

# Commentary

JULY 2012

BUFFIN PARTNERS INC.

ECONOMIC INVESTMENT AND ACTUARIAL RESEARCH

## Expanding Role for Chinese Renminbi

The Chinese Renminbi (RMB) is emerging as a new global currency. Internationalization of the RMB began in 2009 with the launch of the RMB Cross-Border Trade Settlement Pilot Scheme by Chinese authorities. Under the terms of this initiative cross-border transactions are permitted for a variety of current and capital account purposes. Recently there has been a rapid increase in the use of RMB for cross-border transactions and the establishment of an expanding global RMB market. The first international RMB-denominated bond to be issued outside China was announced in April this year. These developments represent the early stages of the emergence of a new major world currency for trade settlement, offshore and cross-border savings and investment, and ultimately, a new reserve currency. The issuance and listing of RMB sovereign bonds in Hong Kong underscores the role of Hong Kong as a growing international financial center.

The use of RMB for trade settlement will make Chinese importers and exporters more competitive by lowering costs and exchange-rate risks. Export-driven activity in China is likely to be stronger than in many other countries in the near future. Together with other initiatives to allow foreign companies to issue RMB bonds and initial public offerings, there will be a sharp slowdown in China's dollar accumulation in the coming years. The RMB strategy implies a policy commitment to steady appreciation of the Chinese currency over time. The expansion of RMB cross-border trade will necessitate a growing emphasis to be given to foreign exchange hedging activities. Hong Kong is well-positioned as the current leader for offshore RMB transactions. However, the City of London has recently announced an initiative to develop London as a major center for

international RMB business. This initiative, organized by the City of London, with a steering committee of five major banks, is supported by HM Treasury, the Bank of England, and the Financial Services Authority. Its aim is to deliver a strategy for London to become a center for RMB products and services, complementing Hong Kong, and benefiting from the significant opportunities that this new market represents.

The internationalization of the RMB is an important development with global financial ramifications. Development of the offshore RMB market is the route by which the RMB can evolve into a major global trading, financing and investment currency, and eventually become a global reserve currency. The international RMB bond market is expected to surpass one trillion RMB within three years as the demand for RMB-denominated assets continues to grow.

The recent news from London has been dominated by reports on the Queen's Diamond Jubilee, the Olympic Games, LIBOR rate-fixing, and scandal concerning a newspaper tycoon. However, the news of the City of London's RMB initiative has not garnered as much attention as it deserves. London's financial center has always had a global outlook. London is the world's largest foreign exchange center and it will undoubtedly play a major part in RMB business transactions. According to the Chairman of the City of London's Policy and Resources Committee, "the RMB could be the world's most important currency in the future." The UK Chancellor of the Exchequer has also championed London's credentials, citing its "long history of global financial inventiveness" and asserting that "RMB trading is the next step along a 400-year road" of London's financial prominence.

The high-profile result of Beijing's drive to internationalize the RMB has

been the development of the offshore RMB bond market. These financial instruments are referred to colloquially as "dim sum" bonds. Until recently, the dim sum bond market has been based in Hong Kong with issuance dominated by mainland Chinese companies, but a number of international companies have begun to issue dim sum bonds, including McDonald's the US fast food chain, Tesco the UK supermarket group, and KfW Germany's national development bank. London is in a good position to benefit from the RMB's increasing usage around the world. Europe accounts for almost half of all global RMB trade payments outside China and Hong Kong, and London handles the majority of these transactions. London-based international banks are now providing a full range of cash management and trade finance products and services for the RMB. Further development work is planned to improve clearing and settlement mechanisms, publicize the features of the RMB market and attract investors and borrowers. The pace of development of the RMB market, both in London and Hong Kong, will also very much depend on Beijing and the approach taken by the Chinese authorities to liberalizing its currency. Beijing maintains tight capital controls that prevent the free flow of RMB between the Chinese mainland and the rest of the world, but has, over the last three years, liberalized some of its currency controls to enable local companies to reduce their reliance on the US dollar for trade purposes.

**Buffin Partners Inc.**

P.O. Box 1255  
Sparta, NJ 07871  
Phone: (973) 579-6371

Email: [commentary@buffinpartners.com](mailto:commentary@buffinpartners.com)  
[www.buffinpartners.com](http://www.buffinpartners.com)

