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Internationalizing the RMB: Pros and Cons

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Presentation



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Internationalizing the RMB: Pros and Cons

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What Is the RMB Internationalization

- The renminbi (RMB) internationalization here refers to the process that the RMB becomes an invoice, settlement and reserve currency in international economic and financial transactions.

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Why Some Chinese Economists Support the RMB Internationalization (Pros)

- The current financial crisis can be viewed as an opportunity
- China needs a financial position proportionate to its economic power
- Domestic market-oriented reform can be deepened
- The financial cooperation in Asia has stagnated
- The global monetary system could be more balanced
- The process of the RMB internationalization has already begun
- China's financial system has been improved smoothly

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Pros: 1. Opportunities

- The developed world has suffered because of the financial crisis
- A multi-polar monetary system becomes more necessary than ever
- China's economic influence has elevated significantly
- China can make contribution to the necessary reform of the global monetary system

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Pros: 2. Changing Economic Status

- China's GDP based on market exchange rate accounts for 10% of the world total in 2011
- China's exports and imports account for 12% and 10% of the world total respectively in 2011
- China's trade dependence is around 60% in 2011
- 90% of China's trade are invoiced and settled in USD
- The share of the RMB as a reserve currency is nearly zero

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Estimates of China's Economic Output in the Future

- In market exchange rate China has become the second biggest economy in the world in 2010
- In PPP China will probably surpass the U.S. in 2020 and become the largest economy in the world
(Justin Lin, 2009)
- In PPP China will exceed the U.S. in 2015 and become the largest economy in the world
(Angus Maddison, 2009)

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Pros: 3. A Driving Force for China's Domestic Reform

- Making the exchange rate policy more flexible
- Establishing a market-based interest rate setting mechanism step by step
- Accelerating the pace to make the RMB fully convertible
- Engaging in financial liberalization in order to expand its financial market size
- Improving financial regulation

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Pros: 4. Limited Progresses Resulted from Asian Financial Cooperation

- Lack of political trust among the Asian big economies
- Negative reaction of the US towards Asian financial cooperation (AMF)
- Reluctance for most Asian countries to concede the monetary sovereignty
- Difficulties in allocating weights to various economies with contrasting economic size and growth momentum
- Low expectation of the Asian economies for monetary cooperation: Rapidly increased foreign exchange reserves since the Asian financial crisis
- Bitter lessons from the debt crisis in the Eurozone

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Pros: 5. An Internationalized RMB Could Be Conducive to Global Financial Stability

- Providing a new investment tool
- Constraining the global dominant currency from acting irresponsibly
- Incorporating the RMB into the SDR reserve basket
- Strengthening financial collaboration in Asia

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Pros: 6. Growing Acceptance of the RMB in Asia

- The RMB has already circulated in HK and other neighboring economies
- The RMB saving accounts are available in Chinese Taiwan, Bangladesh, Malaysia, Indonesia, the Philippines, Singapore and Korea
- China's central bank has signed currency swap agreements with the financial authorities of Korea, HK, Belarus, Malaysia, Argentina, Indonesia, etc.
- Some Asian economies have more or less used the RMB as an invisible currency anchor (e.g., Malaysia)
- China has greatly enlarged the use of the RMB in the cross-border trade

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Pros: 7: Substantial Improvements Made in China's Financial System

- Meeting the requirements of capital adequacy by Chinese commercial banks
- Low non-performing loans
- Introduction of QFII and QDII
- More flexible and sizable treasury bonds market as well as stock markets
- Sound budgetary position
- Huge foreign exchange reserves (maybe too much)

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Why Some Chinese Economists Oppose the RMB Internationalization (Cons)

- Conditions are far from mature
- It runs in the opposite direction with regional cooperation
- The experiences of the Yen internationalization are not supportive
- It may probably give rise to some unfavorable consequences

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Cons: 1. Premature Conditions

- China's economic aggregate is not big enough compared to the U.S. and the EU
- There are many obstacles that may hinder China's long-term growth
- China has a long way to go to entirely open up its capital account
- It remains unknown when China will establish a market-based exchange rate regime
- It will take decades to substantially narrow the gap between China and the developed economies in terms of financial sophistication and size
- The Financial regulation and macro monetary management are not perfect

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Cons: 2. Incompatible with Regional Cooperation

- Regional cooperation becomes trendy in today's world
- Only a united Asia can survive the fierce competition and eventually turn to be the third pillar of the future tri-polar world
- The successful experiences of the Euro provide Asia with a good roadmap
- The Asian peoples are smart enough to find a win-win way to collaborate financially
- Asian financial cooperation has already made headways in many ways

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Asian Financial Cooperation

- Asian Currency Unit (ACU)
- Asian Bond Fund (ABF)
- Chiang Mai Initiative (CMI)
- Reserve Pool
- Various discussions regarding exchange rate regimes
- Potential Asian Monetary Fund (AMF)
- An ultimate goal: An Asian single currency (ASIRO?)

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Cons: 3. Unsuccessful Efforts of the Yen Internationalization

- High level of the dollarization in Asia
- Japan's huge trade surplus with its trade partners
- Dramatic fluctuation of exchange rate between the yen and the dollar
- Backlash from the US

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Cons: 4. Unwanted Aftermath Caused by the RMB Internationalization

- Triffin Dilemma
- Trilemma: exchange rate, capital movement, independent monetary policy
- Counteraction resulted from the domestic vested interest groups
- More fluctuation in exchange rate and assets prices
- Long-term pressure on the RMB to appreciate due to increasing demand
- Potential social-political instability generated by much more exposure of financial sector

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A Possible Tri-polar International Currency System in 2010-2030

- The USD will remain as the most important key currency
- The EURO will play a bigger role despite of the European sovereign debt crisis
- An Asian united currency or one of the Asian economies' currency would become a key currency? The RMB?

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Thank You

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