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Yuan's Global Clout Will Lag Dollar For Years, Economist Says

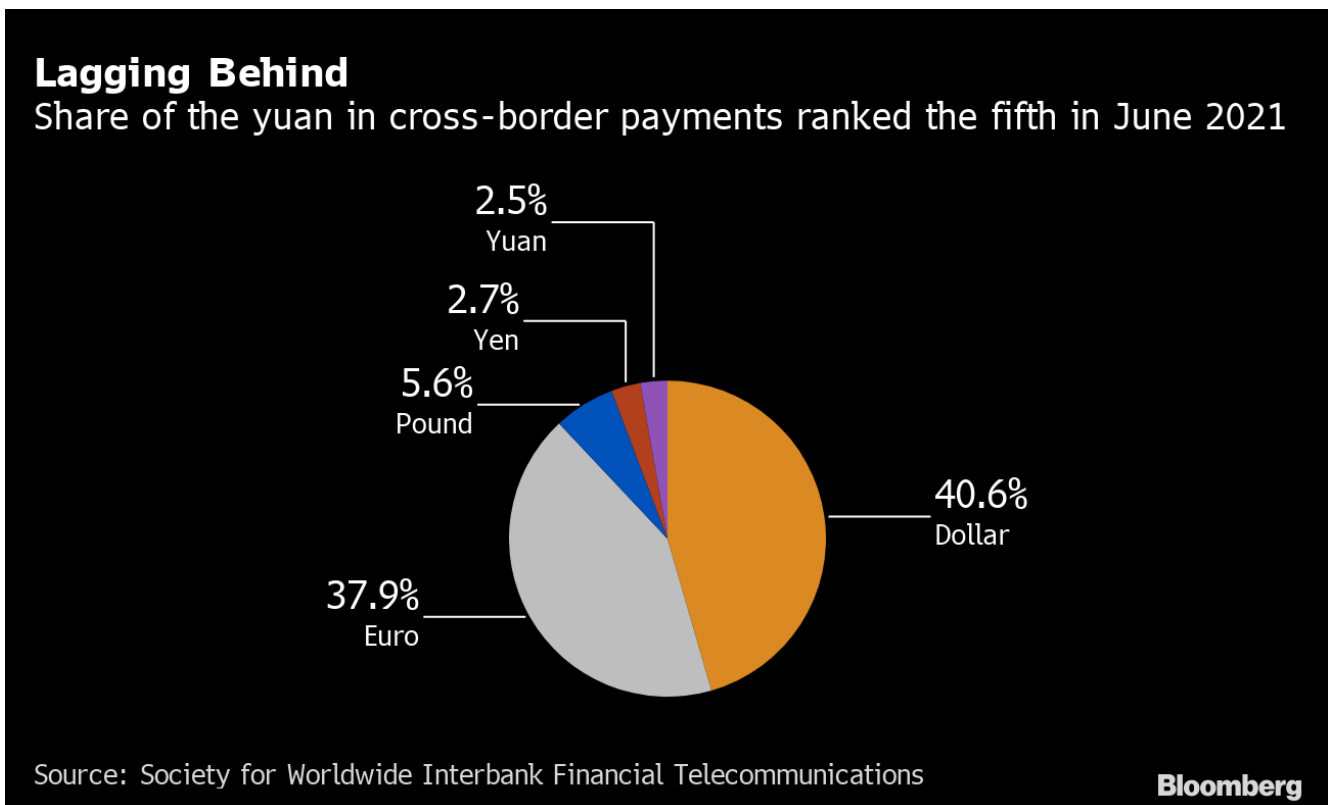
- Hong Kong academic publishes a new book on China's currency
- Yuan's global role will remain limited without reforms

By Enda Curran

(Bloomberg) -- The yuan will be a distant third to the dollar and euro as a global payments currency by 2030 given China's reluctance to relax capital controls and the need for deeper financial reforms.

That's the view of Edwin Lai, a professor of economics and director of the Center for Economic Development at the Hong Kong University of Science and Technology, who has recently published a book on the yuan titled "One Currency, Two Markets: China's Attempt to Internationalize the Renminbi."

Allowing foreign investors to freely buy Chinese stocks and bonds will be critical if the yuan is to become a truly global currency, according to Lai, who previously worked for the Federal Reserve Bank of Dallas. China's currency ranks fifth for cross border payments, according to data from the Society for Worldwide Interbank Financial Telecommunications.



Here are excerpts of the conversation at Lai's university office in Hong Kong, lightly edited for clarity.

Why is the yuan's development as an international currency lagging?

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The capital account is too closed and financial development is still quite immature. The current international monetary system is a legacy of Bretton Woods even though the Bretton Woods system collapsed in 1973 -- the legacy still lives on. There is a brand name issue -- it's the trust issue. China is a very different political and economic system from most of the western countries.

So what does China need to do to boost the yuan's global appeal?

They really need to relax capital controls and open the capital account to allow foreigners to invest in onshore renminbi-denominated products such as bonds and stocks. One important step is to develop and open the domestic bond market to foreign investments. However, the Chinese bond market is very, very new. Most of the developments happened since 2015. Opening the Chinese government bond market to foreign investment is very important in internationalization of the renminbi. Chinese government bonds are the bonds issued by the central government. It's the Chinese equivalent of U.S. Treasuries.

Does that make the renminbi a potential reserve asset?

The bonds are issued by the Ministry of Finance of China and it is a safe asset as it is backed by the central government of China. The default risk is very low as the credibility of the Chinese government is very valuable and China will greatly protect it. If foreign central banks, financial and non-financial institutions were allowed to freely invest in Chinese government bonds then foreign ownership of Chinese government bonds will increase and its market turnover will also increase. The market will become deeper and more liquid. Thus, gradually the renminbi would become a more and more important reserve currency of the central banks of the world. Foreign corporates and financial institutions will also be interested in buying Chinese government bonds in order to maintain a diversified portfolio because it is a safe asset for parking money.

For a while there was a view that China's Belt & Road Initiative would boost internationalization of the renminbi. How has that played out?

Initially I thought BRI would be a major stimulus to renminbi internationalization but after some research I concluded it probably would not be. I actually did some very rigorous analysis to project China's payments share by 2030 and I found that the main bottleneck would be China's capital account opening and financial development. BRI will be useful to renminbi internationalization only to the extent it facilitates improvements in these two aspects.

Will there be a boost in settling two-way BRI trade in renminbi?

BRI countries will trade more with China and China will commit more foreign direct investment into these countries. This strengthens the trade relationship between China and these countries. As a result, China can have more bargaining power in determining the use of the renminbi for trade settlement. But that effect actually is quite minor. If you try to calculate it, you will find that it's not going to have a tremendous impact on the use of renminbi for payment in the world. Some people think that BRI will stimulate the demand for renminbi-denominated bonds and loans to finance the infrastructure projects of BRI, and so it will greatly increase the market for renminbi-denominated international debt securities. However, I find that the effect will be limited. I think that opening the domestic bond market to foreign ownership matters a lot more.

You don't see the yuan rivaling the dollar on the global stage anytime soon. But what sort of time line are you expecting?

The day when the renminbi will rival the euro is far away, not to mention the dollar.

How far away?

There needs to be development and reform of the financial markets -- it's not easy. China is still very underdeveloped in its financial sector. If you look at China, it is still very much a developing economy in the financial sector. According to my model, by 2030 China will be a distant third payment currency surpassing the British pound and yen slightly but its payment share will still be far from that of the euro. I think the U.S. dollar will be the dominant currency in the world for a long time because of its open capital account; broad, deep and liquid financial markets; and large economic size. The thick market of the U.S. dollar will contribute to the persistence of its dominance. I think it will continue to dominate for another 30 years at least.

You make the point that China wants to open at its own pace. What role does Hong Kong have to play in that?

The reason why the title of my book is called 'One Currency, Two Markets' is to draw a parallel between that and 'One Country, Two Systems.' I think there are a lot of similarities between the two ideas.

The idea of 'One Country, Two Systems' is to have Hong Kong as a window, and a portal connecting China with the rest of the world. Hong Kong is allowed to be more open to the rest of the world than the Mainland is. There is a firewall between Hong Kong and the Mainland so that the latter can open at its own pace. Shanghai cannot play that role; Shenzhen cannot play that role. Hong Kong is the only place that can play that role, as it has the infrastructure, the institutions and the track record.

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