

Internationalization of the Renminbi: Opportunities for China and the World

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Internationalization of the Renminbi:



Chinese Financial Services Internationalization



Motivation

“The UK is doing its utmost to keep the city at the forefront of global financial innovation and is clearly making a big effort to get the offshore renminbi market off the ground,...”

“The UK government’s sovereign renminbi bond issue (2 billion three-year RMB bonds, 2.9% yields), the first by a western country, has been a great success ...”

– Chancellor of UK, George Osborne

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“...the essential problem of the international monetary system is the contingent provision of liquidity in times of crisis and the demand for insurance...”

– Emmanuel Farhi, Pierre-Olivier Gourinchas, and Hélène Rey, 2011

Benefits of an International Currency

Papaioannou and Portes (2008); Cohen (2011);

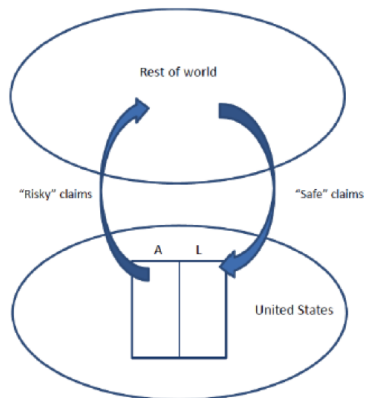
- ▶ Reduced transaction costs
- ▶ Macroeconomic flexibility
- ▶ Reputation
- ▶ “Exorbitant privilege”
 - ▶ Liquidity premium
 - ▶ Risk premium

Liquidity Premium

Also known as “liquidity discount”: issuer of international currency (especially the US government) pays lower bond yield because of high demand and turnover (Portes and Rey, 1998; Rogoff and Tashiro, 2014)

- ▶ Portes and Rey (1998) estimate that this effect amounts to \$5-10 billion (or 25-50 bps on an outstanding stock of 2,000 billion USD) per year
- ▶ Krishnamurthy and Vissing-Jorgensen (2007) estimate 19-55 bps effect

Return Differentials



Source: Shin (2014)

Case of "Dollar is our currency but your problem"?

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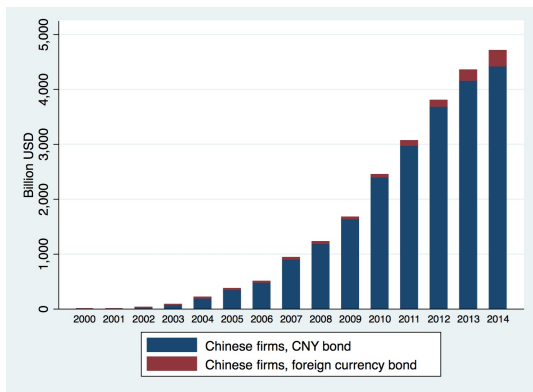
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- ▶ The real and financial risks taken by Chinese firm dollar bond issuances: firm value, performance and financial intermediation.

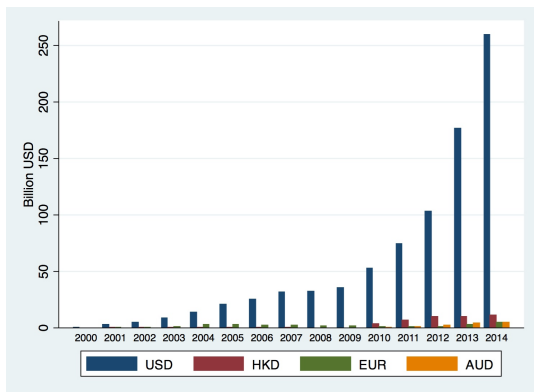
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- ▶ The real and financial risks taken by Chinese firm dollar bond issuances: firm value, performance and financial intermediation.
- ▶ We also study the channels of the real and financial risks of dollar bond issuances across firms by corporate governance, investment rating and foreign exposure.

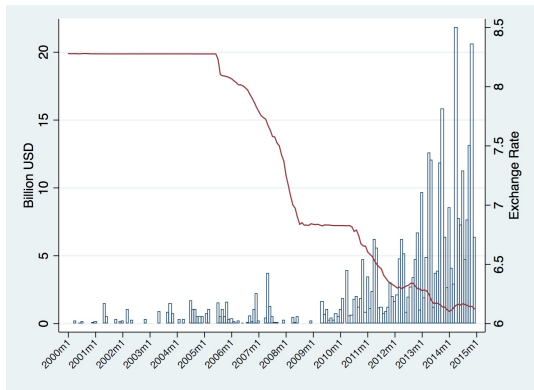
Chinese Firms Bond Outstanding by Currency



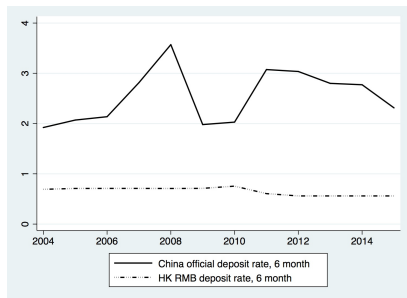
Foreign Currency Bond Outstanding



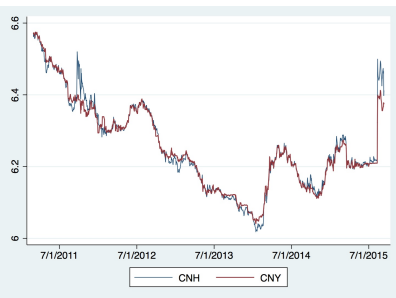
USD Bond Issuance and Exchange Rate



Does Exchange Rate Matter? Two-way Game



Interest Rate Differentials



Onshore/offshore exchange rate

Source: PBOC, HKMA and Datastream.

Real and Financial Risks of Global Dollar Liquidity

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- ▶ The carry trade, measured by interest rate differentials and expectations of RMB appreciation, is positively correlated with dollar bond issuance.
- ▶ Dollar bond issuances are negatively related to firm value and firm performance.
- ▶ For non-financial firms, there is a positive correlation between inter-firm loans and dollar bond issuance, which indicates the role of financial intermediation as predicted by Shin and Zhao(2013).
- ▶ Firms with weaker corporate governance, no investment grade rating and no foreign cash flow tend to have lower firm value and performance and increase inter-firm loans, the proxy of the financial intermediation.

Policy Implications

Firms in a financially repressed environment (such as China) use international bond issuances to raise funds....

....but this is a risky game. Chinese firms that issue dollar bonds and are characterised by weaker corporate governance and lower ratings tend to have lower firm value and performance.

They also tend to extend more (inter-firm) loans, sparking potentially inefficient credit growth and introducing financial fragilities.

Reconsider the real and financial risks of dollar bond issuers while encouraging domestic financial market development.

Looking Forward: Conditions of International Currency Status

Portes and Rey (1998); Flandreau and Jobst (2005); Chinn and Frankel (2007); Dobson and Masson (2009); ...

- ▶ Large share in international output and world trade
- ▶ Macro management
 - ▶ Fiscal capacity (Farhi, Gourinchas and Rey, 2011; Obstfeld, 2013)
 - ▶ Low and stable inflation
- ▶ Deep and well developed financial markets
- ▶ Financial stability (Goldberg et al., 2014)

Thank You
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