

Joachim Nagel: The internationalisation of the renminbi

Speech by Dr Joachim Nagel, Member of the Executive Board of the Deutsche Bundesbank, at the Chamber of Industry and Commerce (IHK) Conference on the “Internationalisation of the Renminbi – Opportunities for Frankfurt”, Frankfurt am Main, 3 July 2013.

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1 Welcome

Dear Dr Raettig,

Dear Ambassador Shi,

Dear Minister Rentsch,

Dear Dr Schuknecht,

Dear Mr Ji,

Ladies and gentlemen

First of all, I would like to thank you for inviting me to speak at today’s conference on the “Internationalisation of the Renminbi – Opportunities for Frankfurt”. I am pleased to have this opportunity to discuss the internationalisation of one of the most interesting currencies at present.

Since its accession to the World Trade Organisation in 2001, China’s GDP has been growing at an average rate of 10% each year. At the same time, China has hugely expanded its volume of foreign trade, overtaking Germany in 2009 as the world’s foremost exporter. Thanks to its continued current account surpluses, the People’s Republic of China has accumulated the largest foreign currency reserves in the world at USD 3.4 trillion. The country’s sheer economic size and its manifold trade relationships all over the world, as well as the appeal of participating in its fascinating growth, awaken a desire to invest in China and in its currency.

A survey among reserve managers revealed that 14% of respondents have already invested in the renminbi. Of those surveyed, 37% indicated that they were considering investing in the currency in the next 5 to 10 years.¹ Given the growing significance of non-traditional reserve currencies, there is certainly a demand for renminbi as an investment currency.

All of us, whether we are representatives from industry or politics, private or institutional investors, have become intrigued by this remarkable process. The development of the currency reminds many of us perhaps of Germany’s economic miracle, but of course on a much smaller scale. In the early 1950s, Germany experienced an unprecedented economic upturn, which led it to accumulate a large volume of foreign exchange reserves and eventually bestowed upon the Deutsche Mark the status of a global investment and reserve currency. The renminbi is certain to have similar long-term prospects if market access is liberalised further.

2 The internationalisation of the renminbi

The further opening of the Chinese market is therefore one of the central objectives of the government’s current five-year plan. Its goals include promoting foreign direct investment in renminbi, supporting domestic banks in issuing renminbi-denominated loans outside of China

¹ RBS (2013), RBS Reserve Management Trends 2012, Central Banking Publications.

and facilitating the gradual development of cross-border renminbi settlement for private investors.

Additionally, Hong Kong's role as a renminbi offshore centre has been further bolstered. Already, over 10,000 banks worldwide are offering their customers the opportunity to settle transactions in renminbi, a remarkable increase from just over 900 banks in June 2011.²

Although international use of renminbi – approximately 0.69% of all transactions worldwide are currently settled in renminbi³ – does not reflect China's economic prowess at present, with its increasing convertibility, the currency has the potential to become one of the future global reserve currencies.

Cross-border use of a currency depends on many factors, one significant factor being the size of the economy, both in terms of gross domestic product and trading activities. It is also essential that investors have confidence in the monetary and fiscal policy of the economy in question, as well as its legal framework. Moreover, the breadth, depth and liquidity of the domestic financial market play a decisive role.

Reserve currencies usually undergo a multi-stage internationalisation process, starting as a trading currency, developing into an investment currency and finally becoming a reserve currency. These stages were also evident in the development of the Deutsche Mark.

The introduction of the Deutsche Mark in 1948 set the stage for the rapid recovery of the German economy after the Second World War; this was followed by Germany's "Wirtschaftswunder" in the 1950s and 1960s. With the introduction of the Bretton Woods system, the Deutsche Mark's exchange rate was pegged to the US dollar. In this system of fixed exchange rates, Germany's frequent current account surpluses manifested in growing gold and foreign currency reserves at the Deutsche Bundesbank.

What stage is the renminbi at now?

The renminbi is a fundamental factor in China's economic development and plays an important role in the Chinese boom. In 1994, China decided to peg its currency to the US dollar. By fixing the exchange rate, China bolstered its export-driven growth strategy. In July 2005, the People's Bank of China moved away from the dollar peg and fixed the renminbi's exchange rate to a trade-weighted currency basket. The widening of the fluctuation range in April 2012 from +/-0.5% to +/-1% further advanced the process of liberalising the exchange rate. Despite the global financial crisis, China's real economy continued to grow strongly even after 2008. And since 2009 in particular, China's continued high current account surpluses have led to a further expansion in its foreign currency reserves.

Summing up at this stage, it is clear that the internationalisation process of the Chinese currency is taking place more gradually than was the case with the Deutsche Mark, which, at times, was subject to radical upheaval, such as the collapse of the Bretton Woods system and the EMS crisis in the early 1990s.

Although the US dollar has been the most commonly used currency for China's trade up to now, use of the renminbi has increased a great deal over the last few years. Between 2010 and 2012, the percentage of trading transactions settled in renminbi has jumped from virtually zero to around 12%, and is likely to increase further.⁴ As a result of the currency's

² HSBC Global Research, The rise of the Redback II (März 2013).

³ SWIFT RMB Tracker (Mai 2013): Abrufbar unter: http://www.swift.com/products_services/renminbi_reports.

⁴ SWIFT (2013): The complicated Path of RMB Internationalisation, abrufbar unter: <http://www.swiftinstitute.org/newsletters/the-complicated-path-of-rmb-internationalisation>.

growing use in foreign trade, international renminbi deposits in Hong Kong have also increased considerably to over 670 billion renminbi (approximately EUR 83 billion).⁵

To come back to my question at what stage is the renminbi now? We can ascertain that the renminbi has already achieved the first step and become a trading currency. Because of the capital controls still in place, the renminbi is currently in transition from being a pure trading currency to being an investment currency. While both inward and outward direct investment is now possible, portfolio investments will continue to be regulated. Nonetheless, China intends to further develop existing initiatives in this area.

What opportunities will be opened up to China and the renminbi by having an offshore market, which clearly sets the renminbi apart from other freely tradable currencies?

The Chinese government established the offshore renminbi market to expedite the transition from being a currency purely intended for trading to an investment currency. By taking this roundabout approach, China is able to establish its currency internationally and protect its domestic financial system at the same time, until the government deems the capital market to have sufficient breadth and depth for a complete liberalisation. From demand side, China's growing economic importance and its manifold trade and investment relationships has led to a steadily growing need around the world for renminbi transactions. Due to the capital controls still in place, the only opportunity to participate in the internationalisation of the renminbi is via the offshore market.

3 Offshore centres: opportunities for Frankfurt as a financial centre

In the past, the internationalisation of major currencies always coincided with the growth of a country's economic power. In the 19th century, between 60% and 90% of international trade was conducted in British pounds. After the Second World War, the US dollar overtook the pound as the most important investment and reserve currency. In 1999, the euro followed in the footsteps of European currencies and with that the Deutsche Mark. Today, the euro is the second most important investment and reserve currency after the dollar.

Given China's growing economic importance, the internationalisation of the renminbi seems long overdue. The Chinese government has been actively promoting this process since 2009. The unique separation of the onshore and offshore currency market, in particular, will facilitate the transition from a currency purely intended for trade to an investment, and potentially, a reserve currency.

The Chinese government chose Hong Kong as the first offshore centre but limited the volume of liquidity allocated to the market. Almost 80% of offshore renminbi trade is currently settled in Hong Kong.⁶ Based on the positive experience to date, China plans to extend the currency's offshore market.

After the positive experiences with Hong Kong, other financial centres are now becoming more important for the renminbi, too. Since July 2012, around 4% of renminbi trade has been conducted both in London and in Singapore.⁷ Singapore and Taipei have both been strengthened by the appointment of a Chinese commercial bank as a clearing bank for renminbi transactions in their respective financial centres. Frankfurt, too, is trying to establish itself as a renminbi trading centre in Europe. The Bundesbank welcomes all these initiatives and sees them as a step in the right direction, towards the free movement of capital. The

⁵ HKMA (2013): Monthly Statistical Bulletin (June 2013 – Issue No. 226), abrufbar unter: <http://www.hkma.gov.hk/eng/market-data-and-statistics/monthly-statistical-bulletin/table.shtml>.

⁶ SWIFT Value Analyser (Oktober 2012).

⁷ SWIFT Value Analyser (Oktober 2012).

high level of interaction between China's and Germany's real economies highlights the necessity for a more active renminbi trade, perhaps even using Germany as a hub.

I would like to conclude with this ideas and I look forward to discussing with you the potential in and for Frankfurt as a financial centre for renminbi, and perhaps at the end of our discussion, we will be able to answer the question together as to what opportunities this may hold for Frankfurt.

Thank you very much for your attention.