

press release

Renminbi internationalisation: The pace quickens

July 2015 brings fifth anniversary of CNH market in Hong Kong; new special report from Standard Chartered Global Research explores the opportunities presented by China's Renminbi internationalisation push

11 June 2015, Hong Kong – Big strides have been made in the internationalisation of the Renminbi over the past five years. China's currency now meets the technical requirements for inclusion in the International Monetary Fund's Special Drawing Rights (SDR) basket, in our view. More than 500 foreign entities, including asset managers, have obtained access to China's onshore bond market, and official reserve holdings of Chinese yuan (CNY) assets have reached USD 70bn-120bn. The network of People's Bank of China (PBoC) swap lines, offshore clearing banks and Renminbi Qualified Foreign Institutional Investor (RQFII) quotas spans the globe.

Given China's important role in the global economy, a more accessible currency opens up important new opportunities for investors and corporate treasurers. However, there are also potential pitfalls. In FX markets, for example, liquidity in non-deliverable FX trading is already thinning, and corporates need to prepare for substantially more two-way variability in the USD-CNY cross in the medium term.

We expect China to achieve its stated goal of "managed convertibility" – a medium-term steady state – by 2018. Restrictions on most capital transactions with a genuine economic basis will have been considerably reduced by then, with tight controls likely to be maintained only on short-term flows and those viewed as speculative.

The PBoC has committed to launching a series of reforms in 2015 to make the Renminbi more freely useable and bolster the case for the currency's inclusion in the SDR basket. We expect this to be followed by a range of new steps over 2016-18 as China makes steady progress toward managed convertibility.

Domestic interest rate liberalisation and the development of Free Trade Zones (FTZs) will provide important support onshore for China's Renminbi internationalisation push. The news here is encouraging and we expect domestic interest rates to be fully liberalised this year.

Renminbi invoicing has grown much faster in recent years than we had expected, and now accounts for 24.6 per cent of China's total merchandise trade. We expect this to rise to 38 per cent by 2017 and as much as 46 per cent by 2020. This would exceed the Japanese yen's share of Japan's trade at its peak in the late 1980s and early 1990s. In absolute terms, it would translate into at least USD 2.6tn, up from just USD 212bn in 2011.

China's official efforts to foster Renminbi globalisation have been impressive. Eight new offshore clearing banks were appointed in 2014 alone, taking the total to 12. Three more have been added so far this year. Emerging markets that meet our criteria for new clearing banks include Brazil, Russia, Indonesia, the UAE and South Africa (which would become the first offshore centre in Africa).

China's domestic bond market is more accessible to foreign investors than most might think. As of end-2014, foreigners' holdings of onshore China Government Bonds were higher in value terms than their holdings in many regional emerging markets. Irrespective of this year's SDR decision, we expect foreign investors' net purchases of Renminbi-denominated bonds to rise to CNY 350-400bn this year from CNY 273bn in 2014. Including equities, this year's portfolio inflows may reach CNY 500-700bn.

Turning to the broader dimensions of Renminbi internationalisation; with the IMF holding informal talks on China's possible inclusion in the SDR basket and its board scheduled to meet on the subject in October, we assign a 60 per cent probability to the CNY's SDR inclusion this year, as it broadly meets the technical requirements, with a very high likelihood of inclusion by 2020 at the latest.

We also see a strong case for official reserve diversification into Asian currencies – and an exceptionally strong case for reserve allocation to CNY assets. China's markets are deep, its internal and external balances are strong, it has the world's largest FX reserves, and it is a major trading counterparty. Its assets are highly rated, and the currency has a negative correlation to broader asset-market volatility. Looking out to 2020, the emergence of new trade corridors and intra-EM trade growth should further boost the CNY's prospective role as a major reserve currency.

Finally, the special report assesses the implications of issuing a reserve currency, as this potentially carries medium-term risks for China, as increased appetite for CNY-denominated assets could spur new debt creation. However, we see this more broadly as a healthy development as the global financial system – and reserve allocations – more accurately reflect the multi-polar nature of the global economy.

Renminbi internationalisation has been welcomed across Asia so far, but could create regional challenges over time. It disrupts the status quo of tight FX market controls in Asia ex-Japan (AXJ), it may give Chinese companies a competitive advantage in managing FX risk, and it positions China better to attract capital inflows. Against this backdrop, pressures for currency reform in the rest of AXJ may build in the years to 2020.

Robert Minikin, Head, Asia FX Strategy, commented: “The policy reforms driven by China’s Renminbi internationalisation ambitions still have plenty of momentum. Even during the course of writing this report, important reforms have been announced, including new steps towards interest rate liberalisation onshore and new channels for offshore banks to access onshore funding. The past five years have seen an enormous amount of positive and exciting development in the Renminbi internationalisation story; we think the future narrative will prove even more compelling.”

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