

The Role of Currency Swaps on the Internationalization of RMB

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Abstract - The people's Bank of China has signed a series of currency swap agreements with many countries and regions. This paper review the practice of people's bank of China currency swap, and then analysis the role of currency swaps on the internationalization of RMB, and give some suggestions on the future of the RMB currency swap.

Index Terms - currency swap; Internationalization of RMB; capital account

1. Introduction

Currency swap refers to the two main holders of different currencies, in accordance with the contract, exchange the two equivalent currencies at the beginning of the period, in the final exchange the principal and pay mutual interest due. A typical currency swap involves three basic steps: first, exchange the principal at the beginning of the period. At the beginning of the swap agreement, Two main exchange the two currencies agreed. The aim is to determine the principal , so as to the future of calculating interest. Second, Interest rate swap. In the duration of the swap agreement, the two sides pay the interest in accordance with the agreement. Finally, the final principal swap again.

After 2008 international financial crisis, currency exchange has been widely used in many countries, To enhance market confidence, provide liquidity support and as policy tools to resolve the financial crisis. The people's Bank of China also actively participated in regional currency swap mechanism, signed a series of bilateral currency swap agreements. The people's Bank of China aim was to cope with the financial crisis. But with the American "quantitative easing monetary policy" and "the European debt crisis", the people's Bank of China accelerated the pace of currency swap .Its purpose is to promote the RMB internationalization process.

2. The Review of RMB Currency Swap

RMB currency swap, making the 2008 financial crisis as the dividing line, can be divided into two stages, the basic purpose of two stages are also different.

A. *The First Stage: Before 2008*

Before the 2008 USA financial crisis, RMB currency swap agreement was mainly based on the "Chiang Mai Initiative", under the framework of the regional financial and monetary cooperation. In May 6, 2000, the finance ministers of 10 ASEAN countries and China, Japan and South Korea, on the 33 Asian Development Bank executive meeting held in Chiang Mai Thailand, announced that they would create a network of bilateral currency cooperation, namely , "Chiang

Mai agreement". "Chiang Mai agreement" is composed of two parts: one is the monetary cooperation within the framework of ASEAN 10+3 arrangement; the other is the independent currency swap by the members of the 10+3 . After Chiang Mai agreement, member countries signed many currency swap agreements. By the end of 2007, the currency swap size is to about \$90,000,000,000. But the majority of them dollar swap. In the framework of Chiang Mai agreement , 2001-2007 years, the people's Bank of China has signed 9 currency swap agreements with other country's central bank, a total amount of \$19,500,000,000.

In these swap agreement, besides the currency swap of the yen totaled approximately \$6000000000 , others are dollar as the currency agreement. At this stage, the characteristics of RMB currency swap agreement , apparently because of the other currency is non convertible currency. And China increasingly large scale of foreign exchange reserve has great appeal to these countries. Since the Southeast Asia financial crisis , some Southeast Asian countries feel the importance of foreign exchange reserve for a country's financial market and monetary stability. Therefore, with the help of RMB currency swap, this kind of borrowed reserves can make up for the lack of foreign reserves, so as to enhance their central bank liquidity, in order to stabilize the domestic financial market and currency exchange rate stability. For china, currency swaps can also be further deepen cooperation between China and these countries.

B. *The Second Stage: After 2008*

After the 2008 USA financial crisis, China signed more currency swap agreements with other countries and areas. By the end of January 18, 2015, Chinese has signed currency swap agreements with 26 countries. The total amount is much more than previously. In this stage, there were two main purpose that China's central bank signed currency swap agreements with other countries. One is the prevention of crisis contagion of the 2008 USA financial crisis and the European debt crisis. Therefore, with the help of currency swap, both sides attempted to inject liquidity into the market, and promote the development of foreign trade and investment, prevent the real economy fall too quickly .The other is push forward the process of internationalization of RMB, by the time of the original international monetary crisis. By expanding the international use of the RMB, get rid of dependence on the dollar . The main purpose of this stage is to promote the process of internationalization of the RMB.

Table I RMB Currency Swaps(2008-2014)

Economy	Date	Amount (RMB)	Term
The Republic of Korea	December 12, 2008	180 billion yuan	3 years
Hong Kong, China	January 20, 2009	200 billion yuan	3 years
Malaysia	February 8, 2009	80 billion yuan	3 years
Belarus	March 11, 2009	20 billion yuan	3 years
Indonesia	March 23, 2009	100 billion yuan	3 years
Argentina	March 29, 2009	70 billion yuan	3 years
Iceland	June 9, 2010	3.5 billion yuan	3 years
Singapore	July 24, 2010	150 billion yuan	3 years
New Zealand	April 19, 2011	25 billion yuan	3 years
Uzbekistan	April 19, 2011	700 million yuan	3 years
Mongolia	May 6, 2011	5 billion yuan	3 years
Kazakhstan	June 13, 2011	7 billion yuan	3 years
Pakistan	December 23, 2011	10 billion yuan	3 years
The United Arab Emirates	January 17, 2012	35 billion yuan	3 years
Turkey	February 21, 2012	10 billion yuan	3 years
Australia	March 22, 2012	200 billion yuan	3 years
Ukraine	June 26, 2012	15 billion yuan	3 years
Brazil	March 26, 2013	\$ 30 billion	3 years
Britain	June 22, 2013	200 billion yuan	3 years
The European Union	October 9, 2013	350 billion yuan	3 years
Switzerland	July 21, 2014	150 billion yuan	3 years
Sri Lanka	September 16, 2014	10 billion yuan	3 years
Russia	October 13, 2014	150 billion yuan	3 years
Qatar	November 3, 2014	35 billion yuan	3 years
Canada	November 8, 2014	200 billion yuan	3 years

Data source: The People's Bank of China Official Website

3. The Role of Currency Swaps on the Internationalization of RMB

A. To Promote RMB International Settlement in Cross-border Trade

The internationalization of RMB refers to the extending process of RMB function. It is the process of domestic public products evolve to international public goods. With the improvement of the international status of RMB, our border regions more and more use RMB as cross-border trade settlement currency in recent years. And the currency swap is helpful to solve the problem of cross-border RMB settlement. Since 2012, China began to implement the reform measures of RMB settlement of the cross-border Direct investment and cross-border trade. At present, trade and investment between China Company and foreign companies can all use RMB to settle. Now the problem is: in China, RMB is not freely convertible, And where foreign enterprises RMB come from? The effective way is to sign a bilateral currency swap

agreement. It also can meet the needs of RMB funds for cross-border trade and cross-border investment.

In the world under the background of economic globalization, China can not force each other must use the RMB to settle in international trade. Otherwise it would be increased the exchange cost. And it will destroy relations and cooperation. When China want to promote RMB international settlement, at the same time, other countries also want to promote their currency in international settlement. Unilateral propulsion, the other does not feel equal to accept. While the bilateral system arrangement is easy to promote, because the currency swap is voluntary, mutual reciprocity, mutual benefit, and flexible. Therefore, currency swap can not only solve the problem of monetary settlement between the two countries, but also maintain the long-term cooperation between countries. Although the the currency swap is bilateral, when we signed more and more agreement, it is easy to form the multilateral mechanism, RMB trading atmosphere will gradually formed, the status of RMB in the international market will be gradually accepted.

B. To Widen the Channels and Scope of RMB Outputting Overseas

The ransaction inertia is the intrinsic attribute of international currency. US dollar as the international currency, because of the transactions inertia and constraints of currency transaction cost. It is difficult to shake the global super currency hegemony of US dollar. In the process of internationalization of the US dollar, American use various means to output dollars to the world. During the Second World War, USA economic strength had been greatly enhanced. But in order to exclude the currency of the world, USA use the dollars for European aid. After the war, and then through the Marshall plan, offered \$13000000000 in aid of the European Renaissance, but still require the use of dollars. The purpose of these practices is to output dollars to the world. In the process of internationalization of dollar, the other key step is to open the domestic market, actively expand import. After the war, American first trade deficit was in 1971. Since then ,American trade deficit had been more and more wide. In recent years, USA economy greatly affected by the huge trade deficit. Nevertheless, it can not shake the dollar supremacy. The dollar expansion is faster and faster, more and more widely. Today America is still output dollar to the world by large trade deficit. Since 30 years of reform and opening up, China has been surplus country. The trade deficit will lead to Chinese manufacturing transfer abroad to bring domestic unemployment, with the current economic development stage incompatible. Our country has not completed the fundamental transformation of economic development mode. The trade deficit to output of RMB will bring the contradiction of employment, economic depression, recession and other issues. Therefore, to carry out monetary cooperation is the effective way to output RMB to international financial market.

When signed a currency swap agreement, the two sides will also sign the local currency settlement agreement. Each hold each other currency in international trade, import and

export will first use the other currency valuation and settlement. China can with the help of world trade, through large amounts of RMB currency swap, output RMB to the world. This not only can accelerate the process of internationalization of the RMB, but also control of financial risk.

C. To Break Through the Obstacles of RMB Capital Account not Fully Open

At present, in the international financial market, RMB is not like the US dollar, the euro and other international currencies that have rich financial products and investment hedging tool. Overseas enterprises and foreigners are still difficult to think that the hands of the RMB financial management and value-added, value. because the RMB is not a freely convertible currency, not the international monetary. This is also the reason why the international financial market Multi-National Corporation are unwilling to use RMB settlement.

If currency can not exchange free, it is the high risk of currency. In international trade, international investment market is accepted, recognized the degree of acceptance is very limited. Because RMB is not freely convertible currency, is not an international currency, which is why the international financial market Multi-National Corporation are unwilling to use RMB settlement.

So far China still does not have conditions of full opening capital account .Capital control is the largest obstacle to the internationalization of RMB. Today China is already the biggest exporter and the biggest trader in the world. But the proportion of RMB trade settlement in the total international trade settlement is very low. The two countries once started a currency swap agreement, the two sides of cross-border trade and cross-border investment can directly use the local currency settlement, instead of using a third country currency. This will ensure that the RMB of overseas customers return of domestic, but also solve the source problem of overseas customers RMB settlement funds. Currency swap overcome the restriction of capital account not open for the internationalization of RMB. In this way, the overseas customers do not have to worry about the problem of RMB value of holding hands.

D. To Deepen the Relationship between China and Other Countries

In the open economic conditions, A country's economic development cannot do without the world economic environment and the surrounding country environment. The stability and harmonious development of national relations is an important prerequisite for a country's economic development. Influenced by the interests of the state, between country and country there is always two sides of competition and cooperation. To some extent, between China and the developed countries, the competition is more than cooperation; and between China and the developing countries, cooperation may be more greater than the competition. The developed countries have completed the currency internationalization. The attitude of these countries on the internationalization of

RMB are more wait-and-see and even negative. Europe countries and other developed countries, Based on the national interests, don't want RMB as another international currency to share gains their currencies have been obtained.

But in the developing world, internationalization is at the beginning stage, economic and finance in these countries are more vulnerable to external shocks. Therefore, these countries need to strengthen their financial strength through the financial cooperation with foreign countries, in order to stabilize its economy and financial market. RMB, supported by China increasingly strong economic strength, is an important object of these countries to carry out foreign financial cooperation.

Under this background, the people's Bank of China can through the RMB currency swap agreement with Asian countries , Latin American countries and African countries , play the positive role of RMB on the economies of these countries currency and financial stability, promote the development of bilateral trade and investment. Therefore, currency swaps has not only economic significance, but also has political significance.

4. Suggestions

A. To Promote the Practical Use of RMB Swap fund

At present, China has signed bilateral currency swap agreement with many countries and regions. In order to promote bilateral trade settlement and investment. But from the current point of view, Substantial use of currency swap funds is less. Many currency swap agreements are spare. In the future, we suggested that the people's Bank of China through the flexible arrangement, promote the actual use of RMB swap funds. For example, to carry out cross-border trade settlement as the condition, reduce interest level. Or to each other to accept RMB settlement for energy, raw materials, key equipment as conditions, reduce interest rate swap. With these initiatives, Substantial driving enterprises to use bilateral currency settlement in cross-border trade. In addition, in currency swap background, we should promote commercial bank currency swap and policy bank currency swap. This can be more easily to use both currencies in trade and investment, but also increase channels of supply RMB liquidity .

B. To Combine Currency Swaps And Other RMB Output Means

In the condition of RMB capital account not full open, we should also accelerate the other way to output RMB , to meet the diversified needs of RMB offshore. First, Widening current-account RMB foreign output channel. Simplified RMB payment settlement procedures and audit process, support convenience for the enterprises payment with RMB current account and the capital account. At the same time, release the individual residents to use RMB foreign payment of tourism, shopping, education expenses and other restrictions, propelled by a bank card on the outside RMB withdrawal and use. Second, To promote the RMB Foreign Direct Investment. At present ,the RMB foreign direct investment scale is small. We should actively explore a new model of foreign direct investment, expand the scope of the subject of foreign direct

investment, Encourage enterprises through the transnational merger and acquisition, sharing holding, the establishment of overseas industrial parks and other forms to increase the output scale of RMB. Third, to promote the development of offshore RMB loan business. Strengthen investigation domestic and overseas market , provide RMB loan business according to the demand for funds offshore , make full use of the multinational enterprise, commercial bank business resources and advantages of international cooperation. At last, to expand the use of RMB foreign aid. Our country also should be more use RMB in the government loans and international aid. We can make it be in the overall framework of the internationalization of RMB, which lead to more countries and regions use of RMB in international investment and transnational procurement.

C. To Make the Currency Swap System and Long Term By Using the Standard Form

In order to solve the problem in the exchange of expiration that may still need to promote bilateral trade, investment or to solve the shortage of liquidity, the existence of credit crisis, a feasible method is that the currency swap arrangement system of long-term. In this way, it becomes a part of international finance, but also become a long-term cooperation project between the central bank. As the first step towards this goal, the text of the currency swap should be immobilization. Thus, if the need, the new swap arrangement can be more quickly and reliably determined.

5. Conclusion

In this paper, based on reviewing RMB currency swap practice, focuses on the analysis of the role of currency swap on the internationalization of the RMB. First, currency swap has solved the problem of cross-border RMB trade settlement. Second, currency swap has widened the RMB channels and use scope to output overseas. Third, currency swap has broke through the obstacles of capital account not fully open. At last, Currency swap has deepen relations between China and other countries. It has an important political and economic significance. In summary, currency swap is a effective mean to promote the internationalization of RMB at this stage.

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