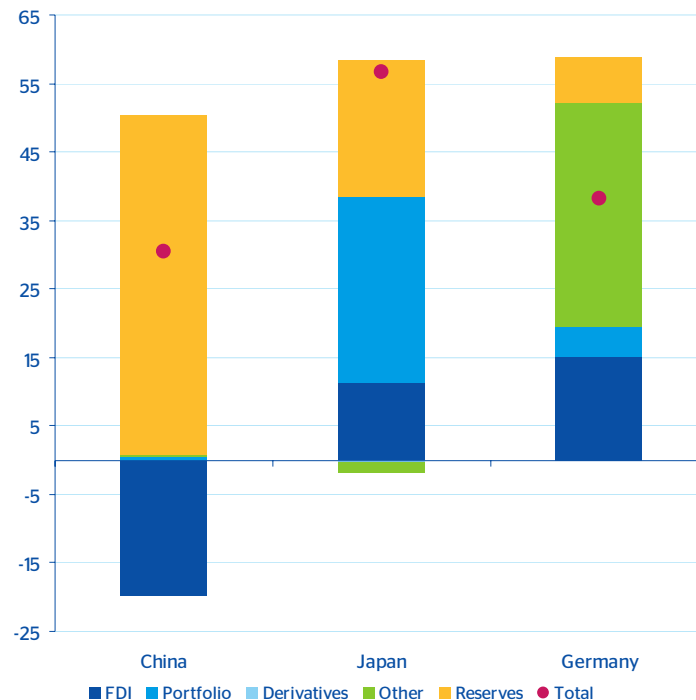
Two possible – and yet opposed - reasons:

- A. The external creditor/diversification story**
- B. Net debtor story (longer term)**

1. Why is China pushing to internationalize the RMB?

A. China as huge external creditor

International Investment Position 2010 (% of GDP)
Source: BBVA Research and IMF



1. Why is China pushing to internationalize the RMB?

With all its external wealth in foreign currency, **diversification needed.**

Two ways

1. Diversifying the currency holdings away from USD and Euro too difficult
2. RENMINBISING China's foreign assets may be easier
 - How much would be enough?
 - Probably more similar to Japan than the US.
 - About 12% of holdings of Japanese debt securities are in yen vs 90% for US ones in USD
 - Still China has a long way to go: starting basically from 0%!

1. Why is China pushing to internationalize the RMB?

B. China becoming a net debtor

Why should China become a net debtor?

1. Aging and increasing pension/health costs
2. Potential costs of a bank bailout in the event of a hard landing (stemming from the accumulation on loans to LGFVs/developers/etc)

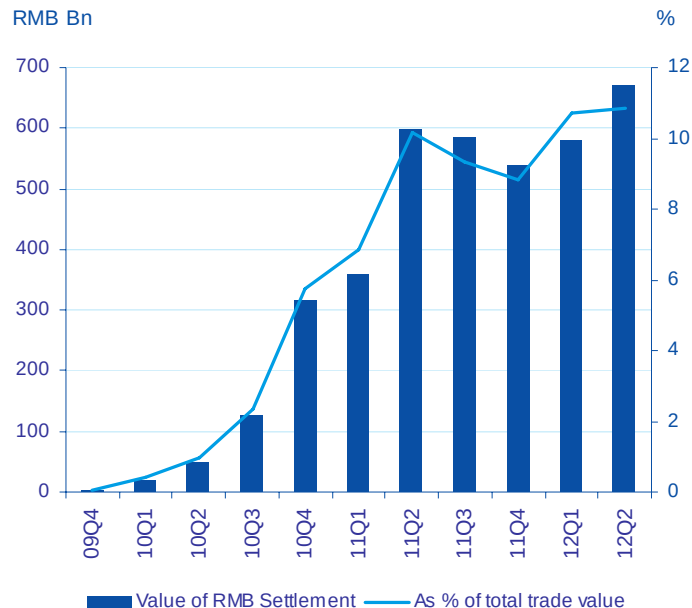
China interested in accessing the “exorbitant privilege of having a reserve currency” to finance its growing debt

2. Recent development and headwinds

- From the pilot program to full coverage
- The trade value settled in RMB settlement increased rapid (0.04% of total trade value in 2009 to 8.9% in 2011)
- The international acceptance of RMB are on rise.

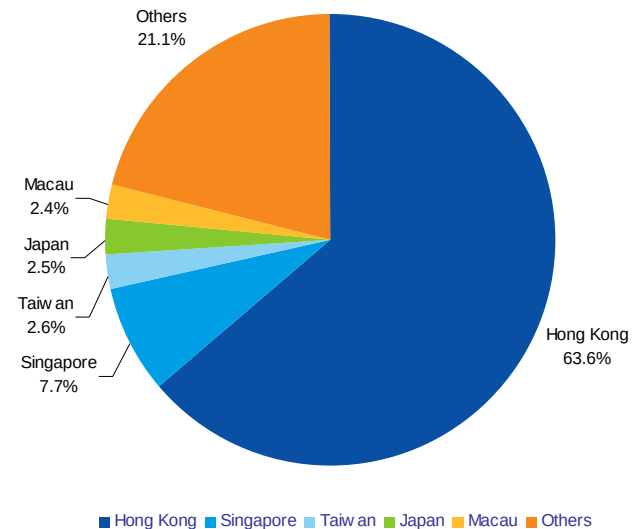
RMB settled trades accounted for 8.9% of total trades in 2011

Source: HKMA, CEIC and BBVA Research



The geographical distribution of RMB settled trades

Source: PBoC and BBVA Research



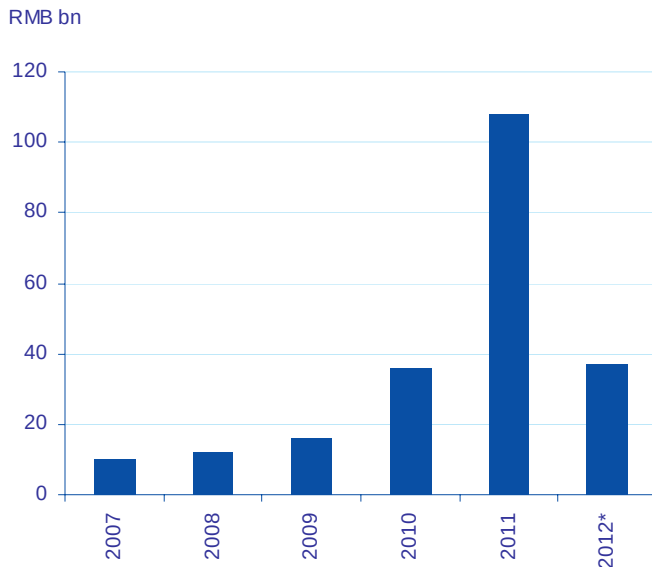
2. Recent development and headwinds

The offshore RMB business continue to expand

- The Dim Sum Bond market
- Other forms of RMB asset
- Asset less than liability (deposit)

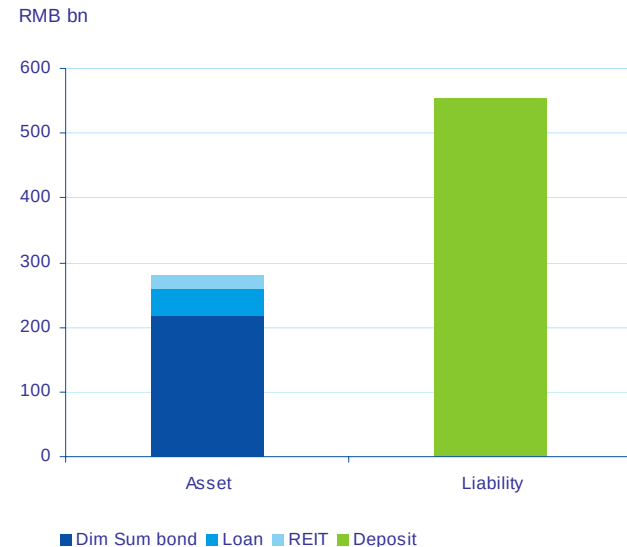
Dim Sum bond issuance

Source: HKMA, CEIC and BBVA Research



Offshore RMB asset and liability

Source: Bloomberg and BBVA Research



2. Recent development and headwinds

- The rise of other offshore RMB centers
- Hong Kong can't absorb global demand for RMB
- Risk to financial stability (bank liquidity and currency mismatches)
 - Development of onshore market crucial
 - Meanwhile development of other offshore centers also relevant

Possible choices and relationship with Hong Kong

- Singapore (direct competition with Hong Kong?)
- London (Business hub?)
- Taipei (Service its own demand?)
- New York

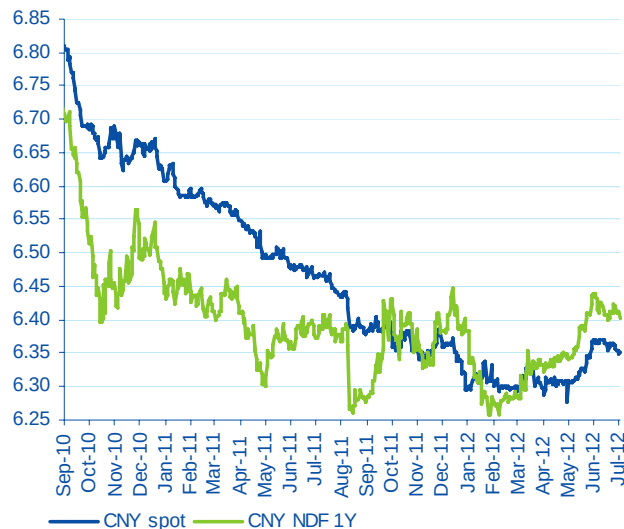
2. Recent development and headwinds

Headwinds against RMB internationalization emerged as appreciation expectation dampened

- The RMB appreciation trend halted amidst the intensification of European debt crisis
- Offshore Deposit stagnated recently

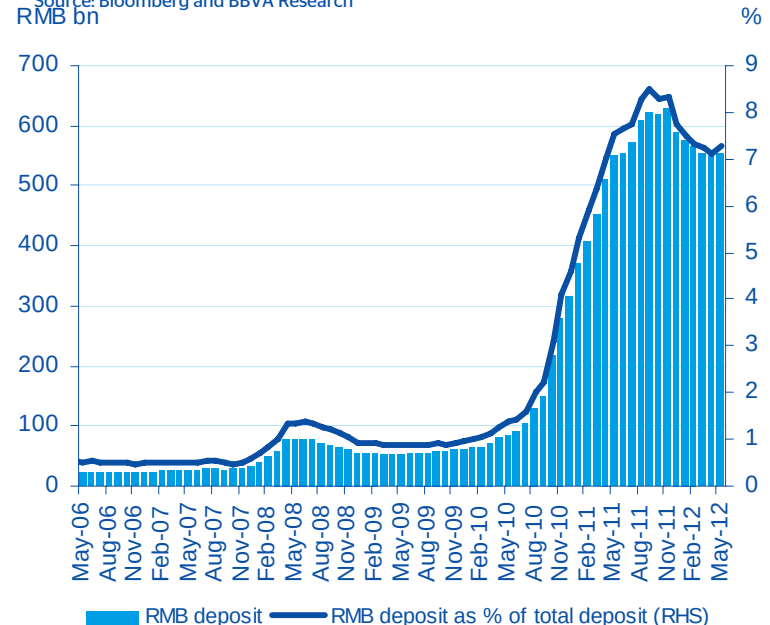
The appreciation expectation of RMB weakened

Source: HKMA, CEIC and BBVA Research



RMB deposit in Hong Kong rose rapidly last year but slowed from Q3 2011

Source: Bloomberg and BBVA Research



3. Policy Suggestions

- The internationalization of RMB is still a policy driven one
- China's authorities' policy initiatives
 - Expansion of the pilot program
 - Swap lines and direct trading with other currencies
 - Limited liberalization of capital account: RQFII, RMB FDI,
- Easing of Hong Kong's policy regulation
 - Liquidity limits: relaxation of RMB Net open position and liquidity ratio
 - Utilization of Swap line to provide RMB liquidity

3. Policy Suggestions

- Preferential treatment for using the RMB as an invoicing currency in cross-border trade transactions and investment
- Direct trading of RMB against other currencies, especially with ASEAN trading partners, South Korea and Taiwan.
- Further develop the RMB market in Hong Kong and expand the pool of offshore RMB liquidity.
- Broaden RMB investment channels.
- Develop offshore Dim Sum Bond market by introducing RQDII

RMB internationalization:

Recent Development and headwinds

Comments welcome

Alicia Garcia-Herrero (alicia.garcia-herrero@bbva.com)