Zeti Akhtar Aziz: Renminbi and China's global future

Keynote address by Dr Zeti Akhtar Aziz, Governor of the Central Bank of Malaysia (Bank Negara Malaysia), at the HSBC Reminbi Forum "Renminbi and China's Global Future", Kuala Lumpur, 17 August 2015.

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The increasing role of the renminbi in the global financial system from a trade currency to an investment currency and now its potential role as a global reserve currency will have significant global implications. I am delighted to be here this morning to speak at this Renminbi Forum. The renminbi sphere has indeed extended beyond the Asian region, extending to other continents, to Europe, Latin America and the Middle East. The renminbi is no longer an Asian story, but it has now become a global story. It reflects China's importance and influence in the changing contour of the global economic and financial landscape, and the steps that have been taken to enhance its international role.

My remarks today will focus on the increasing trend of the internationalisation of the renminbi despite the recent challenges faced in the Chinese economy; the implications of this trend to the region and finally on the steps that Malaysia has taken as the region transitions into this environment.

Long-term prospects for the Chinese economy and the renminbi

After decades of rapid growth, the Chinese economy is now transitioning to a growth path that is more sustainable. It is important to recognise that the moderation in the Chinese economy has been in part, policy-driven, through conscious reforms to restructure the economy to become more balanced and domestic demand-centric. These economic reforms have been accompanied by financial and exchange rate reforms, geared towards modernising the economy and financial system that is increasingly more integrated with the global economy. These reforms are mutually reinforcing as the transformation of the structure of the Chinese economy is necessary to support its integration with the world economy and the international financial system.

The commitment to these reforms is crucial in securing the long-term growth prospects for China, even as the Chinese economy faces short-term challenges in the recent period. The recent one-off adjustment of the renminbi reflects a conscious effort by China to align the renminbi to a market-driven mechanism as a part of a crucial reform to allow the renminbi to reflect financial market developments and economic fundamentals. In an environment of continued weakness in global trade, these short-term challenges include managing the ongoing corrections in the real estate sector, leverage in the financial system and more recently, the volatility in the stock market. While these uncertainties may generate concerns over the renminbi in the near term, it needs to be recognised that the long-term growth prospects for China remain intact, and that this will continue to strengthen the foundations that will support the transition of the renminbi as an international reserve currency. China has a high rate of savings, healthy external position, an inherent competitive mass manufacturing advantage and a large educated workforce to sustain its long-term potential economic growth.

Importantly, the narrative of the global future of China cannot be explained in isolation – it is part of a broader account of the growing importance and greater integration of Asia, and the stronger interlinkages with other emerging economies in the global economic landscape. China and the region are becoming more than just global exporters. The increased efforts are seen in the steps to develop more extensive investment and financial linkages in the region as well as the rest of the world through key strategic initiatives such as the One Belt One Road initiative, the Asian Infrastructure Investment Bank and the New Development Bank. Reflecting its expanding role in the global economy and the international financial system, the renminbi will assume greater strategic importance in facilitating the development of these new investment and financial linkages, including meeting the greater demand for infrastructure spending. This is also reinforced by the transition of Asia from a global producer to a global consumer thus becoming an important driver of growth in the world economy.

The rise of the renminbi is often associated with expectations of rapid capital account liberalisation. In this regard, the historical experience of the major currencies over the recent fifty years holds important lessons for the renminbi. Many advanced economies continued to retain significant capital account restrictions until early 1980s, later than the internationalisation process of their currencies that began in earlier decades. Such evidence suggests that the transition of the renminbi as an international currency can commence with the gradual and sequential liberalisation of the capital account. China's position on a 'managed convertibility' approach instead of the traditional 'fully or freely convertible' can therefore be appreciated given the lessons from the Global Financial Crisis and the risks associated with volatile capital flows even for such a large emerging economy like China. It is important to note that China has made significant progress in this area. This is even acknowledged by the IMF in its recent reports as they note that China has already achieved full or partial convertibility in 35 out of 40 items under the capital account.

The rise of the renminbi and its implications

While the path for the renminbi to be a fully international currency will remain gradual, the renminbi has already achieved significant milestones. It is now the second most used currency globally for trade finance and the fifth most used currency for global payments. One-quarter of China's total trade is now invoiced in renminbi, and this is expected to double within the next five years. By some accounts, more than sixty central banks around the world already hold renminbi in their official reserves.

The rise of the renminbi as an international currency would facilitate trade, investment and financial activities that are commensurate with the continued growing importance of China in the global landscape. Of significance to the Asian region, the rising importance of the renminbi will reinforce the trend towards greater regional financial and economic integration. China is already the main trading partner for most economies in the region. The increased usage of the renminbi and the more developed regional financial markets for the renminbi provides an opportunity to recycle savings within the region and thus support the increased intra-regional investment activities. More renminbi-based trade within the region will create pools of renminbi liquidity which would create a demand for instruments which would in turn spur the development of more efficient and integrated renminbi capital markets in the region that can contribute towards better intermediation between the surplus and deficit units in the region.

In addition, the renminbi can be a source of stability for the global monetary system. The increasing use and recognition of the renminbi as an international reserve asset will strengthen the foundations of the current global monetary system that is currently reliant on too few major currencies. With the increased economic and financial interconnectivity in the world today and the greater potential for international policy spillovers, a more multipolar global monetary system with more diverse sources of global liquidity would contribute towards a more stable international financial system.

Looking ahead, these developments present tremendous opportunities for the private sector. Indeed, trade invoicing in renminbi has already begun to spread beyond predominantly Chinese enterprises to multinational companies (MNCs) turning to China as a key market for their products and services. Notably, despite the initial difficulties in operationalising the renminbi-based system, some MNCs have successfully upgraded their global invoicing and payment systems to settle trade and working capital in renminbi with their Chinese counterparts. This allows for significant cost-savings on foreign exchange transactions in addition to efficiency gains from matching trade receipts to funding working capital requirements. The increased use of the renminbi for their investment activities in China is supported by the flexibility provided in China for movements of global funds in and out of the country. The potential longer-term benefits from using the renminbi-based system for their trade, working capital requirements and FDI in China is thus seen to clearly outweigh the implementation costs.

In the more recent decade, financial investments have also gathered momentum as foreign investors commenced investment activities in Chinese financial markets since 2003 through the Qualified Foreign Institutional Investor (QFII) program. Wide-ranging measures, including the introduction of China Interbank Bond Market (CIBM) foreign quota in 2009, the Renminbi Qualified Foreign Institutional Investor (RQFII) in 2011 and the operationalisation of the Hong Kong-Shanghai Stock Connect in 2014, are all aimed at encouraging greater participation of foreign investors in China's mainland financial markets. At the same time, China is improving the global renminbi settlement and clearing system through a wider network of renminbi clearing banks and the upcoming Cross-Border Interbank Payment System (CIPS) to lower the transaction costs for the renminbi relative to other major currencies.

Currently, there are at least five hundred global investors, including sixty or more foreign central banks and sovereign wealth funds, that have gained direct access to China's financial markets. Many more have access through the Hong Kong-Shanghai Stock Connect. Malaysian institutional investors seeking to internationally diversify their investments would need to intensify the learning curve process in the Chinese financial markets to realise its benefits.

Malaysia: A pioneer in the cross-border use of the renminbi

Malaysia was one of the earliest countries to recognize the potential role of the greater cross-border use of renminbi. Given China's significance as Malaysia's largest trading partner, the settlement of trade and investment in renminbi significantly lowers costs and promotes greater cross-border trade and investment activity. In turn, fund-raising activity in renminbi has become a means for Malaysia to utilise the renminbi liquidity obtained through trade settlements. Malaysia has a comparative advantage in this area, as the largest debt securities market in Southeast Asia and as a leading centre for sukuk issuance.

As an early pioneer of renminbi initiatives, Bank Negara Malaysia (BNM) was the first ASEAN central bank to sign a currency swap agreement with the People's Bank of China (PBC) in February 2009. In the same year, BNM was also the first Asian central bank to become a QFII investor and among the first wave of foreign investors in CIBM. In 2010, the Malaysian ringgit became the first emerging currency to be directly traded with the renminbi in the China Foreign Exchange Trading System (CFETS). In 2013, BNM signed a Cross-Border Collateral Arrangement (CBCA) with PBC to enable the use of home currency collateral to obtain domestic liquidity in the host country. In November 2014, BNM signed an MOU on a renminbi clearing bank arrangement. The Bank of China Malaysia was appointed as the renminbi clearing bank in January 2015. Going forward, BNM will work towards further enhancing financial co-operation with PBC in the area of Renminbi Qualified Foreign Institutional Investor (RQFII) to provide an alternative avenue for Malaysian investors to invest in onshore Chinese financial markets.

BNM has also worked to integrate the renminbi into the domestic financial system by incorporating the renminbi in Malaysia's Real Time Gross Settlement System (RENTAS). In November 2013, BNM introduced the Renminbi Liquidity Facility (RLF) to licensed onshore banks to facilitate more effective renminbi liquidity management in Malaysia. Today, the usage of renminbi in Malaysia has grown rapidly, with the daily size of renminbi foreign exchange volume at RMB6.7 billion. Malaysian institutions and corporations such as Khazanah, Cagamas, Axiata and Maybank have issued renminbi bonds. With the various renminbi financial infrastructure that has been put in place to support trade, investment and financial flows between Malaysia and China, this trend is expected to increase. Malaysian entities with large regional network should consider using Malaysia as the centre for their regional renminbi transactions and thus contribute towards greater economies of scale over time. This would in turn enable the transactions to be conducted in the most efficient and cost effective way.

Conclusion

Let me conclude my remarks. In a short time span of six years since 2009, the renminbi has accomplished much of its goals but there is still a long journey ahead as most international currencies have evolved over several decades. The impact of the Chinese economy on Asia has been significant with many countries now counting China as their largest trading partner, and in some cases, among the largest foreign investors. Reflective of the underlying fundamental economic changes, the rise of the renminbi, although gradual, is inevitable with important implications not only to Asia but to the rest of the world. Undoubtedly, the renminbi is more important to Asia than anywhere else. Given this, Asia including Malaysia must be ready for this transition of the increased internationalisation of the renminbi and its potential role with Asia's integration path and thus contributing towards further unlocking the potential of the region.