Burkhard Balz: The role of the renminbi in international payments

Keynote speech by Mr Burkhard Balz, Member of the Executive Board of the Deutsche Bundesbank, at the 5th European-Chinese Banking Day as part of the Euro Finance Week, Frankfurt am Main, 14 November 2018.

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1 Introduction

Ladies and gentlemen,

There's an ancient Chinese proverb which reads: "Don't be afraid to be slow. Be afraid only of standing still." And indeed, tenacity and staying power often do pay off.

Patience and perseverance are also called for when it comes to anchoring the renminbi in the group of key international currencies.

I am pleased to be able to highlight this topic – the role of the renminbi in international payments – in my keynote speech here today, at what is already the fifth European-Chinese Banking Day.

2 The internationalisation of the renminbi: the story so far

The internationalisation of the renminbi is certainly a less prominent topic in current debate than it was a few years ago. On the other hand, the political influences that impact on the renminbi today feature somewhat more strongly. The spectre of a trade war between the United States and China is omnipresent, and accusations of currency manipulation and of a currency war as a result haven't quite died down yet. In my speech today I would like to look more closely at these and other topics.

For quite some time now, the Chinese government has been pursuing the long-term aim of bringing the use of the renminbi in international payments, amongst other things, into line with the importance of the Chinese economy. Moreover, the Chinese want to strongly increase the influence of the renminbi as a trading and investment currency. Yet developments surrounding the renminbi in the individual areas are not always synchronous.

A look at the statistics will give you an idea of why I speak of patience and perseverance in the context of the renminbi's role in international payments. Whereas the share of global economic output accounted for by China in 2017 was just over 17%,[1] the renminbi's share in international payment flows in August 2018 was a mere 2.12%.[2]

The US dollar and the euro find themselves in a different position. The share of global economic output for the US in 2017 was 15%, and that for the euro just over 16%.[3] By contrast, commanding a share of just over 39%, the US dollar undisputedly remains the world's most often used currency in payments, followed by the euro with just under 34%.[4] As a payments currency, the renminbi currently ranks fifth (behind the US dollar, the euro, the pound sterling and the Japanese yen).

Still, this is a sign of its ascendancy, since it came in at only sixth place last year. Use of the renminbi as a global trade currency has gained momentum again after a negative trend in 2016 and 2017. However, it has not yet returned to 2.45%, which was its share in September 2015[5]

This development is probably due in part to the fact that the Chinese economy has experienced weaker growth than in earlier years. This has also had an impact on trading activities and the underlying payment flows.

There are signs of a similar picture with regard to the renminbi and foreign reserves. According to a recent survey of central banks and sovereign funds on their plans for the management of their foreign currency reserves, the present weighting is not expected to change greatly in the near future. Although the renminbi was among the biggest winners last year, the US dollar remains the standard currency for new investments of reserve assets. This makes it all the more important that the Chinese government demonstrates staying power in order to reach its objective in this respect, too.

Last year the renminbi took only a 1.7% share of global foreign exchange reserves, so that it ranked behind the Canadian dollar.[6] This is due, not least, to concerns surrounding financial stability in China as well as to capital restrictions. Progress will have to be made in this respect if the renminbi is to become more attractive as a foreign reserve currency.

As I have already mentioned, however, the strategy of internationalising the renminbi is geared for success in the long term. Phases in which use of the renminbi stagnates should not, therefore, come as a surprise. The Chinese government’s objective is clear. It wants to see the renminbi established as a trustworthy and widely used international reserve currency, trade currency and payments currency.

The much needed patience I spoke of earlier paid off handsomely for China in October 2016. The renminbi was officially added to the International Monetary Fund's (IMF) basket for special drawing rights (SDR). Since then, it has occupied a place in this select group of currencies alongside the US dollar, the euro, the Japanese yen and the pound sterling. With that, the renminbi took its first formal step on its way to becoming an international key currency.

This was a step that crowned many years of political wooing and a process of cautiously opening up the Chinese capital markets, as well as a variety of programmes to give foreign investors access to China’s capital markets. Use of the renminbi as a reserve and investment currency was gradually increased as a result. The first milestone was reached in 2017, when Bond Connect, a joint venture of the China Foreign Exchange Trade System (CFETS) and Hong Kong Exchanges and Clearing Limited, was set up. Amongst other things, the idea behind Bond Connect is to make it easier for foreign investors to participate in trading in the Chinese fixed-income market. Close to 400 foreign investors have so far joined the interbank bond market via Bond Connect. In March of this year, Daimler took advantage of the opening up of the Chinese capital market to international issuers to become the first large German enterprise to issue a renminbi bond.

Over and above that, foreign financial corporations in particular have, for the most part, had quite a hard time in China to date. But China’s President and party leader, Xi Jinping, announced a new “opening-up phase” earlier this year. Foreign enterprises are now permitted to take majority shares in Chinese banks, brokers and insurers. Moreover, non-residents will in future be able to hold up to 51% of financial enterprises.

This is an important step towards the further opening up of the capital markets, given that foreign investors were barred in the past from engaging in the Chinese financial markets independently. The only role open to them was that of junior partner holding a share of no more than 49%.

Although the markets’ response to this new opening-up process has so far been muted, this constitutes major progress. What’s more, the Chinese government has announced that it will completely remove the restrictions on participations in the coming years, thereby ending the requirement that foreign service providers enter into a joint venture with Chinese companies. That said, international investors will undoubtedly have to continue to demonstrate patience in the near future.

Bond Connect and the loosening of the joint venture requirement are just two further additions to a chain of measures designed to establish a modern market infrastructure in China.

For instance, the interbank payment system CIPS (Cross-border Interbank Payment System) makes the clearing and settlement of cross-border renminbi payments possible.

CIPS was launched in October 2015 with 19 direct participants. By August 2018, no less than 31 financial institutions were direct participants, with 750 financial institutions taking part indirectly. CIPS clearly demonstrates the importance of international standardisation in an increasingly globalised economy, given that CIPS is based on what is known as the ISO 20022 standard, which is making great strides in European payments as well. The more internationally operating institutions use this standard, the simpler it will be to make use of CIPS internationally, which will benefit the internationalisation of the renminbi.

Accordingly, the internationalisation of the Chinese currency will receive a boost from the use of the ISO 20022 standard in CIPS as more and more internationally active institutions apply this standard.

On top of that, 25 Chinese banks representing 86% of Chinese cross-border payments use the SWIFT Global Payment Initiative (SWIFT gpi). SWIFT gpi offers more transparency through uniform standards and the payments tracking service, which ensures a fast, transparent and low-cost settlement of renminbi transactions, despite the time-consuming transformation costs that are incurred in transferring international payments into China's national payments system.

3 Factors affecting the internationalisation of the renminbi

The successful implementation of the strategy to internationalise the renminbi rests on the interaction between two core elements.

- These are, first, the gradual liberalisation and international opening up of the capital markets, which I just described to you, and
- second, the global broadening of the user base of the renminbi.

The inclusion of the renminbi in the IMF's basket of currencies provides an element of support in China's internationalisation efforts.

Yet purely foreign exchange policy aspects are no longer to be made the sole point of focus. Politically realistic considerations are also being increasingly placed in the foreground.

In this respect, a key role is played by China's Belt & Road strategy, developed by China and first presented to the public in 2013. The idea behind this is to reopen the ancient "Silk Road", which once led from China through Central Asia, the Middle East and central Europe to western Europe, and to supplement it by a maritime trade route. Plans exist for the Chinese state and participating companies to make investments worth billions in various infrastructure projects along these routes, thus stimulating trade between countries situated along these routes as well as between them and China.

At the same time, the Chinese hope that the payment flows stemming from these trading activities will help them to encourage use of the renminbi in those countries. The Chinese government's hopes not only concern the success of the projects in the various emerging markets along the Silk Road.

Rather, it is hoped that trade relations with Germany as Europe's largest economy will also be strengthened. In fact the German town of Duisburg, with the biggest inland port of its kind in Europe, represents the "western" end of the trade route often referred to as the "new Silk Road". And in this context, the Frankfurt financial centre, given its position as a one of 23 renminbi clearing hubs worldwide, would be forming the link for payment flows between Germany and China.

Recently, however, China's efforts have met with more and more obstacles. For example, the additional tariffs on Chinese goods and the threat of a trade war with the United States are damaging relations between the two countries, with negative repercussions for global equilibrium. This can have an adverse effect on the entire world economy, as there are only ever losers in a trade war. Imposing tariffs and retaliatory tariffs undermines an important foundation of our prosperity.

However, at the recent meeting of the International Monetary Fund (IMF) in Bali, both the United States and China indicated that neither was interested in an escalation of the trade conflict. I very much hope that this proves to be the case.

In debate, the Chinese government is often accused of taking advantage of a depreciation of the renminbi, risking a downward spiral in the process. Yet studies to date show that China has no wish for an artificial devaluation. At the meeting in Bali, Dr Yi Gang, President of the People's Bank of China (PBoC), also promised that China would not initiate a spiral of depreciation in the trade conflict. Rather than take part in a race to the bottom, China would like the market to continue to determine the exchange rate.

This stance is a most welcome one. Against the backdrop of loosened monetary conditions, the PBoC successfully implemented a number of measures to halt the downward trend of the renminbi, which persisted until the middle of August. This is confirmed by the currency's slight upward tendency. Given the uncertainty surrounding economic developments, however, there is still palpable concern regarding a depreciation and renewed capital outflows, all the more as China is one of the last big economies that is continuing to loosen parts of its monetary policy.

4 The importance of the Frankfurt financial centre for German-Chinese cooperation.

Frankfurt has always been the mainstay of the good relations between our two countries.

The Deutsche Bundesbank is not just an onlooker with regard to promoting German-Chinese relations; it also makes its own active contribution.

One year ago, my predecessor Carl-Ludwig Thiele announced at this very location a joint study by the Bundesbank and the Academy of Internet Finance of Zhejiang University Hangzhou, the Sino-German Center and Professor Bernd Skiera of the Goethe University in Frankfurt, and supported by the Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) to examine consumers' payment behaviour in Germany and China. The results have now been published. A number of parallels have been found to exist between our countries. In China, providers of innovative payment procedures such as Alipay and WeChat today play a dominant role in online trade and at points of sale, with market shares of up to 65%. Cash is still most commonly used in rural areas, however.

Innovative payment methods are increasingly gaining market shares in Germany, too, although many consumers still do not see the advantages of the new technology or view it with distrust. For this reason, preference is still given to traditional payment methods.

The study is one of numerous initiatives that have been launched to foster dialogue and promote mutual understanding.

In this context, the Sino-German Center of Finance and Economics I just mentioned, which is a research centre run jointly by the Goethe University in Frankfurt and the Renmin University in Peking, acts as a platform for the exchange of independent ideas and organises regular workshops in Frankfurt and Peking, amongst other things.

And interest in a close exchange of thoughts between China and Germany is likely to grow still further in the years to come.

Given the forthcoming Brexit, Frankfurt's role as a major financial centre within the European Union will grow more and more important. This means that, besides Chinese business representatives, representatives from the fields of politics and academia will increasingly seek to exchange thoughts on matters of business and finance with Frankfurt. Moreover, current geopolitical discussions could lead to us complementing our present transatlantic partnership with more strongly focussed cooperation with Asia.

5 Conclusion

Ladies and gentlemen,

In Germany we have a saying that roughly translates as: "Slow and steady gets you there."

The internationalisation of the renminbi was a success story for many years owing to China's impressive economic growth. The economic reorientation in China led to a phase of relative disillusion. However, the outlook gradually seems to be brightening up again.

In this context, we recognise the continued willingness of China's decision-makers in politics and business to help the renminbi assume a role in global economic activity that is commensurate with the importance of the Chinese economy. This willingness shows that the renminbi has not yet reached the end of the road as regards comprehensive internationalisation. We therefore look forward to future developments.

On that note, let me wish you exciting discussions and fascinating insights.

And to everyone who is actively involved in the onward development of the renminbi, I wish you continued perseverance and patience. I am sure that both will pay off in the end.

Thank you for your attention.

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1 See Federal Statistical Office.

2 See SWIFT RMB Tracker.

3 See IMF.

4 See SWIFT RMB Tracker.

5 See SWIFT RMB Tracker.

6 See IMF.