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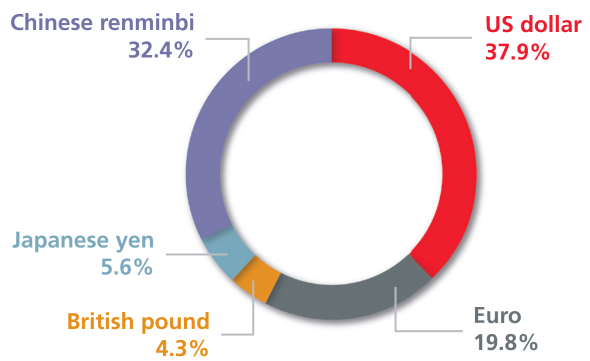
# DO NOT UNDERESTIMATE THE RENMINBI


**The renminbi's (RMB) global influence may be larger than traditional metrics suggest. With the recent pricing of oil in RMB seen as another step in China's internationalisation efforts, the case for long term investors to raise their RMB exposure continues to strengthen.**

In a recent working paper[1] by the International Monetary Fund (IMF), authors Camilo and Nor examined the economic influence of five reserve currencies – the US dollar, the euro, the British pound, the Japanese yen and the Chinese RMB. While the results confirm the dominance of the US dollar, the RMB bloc is estimated to influence about 30% of global GDP, surpassing the euro bloc.

Through a two-step regression analysis, the authors calculated the degree of influence each of the reserve currencies has on individual national currencies. Depending on the degree of influence, individual national currencies were then assigned to one of the five currency blocs. Next, the estimated influence of each reserve currency on each national currency is multiplied by the respective country's annual share in global GDP in purchasing power parity terms. The results are then added to obtain the economic size of each currency bloc (see Fig.1).

**Fig.1: Global influence of currency blocs**




The findings are a stark contrast to what traditional metrics are telling us. For example, payments data reveal that the RMB only makes up 1.7% of international payments[2]. Official data also shows that the Chinese currency only makes up around 1% of official foreign reserve assets even after the RMB's entry into the IMF's Special Drawing Rights (SDR) basket in September 2016 (see Fig.2).

If the RMB's global influence is only second to that of the US dollar as suggested by the IMF working paper, this then strengthens the case for long term investors to consider raising their RMB exposure within a diversified portfolio.

**Fig.2: Breakdown by currency**

| Share (%) | US dollar | Euro | British pound | Japanese yen | Chinese renminbi |
|---|---|---|---|---|---|
| **Before Q3 2016** | | | | | |
| Official foreign reserve assets[a] | 63.3 | 20.3 | 4.5 | 4.5 | - |
| Special drawing rights[b] | 41.9 | 37.4 | 11.3 | 9.4 | - |
| **After Q3 2016** | | | | | |
| Official foreign reserve assets[c] | 54.8 | 18.1 | 3.5 | 3.1 | 1.0 |
| Special drawing rights[d] | 41.7 | 30.9 | 8.1 | 8.3 | 10.9 |

## THE RMB EXTENDS ITS REACH

The RMB's path towards greater internationalisation has been rocky. The Chinese government's efforts since 2009 to lower regulatory barriers, ease market access and establish cross-border payments infrastructure have at times been mitigated by the shorter term volatile price movements of the RMB.

More recently, the pricing of oil in RMB is another step in China's internationalisation efforts. China launched its first RMB-denominated crude futures contract on the Shanghai International Energy Exchange (INE) on 26 March. For the first time, Chinese crude oil buyers will be able to hedge their prices and pay in RMB. As the exchange is registered in Shanghai's free trade zone, foreign traders will be allowed to participate, another first for China's commodity market.

China is currently the world's largest importer of oil, importing 8.4 million barrels a day last year and outpacing the US which imported 7.9 million barrels a day. Being the largest buyer of oil, it makes sense that China would push for the usage of RMB for payment settlement. It was reported that Iran and Russia have already agreed to transact in RMB terms.

It is likely to take some time before China can challenge the US dollar's status as the default crude oil transactional currency. The success of the RMB-denominated contract hinges on a number of factors including high trading volumes, diversity of market participants and security of supply. Concerns over regulatory certainty and currency convertibility may also keep potential players on the side lines for now.

On a broader scale, further market reforms including greater currency convertibility and increased hedging options will be needed to make the RMB truly international. The development of deep and liquid onshore financial markets will also help to reinforce the renminbi's global influence. As such, the inclusion of selected China A shares into the MSCI Emerging Market Index this year as well as the move to add Chinese RMB-denominated government and policy bank securities to the Bloomberg Barclays Global Aggregate Index from April 2019 are important.

Currently, RMB-denominated assets make up only 1.4% of the global investors' portfolio[3]. In an earlier report (China's debt mountain), we highlighted that long term investors cannot afford to ignore the growing investment opportunities in China's rapidly developing and steadily internationalising bond market. Given the RMB's growing global influence, the same can be said for China's equity markets.

Sources: [1]Camilo E. Tovar and Tania Mohd Nor, "Reserve Currency Blocs: A Changing International Monetary System?", as at 2018. [2]Worldwide Interbank Financial Telecommunication (SWIFT) data, as at January 2017. [3]People's Bank of China, as at 2014. Fig.1. IMF's International Financial Statistics, COFER and Survey on the Holdings of Currencies in Official Foreign Currency Assets. Fund staff calculations. Kawai and Pontines approach - using sample of 130 countries. Fig.2. IMF's International Financial Statistics, COFER and Survey on the Holdings of Currencies in Official Foreign Currency Assets. Fund staff calculations. [a]At the time the RMB was not considered by the IMF a freely usable currency, and hence was not counted as part of a country's international reserves, as at 2014. [b]Pre-October 2016 currency composition. [c]As at Q3 2016. [d]Post-October 2016 currency composition.