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### BIG ISSUE DEBATE

## Stay calm: internationalise the RMB

**Each new step in the internationalisation of the renminbi is leading to a redoubling of interest in the currency.**

Today's Big Issue Debate (BIG) on the renminbi (RMB) could not be more timely: what better time than the month in which SWIFT's RMB tracker revealed the currency had entered the top four of world payment currencies by value, and a week to the day since the launch of the much-heralded China International Payments System (CIPS)?

The internationalisation of RMB has been described as the most significant financial market development since the formation of the euro. If the media interest in the currency is anything to go by, it will be significantly more important, as the Chinese currency's ascent has, if anything, been even more closely followed than the European currency's debut. Each SWIFT RMB tracker release leads to acres of print coverage, not only in Asia, but all around the world.

The Sibos edition RMB Tracker showed that in reaching the top four of world payment currencies by value in August 2015, the RMB had not only overtaken the Japanese yen, but also reached a record high share of 2.79% in global payments. The Japanese yen is now trailing the RMB 2.76% to 2.79% so the gap between currencies is minor; the volatility in the Chinese market in August likely played a significant role in its increased usage.

Even so, the RMB has further established itself as the dominant currency for trade finance behind the USD, and has become the number one currency for Asia Pacific intra-regional payments with China and Hong Kong. The use of additional offshore clearing centres outside of Hong Kong – all of them vying for an important role in RMB clearing – has played a key role in driving RMB adoption, with most showing impressive growth in volume.



Andrew Sheng, distinguished fellow, Asia Global Institute

### Seven engines

Ever since the People's Bank of China (PBOC) introduced a series of policy measures in 2009 to facilitate the expansion of the nascent RMB offshore market and to overcome the constraints of the currency's limited convertibility, excitement around its internationalisation has been tangible. Today's debate will discuss just how fast this game-changer is upon us.

The PBOC has shown strong commitment to its 2009 policy by applying a "seven engines" approach: expanding currency swap contract coverage and amounts; launching new offshore RMB clearing centres; establishing more free trade zones;

further liberalising of capital account items; introducing new RMB investment schemes; setting up new multinational financial institutions, and widening RMB trading bands.

Full internationalisation of the RMB however requires the currency to be fully liberalised and convertible – the ongoing efforts towards which have been hindered by recent volatility in Chinese equities. Views are mixed on the impact this will have.

"Progress on planned reforms will likely be delayed, but the Shenzhen-Hong Kong Stock Connect (SZHK) link and the increase in Qualified Foreign Institutional Investor (QFII)/Renminbi Qualified Foreign Institutional Investor (RQFII) quotas will push forward with haste," says Aaron Boesky, CEO of

China A share specialists Marco Polo Pure Fund Management.

"China is amongst the top three countries for most of our multinational clients. Irrespective of a slowdown, that picture is unlikely to change. We will continue to see adoption of RMB as a trade and treasury currency," says Amol Gupte, region head for treasury and trade solutions, Asia Pacific, Citi, also speaking today. "The speed of adoption could go up or down a little, but the fundamental direction stays intact."

### Ongoing reforms

In terms of its currency regime or management framework, the PBOC recently switched the RMB from its former dollar peg to a managed float. This is a step closer to free market exchange and a move that was welcomed by the US Treasury Department and the International Monetary Fund (IMF).

The move towards a market-oriented direction for daily fixing should help increase the chances of the RMB's inclusion in the IMF's Special Drawing Rights (SDR) basket. Whilst the SDR is a notional currency and accounting unit, its inclusion in the basket would serve as an official endorsement of the RMB's progress. But China's ambitions in this direction witnessed a recent setback. Shortly after the move to a managed float, the IMF pushed back until September 2016 its decision on whether the RMB would be included in its basket of reserve currencies. It is possible that the delay has been made to allow China more time to comply more fully with IMF requirements and implement more reforms towards making the RMB fully exchangeable.

What is likely to happen next in the journey? Firstly, say observers, an expansion of the Qualified Domestic Institutional Investor (QDII) quota, which will allow Chinese mutual funds to issue products linked to foreign assets. Secondly, its sequel, dubbed "QDII2", which will allow Chinese households to invest in overseas securities and physical assets. A pilot scheme is understood to be close to launch across six cities in China.

There is probably going to be further growth of the QFII and RQFII quotas as well, which allow for more foreign participation in China's stock and bond markets. Also en route are the SZHK, following the

success of the link between the Hong Kong and Shanghai bourses, and implementation of a mutual fund recognition agreement, which will allow eligible mutual funds from China and Hong Kong to be sold in both markets.

### CIPS and beyond

The PBOC launch last week of the cross-border payment CIPS system is widely heralded as one of the most critical steps in RMB internationalisation – not least as it is set to further facilitate clearing transactions, boost liquidity, cut transaction costs and reduce processing times.

The CIPS will be used to support cross-border goods and services trade settlement, direct investment, as well as financing and individual fund transfers, according to the PBOC's announcement. A total of 19 banks have been selected to participate in the system, including eight Chinese subsidiaries of foreign banks.

Reporting on the news, Reuters said the new system will "put the yuan on a more even footing with other major global currencies like the dollar, helping to promote the currency in global trade and raising global profile of the yuan". All this just as the IMF continues to ponder whether to grant RMB elite status as a reserve currency, alongside the dollar, sterling, euro and yen.

"Will current turmoil in the A share market disrupt the internationalisation of the RMB?" asks Andrew Sheng, distinguished fellow of the Asia Global Institute and one of the panellists in today's BIG. Tantalisingly, he doesn't answer: "It's a question that will impact not only on international currency markets, but which is already putting huge pressure on global financial markets." ■