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RMB Internationalization Report 2015

Monetary Strategy in One Belt and One Road Initiative

Press Release

International Monetary Institute, Renmin University of China

Contents

※ This is an excerpt from *RMB Internationalization Report 2015*, prepared for the Press Conference of *RMB Internationalization Report 2015*.

1. Introduction

Till 2014, if we count from 2009 when China started pilot cross-border RMB trade settlement service, the practice of internationalization of RMB has already been carried out for five years. Taking the experience of internationalization of the sovereign credit currency into consideration, five years is quite short compared with the span of the rise of the main international currencies. Especially in the first period, it is easy for newly-developing international currencies to emerge, but is is almost impossible to progress stably and quickly. However, RMB is rewriting the history.

According to the calculation of research team from RUC, RMB internationalization index (RII) has reached 2.47% at the end of 2014. At the end of 2009, it was only 0.02%, which means it has increased more than 120 times in five years. Besides, the share of international use of the four main international currencies, including dollar, Euro, yen and pound, decreased obviously when compared to last year. Meanwhile, the share of RMB, Canadian dollar, Australia dollar and many other newly-developing international currencies increased. At the end of 2014, the yen internationalization index had decreased to 3.82%. As long as there are no major adverse events, the degree of internationalization of RMB will surpass that of yen in the coming one to two years. Then RMB will be one of the major international currencies.

In 2014, the degree of internationalization of RMB kept on growing at a relatively high speed. Trade and finance were main motives. The acceptability of RMB increased in many countries. With the progress of regional trade cooperation, the policy of cross-border RMB trade settlement gradually settles down. In 2014 the amount of cross-border RMB trade settlement reached 6.55 billion, or 41.6% of year-on-year growth. The share of cross-border RMB trade settlement increased to 2.96%. Meanwhile, finance trade gradually became the main motive of the increase of the international share of RMB. In 2014, the direct investment reached 1.05 billion, year-on-year growth is 96.5%; the market of the international RMB bond is becoming more and more prosper. Offshore RMB financial markets throughout Europe and Asia have achieved great progress. The share of RMB reached 2.8% in global capital and finance trade. At present, RMB is the second widest used currency in international trade financing, the fifth widest used means of payment and the seventh widest used currency in foreign exchange transactions. RMB has also received much recognition officially. People's Bank of China has signed currency swap agreements with 28 monetary authorities in different countries and regions. The total amount is over 4.07

billion yuan. RMB has already been accepted as reserve currency or intervening currency by some central banks.

Considering this, in 2015 it is of great possibility that RMB will be taken into currency basket of SDR. If RMB is added to SDR currency basket, it means IMF will recognize RMB as an international reserve currency officially. It is also the critical symbol of RMB entering the main international currencies. If executive board refuses RMB again with the criterion of “free use of money”, it can’t hold back or slow down the progress of internationalization of RMB. Because on the basis of existing achievement. “One Belt One Road” which is actively promoted by China will provide more and better chances for the internationalization of RMB. Then the progress of internationalization of RMB will be quick and stable.

Adhering the spirit of ancient Silk Road, which is “peaceful cooperation, open and inclusive, learning and benefit from each other, and win-win results”. In 2013, China proposed “One Belt One Road” strategy. This is a new regional cooperation pattern. The goal is to make the most of the largest economic corridor in the world. “One Belt One Road” and internationalization of RMB are the two important strategies promoted by China in the 21 century as an emerging country. These two strategies serve China's national interests, providing indispensable support for emerging countries. Meanwhile, they serve the global interest. They are further improvements for the world economic order and the international monetary system, which shows the responsibility of an emerging country.

The theme of the report on internationalization of the renminbi of 2015 is: monetization strategy in the execution of “One Belt One Road” strategy. Our research team mainly completed the following tasks. First, we clearly put forward the target, which shows the good will and history bear of China. Second, we studied the logic of the two strategies interact with each other from theory exploration, historical experience and empirical test. Finally, we emphasized that commodity pricing and account settlement, infrastructure finance, industry development zone construction, cross-border e-commerce should serve as the breakthrough of promoting the standards of the internationalization of RMB by the construction of “One Belt One Road”, and make in-depth discussion related to necessity and feasibility.

The defection in supply and structure disequilibrium of global public goods, especially the extreme defection of public goods in developing countries, seriously hinders the development of global economy and finance. In the circumstance of developed countries like the US decreased the supply of global public goods, as the world's second largest economy, the biggest trading nation and an important direct investment country, China has the ability of providing global public goods. Besides, being the biggest developing country, China can have the ability of satisfying the supply of global goods for developing countries. “One Belt One Road” will set up the most charming win-win cooperation and the common of destiny in the world. Taking this chance; China can increase the global public goods in five facets: creating new notion and new mode of international cooperation; realizing efficient device interoperability, providing new international currency; founding new international financial organization; providing new methods of eliminating local wars and terrorism.

Countries along “One Belt One Road” use more RMB, which also means China increasing the supply of global public goods. RMB receives more and more recognition in international trades. This helps to decrease the cost of trading with China, make trade settlement convenient and avoid the risk of using a third party currency in bilateral trade. China has its own special advantage in infrastructure construction. By setting up new multilateral financial institutions and providing financial support for major projects with the method of RMB bonds, loans and direct investment, the material basis of “One Belt One Road” can be tamped. In fact, RMB fulfill the function of trade pricing and account settlement, financial transactions and foreign currency reserves, which means China provides new international currency and risk management mechanism for countries along “One Belt One Road”. By doing this, China is able to build safe anchor for economy and finance, and make great contribution for the stability of regional economic and financial stability.

“One Belt One Road” has five goals, which are policy coordination, communication facilities, free trade, unimpeded financing, unity of peoples. Ultimately, it is to strengthen the economy cooperation of China and countries along“One Belt One Road”and gradually form the big structure of regional deepen cooperation. Countries along “One Belt One Road”have different kinds of resources, so the economic complementarity is strong. The potential and space of cooperation is huge. China is promoting the progress of the internationalization of RMB and strengthening the circulation of currency of the countries. We are exerting positive effects on achieving the goals and deepen the regional economy cooperation. The results of theory and empirical studies show that increasing the share of the most frequently used currency within the region can be helpful to manage regional financial risks, reduce transaction costs, improve the integral competitiveness within the region, and facilitate the progress of trade and economic integration in the region. China is an important trade partner of countries along “One Belt One Road”. The development of economy and finance of China is in the leading position within this region. The stable politics and proper culture make good preparation for the expansion of RMB in “One Belt One Road”. As long as we keep on increasing the facility and lowering the cost, with the progress of the construction of “One Belt One Road”, countries alongside will gradually increase the share of RMB in trade, investment and financing, financial transactions, and foreign exchange reserves.

According to this report, “One Belt One Road” not only bring benefits to people in alongside countries, but also provide chances for the internationalization of RMB. These two national development strategies, which are “One Belt One Road” and internationalize of RMB, can complement each other. But in practice, we should take the following issues into consideration:

Firstly, monetization strategy of the construction of “One Belt One Road” should seek breakthrough in the following four aspects. First, China should take active measures to promote the use of RMB as the pricing and settlement currency in commodity trades. This can be done by taking advantages of China’s large market share in this region and China’s advanced financial institutions and futures market. We should give priority to the import of iron ore, aluminum ore and coal. Second, China needs to take use of China’s experiences of infrastructure construction and capital mobilization, and make RMB be the major currency in infrastructure financing, especially in international government aids, policy loans and so on. Third, by taking advantage of China’s experiences, China can seek to promote the use of RMB in construction and operation of industrial parks in the region, which will also promote the reasonable layout of RMB off-shore financial markets and form the transaction network of global RMB. Forth, China should promote the use of RMB in e-commerce transactions by taking advantage of geographical and cultural developments.

Secondly, we need to hold on to the notion of open and inclusive to mobilize global resources and bring benefits to countries alongside. The fact that AIIB is widely accepted reminds us that it is important to find the greatest common divisor for values which we can share. Then the goal of win-win can be achieved. Therefore, China should welcome countries alongside to actively participate the construction of “One Belt One Road” and the accompanying monetary arrangements. Particularly, we need to learn the experience and wisdom of economic construction, risk management, regional cooperation and multilateral management in developed countries.

Thirdly, these two strategies need the support of the development of domestic economy. Foreign investment and loans not only need to put emphasis on the efficiency and safety of capital, but also to learn from the mistakes of western countries. To stand out from fierce competition, a country need to forbid blind drain of capital or the update of domestic industry will face great difficulty. Considering this, whether these two strategies can be successful comes down to China’s domestic economic transition, technical progress and institutional innovation.

2. RMB Internationalization Index

2.1 RMB Internationalization Index and Comparison of Major Currencies

Based on the currency's theoretical functions, as a unit of account, as a medium of exchange, and as a store of value, the calculation of RMB Internationalization Index (RII) takes account of the weight of RMB in trade valuation, financial valuation, and official foreign exchange reserves. RII is ranged between 0-100. If RMB were to be the world's only international currency, the value of the indicators of the RII system would be 100%, and RII would be 100; otherwise, RII is 0. If the value of the RMB internationalization index becomes greater, then the RMB plays an increasingly important role in the international economy, and its level of internationalization is increasingly high. RII has been on the rise in 2014 and RII of the fourth quarter is 2.47 with a growth of 45.4%, more than 120 times growth in five years (Figure 2-1).

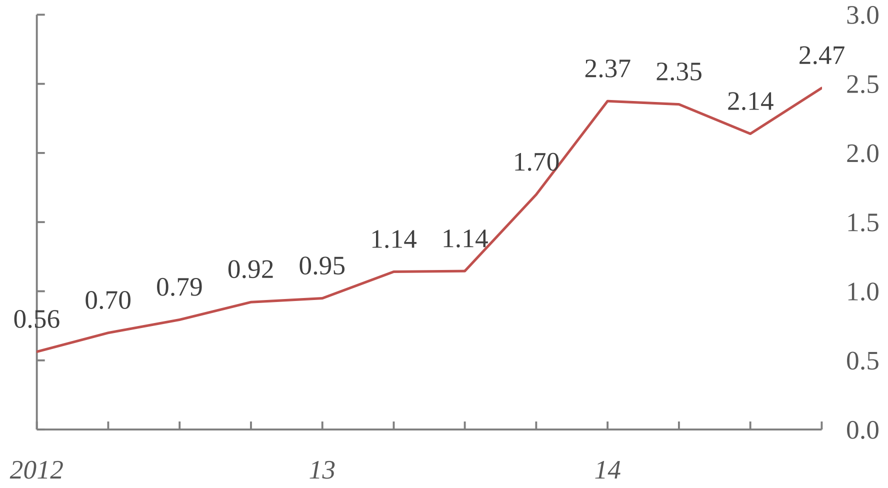

Figure 2-1 The international index of RMB (RII)

Note: due to statistic adjustment of the raw data, RII of the fourth quarter of 2013 is adjusted to 1.70 from 1.69 (RMB Internationalization Report in 2014).

According to the above compilation methods of the RMB internationalization index, the variation of trade settlement, financial transactions and foreign exchange reserve proportion will all influence RII. At the original period of RMB internationalization, the main influence relied on trade settlement. With the RMB internationalization proceeding going on, the driver of RII had turned into a parallel drive of both trade settlement and financial transaction. In 2014, the financial transaction driving force has become more obvious. At the same time, the proportion of RMB as the foreign exchange reserve had increased sharply. In a comprehensive view, the international trade settlement function provides a basic guarantee of the steady increasing of RII, and the acceptance of RMB as a reserve currency and the using of RMB in the international financial transaction have become the main power to push the RII growth.

While RII is increasing, the total internationalization indexes of U.S. dollar, euro, yen and pound decreased by 5.04% year-on-year (Table 2-1). The U.S. economic recovery has helped lift the dollar, and driven the USD internationalization index up from 53.41 last year to55.24, which further enhanced U.S. dollar' role as an international currency. The euro zone had yet to get rid of the economic woes, and the European central bank announced the implementation of quantitative easing policy to stimulate economic recovery, which caused the devaluation of euro and dampened the international confidence in euro, the EUR internationalization index dropped from 32.02 the year before to 25.32, and its level of internationalization fell further. The structural adjustment of Japan's economy was still in progress, and the market remained suspicious of the prospect of Prime Minister Abe's economic reforms. Japan's economy decreased, and there appeared a huge devaluation in yen, which made the JPY internationalization index fall from 4.24 to 3.82, the international status of yen declined. Instead, the United Kingdom, which keeps a certain distance with the Europe, performed better than expected in terms of economy, its trade and investment were growing rapidly, the pound remained strong, the GBP internationalization index rose from 4.39 the year before to 4.94, the pound's international status has risen steadily.

Table 2-1 Major world currency internationalization indexes

	2013Q1	2013Q2	2013Q3	2013Q4	2014Q1	2014Q2	2014Q3	2014Q4
Dollar	52.84	55.53	53.47	53.41	53.05	55.11	55.27	55.24
Euro	24.69	27.85	25.19	32.02	24.38	23.59	24.68	25.32
Yen	4.10	4.62	4.58	4.24	4.17	4.61	4.12	3.82
Pound	4.40	4.25	4.05	4.39	5.42	5.05	4.52	4.94
Total	86.03	92.26	87.30	94.06	87.03	88.36	88.59	89.33

2.2 Six Impetuses for RII

Firstly, China's economy is going to "the new normal", which has consolidated the foundation of the internationalization of RMB comprehensively.Since 2014, China has put an end to thirty years of high-speed economic growth model, and turned to the rapid development of the new normal. China starts to solve the negative effects caused by the old model, such as the imbalance of economic structure, the deterioration of the environment and excessive use of resources. Third Plenary Session of the 18th CCP claims the strategic reform task in new period and decisive role of market in the allocation of resources, in order to remove the institutional barriers and stimulate the unlimited potential of the China's market. The reform has improved both the economic development coordination and sustainability, and enhanced the Chinese economic growth stamina. In 2014, the growth rate of per capita disposable income of Chinese residents reached 8%, exceed the growth rate of GDP. The contribution rate of consumption rose to 51.2%, transition of the impetus to the economic development was taking effects. The share of service industry output was up to 48.2%, and the mobile Internet, high-tech equipment manufacturing and other strategic emerging industries were growing rapidly. E-commerce and other new industry were growing rapidly and the international competitiveness and bargaining power of Chinese enterprises has been greatly increased. China has improve people's livelihood, health care, education, and social security system construction, and rule by law and strict rule over party strengthen the system base for the stable development of China’s economy and society, enhancing the domestic and international confidence on China’s government. China has promoted the commercial system reform and reduced 1/3 administrative examination and approval matters. As a result, the growth rate of newly registered enterprises reached 45.9% and a wave of innovation and pioneering has been brought. Despite the greater economic downward pressure, with a series of stable macroeconomic policies to resolve Chinese structural problems, China achieved 7.4% economic growth this year, which was in the forefront of the world’s major economies. The year of 2014 was the first year of deepening reform and China has actively sought to improve the quality of economic and social development, which provides a solid economic foundation and bright prospects for the internationalization of RMB.

Secondly, the acceleration of financial reform and improvement of cross-border RMB policy enhance the double-wheel drive mode for the internationalization of RMB. In 2014, China's financial reform has made significant progress in the areas of the openness of financial markets, interest rate liberalization and market-oriented exchange rate mechanism, which is the institutional foundation for the perfect, effective modern financial system, supporting the next step of RMB internationalization. For example, in March 2014, People's Bank of China basically withdrew from the normalization of foreign exchange intervention, and the floating rate of yuan against dollar trading price in the inter-bank spot foreign exchange market expands from 1% to 2%, resulting in the enhancement of two-way floating flexibility in RMB exchange rate. In July 2014, the establishment of WeBank, Wenzhou Minshang Bank and Tianjin Jincheng Bank broke the former financial monopolies, which help ease the financing problems of mid-small size enterprises and enhance the efficiency and fairness of China’s financial market. In November 2014, People's Bank of China announced that the upper limit of the deposit interest rate floating band of financial institutions was expanded to 1.2 times of the benchmark interest rate, and consulted on Deposit Insurance Regulation (consultative draft), furthering the interest rate liberalization. In addition, in order to adapt to the basic requirements of Reform and Opening-up in a higher level, the cross-border RMB policies are improved in the process facilitation of process and the RMB's usable range has been expanded, showing the development tendency of from the pilot area to the whole nation, from enterprises to individuals, and from trade account to capital and financial account. It then improves the double-wheel of trade and finance drive mode and accelerates the process of RMB internationalization.

Thirdly, the improvement of China's capital account openness enhances the international function and attraction of RMB. China (Shanghai) Pilot Free Trade Zone and Shanghai-Hong Kong Stock Connect program are allowed to conduct some pilot experiments with deepening RMB convertibility under capital accounts. In 2014, the cross-border RMB settlement under current account and direct investment account was further simplified, RMB offshore loan, two-way yuan cash pooling and centralized cross-border current account yuan payments and collections were allowed under certain conditions, third party payment joined cross-border e-commerce RMB settlement and the free trade account (FT account) system was established in China (Shanghai) Pilot Free Trade Zone These measures improved the efficiency and convenience of cross-border RMB usage, and promoted the expansion of cross-border RMB business in FTA. In order to promote the development of Shanghai international financial center and the construction the channels of RMB capital flows, Shanghai Gold Exchange launched the international board of precious metals futures RMB denominated in September 2014 and the crude oil futures trading in December 2014, realizing the depth integration of onshore and offshore funds, and enhancing the China's power in international commodities pricing and RMB's price discovery function of commodities. In particular, the Shanghai-Hong Kong Stock Connect Program officially launched in November 2014, not only enhancing the comprehensive strength of Hong Kong and Shanghai stock market and expanding RMB investment channels in both sides, but also marking that the opening of China's capital market had entered a new phase and the RMB return mechanism had been completed basically. The new measures to China's capital market openness above undoubtedly have enhanced the RMB's attractiveness as an international investment currency, further expanding the scope and function of RMB in the international financial transactions.

Fourthly, "One Belt and One Road" opens the strategic window for the internationalization of RMB. "One Belt and One Road" is the national strategy of China in new period, and is the cooperation concept that China actively takes international responsibility and promotes the mutual beneficial cooperation and development of countries and regions along the route. In 2014, the strategic concept of "One Belt and One Road" has become a hot topic in many international conferences, such as G20, APEC and the Boao Forum, and has gained the active response and universal recognition of countries. The provinces and cities along the route promote intensive strategic planning and deployment, meanwhile financial and non-financial enterprises targeting the opportunity actively participate in related programs. “One Belt and One Road” is a new pattern of economic regionalization led by China and will bring long-term driving force for the economic development of China and countries and regions alongside, to provide new opportunities and breakthroughs for the internationalization of RMB. It is the important guarantee for “One Belt and One Road” to strengthen the capital circulation and the use of RMB is an effective means of reducing the circulation cost and enhancing financial risk resilience for countries along the route. “One Belt and One Road” brings various international financing, investment and trade programs, and Asian Infrastructure Investment Bank and the Silk Road Fund are established. RMB will play more international monetary function in the construction of “One Belt and One Road”, accelerating the realization of RMB regionalization stage goal.

Fifthly, RMB offshore market has been expanded and RMB clearing system arrangement has been basically completed. Considering the first trading status of China, mangy multinational companies take RMB into their fund liability management and risk management system. Especially with the long-term stability of RMB and the expected high economic growth of China, there is a rapid growth of the investment and financing demand of offshore RMB. The market behaviors of the microcosmic entities promote the countries with closer trade and economic ties with China, actively build and develop RMB offshore markets. In 2014, the European countries actively develop the RMB offshore markets, and China offered support and arrange RMB clearing banks, optimizing the global layout of the RMB offshore markets. Approved by the State Council of China, one each Chinese bank is arranged as the RMB clearing bank in Sydney, London, Frankfurt, Seoul, Paris, Luxembourg and Toronto, after Hong Kong, Macao, Taiwan and Singapore. Through the arrangement abroad of offshore RMB clearing bank, China has constructed the global RMB clearing network coverage, offering strong technical support for RMB's international flow and trade facilitation. The improvement of the offshore RMB markets and the clearing system further boosts the RMB usage confidence of foreign enterprises, and is conducive to expand the circulation channels of offshore RMB abroad. The deposit amount, product types and participants in RMB offshore markets all show a significant growth in 2014.In addition, in 2014, the China International Payment System (CIPS) settled in Shanghai, connected with all the direct participants inside and outside China, dealing with RMB cross-border payments of trade and investment and covering the RMB settlement in major time zones of the world, to provide a solid hardware support for the internationalization of RMB.

Sixthly, the international cooperation is deepening, and China actively undertakes major power responsibility to advance the mutual benefit and win-win development of countries. In 2014, China actively carried out international economic and financial cooperation: the bilateral and multilateral trade cooperation achieved outstanding progress, that China-Switzerland and China-Iceland Free Trade Agreement formally implemented, and China-ASEAN cross-border RMB business center was established in Nanning, Guangxi, expanding the channels of RMB cross-border usage; China started RMB direct currency trading with NZD (New Zealand Dollar), GBP (Great British Pound), EUR (euro) and SGD (Singapore dollar) in the interbank foreign exchange market, reducing the exchange cost between RMB and these major currencies and breaking the barriers of RMB cross-border usage; People's Bank of China continued to promote the international currency cooperation and successively signed the currency swap agreement with the monetary authorities of five countries that were Switzerland, Sri Lanka, Russia, Kazakhstan and Canada, enhancing the official recognition of RMB. Furthermore, China actively participate in the making of multilateral and international rules, strengthen the cooperation with other developing countries, promote the construction of “One Belt and One Road” and set up Asian Infrastructure Investment Bank and Silk Road Fund. China is growing into a world power that dares to take international responsibility and hold the win-win concept, to actively participate in the international affairs. These international cooperation in trade, finance and other fields, will support RMB toward the center stage of international currencies.

3. Current Situation of RMB Internationalization

3.1 RMB Cross-border Trade Settlement

(1) Rapid expansion of scope, the proportion of RMB settlement in total imports and exports declined first and then increased.

In 2014, RMB cross-border trade settlement has expanded its scope, with a total amount of 6.55 trillion Yuan, an increase rate of 41%, equivalent to 1.92 trillion Yuan. The proportion of RMB cross-border trade settlement in total exports and imports was 25.44%, and it enjoyed an increase rate of 0.81% compared with last year (Figure 3-1). Influenced by the expectations on the United States' quitting quantitative easing, capital flow into the US due to its economic recovery and China's losing capital, the proportion of RMB settlement in total imports and exports declined during January to August in 2014. However, that figure bounced during the rest of the year due to the new normal conditions, the enabling environment created by One Belt One Road initiative and the Shanghai-Hong Kong Stock Connect and boosted confidence among international societies.

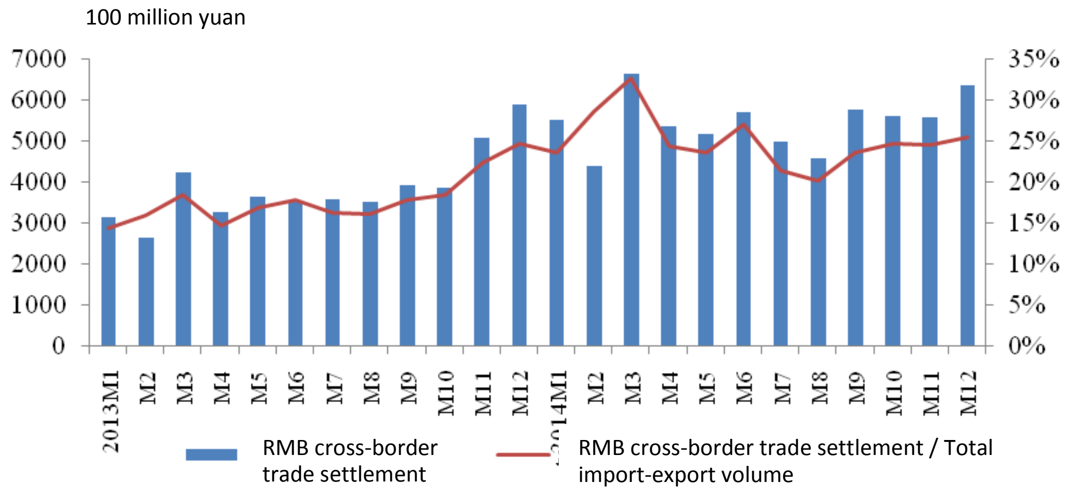

Figure 3-1 the scope of RMB cross-border trade settlement

Source: People's Bank of China, the Ministry of Commerce

(2) Goods trade settlement dominates and the scope of service trade settlement expands

Total amount of RMB goods trade settlement was 5.9 trillion Yuan in 2014 and the ratio of goods trade settlement was 90.08%. The ratio of service trade settlement and other settlement was 10.02%, equivalent to 656.5 billion Yuan. The ratio of goods trade settlement was larger than that of service trade settlement. This phenomenon was more salient since the People's Bank of China adjusted the measurement standards (Figure 3-2, 3-3).

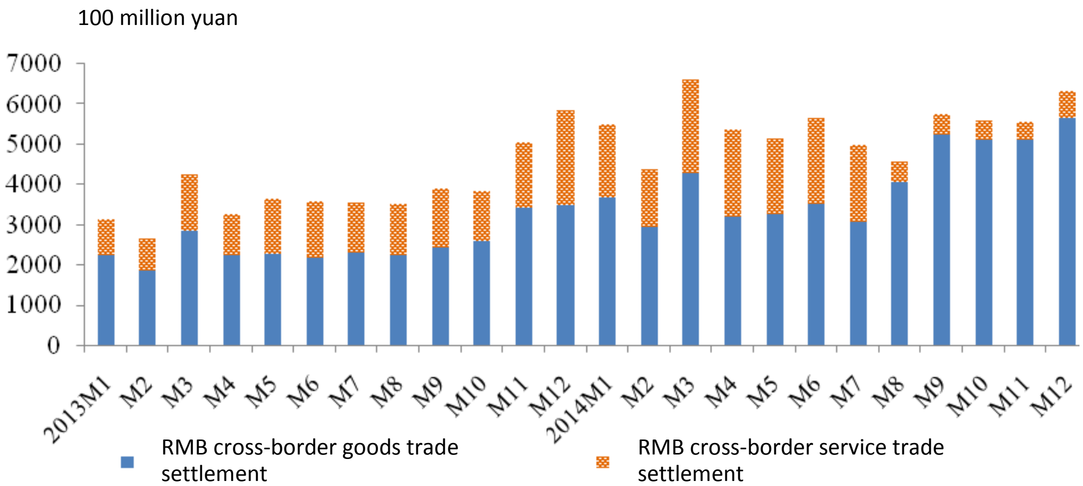

Figure 3-2 the trend of RMB settlement scale in goods trade settlement and service trade settlement

Source: People's Bank of China, the Ministry of Commerce

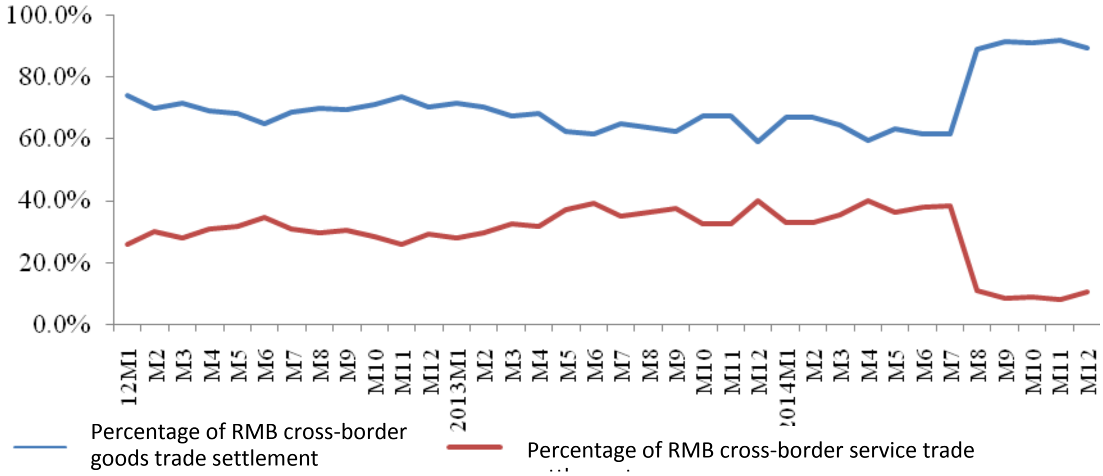

Figure 3-3 the ratio of RMB goods trade settlement and service trade settlement

Source: People's Bank of China, the Ministry of Commerce

(3) Balance in Receipts and payment is stable and export RMB settlement grows rapidly

From the perspective of RMB settlement, in the whole year of 2014, cross-border RMB trade settlement businesses were paid-in 2.73 trillion Yuan, an increase of 0.85 trillion Yuan, a 45.21% increase; the real pay reached 3.82 trillion Yuan, an increase of 1.07 trillion Yuan, a 38.91 % increase. The ratio of receipts and payment dropped from 1:1.37 in 2013 to 1:1.4, reflecting more RMB cross-border trade settlement made by foreign enterprises. The total amount of RMB cross-border trade in receipts and payment is stable (Figure 3-4).

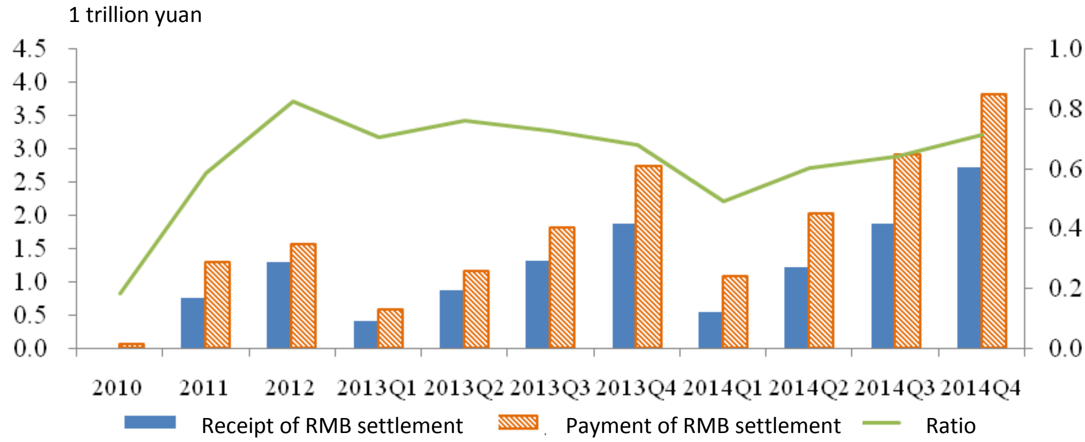

Figure 3-4 2010-2013 the ratio of receipt and payment in cross-border RMB settlement businesses

Source: the People's Bank of China

3.2 RMB Financial Transactions

The international financial transaction function of RMB has been enhanced and its financial transaction scale is expanding in international credit, direct investment, and international bonds and notes, with a high-speed growth rate. By the end of the fourth quarter of 2014, the comprehensive proportion of RMB denominated international financial settlement is 2.8%, showing a growth of 34.0%. Overall, the sharply rising issue scale of RMB international bonds and notes is the main driver of the comprehensive index for RMB-denominated international financial settlement (Figure 3-5).

Figure 3-5 Comprehensive index for RMB-denominated international financial settlement

3.2.1 RMB Direct Investment

(1) RMB Overseas Direct Investment

In 2014, the total amount of foreign investment and RMB foreign investment has increased. According to the statistics of the Ministry of Commerce, in 2014, Chinese domestic investors made non-financial overseas direct investment in 6,128 foreign firms in 156 countries and regions, increased by 14.1% over the previous year. The amount of RMB ODI was 186.6 billion RMB, accounting for 17.77% of the total ODI at the exchange rate at the year end, with the growth of 118.0%, an increase of 101 billion Yuan. The proportion of RMB of the total ODI has fluctuated from January to August. Later, supported by the ODI made by quite a number of financial institutions and favorable policies, particularly the expanded scale of offshore RMB markets and high liquidity, Chinese enterprises had made investment in more areas, making the RMB ODI ratio larger in the total ODI (Figure 3-6).

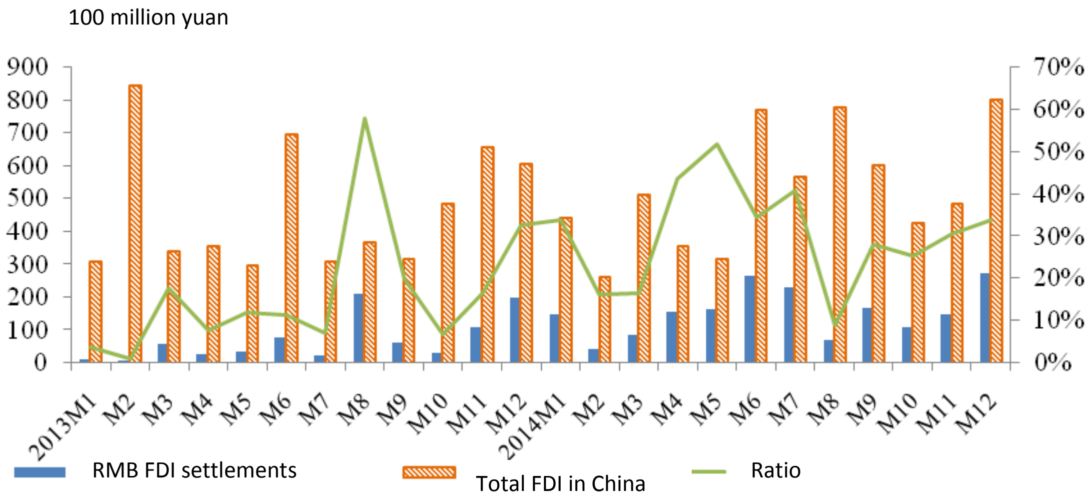

Figure 3-6 RMB ODI settlement's ratio in the total Chinese FDI

Source: People's Bank of China; "Chinese Monetary Policy Implementation Report"; the Ministry of Commerce;

(2) RMB Foreign Direct Investment

In 2014, the actual use of FDI accounted 119.558 billion USD, up 1.68% over the previous year, an increase of 1.972 billion USD, going abreast with the RMB ODI. The foreign investors were mainly coming from Hong Kong, Singapore, Taiwan and Japan and they were mainly engaged in the manufacturing industries, real estate, leasing and commercial services. Foreign direct investments using RMB settlement accounted 862 billion Yuan, up 92.4% over the previous year, an increase of 413.8 billion Yuan (Figure 3-7). With more RMB in the offshore markets and increasing confidence in Chinese economy, more foreign investors are using RMB to conduct FDI.

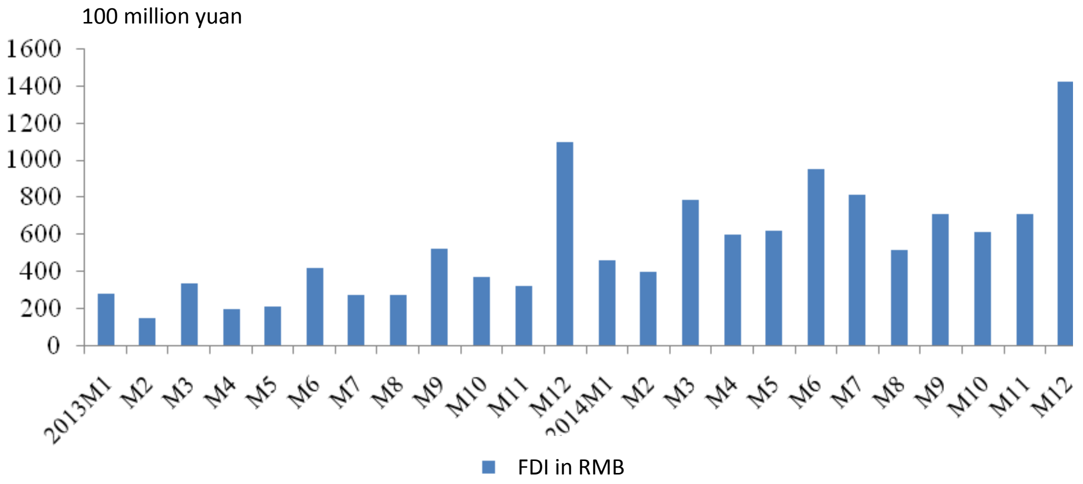

Figure 3-7 FDI RMB settlement

Source: The Ministry of Commerce; People's Bank of China

3.2.2 RMB securities investment

(1) International Bonds and Notes Market

As China's interest rate is higher than other major countries, companies' overseas financing can effectively lower the cost of funds. Thus, companies have greater demand for overseas financing. Meanwhile, the fast growth of overseas RMB fund supply also stimulates the demand for RMB investment. Propelled by demand and supply, the issuing scale of RMB bonds and notes continuously sets new record. In the first three quarters of 2014, the issuance of RMB international bonds and notes was $32.96 billion, up by 130% compared with the same period in 2013, an increase of $18.8 billion (Figure 3-8).

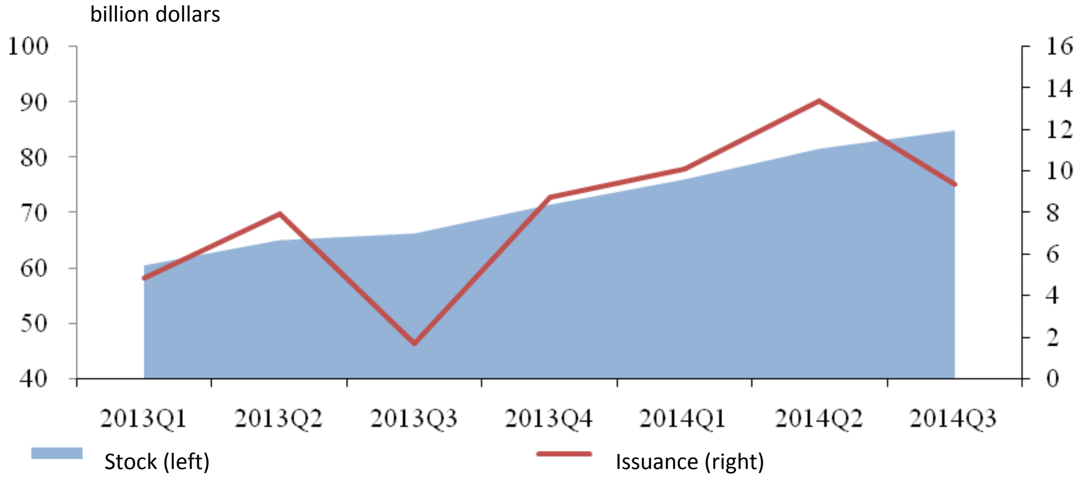

Figure 3-8 Stock and issuance of RMB international bonds and notes, 2013-2014

Source: Bank for International Settlements

Compared with the fluctuation on the scale of issuing RMB international bonds and notes in 2013, that in 2014 has gone through adjustments but still maintained relative stability. By the third quarter of 2014, the issuance of RMB international bonds and notes reached $ 94 billion, an increase of $ 22.55 billion, about 31.56% compared with that in 2013. However, the issuance of RMB international bonds and notes only accounts for a small proportion of global bonds market, at 1.06%. The balance of RMB international bonds and notes reached $ 84.9 billion, a year-to-year increase of $ 18.55 billion, an increase of 24.90% compared with 2013 and the stock of RMB international bonds and notes accounted for 0.4% of global bonds and notes, an obvious increase compared with the same period in 2013 (Figure 3-9). RMB internationalization started since 2009. Although with an increasingly higher level of internationalization, there is still a huge gap compared with the major international currencies. Over the same period, among the global international bonds and notes balance, the dollar accounted for 39.05%; the euro accounted for 42.14%; the sterling accounted for 9.55% while Japanese yen accounted for 2% (Figure 3-10). There is still a long way before RMB being fully internationalized. We need more development and improvement.

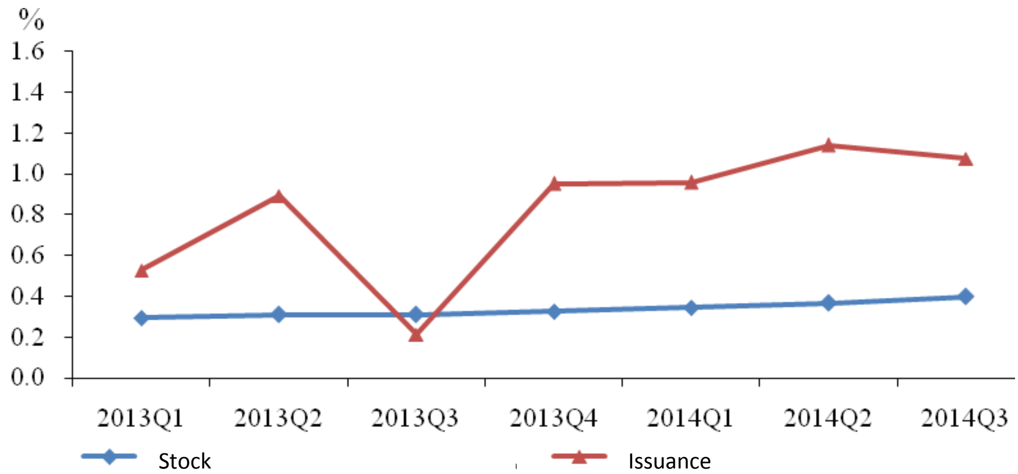

Figure 3-9 Proportion of RMB international bonds and notes on global market: in stock and issuance perspective, 2013-2014

Source: Bank for International Settlements

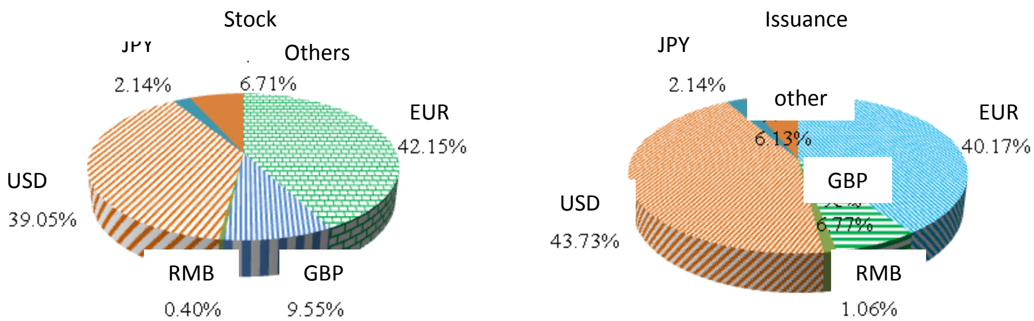

Figure 3-10 Currency structure and stock of international bonds and notes in the first three quarters in 2014

Source: Bank for International Settlements

International bonds are an important part of global capital market. The increasing issuance of RMB international bonds and notes signifies that RMB's function of financial trading is gradually being realized.

RMB international bonds are mainly issued in offshore markets. 2014 saw many international financial centers started RMB offshore business. Hereafter, offshore RMB deposits rapidly expanded, which established a sound environment for RMB international bonds issuance. The participation and products of offshore financial market became more diversified not only in Hong Kong, but many other places, such as Singapore, London, Taiwan, Seoul and Frankfurt as well. Of course, Hong Kong is still the largest offshore RMB market for China. In 2014, the stock of RMB bonds in Hong Kong increased to 386.087 billion Yuan from 290.41 billion Yuan in 2013, an increase of 33%, within which, the financial bonds had the fastest growth, increased from 49.127 billion Yuan in 2013 to 111.227 billion Yuan in 2014, up by 10 % of market shares. (See Table 3-1)

Table 3-1 2014 product size and structure of RMB bonds in Hong Kong

Category	Stock (¥100million)	%	Bonds number	%
Corporate bonds	1820.50	47.15	161.00	48.79
Financial bonds	1112.27	28.81	129.00	39.09
Treasury Bonds	805.00	20.85	29.00	8.79
Convertible bonds	123.10	3.19	11.00	3.33
Total	3860.87	100.00	330.00	100.00

Source: WIND database

(2) Stock market

2014 is the starting year for China to comprehensively deepen reform. With the stimulus brought by favorable policies, such as stock issuance registration, mixed ownership reform of SOEs and Shanghai-Hong Kong Connect, China's stock market in 2014 has the greatest vitality and highest growth in the world. In 2014, Shanghai Composite Index finally closed at 3234.68, up by 52.87% compared with 2013; Shenzhen Composite Index closed at 1415.19, an increase of 33.80%; by the end of 2014, the average price-earnings ratio of Shanghai stock market increased from 10.99 times at the end of 2013 to 15.99 times while the average price-earnings ratio from Shenzhen stock market rose from 27.76 times by the end of 2013 to 34.05 times.

In 2014, market capitalization (A, B shares) totaled 37.254696 trillion Yuan, an increase of 13.346977 trillion Yuan compared with that of last year, an increase of

55.83%. The stock market circulation value totaled 31.562431 trillion Yuan, an increase of 11.604477 trillion Yuan, compared with that of last year, an increase of 58.14%. Trading in Shanghai and Shenzhen stock market was very active due to higher stock prices and the turnover continuously set new records. Accumulated turnover was 74.391298 trillion Yuan, an increase of 27.518438 trillion Yuan, up by 58.70%. Average daily turnover was 303.638 billion Yuan, up by106.693 billion Yuan, an increase of 54.17% (Figure 3-11).

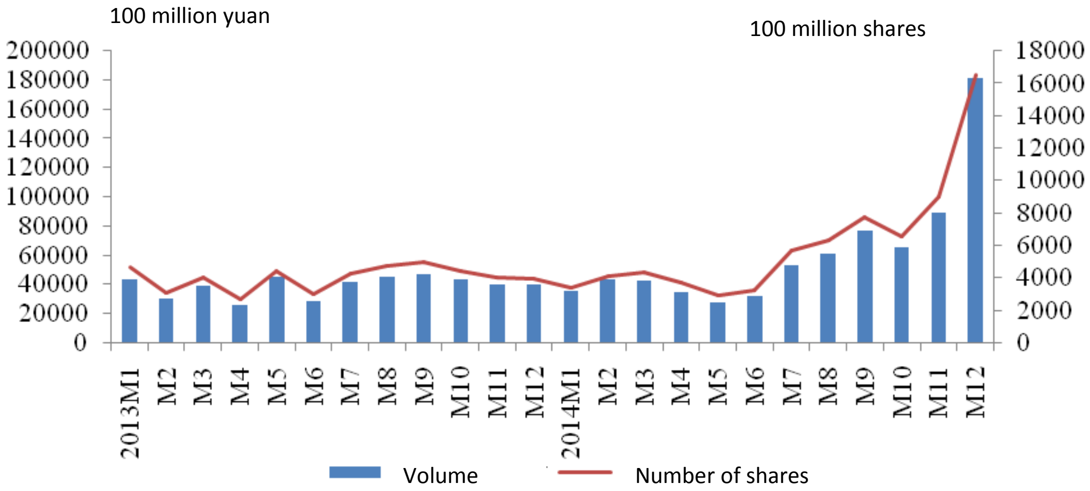

Figure 3-11 Chinese stock market transactions

Source: China Securities Regulatory Commission.

Capital market and direct finance play a more important role in corporate finance. In 2014, there were 125 new companies going public, within which 43 listed in the major board of Shanghai Exchange, 31 in SMEs board of Shenzhen Exchange and 51 in Growth Enterprise Market (GEM). Newly listed company raised 66.889 billion Yuan through stocks; the directorial additional issuance of originally listed companies also went up, compared with 2013 by178.471 billion Yuan, reaching 403.130 billion Yuan, up by 79.44% (Table 3-2).

Table 3-2 Chinese stock market financing amount

Time	Initial Issuance Amount			Refinancing Amount					
				A					
	A	B	H	Public Additional	Directional Additional	Placement	Warrants Exercise	B	H
2012	0.39	0.00	82.50	104.74	1867.48	121.00	0.00	0.00	77.14
2013	0.00	0.00	113.17	80.42	2246.59	475.75	0.00	0.00	59.5

									1
2014	668.89	0.00	128.72	18.26	4031.30	137.98	0.00	0.00	212. 90

Source: China Securities Regulatory Commission.

Note: A shares ： In hundred million Yuan

B shares ： In hundred million U.S. dollar

H shares： In hundred million U.S. dollar

(3) Derivatives Market

By the second quarter of 2014, the outstanding balance on global OTC interest rate derivatives market is $563 trillion: where the dollar, euro, Japanese yen, British pound, Swiss franc and Canadian dollar accounting for respectively 28.55%, 39.39%, 9.18%, 10.80%, 0.95% and 1.86% (Figure 3-12), whereas other currencies accounting for a total of less than 10%. Since China’s derivatives market lags behind and has a relatively small scale, there is still a big gap between China and developed countries and it has not been yet included in a separate statistical currency ranks by Bank for International Settlements.

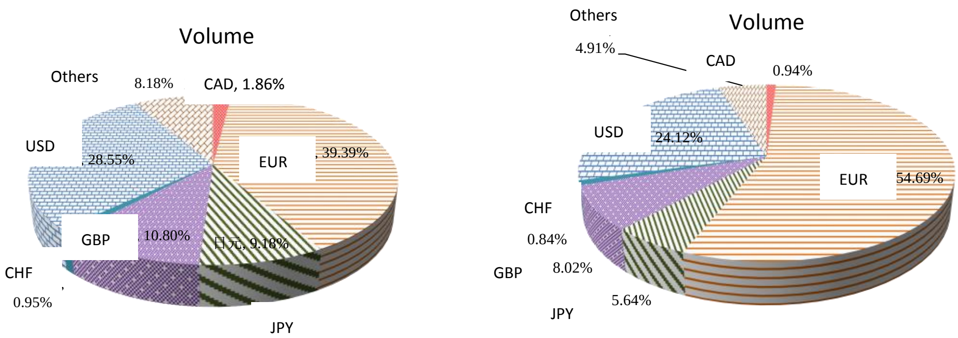

Figure 3-12 The currency structure of interest rate derivatives on the global OTC market in late Q2 of 2014

Source: Bank for International Settlements.

As shown in Table 3-3, compared with the fourth quarter of 2013,the outstanding balance and market value of other currencies’ interest rate derivatives on the global OTC market both increased, within which their proportions to all the currencies went up from 8.28% to 9.28% and from 4.56% to 5.76% respectively.

Table 3-3 currency structure on the interest rate derivatives market of global OTC market in Q4 2013 and Q2 2014

	Interest rate derivatives market of global OTC market	Interest rate derivatives market of global OTC market

	Outstanding balance		Market value	
	Q4. 2013	Q2.2014	Q4. 2013	Q2.2014
Euro	41.32%	39.39%	49.22%	54.69%
Yen	8.99%	9.18%	4.90%	5.64%
Pound	9.00%	10.80%	9.11%	8.02%
Swiss Franc	0.98%	0.95%	0.85%	0.84%
Canadian Dollar	1.78%	1.86%	0.98%	0.94%
U.S. Dollar	29.65%	28.55%	30.38%	24.12%
Others	8.28%	9.28%	4.56%	5.76%

Source: Bank for International Settlements.

The reform in the marketization of RMB interest rate has entered into a crucial stage; the system of RMB exchange rate has more connected to the market, so the market influence to interest rate and exchange rate is increasing obviously. To avoid the risks posed by interest rate and exchange rate, RMB derivatives are flourishing in recent 2 years. In August, 2013, HKEx launched China 120 Index futures. In October, 20, 2014, SGx launched RMB futures contract, including U.S. dollars /offshore RMB futures and futures contract of the RMB against U.S. dollars with a volume of 100, 000 dollars and 500, 000 RMB respectively. Currently, two types of RMB derivatives can be brought in HKEx: the futures of the U.S. dollars against the RMB and China 120 Index futures. In 2014, the former reached 195, 049 hands, increased by 56, 341 than 2013, with an increase of 40.62%. The later reached 42, 039 hands last year, with a stable transaction every month (Table 3-4).

Table 3-4 U.S. dollar against RMB futures and China 120 Index futures transactions summarized Unit：hand

	2013				2014			
	Season 1	Season 2	Season 3	Season 4	Season 1	Season 2	Season 3	Season 4
U.S. dollar against RMB futures	25054	46238	26868	40548	75498	33359	42843	53349
China 120 Index futures	0	0	-	-	9824	8678	10935	10756

Source: HKEx.

In 2014, the asset market continuously sees a vigorous activity in RMB interest rate swap, with increasing demands. The total transaction of interest rate swap has reached 403, 173 billion yuan, increased 132, 151, 2 billion yuan, with an increase of 48%. The bond forward and forward interest rate transaction are flourishing, which is contrary to the condition in 2013. They has reached 781 million yuan and 4, 808 billion yuan respectively. This is a tremendous increase than that of 50 million yuan and 101 million yuan respectively in 2013 (Table 3-5).

Table 3-5 2013-2014 Turnovers on major inter-bank markets

Unit: billion yuan

	2013				2014			
	Season 1	Season 2	Season 1	Season 1	Season 1	Season 1	Season 1	Season 1
Interest rate swap	7375.83	7960	5697.8	6068.55	8044.5	8908.53	9577.68	13786.59
Forward rate	0	0	0.5	0	0	2.16	2.91	2.74
Bond forward	1.01	0	0	0	0	0.07	0.96	47.05

Source: China Foreign Exchange Trading Center

In 2014, CSI 300 stock index futures has reached a turnover of 163, 12 trillion yuan, increased by 22, 44 trillion yuan than 2013, with an increase of 16% percent. The fourth quarter sees the biggest transaction volume, the CSI 300 index increased 44.17%, increased by 110% than the third quarter. A parallel relation exist in the turnover of CSI stock index futures, and the fluctuation of CSI 300 index. This indicates the CSI 300 stock index futures can prevent hedging. In 2014, the government bond futures launched by previous year enjoys a thriving in the market, reaching 878, 515 billion yuan, with an increase of 186% than last year (Table 3-6).

Table 3-6 2013-2014 stock index futures and bonds transactions

Unit: billion yuan

	2013				2014			
	Season 1	Season 1	Season 1	Season 1	Season 1	Season 1	Season 1	Season 1
CSI 300 stock index futures	348706	331666	402067	324564	272821	275356	348607	734601
government bond futures	0	0	1443.83	1620.05	1083.95	1078.99	1322.63	5299.58

Source: China Financial Futures Exchange

(4) Foreign investors invested in RMB financial assets

Within the process of opening Chinese financial market, non-habitual investors can access to stock market and inter-bank market. There are three channels for investors to allocate RMB stocks: qualified foreign institutional investors (QFII), RMB qualified foreign institutional investors (RQFII) and CSI. The previous two approaches apply to institutional investors, and individual investors can invest in stocks of SSEx through CSI.

In November 17, 2014, the stocks under CSI has been launched. Data from HKSx indicates that the turnover of Shanghai stock reached 46, 589 billion yuan in November, 2014, and Hong Kong stack reached 7.6 Hong Kong dollars. In December, they are 120, 922 billion yuan and 18, 411 billion yuan respectively. The CSI has increased the influence of RMB in pricing financial products, also facilitate the condition to open CSI and Chinese asset accounts.

Inter-bank bond market allows QFII, RQFII, foreign banks and insurers to participate in the transaction. Up until the end of 2014, our inter-bank bond market has permitted following institutions: 14 QFII, 66 RQFII, 97 foreign banks and 11 foreign insurers. In 2014, the transaction of overseas institutions reached 116, 963 hands in inter-bank bond market, with a total volume of 10, 168, 339 billion yuan (Figure 3-13).

Figure 3-13 2014 transaction of overseas institutions in inter-bank bond market

Source: China Foreign Exchange Trade Center

3.2.3 RMB Overseas Credit Market

Up until the end of 2014, the balance of RMB overseas loans in domestic financial institutions reached 198, 968 billion yuan, an increase of 6.19% than 2013. The new loans reached 11, 591 billion yuan, increased 5, 126 billion yuan than 2013. The ratio of RMB overseas loans to total loans borrowed by the financial institutions is 0.24%, with a slightly decrease form 2013 (Figure 3-14). The reason attributes to the increase ratio of overseas loans is slower than that of the total loans. With the increasing position of RMB in international market, especially the decreasing of RMB interest rate, the RMB overseas loans will be expanded in its scope, as well as takes more account in the total loans.

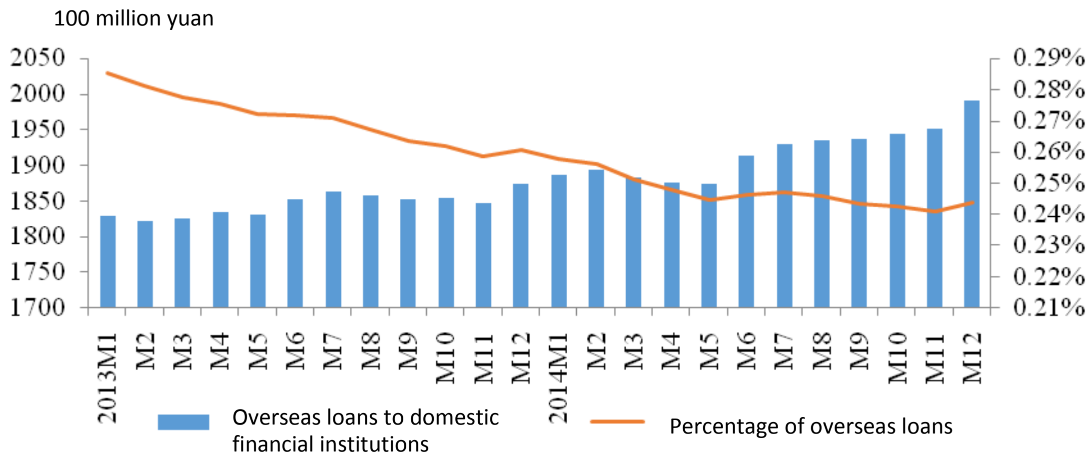

Figure 3-14 2013-2014 RMB overseas loans and the ratio of domestic financial institutions

Source: the People's Bank of China

RMB overseas loans include overseas loans of domestic financial institutions, also contains the RMB loans issue from overseas financial institutions to domestic institutions. The RMB interest rate is lower in the overseas, so the domestic institutions are willing to take loans form overseas. In 2013, PboC has approved this practice in Shanghai FTZ, ShengzhenQianhai zone and Kunshan pilot area. This practice has been expended to more areas, include Tianjin, Guangxi and Yunnan. Some enterprises can access to the southeast Asia and other RMB offshore market, so as to take loans. This can support the real economies which are in line with the national macro policy and industrial orientation, such as enterpot trade, infrastructure establishment and clean energy.

3.2.4 RMB in Foreign Exchange Market

In 2014, the spot transaction of RMB foreign exchange reached 4.12 trillion U.S. dollars, with an increase of 1.2% year on year. To reduce the cost of currency conversion, facilitate bilateral trade and investment, PBoC adopted active approaches to bolster the direct transaction between different currencies, including major currency and currencies of neighboring countries. In 2014, inter-bank FX market witnessed a expansion of currencies for direct transaction, such as New Zealand dollar, pound, euro and Singapore dollar. The inter-bank market has also been enriched by RMB and tenge to develop regional trade. The currencies of neighboring countries has expended tremendously, from ringgit, ruble, to principal reserve currencies of euro, pound and yen, as well as to convertible currencies like Australian dollar, New

Zealand dollar and Singapore dollar. The network of direct transaction using RMB is emerging (Table 3-7).

In 2014, the direct transaction of RMB against foreign currencies reached 1.05 trillion yuan, accounting for 4.7% of spot transaction in inter-bank foreign exchange market. RMB for direct transaction is popular in the inter-bank foreign exchange market, and the liquidity of RMB is increasing which can lower the currency conversion cost of micro-economic units.

Table 3-7 2014 RMB against other currencies transaction in inter-bank FX spot market Unit: billion yuan

Currency	USD	EUR	JPY	HKD	GBP	AUD	NZD	SGD	CAD	RUB	THB	KZT
Volume	239942	3155	4551	2031	1377	1486	281	838	14	255	2	3
Year-on-year	4%	15%	-64%	40%	702%	-1%			65%	369%	-63%	

Source: China Foreign Exchange Trade Center

Swap is the major product in the RMB foreign exchange (FX) derivatives market (Figure 3-15). The transaction of RMB FX swaps accumulated to 4.49 trillion U.S. dollars, with an increase of 32.1% year on year. Among the transaction, overnight U.S. dollars swaps reached 2.36 trillion U.S. dollars, accounting for 52.6% of the total swaps. The RMB FX forward market accumulated to 52.9 billion U.S. dollars, increased 63.5% year on year. In 2014, the turnover for foreign currencies against RMB reached 60.6 billion U.S. dollars, reduced by 5.7% year on year. The biggest share goes to U.S. dollars against Hong Kong dollars, accounting for 35% in the market.

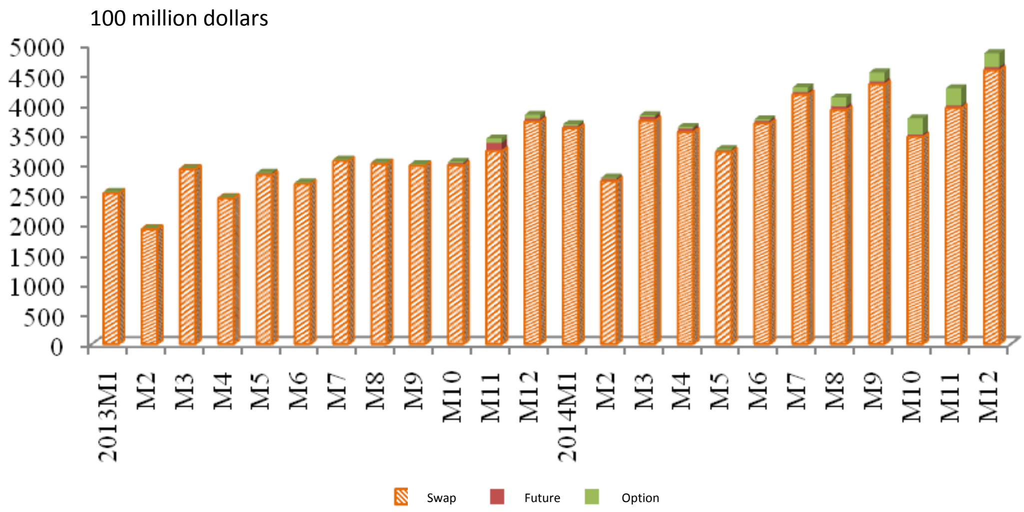

Figure 3-15 2013-2014 derivatives market of RMB foreign exchange

Source: China Foreign Exchange Trade Center

The participating bodies in the foreign exchange market are expending. By the end of 2014, the market holds 465 institutions for spot transaction, 98 for forward transaction, 97 for foreign exchange swap transaction, 84 for swap transaction and 39 for options transaction. There are 31 market makers in spot market, and 27 in forward market and swap market. These institutions include domestic institutions, such as four state-owned banks, major joint-stock banks, China development bank. Foreign institutions also included, like Bank of America, Citibank, HSBC, Deutsche Bank and Mitsubishi Bank.

3.3 RMB in Global Foreign Reserves

3.3.1 Enhancing Monetary and Financial Cooperation

The IMF divides official foreign reserves into two categories: allocated reserves and unallocated reserves. By the end of the third quarter of 2014, allocated reserves was $6.19 trillion, and unallocated reserves reached $5.58 trillion, respectively accounting for 52.55%, and 47.45% of the global total volume.

By the end of 2014, the People’s Bank of China has signed the bilateral local currency swap contracts with monetary authorities from 28 countries and regions, with a total amount of RMB 3.12 trillion yuan (Figure 3-16). Among which, it was the second time the People’s Bank of China sign the agreement with New Zealand, Argentina, Kazakhstan, Thailand and Pakistan; and the third time with Mongolia, South Korea and Hong Kong. Compared with that in 2013, there are 5 newly-added countries and regions, including Switzerland, Sri Lanka, Russia, Qatar and Canada. These agreements are different from those signed among developed economies in that they aim to maintain regional financial stability and promote bilateral trade and investment as well.

The People’s Bank of China has signed currency swap contract with monetary authorities in Qatar, Canada, Malaysia, Australia and Thailand. And it has signed the Memoir of RMB Settlement with Doha, Canada, Kuala Lumpur, Australia and Thailand. PBC also agreed to expand the pilot project of RMB overseas qualified institutional investors to Qatar and Canada, the initial investment totaled RMB 30 billion yuan and RMB 50 billion yuan respectively. Next, it will cooperate with Doha, Toronto, Kuala Lumpur, Sydney and Bangkok to establish RMB settlement banks. The intensified efforts made by the PBC in identifying RMB settlement business with other monetary authorities marked a milestone in our financial cooperation with other countries and regions.

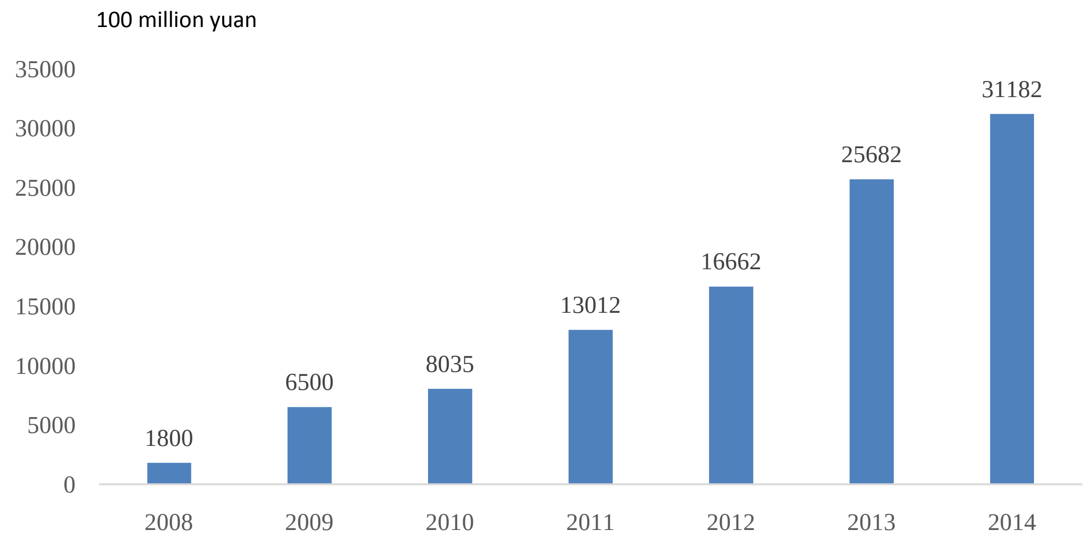

Figure 3-16 Amount of currency swap between PBC and other monetary authorities

Source: The People's Bank of China

3.3.2 Diversification of International Reserve Currencies

By the end of the third quarter of 2014, among the allocated reserves of IMF, dollar reserve was \$3.86 trillion, accounting for 62.32%; euro was \$1.4 trillion, accounting for 22.62%; pound was \$0.24 trillion, accounting for 3.84%; yen \$0.25 trillion, accounting for 3.96%; Swiss francs was \$16.457 billion, accounting for 0.27%; Canadian dollar was \$0.12 trillion, accounting for 1.92%; Australian dollar was \$0.12 trillion accounting for 1.89% (Table 3-8). The exit of OE in the US leads to the appreciation of dollar, whereas the economic growth in Europe lacks speed and momentum. Therefore, the share of US dollar is sharply on the rise while that of euro is obviously decreasing. Progress has been made in the diversification of International Reserve Currency. The Canadian dollar and Australian dollar account for over 1 % of their respective official reserves. And the IMF has added them into the international reserve currency statistics.

In 2014, the IMF will examine the value of currencies in the inclusion of SDRs so as to decide which currencies can be included in the SDRs and their respective shares. There are two standards: the scale of the use of this currency in trade settlement, and whether this currency can be freely used. Now RMB has met these requirements, so it will be very likely to join in the SDR club so as to play its functions as an international currency more extensively.

Table 3-8 Percentages of currencies in global FER 2014 (%)

	2013					2014		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Global reserves	100	100	100	100	100	100	100	

Allocated reserves	54.88	54.61	54.12	53.30	52.69	52.66	52.55	
US dollor	61.83	61.83	61.42	61.04	60.79	60.68	62.32	
Euro	23.54	23.85	24.12	24.38	24.33	24.11	22.62	
Japanese yen	3.88	3.84	3.80	3.82	3.94	4.03	3.96	
British pound	3.87	3.82	3.92	3.98	3.86	3.87	3.84	
Swiss franc	0.26	0.26	0.26	0.27	0.26	0.27	0.27	
Canadian dollar	1.58	1.79	1.84	1.83	1.87	1.98	1.92	
Australian dollar	1.66	1.69	1.68	1.81	1.89	1.93	1.89	
Other currencies	3.38	2.93	2.97	2.86	3.04	3.14	3.18	
Unallocated reserves	45.12	45.39	45.88	46.70	47.31	47.34	47.45	
Developed economies	33.18	33.02	32.96	32.67	32.68	32.68	32.63	
Emerging economies and developing countries	66.82	66.98	67.04	67.33	67.32	67.32	67.37	

Source: IMF COFER Database, International Financial Statistics released by IMF.

Notes：

1 Data of allocated reserves come from IMF COFER database; proportion of each currency is the ratio of the amount of reserves denominated by this currency to the amount of total allocated reserves.

2 The amount of unallocated reserves is equal to the difference between that of global reserves and allocated reserves.

4. RMB Internationalization and One Belt and One Road Initiative

4.1 RMB Internationalization and One Belt And One Road Initiative: Reciprocity

(1) Taking the opportunity of "One Belt and One Road" to boost China's supply of public good to the world.

The Silk Road has enjoyed prestige all over the world for more than 2000 years with trading Chinese silk as its original intention. Listed as the world heritage, the Road witnessed the history of interconnectivity and cultural integration between the East and the West. In 2013, China proposed the initiative of "One Belt and One Road" on the basis of the Ancient Silk Road spirit, namely "peace and cooperation, openness and inclusiveness, mutual learning and mutual benefits", aiming to tap the potential of the largest economic corridor in the world. Trade will be the forerunner, facilities connectivity the foundation, policy communication the security, financial integration the support and people-to-people bonds the source of power.

The "One Belt and One Road" is the most important national strategy under the New Normal. Through the initiative, China will be able to adjust regional economic structure, accelerate industrial upgrading, drive export growth, facilitate innovations of export models and help Chinese investment and corporation go global to provide support for RMB internationalization.

The weakening hegemony resulted in less American supply of public good in the world. In addition, there are shortcomings, like irrational governance structure and undervaluation of the developing countries, in such organizations that address global issues as UN, IMF and WTO. This situation leads to insufficient supply and irrational distribution of public good in the world. In particular, some developing countries are suffering a severe shortage of essential public goods.

In most cases, the supply of global public goods is dominated by superpowers and realized by sovereign states and international organizations. China is one of the neediest countries in terms of global public goods. As the representative of emerging countries and developing countries, China must play a bigger role and bear more influence on global economic governance and it is capable of doing that. Providing global public goods is a practical way to exert China's influence.

"One Belt and One Road" is designed to create the most attractive community of common destiny featuring cooperation and mutual benefits. Taking this opportunity, China will increase supply in the following areas: new philosophy and new model of international cooperation, efficient facility connectivity, new international currency, new international financial organizations and new methods to combat local wars and terrorism.

(2) Complementary “One Belt and One Road” and RMB internationalization

China is the initiator of “One Belt and One Road” program, so RMB internationalization will facilitate the financing of the encompassing countries. It will enhance the connectivity in policies, currencies, roads and public support as well as deepen regional economic integration. The theoretical and empirical studies have demonstrated that a larger proportion of the most-frequently used domestic currency will effectively prevent financial risks, lower transaction cost, enhance overall economic competitiveness and accelerate the integration of trade and economy in the region. China has the most foreign currency reserves and a high saving rate. As China’s capital account is gradually liberated, the offshore market of RMB will witness a rapid development, providing sufficient liquidity of RMB for the enterprises and institutions along the “One Belt and One Road” region. As a price currency in trade, RMB is increasingly accepted in international trade, which will bring down the trade costs with China, facilitate trade settlement and avoid the risks of using a third-party currency. China boasts unique advantages in infrastructure development. More material support can be offered to develop the “One Belt and One Road” through multilateral financial institution to mobilize global resources and RMB bonds, loans and direct investment to fund for major supporting projects. If RMB bears the functions of trade pricing and settlement, financial trading currency and foreign exchange reserve, China can provide a new international currency and risk management mechanism, a safe anchor for economy and finance, thus making greater contribution to the stability of regional economy and finance.

“One Belt and One Road” is a great undertaking beneficial to all along the line. It also offers a historic golden opportunity for RMB internationalization. “Interconnection” will drive economic growth in the region and strengthen the economic ties between countries, thus forming a new regional cooperation pattern across the Euro-Asian Continent. According to international experience, whether a type of currency can be the major currency in a region is mainly decided by the country’s economic strength, overall national risk, trade development, financial and economic capacity, etc. As the second largest economy in the world as well as a major trade partner and an important direct investment destination, China serves as a key trade partner along the “One Belt and One Road” region. With political stability and cultural prosperity, China leads the region in economic and financial development. Therefore, the country is fully prepared for the expanded use of RMB in this region. As the “One Belt and One Road” moves forward, the share of RMB will undoubtedly rise in trade, financing, investment, financial transaction and foreign exchange reserve as long as we make more efforts in enhancing convenience and lowering transition cost. This will inject sufficient momentum to make RMB a major international currency in the world.

4.2 Promote RMB Internationalization under One Belt One Road Initiative

(1) Based on real economy and promoting the stable internationalization of RMB

In the past five years, the continuous increase of China's share in international trade has won reputation for the internationalization of RMB. Due to the rapid development of offshore RMB markets throughout the world in recent two years, RII has maintained a good momentum. However, we need to see the internationalization of RMB with a sober mind. Financial transactions help RII grow rapidly in a short period of time, but the growth is not continuous and has risks. In the long run, the internationalization of RMB relies on the continuous demand of the global market for the products "made in China" and "created in China". We should seize the opportunity of the "One Belt and One Road" initiative to raise the proportion of RMB in trade pricing and settlement and increase the use of RMB in FDI, trade financing (TF), and loan and bond issuance which are closely related to real economy. This will promote the stable internationalization of RMB.

The recommendations are as follows: First, to strengthen the demonstration role of the policy-based financial support system. The creation of the AIIB, BRICS Development Bank, SCO Development Bank and Silk Road Fund will stimulate more social investments into the "One Belt and One Road" initiative and shift the pricing in both USD and RMB to that mainly in RMB. Second, to improve the domestic financial system. We should accelerate the process of building a multi-level, efficient and diversified capital market. We should allow insurance, lease, rating and legal services agencies to play a better role. Insurance agencies, in particular, should provide credit insurance products for the bonds issued to fund the infrastructure along "One Belt and One Road", cut the structural rate and expand channels for RMB investing and financing. Commercial banks need to optimize overseas structure and internal procedures and to promote innovations in products and services. They need to cooperate with the emerging multilateral institutions and policy banks, including the AIIB and Silk Road Fund. To ensure safe operation, they need to cooperate with insurance agencies to develop risk management tools. They should help large Chinese enterprises go global by providing TF, payment and settlement tools in RMB to reduce their financial costs. They need to provide comprehensive financial services such as two-way cross-border RMB cash pooling, centralized receipts and payments, fund transfer, and financial management by integrating the services including cash management and cross-border financial services, and using cloud computing, big data and other modern information technologies. Third, to make RMB more convenient and attractive to be used along the "One Belt and One Road". We will expand the bilateral local currency swap arrangements with the countries along the "One Belt and One Road", give full play to the offshore RMB hubs, establish RMB clearing mechanisms in the countries where investments and financing are active, and encourage the countries along the "One Belt and One Road" to use RMB in the pricing and payment of trade and infrastructure investments.

(2) To establish a multi-tiered mechanism for cooperation and shape a community of common destiny

The "One Belt and One Road" initiative is a new model of regional cooperation advocated by China. China should take its responsibility to provide global public goods and build the countries along the "One Belt and One Road" into a community of common destiny. A multi-tiered mechanism for cooperation is needed to meet the target of connectivity. First, the government should take the initiative to establish a multilateral framework for regional cooperation. Trade and investment agreements and comprehensive tax treaties should be signed as soon as possible. We should establish common mechanisms for dispute settlement, information sharing, and crisis response. This will raise policy coordination and regulation consistency, which will help create a sound environment for regional economic, trade and investment cooperation. Second, facing the new problems and challenges while building "One Belt and One Road", we will focus on shaping an international platform for thought, culture and policy exchanges. Based on the official mechanisms such as Boao Forum for Asia (BFA), Sino-Arab Cooperation Forum, and China-ASEAN Forum, we will encourage non-governmental exchange mechanisms like think tanks, colleges and cultural groups. Views will be exchanged to build the common values of "amity, sincerity, mutual benefit and inclusiveness" and "joint contribution and shared benefits". The effective solutions to the practical problems will be explored. Third, we will stick to the principle of openness and inclusiveness and launch multilateral cooperative institutions. Imitating the model of the AIIB, we welcome developed countries and other countries outside of the region to participate in the "One Belt and One Road" initiative with their superior resources. We will absorb the fruits of various civilizations, particularly learning from developed countries the experience in economic development, risk management, regional cooperation and multilateral governance, etc. Fourth, we will implement education and training programs, cultivating caliber personnel qualified in technology, business, finance and law services at the international level.

(3) To provide favorable conditions for the use of RMB in the pricing of commodities

Chinese-funded financial institutions should focus on providing financing service for the commodity trade from the countries along "One Belt and One Road" to China. They should facilitate RMB settlement and financial transactions in cross-border trade.

RMB needs to catch up with USD and EUR in terms of transaction cost and efficiency. Meanwhile, they should develop OTC derivatives such as RMB forward and options to satisfy various risk preferences.

The domestic commodity futures market will be developed to play the role of hedge and price discovery. We will encourage domestic importers to manage risks by trading futures. Drawing the experience of the gold international version of Shanghai FTZ, we will take steps to introduce foreign hedgers and investors into the domestic futures market and open more futures of bulk raw materials and energy commodities.

We will allow the RMB pricing of commodity futures trading in the offshore RMB market, providing a mechanism of price stabilization and risk management for the trade in the countries along the “One Belt and One Road”. We recommend futures exchanges in Dalian and Zhengzhou explore models to cooperate with RMB offshore financial centers, increase the size and influence of the RMB commodity futures trading markets through strategic alliances and Q&A, establish a mechanism to increase the RMB returns of the trade to China, and expand channels to maintain and increase the value of RMB assets for the enterprises from the countries along the “One Belt and One Road”.

(4) To promote Chinese standard and the use of RMB in the construction of infrastructure

The differences in the construction standards are one of the major challenges faced with the connectivity of One Belt and One Road facilities. Chinese standard for technology, product and equipment, which fits the conditions of developing countries, and has been successfully applied in many African countries, should hence be applied more in the construction of One Belt and One Road infrastructures. By doing so, China’s enterprises and financial institutes can offer more support to the countries along the line

The connectivity of One Belt and One Road infrastructures benefits all relevant countries. Its construction needs to mobilize fund and efforts of the whole world. Although China is the main capital supplier, we still need to enhance communication with other countries and innovate the cooperation mechanism of investment and funding. Besides, RMB should be more used in the construction and operation of infrastructures in countries along the line. The details are as follows.

First, we need to respond to the growing capital needs of RMB by increasing RMB products in our foreign assistance, outward investment and project loans (including policy ones and commercial ones), and the use of RMB in multilateral financial institutes like World Bank, ADB, AIIB, and New Development Bank. Second, explore the issuance of Silk Road bond in different ways like public-private partnership, syndicated loan, and industrial investment fund home and abroad. Encourage pricing and settlement with RMB, and increase the use of RMB in funding plan for the construction of infrastructures. Third, enhance currency swap, introduce RMB into the local credit system, and increase the capital source for infrastructure construction of host countries. Fourth, promote the host countries to improve the policies such as investment laws and land tax to improve the business environment. Establish a partnership that involves government, private sectors, industrial associations, and international organizations to realize the infrastructure connectivity under the framework of regional and international cooperation framework.

(5) Industrial parks should value flagship projects and the accompanying use of RMB

Industrial parks mainly rely on the development of economic corridors, and thus flagship projects like “Sino Pakistan Economic Corridor” should be given more emphasis to realize the early yields of the “One Belt and One Road” strategy. The layout of the industrial parks should be in line with the goals of the connectivity and be arranged according to the focus of different corridors, resources of different countries and the geographical advantages. Parks should be built in key cities, ports, border ports, etc. The radiation effect of the parks should be given full play so that overall win-win cooperation can be achieved by expanding the successful experiences of the parks to the whole region. We suggest the industrial parks should be built by China and host countries together. We may establish high-level government dialogue mechanism, and policy coordination institutes. The daily operations of the parks can be managed by the Park Management Committee composed of representatives from both parties.

The establishment and operation of industrial parks can create favorable conditions for expanding the use of RMB around the world. First, parks can assign specific regions for financial services and offer preferential policies in tax, supervision, etc. to the service suppliers, so as to attract financial institutes from all over the world. Second, China’s financial institutes should enter the parks in an early stage so as to satisfy the demand of investment, funding, trade settlement in the construction of the park and the operation of the enterprises by developing relevant RMB financial products, increasing the use of RMB in local areas and establish the RMB outflow and backflow mechanism. Third, the services of financial institutes should be expanded from the basic ones to an overall and multilateral financial support system so as to meet the demand of the parks in different times from its very beginning to rapid development. RMB offshore market should be built to exert its radiation effect on countries along the “One Belt and One Road” line and even other Asian and European countries.

(6) To eliminate barriers of RMB pricing and settlement in cross-border e-commerce

China is capable of helping countries along the line to eliminate obstacles in the development of e-commerce. We should encourage communications, internet, and IT companies to conduct direct investment and support construction of facilities in industries like transportations and logistics. Supporting services like clearance, information security, finance, and law should also be gradually improved. We should take good use of the standards and systems of international organizations like WTO so as to draft and practice rules and conditions for cross-border e-commerce trade, establish product quality traceability mechanism, and enhance supervision on clearance and delivery inspection and quarantine. Meanwhile, we should also strengthen international communication on e-commerce with trade partners and international organizations so as to help domestic companies to deal with e-commerce trade disputes.

The process should be optimized and the cross-border e-commerce system should be fully upgraded to create conditions for online RMB internalization. We should encourage large international express enterprises to cooperate with domestic cross-border e-commerce enterprises and logistic enterprises to promote the development of cross-border logistic industries. Information of e-commerce should be shared, and the e-commerce integrity system can be built to punish counterfeit sand immoral behaviors in cross-border e-trade. The function of overseas Chinese groups may also be tapped to enhance the demonstration of cross-border e-commerce application projects.

We should also encourage the use of RMB in cross-border e-commerce pricing and settlement. The pricing on cross-border e-commerce websites should use both dollar and RMB instead of dollar alone, and RMB should be used more in the future so it will become the major pricing currency. Domestic third payment platforms and cross-border e-commerce companies can become strategic allies to develop products and offer services according to the cultural tradition and payment habits of the countries along the “One Belt and One Road” line so as to promote the use of RMB in settlement and increase its security, efficiency and attractiveness.

(7) Put the RMB cross-border payment system into use

RMB cross-border payment system constitutes an essential technical support for the internalization of RMB and also a public product that China offers the world. Given the condition of countries along the “One Belt and One Road” line, the payment system of PBOC have distinct advantages in terms of technology and equipment and can thus offer cross-border payment services for the construction of the “One Belt and One Road”. The system, combined with China’s large foreign exchange reserves, can also undertake businesses like foreign exchange, guarantee, and foreign currency funding when risks can be controlled.

Before the establishment of RMB cross-border payment system, the currency swap among central banks should be fully exploited. We should offer cheap, safe and efficient RMB payment and clearing services for countries along the line through designating the system of offshore RMB clearing banks. We should do our best to help the local payment and clearing system be connected with the current RMB cross-border payment and clearing system.

In order to satisfy the growing demand of RMB clearing throughout the world, the establishment of RMB cross-border payment system should be accelerated so that it can be put into use in the early stage of the internalization of RMB and the relevant countries can get used to the it as soon as possible. Hence, a high cost for currency replacement in the future can be avoided. Meanwhile, we should take the opportunity of connectivity to further enhance the security and efficiency of RMB cross-border payment system. We may also set the West Cloud Valley project in Ningxia as the center of the circle, and expand the RMB cross-border payment system westward along the oil pipelines and telecommunication infrastructures so as to support the services of the third party payment platforms like the Unionpay.

We should integrate and revise policies related to the internationalization of RMB and upgrade its level of legislation. Specific laws about cross-border RMB clearing and payment should be made to specify the rights and obligations of all parties and provide legal insurance for the smooth operation of cross-border RMB payment system.

5. Timeline of RMB Internationalization 2014

Date	Event
January 7, 2014	HSBC becomes first custodian bank servicing RMBQualified Foreign Institutional Investors (RQFII) in London as China grants license to London based Ashmaore group.
February 20, 2014	With the authorization of the People's Bank of China (PBoC), the PBoCShanghai Head Office issued the *Notice on Expanding Cross-border Use of RMB in the China (Shanghai) Pilot Free Trade Zone*.
March 7 and 10, 2014	On March 7 in London, and March 10 in Frankfurt, Agricultural Bank of China (ABC) held the New Silk Road International Forum on Cross-border RMBUse.
March 14, 2014	The trading price of the RMB against the U.S. dollar in the Inter-bank spot foreign exchange marketwas allowed to float within a narrow band of 1%. The range was expanded to 2%.
March 14, 2014	The *Notice of the People's Bank of China on Certain Issues Concerning the Administrative over the Enterprises Engaging in RMB Settlement of Goods Exports* was jointly issued by six ministries and departments of the Chinese government.
March 14, 2014	Foreign non-financial corporation issued the first RMB bonds in China
March 19, 2014	Direct trading between the New Zealand dollar (NZD) and theChinese RMB was launched in the onshore interbank RMB foreign exchange market.
March 26, 2014	China has granted French financial institutions a quota of 80 billion yuan ($12.88 billion) for investing in China's domestic capital markets
March 28, 2014	PBoC and the Deutsche Bundesbank have signed a Memorandum of Understanding (MOU) regarding the clearing and settlement of payments denominated in the Chinese RMB in Frankfurt
March 31, 2014	PBoC and The Bank of England (BoE) signed a Memorandum of Understanding (MOU) to establish an RMB settling and clearing service in London
April 10, 2014	The China Securities Regulatory Commission (CSRC) made an announcement on the principle and institution of Shanghai-Hong Kong Stock Connect

April 11, 2014	Bank of China issued “Oceania Bond” in Australia
April 23, 2014	The Hong Kong Exchanges and Clearing Limited (HKEx) promoted commodity futures contracts denominated in RMB
April 25, 2014	The Central Bank and the Reserve Bank of New Zealand renewed the bilateral local currency swap agreement
April 26, 2014	RMB ranks as No. 7 most frequently used currency in payment in the world
April 28, 2014	Singapore becomes the world’s No.2 offshore RMB trade center
May 4, 2014	China Construction Bank established China-ASEAN cross-border RMB business center
May 4, 2014	RMB is expected to become the core currency in African Foreign Exchange Reserves
May 4, 2014	The Central Bank released *The Notice on the Establishment of International Business Model in Shanghai Gold Exchange*
May9, 2014	The PBoC successfully issued “Schengen Bond” in Luxembourg
May 16, 2014	The official launch of pilot projects of central management of capital for enterpriseheadquarters in Shanghai FTA
May19, 2014	China Construction Bank issued “Goethe Debt” in Frankfurt
May22, 2014	*Separate Accounting Implementation Rules for China (Shanghai) FTA Pilot Zone (trial)* and *Rules on Prudential Management of Risks in Separate Accounting for China (Shanghai) FTA Pilot Zone* were officially released.
May30, 2014	The first time that PBoC used the currency of the other party under a currency swap agreement
June 3, 2014	Shanghai Clearing House served as an agent of RMB IRS
June 11, 2014	PBoC issued the *Guideline on Implementation of Opinions of the General Office on Supporting the Steady Growth of Foreign Trade*.
June 17, 2014	The Agricultural bank of China and Bank of China respectively signed a Memorandum of Understanding with London Stock Exchange Group.
June 17, 2014	PBoC designates China Construction Bank as RMB clearing and settlement bank in London.
June 18, 2014	The first financial institutions in Shanghai launched the free trade account service.
June 18, 2014	PBoC designated PBoC Frankfurt Representative Office as RMB clearing and settlement bank.
June 19, 2014	The direct trading between yuan and British pound

June 28, 2014	PBoC signed the Memorandum of Understanding (MOU) with Bank of France and Central Bank of Luxembourg to establish the RMB settling and clearing service in Paris and Luxembourg respectively.
July 3, 2014	PBoC and Bank of Korea signed an MOU on establishing RMB clearing arrangements in Seoul. PBoC designated Bank of Communications (Seoul) as the clearing and settlement bank. Korea was granted 80 billion yuan RQFII quota.
July 7, 2014	Germany was granted 80 billion yuan RQFII quota
July 15, 2014	New Development Bank (NDB) was established with headquarter in Shanghai
July 18, 2014	PBoC and Argentine Central Bank renewed the currency swap agreement
July 21, 2014	PBoC and Swiss National Banksigned a bilateral currencyswap agreement
August 7, 2014	Chin and Korea signed the repurchase agreement of RMB denominated bonds
August 21, 2014	PBoC and Bank of Mongolia signed a bilateral currencyswap agreement
August 25, 2014	Central Bank ofSri Lanka allowed to invest in China'sinterbank bond market
September 1, 2014	RMB loan commitmentbetween Chineseand Koreancommercial banks
September 4, 2014	Agricultural Bank of China issued RMB denominated "EmiratesBond" in Dubai
September 4, 2014	Four-party Agreement forShanghai-Hong KongStock Connect was signed at Shanghai Stock Exchange
September 5, 2014	China ConstructionBank and Bank ofChina each issued"Formosa Bond" of 2 billion yuan in Taiwan
September 5, 2014	Bank of China was authorized as the clearing bank in Paris
September 5, 2014	ICBC was authorized by PBoCas the clearing bank in Luxembourg.
September 15, 2014	China Development Bank issuedRMB denominated bonds in London
September 15, 2014	Bank of China issued "Triumph Bond" in Paris
September 16, 2014	ICBC issued "Lion City Bond" in Singapore
September 16, 2014	PBoC and Central Bank of Sri Lanka signed bilateral currency swap agreement
September 18, 2014	The international board of Shanghai Gold Exchange was launchedin Shanghai Free Trade Zone

September 22, 2014	Malaysia issuedRMB denominated “Golden Tiger Bond”
September 28, 2014	PBoC issued the *Notice on Cross-Border RMB Settlements for the Issuance of RMB Debt in China by Foreign Institutions*.
September 29, 2014	Direct trading between RMB and Euro on the interbank foreign exchange market is authorized.
October 9, 2014	The British government launched the sovereign bond issuance project.
October 10, 2014	ICBCSeoul branch deal with the first loans sale
October 11, 2014	PBoC and the central bank of Korea renewed the bilateral currency swap agreement
October 13, 2014	PBoC and the central bank of Russia signed a currency swap agreement.
October 14, 2014	The British Ministry of Finance issued the first RMB denominated sovereign bond.
October 14, 2014	Establishment of Asian Infrastructure Investment Bank (AIIB)
October 14, 2014	ICBC issued “Kimchi Bond” in Korea
October 17, 2014	Cross-border Interbank Payment System(CIPS) launched in Shanghai
October 20, 2014	Singapore Exchange(SGX)launched RMB futures contracts
October 28, 2014	RMB and Singapore dollar achieved direct trading in the interbank foreign exchange market
October 28, 2014	HK and France signed the Memorandum of Understanding on the development of offshore RMB business
November 1, 2014	PBoCreleasedthe*Notice on Centralized Cross-Border RMB Fund Operation Conducted by Multinational Enterprise Groups*.
November 2, 2014	RMB currency swap agreements helped Pakistan avoid economic crisis
November 3, 2014	The PBoC and its counterpart in Qatar signed bilateral currency swap agreements and the Memorandum of Understandingto establish RMB clearing arrangements in Doha. Qatar was granted 30 billion yuan RQFII quota.ThePBoC authorized the ICBC as a clearing bank for RMB business in Doha.
November 6, 2014	The PBoC released the *Notice on Foreign Securities Investment by RMB Qualified Domestic Institutional Investors (RQDII)*.
November 8, 2014	The PBoC and its counterpart in Canada signed bilateral currency swap agreements and the Memorandum of Understandingto establish RMB clearing arrangements in Canada.Canada is granted50 billion yuan RQFII quota.ThePBoC authorized the ICBC as a clearing bank for RMB business in Toronto.

November 8, 2014	Establishment of the Silk Road Fund
November 10, 2014	The PBoC and its counterpart in Malaysia signed bilateral currency swap agreements and the Memorandum of Understandingto establish RMB clearing arrangements in Kuala Lumpur.
November 10, 2014	The PBoC and China Securities Regulatory Commission(CSRC) jointly issued the *Notice on Shanghai-Hong Kong Stock ConnectPilot Program*.
November 17, 2014	The PBoC and the Reserve Bank of Australia signed an MOU on RMB clearing business. Australia is granted 50 billion yuan RQFII quota. The PBoC authorized its Sydney Branch as the RMB clearing bank in Sydney.
November 17, 2014	Launch of the Shanghai-Hong Kong Stock Connect Program
November 19, 2014	New South Wales of Australia issued 1 billion yuan offshore bonds.
November 21, 2014	The PBoC announced an asymmetric interest rate cut.
November 22, 2014	The PBoC renewed the bilateral currency swap agreement with the Hong Kong Monetary Authority.
November 30, 2014	Release of the *Deposit Insurance Act (Draft)*
December 1, 2014	Direct trading between RMB and KRW was launched on the Seoul interbank foreign exchange market.
December 4, 2014	ICBC Luxembourg branch officially launched RMB clearing services
December 14, 2014	China and Kazakhstan renewed the currency swap agreement.
December 14, 2014	RMB was included into New Zealand’s Trade Weighted Index (TWI).
December 15, 2014	15 policies on Nansha financial innovation were issued.
December 15, 2014	The China Foreign Exchange Trading System (CFETS) announced KZT/RMB trading in the interbank regional market.
December 17, 2014	China and Nepal signed an MOU on co-building the “Silk Road Economic Belt”.
December 18, 2014	The Yunnan cross-border RMB loan pilot was approved.
December 22, 2014	The PBoC and the Bank of Thailand signed an MOU in establishing the RMB clearing arrangements. The two parties also renewed the bilateral currency swap agreement.
December 23, 2014	The PBoC and the State Bank of Pakistan renewed a bilateral currency swap agreement.
December 31, 2014	Guangxi officially launched the regional cross-border RMB business platform.
December, 2014	RMB became the fifth most used payment currency.

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