



Expert Seminar at EGMONT, 13/9/2011

## **WILL THE REDBACK REPLACE THE GREENBACK ?**

### **IF SO, WHEN ?**

**by Prof. Sylvain Plasschaert**

#### **I/ ECONOMIC BACKGROUND**

- Unprecedented growth of GDP in China since 1980 , at around 10 % p. a.
- Even faster growth of ( the values) of its exports
- Skyrocketing foreign exchange reserves
- Large overall current account surplus
  
- These developments are likely to persist in the medium term
- The 2009 financial tsunami only marginally affected the Chinese financial system

#### **II/ STATUS OF THE RENMINBI**

- under the Centrally Planned Economy, the official forex rate was economically meaningless and irrelevant for int'l trade
- the Chinese banking system, technically bankrupt around 2000 , has been drastically revamped

- 1994 convertibility (only) on current account
- export proceeds to be surrendered to the central bank
- exchange rate fixed by central bank
  - 1994 : RMB pegged at 8.6 RMB to one US dollar
  - 2005-08 : unpegged from US dollar :  
RMB appreciated to 6.8 to one \$
  - 2008 pegged again to \$
  - June 2010 , limited floating rate against basket of currencies : since, slight but perceptible appreciation
  
- China's 'real effective exchange rate '( a gauge of int'l purchasing power evolution ) of China now also on the rise

### **III/ THE DEBATE ABOUT THE ' UNDERVALUATION OF THE RENMINBI '**

- pressures esp. in the USA for fast and substantial upvaluation of the RMB to restore equilibrium in the US-China trade balance : USA should threaten with high import duties.
- the arguments thereto are weak, because :
  - a/ misreading of Chinese trade statistics :
    - half of exports from China are performed by foreign multinationals ( incl. HK one's)
    - the value added within China amounts to only half of the value of the exported products— even abstracting from the value added during the after-export, commercialization process to final customer

b/ items imported from China into the USA often are no longer manufactured in the USA

c/ highly taxed imports of labor-intensive goods imported from China could easily be sourced from manufacturers in other countries

d/ it is misleading to focus only on bilateral deficit of US int'l trade with China

e/ more generally, emphasis on trade balance is overdone: the value of the output of foreign affiliates of US firms amounts to 1/3 of that of US exports

f/ imbalances on current account are not highly trustworthy :

- the implied reference to the domestic savings-investments macro-ratios is weakened by conventional character of definitions of savings and consumption
- what is the optimal level of current accounts ?
- recently, a devastating criticism of the current account paradigm by BIS economists, pointing to the need to go beyond their global outcomes and to recognize the cross-country financial flows in today's globalized 'credit economies' and the associated financial imbalances, which involve currency, liquidity and credit risks

## **IV/ STEPS ON THE INTERNATIONALIZATION TRAIL**

### **1/ IMPROVING THE ONSHORE FX MARKET**

- UNTIL NOW , NO GENUINE FX MARKET: IMPERATIVE REPATRIATION OF EXPORT PROCEEDS AND THEIR SURRENDER TO CENTRAL BANK
- NOW SEVERAL PAIRWISE BILATERAL QUOTATIONS FOR CURRENT TRANSACTIONS
- STILL VERY LIMITED TURNOVER, BUT GROWING
- CONVERTIBILITY ON CAPITAL ACCOUNT ANTICIPATED IN MEDIUM -TERM AND INCREASINGLY BREACHED

### **2/ PARTIAL RELAXATIONS OF FX CONTROLS**

- NO LONGER COMPULSORY REPATRIATION OF EXPORT PROCEEDS
- LIMITED SCOPE FOR TRANSACTIONS BY NON-RESIDENTS ON CHINA'S STOCK EXCHANGES

### **3/ USE OF RMB IN INT'L TRADE WITH CHINA**

- INVOICING OF TRADE IN RMB GROWING, EVEN IN EXPORTS TO CHINA

### **4/ EMERGENCE OF OFFSHORE RMB MARKET, ESP. IN HONG\_KONG**

cfr Euro-dollar market since 1960's in London and elsewhere

- PROMPTED BY SOMEWHAT MORE FAVOURABLE  
REGULATORY PARAMETERS IN HONG KONG
- GROWING OFFSHORE RMB DEPOSITS FEED PANOPLY OF  
FINANCIAL PRODUCTS

#### **5/ THE RMB AS A COMPONENT OF THE SDR**

- REJECTED IN OCT. 2010 BY THE IMF, NOW ACCEPTABLE
- MIGHT SOFTEN VOLATILITY OF FX QUOTATIONS

#### **6/ HONG KONG AS A PUSH FACTOR IN THE INTERNATIONALIZATION OF THE RMB**

- TRUMP CARDS OF HONG KONG : LEGAL SYSTEM;  
WIDESPREAD USE OF ENGLISH; SOPHISTICATED  
FINANCIAL SYSTEM; FULL CONVERTIBILITY OF HK\$
- RMB DEPOSITS GROW RAPIDLY
- RMB -DENOMINATED 'DIM SUM' BOND ISSUES  
EXPANDING RAPIDLY

- BOTH PRC AND HK AUTHORITIES FOSTER ROLE OF HONG KONG AS BRIDGEHEAD TO CHINA
- SPECIFIC MEASURES BY HONG KONG, E.G IN TAX AREA
- AND 'CLOSER ECONOMIC PARTNERSHIP ARRANGEMENTS'

## **V/ CONCLUSIONS**

- RMB RAPIDLY BECOMING AN INTERNATIONALLY

RELEVANT CURRENCY

- FULL CONVERTIBILITY TO BE EXPECTED BEFORE LONG
- CHINA WANTS TO MOVE TO A MULTI-POLAR

MONETARY SYSTEM, AT ITS OWN PACE

- RESERVE CURRENCY STATUS OF THE RMB STILL REMOTE

BECAUSE CONDITIONAL UPON A MODERN DOMESTIC

FINANCIAL SYSTEM IN THE PRC

- HONG KONG AS A POTENT DRIVING FORCE

- A REGIONAL CURRENCY BLOC IN EAST ASIA, AROUND THE RMB ?