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Annual Report on the Internationalization of Renminbi

人民币国际化报告2012 英文版

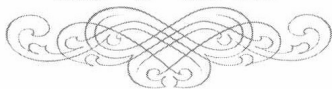
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Internationalization Index of Renminbi

1. 1 RMB internationalization index and its principles

1. 1. 1 Internationalization of the RMB

Currency internationalization refers to a sovereign currency performing functions of currency, being widely used by other countries in international trade, international capital flows and foreign exchange reserves. From a static view, currency internationalization describes the status and result of currency being used as an international currency, and from a dynamic view, currency internationalization involves the whole process of becoming an international currency.

According to the above definition of currency internationalization, we give the following definition of internationalization of the RMB. Internationalization of the RMB refers to the process of RMB performing functions of currency worldwide, becoming major pricing and settlement currency in trade, and becoming financial transaction currency and governments' international reserve currency.

From a historical perspective, there are some basic conditions for a country's currency to realize internationalization. For example, the real economy should maintain steady development, and play an important role in international trade and economy; there should be a higher level of domestic financial liberalization and international openness; and the basis of market system and



macro economy which is helpful for currency internationalization should be established. Although the RMB initially has some conditions of internationalization, China still faces a long and arduous process to realize the ultimate goal. There is no doubt that internationalization of the RMB is a process of combination between natural market formation and government's policy guidance, a process full of gaming among various international forces, and a process of rising of China's political and economic soft powers.

1. 1. 2 The definition of RMB internationalization index

RMB internationalization index refers to the indicator and data that take global proportion of all functions of the RMB viewed as the international currency into consideration, which shows an objective, dynamic, and scientific description of the degree of internationalization of the RMB.

Internationalization of the RMB is our realistic choice of protecting national interests after the global financial crisis. Promote internationalization of the RMB means breaking the current pattern of international monetary system, sharing vested interests with existing international currencies, and bearing accompanied and unprecedented monetary regulation and risks of external shocks. In the process of internationalization of the RMB, how to accelerate China's economic growth pattern transformation under the premise of avoiding major crises is definitely an initial problem in government's macroeconomic management. Compile RMB internationalization index can comprehensively reflect the degree of internationalization of the RMB, and can also supply an operational scientific tool and an efficient management way for government decision making sectors to accurately grasp dynamic process of internationalization of the RMB, helping them timely seize new opportunities and challenges from home and abroad during the process of internationalization of the RMB, and pointedly adjust or formulate macroeconomic policies.

1. 1. 3 The purpose of the compilation of RMB internationalization index

Firstly, base upon functions of currency, analyze current status and important determinants of internationalization of the RMB, and provide a comprehensive indicator system for government decision making sectors to scientifically evaluate the process of internationalization of the RMB.

Secondly, reflect the process of internationalization of the RMB objectively, con-

veniently, and dynamically, provide a reflection of the dynamic evolution of internationalization of the RMB to the globe, and then provide a new general measurable indicator for the research of internationalization of the RMB, filling the theoretical blank of the research in internationalization of the RMB.

Thirdly, comparative analysis of the internationalization index of the RMB and other major currencies can help understand the main factors that promote or hinder internationalization of the RMB from the structure, learn the gap between internationalization of the RMB and internationalization of other major currencies, find the principal contradiction and the prominent problems, and provide government with a convenient evaluation tool to analyze and review the achievement of internationalization of the RMB and the effectiveness of relative promoting measures, so as to help the government grasp opportunities in internationalization of the RMB in time, and formulate appropriate and targeted policies to advance internationalization of the RMB.

Fourthly, provide countries all over the world with a reference of currency selected to be used in trade and official reserves. Although internationalization of the RMB is a natural selection that goes with the tide of international economic situation after the global financial crisis, several countries are not willing to choose RMB as their official reserves due to lack of understanding of the international use of the RMB. RMB internationalization index can strengthen foreign governments and corporations' understanding of the degree of internationalization of RMB, and can provide them with a convenient decision making basis in choosing RMB as the settlement and reserve currency.

1.2 The compilation principles of RMB internationalization index

According to the definition of internationalization of the RMB and the purpose of the compilation of RMB internationalization index, as well as drawing the experience from compiling various financial indices, principles of compiling RMB internationalization index are as follows.

Firstly, the function positioning should be clear and specific to reflect the actual situation of the international application of the RMB. The compilation of any index is to meet specific functional requirements. And the core goal of the compilation of the RMB international index is to objectively reflect the status of the use of the RMB around the world, so as to provide objective, fair and reliable basis for government departments to make relative decisions, and for pri-



vate sectors to use RMB-related financial products and formulate relevant financial strategies.

Secondly, reflect the distinctive guiding direction of internationalization of the RMB, and underline the circulation and transaction function of the RMB in real economy. The compilation of the index should not only reflect the status of internationalization of the RMB, but also highlight Chinese financial strategies, especially reflect the top-level goal-oriented design of financial strategy. The outbreak of the global financial crisis makes people profoundly recognize the serious harm of over-developed virtual economy. Once the currency runs away from the real economy and produces endogenous inflation, it will cause great destruction to the stability of the entire financial system. Thus we must not focus too much on virtual economy or financial transaction function in internationalization process of the RMB; instead, we should pay more attention to circulation and transaction functions of the real economy. And this will be fully reflected in the process of compiling the RMB internationalization index.

Thirdly, insist on the scientific and systematic principles of design. The authority and instructiveness of the index depend on whether the design is scientific or not. The design of RMB internationalization index must start from the nature of international currency; scientifically define the connotation and denotation of internationalization of the RMB based on adequate theories about international currency and international finance, and go on research combining practices of internationalization of the RMB. This makes RMB international index not only reflect universal laws and characteristics of international currency, but also reflect its strategic goals. In the design of RMB index system, we focus on the accurate connotation of a single indicator and the systematicness and comprehensiveness of the index system. As internationalization of the RMB is generated by systematic development of various international monetary functions of the RMB, the RMB internationalization index which acts as an evaluation system must have the function of broadly reflecting every important aspect of internationalization of the RMB. As a result, the index system of internationalization of the RMB is not the simple structure comprising several single indicators, but should maintain systemic integrity; and indicators should complement each other and show a comprehensive reflection of internationalization of the RMB from different levels and perspectives.

Fourthly, take comparability and availability into account. One of the purposes of RMB internationalization index is providing the basis of selecting

trade and reserve currency for countries around the world, which requires that the horizontal and dynamic comparability of the evaluation results must be considered in the design. Meanwhile, availability and manipulity of the data should also be considered in the design of the index system. For some indicators which are highly important but not available, we should estimate them with as much information as possible. Besides, indicators should be easy to be understood and should not be ambiguous to make sure that RMB internationalization index can be calculated and applied accurately and conveniently.

Fifthly, flexibility should be kept along with the structural stability. Indicators and their weights used in compilation of RMB internationalization index should not be changed frequently to ensure the continuity and dynamic comparability of the interpretation of the evaluation results. However, it is not wise to keep indicators and their weights strictly fixed; instead, they should have some flexibility. Because there are different strategic goals in different phases of internationalization of the RMB, and these strategic goals should be adjusted appropriately according to changes of international political and economic situations. In order to reflect the internationalization process of the RMB accurately and objectively, the indicators and their weights used in the compilation of RMB internationalization index should be compatible with the practice of internationalization of the RMB and Chinese strategic goals, and should be able to make appropriate adjustments in different stages.

Sixthly, the compilation method of the index should be transparent and simple. The principles of selecting indicators and determining weights in compiling RMB international index should be carried out under scientific and operational guidance. At the same time, we should use a relatively simple and intuitive calculation method, and avoid complex and obscure method. In addition, the compilation method should be open to public to assist staff from governments and relative departments study internationalization of the RMB together, which will lay a solid mass foundation for the scientific development of RMB internationalization index.

1.3 The compilation method of RMB internationalization index

1.3.1 Indicator system

According to the definition of internationalization of the RMB, we select two major categories of indicators which can reflect international monetary



functions of the RMB to construct RMB internationalization index system. These two categories of indicators are consistent with the two categories of international economic transactions defined in *the Balance of Payments Manual* issued by the International Monetary Fund (IMF). The first category reflects international pricing, clearing and settlement functions of the RMB, specifically including indicators of RMB used in international trade and indicators of RMB used in capital and financial transactions. The second category reflects function of the RMB as international reserve(Figure 1-1 and Table 1-1).

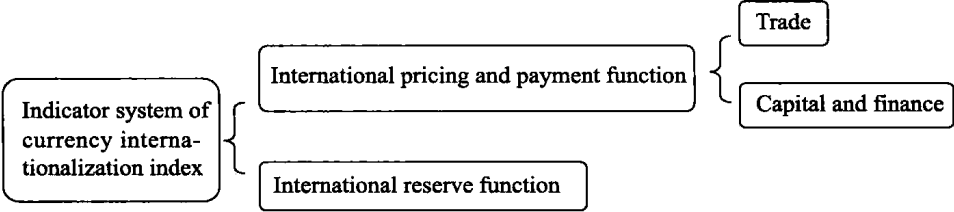


Figure 1-1 Indicator system of RMB internationalization index

Table 1-1 Indicator system of RMB internationalization index

First-class indicators	Second-class indicators	Third-class indicators
International pricing and payment function	Trade	Proportion of RMB settlement in world trade
	Capital and finance	Proportion of RMB credit in global foreign credit
		Proportion of RMB security in global issuance of international bonds and bills
		Proportion of RMB security in global remaining sum of international bonds and bills
		Proportion of RMB direct investment in global foreign direct investment
International reserve function	Official foreign exchange reserves	Proportion of RMB foreign exchange reserves in global foreign exchange reserves

Proportion of RMB settlement in world trade=the amount of RMB cross-border trade /total value of world import and export trade;

Proportion of RMB credit in global foreign credit=the amount of RMB overseas credit/the amount of global overseas credit;

Proportion of RMB security in global issuance of international bonds and bills=the issuance of RMB international bonds and bills/the issuance of global international bonds and bills;

Proportion of RMB security in global remaining sum of international bonds and bills=the remaining sum of RMB international bonds and bills/the remaining sum of global international bonds and bills;

Proportion of RMB direct investment in global foreign direct investment=the amount of RMB direct investment/the amount of global direct investment;

Proportion of RMB foreign exchange reserves in global foreign exchange reserves=the remaining sum of RMB official exchange reserves/the remaining sum of global foreign exchange reserves.

Theoretically, currency has three primary functions: as a unit of account, as a medium of exchange, and as a store of value. In international trade, pricing currency is usually the settlement currency, and one of the purposes of compiling RMB internationalization index is to focus on reflecting the actual use of RMB in international economic activities. Therefore, this report will merge the function as a unit of account and as a medium of exchange together.

According to one of the principles in compiling RMB internationalization index, i. e. , emphasizing the circulation and transaction functions of RMB in real economy, the functions of RMB in international trade should be the most important component in evaluating internationalization of the RMB. And we select the proportion of RMB settlement in world trade as the specific indicator.

According to the balance of payments, capital and financial accounts include all transactions between residents and non-residents, which include direct investment, international security and international credit. RMB internationalization indicator system covers indicators from these three aspects. We have designed corresponding indicators based on functions of RMB in these three categories of transactions. And the following are some additional notes about indicators of securities.

International securities includes bond and stock. Because of great risk of information asymmetry in international finance, the scale of international bond market with fixed income is far larger than that of international stock, which has been always in dominant position in international securities market. What's more, the scale of major national stock markets are often quoted in local currency, and they are lack of statistics on non-residents' stock investment. Therefore, by taking financial theories and data availability into consideration, this report will use the international bonds and bills indicator of the Bank for International Settlements (BIS) to reflect international securities transactions. According to the classification of BIS, international bonds and bills include: firstly, all bonds dominated in foreign currencies issued by domestic institutions and non-domestic institutions; Secondly, the bonds dominated in domestic currency and issued by foreign institutions in domestic market; Thirdly, the bonds dominated in domestic currency and issued by domestic institutions in domestic market are also seen as international bonds and bills if they are targeted to non-domestic investors. Thus, the international bonds and bills indicator can reflect the internationalization degree of a country's currency in international securities markets very well.



In order to reflect transactions of RMB international bonds more comprehensively and accurately, this report further divides the indicator into two indicators. One is the stock indicator, namely, the remaining sum of outstanding bonds and bills. The other is the flow indicator, namely, the issuance amount of bonds and bills. The reason of doing this is that the stock indicator can objectively reflect the status quo of RMB in international bonds and bills transactions, and the flow indicator can better capture dynamic changes of RMB international bonds and bills. Certainly, accumulation of the flow results in the stock. And the relationship between these two indicators determines that the stock indicator itself involves the information of the flow indicator, thus we give a larger weight to the stock indicator of RMB international bonds and bills transactions.

The international reserve function is the most typical and centralized one among all international monetary functions. Generally, the proportion of a currency in foreign exchange reserves is the most immediate and intelligible indicator to measure its internationalization degree. So far, under the existing international monetary system, IMF only accounts the proportion of the dollar, the euro, the yen, the pound, the Swiss franc and other major currencies in official foreign exchange reserves. Since the scale of the RMB in official foreign exchange reserves is quite small, it is not accounted by IMF separately. In addition, for the sake of governments' own interests, a majority of governments in the world normally do not publish specific currency structure of their official foreign exchange reserves, which leads to great difficulties in collecting data that reflects international reserve function of RMB. In fact, there are already nearly ten countries using RMB as one of their foreign exchange reserve currencies. With gradual improvement of our statistic system and deepening of international cooperation, the data availability of RMB as official reserve is expected to be improved.

1.3.2 The source and processing of data

The detailed introductions of the sources and processing methods of the data are showed in Table 1-2.

The biggest difficulty in compiling the RMB internationalization index comes from limitation of data availability. Firstly, RMB is not a free convertibility currency due to incomplete openness of the capital account, and it is rarely used in international economic activities, thus global proportions of various