# Renminbi internationalisation deferred

**by William Overholt 15 May 2020**

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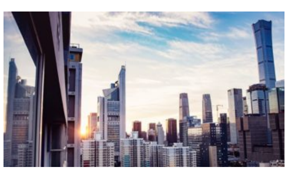

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## *Capital controls have strengthened rather than loosened*

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A decade ago, China's leadership started implementing impressive plans to internationalise the renminbi.

Beijing's motivation began with its disillusioned reaction to the 2008 financial crisis. The dollar-based system wasn't safe or reliable, so it needed to change.

Second, China was dangerously exposed to dollar volatility. Most of the country's liabilities were in dollars, while the majority of its assets were in renminbi. If the Chinese currency achieved broad international use, then this imbalance could be mitigated.

Third, since renminbi internationalisation required financial liberalisation, influential economists and officials controversially wanted to use renminbi liberalisation to spur domestic financial liberalisation. Fourth, never to be underestimated, Chinese leaders saw great prestige in the renminbi being a peer of the world's leading currencies.

China created a market-driven offshore renminbi, initiated swap centres around the world with banks designated to conduct the business, and made a particular effort to build renminbi trading centres in Hong Kong and London. In three years, the number of banks conducting renminbi trades rose to 10,000 from 900.

Beijing promoted the renminbi as a settlement currency for China's trade, leading to major savings for companies like Samsung that no longer needed to exchange renminbi for dollars and then dollars for South Korean won. Chinese leaders made it easier for companies with multiple subsidiaries to consolidate their accounts.

They set up an international free trade zone in Shanghai a precursor to a broader national liberalisation in which currency trading and settlement were major components. They announced a step by step liberalisation of foreign acc to equity and bond markets and a gradual liberalisation of foreign direct investments. They set about freeing domesti interest rates. They promoted the renminbi as a reserve currency and convinced many countries to accept renminbi as part of their reserves. They persuaded the International Monetary Fund to accept the Chinese currency as a component of special drawing rights.



Five years ago, the trends in use of the renminbi were spectacularly positive, albeit from a low base. That has not continued for several reasons.

The bond market continues to be fragmented under four different regulators, so it is more like the euro market, puddles of liquidity rather than one deep pool. Bureaucratic fragmentation means there is no coherent yield curve. China's credit needs are still served mainly by banks rather than bonds, so the bond market remains less developed than it could be.

Strong non-market interventions, as with the stock market in 2015, prevent market participants from calculating market outcomes. US and European Union central bank interventions affect markets more than they once did, but the political component in China remains much bigger.

As in Tokyo, the market for corporate control is extremely constrained and that is a barrier to an important stream of capital flows. Recent strengthened support for central control of state-owned enterprises and for consolidation of national champions reinforces this.

The legal system is now under even tighter political control so market participants are not confident of how disputes would be settled.

Perhaps above all, capital controls have strengthened rath than loosened as once was expected. The problem of open the market is not just technical. There is a widespread desi by firms and families to move their money out of China because of uncertainty about conditions under which their funds can be taken away from them. The anti-corruption campaign makes firms and wealthy people nervous. Whereas tough authoritarianism is often seen in the West as signifying stability, in China families see it as a sign of fear and uncertainty, so they want their money somewhere safer. This is a much more serious issue than five years ago, and will not change anytime soon.



Finally, the level of debt, the slowing of the formerly rapid growth on which much lending was premised, and possibly decreasing efficiency in the use of the debt, create risks for the banks and make tightened financial controls a needed prudential measure.

All of this means that the renminbi's aspirations to become a top international currency are at best deferred for many years.

Beijing hopes that the Belt and Road initiative will facilitate the emergence of a China-centred blockchain settlement system that would fulfil many of the aspirations associated with renminbi internationalisation. It is too early to speculate about how this will evolve.

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