RMB Internationalization: a payments view

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Exchange rates: deviations from par

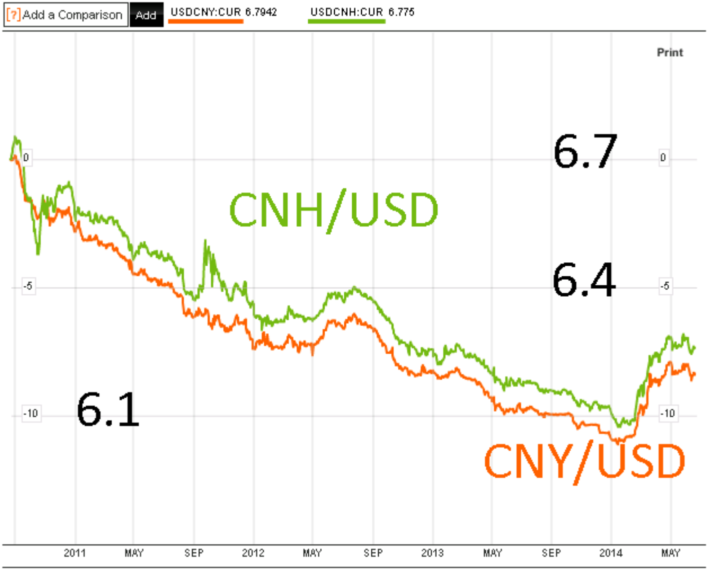

Figure 1: Onshore and offshore exchange rates

Market liquidity of CNH / CNY exchange

- Spread is small when liquidity is adequate
- Excessive one-way flows drive the spread apart
  - Late 2010: CNH premium
  - Late 2011: CNY premium
- No jumps in the spread since 2011
- PBOC–HKMA swap line, clearing quota as backstop
  - Interface between onshore payment system and offshore market
  - Clearing bank

Interest rate spread

Figure 2: Onshore and offshore interest rates

Par exchange with different yield curves

- The forward FX market could absorb the interest-rate differential (CIP)
- Commitment to par exchange then makes spot–forward fx arbitrage profitable
  - CNH balances seen as driven by "speculative demand"
- Capital account flows
  - Copper financing
  - Nei bao wai dai
  - Over/under-invoicing

The PBOC as market maker

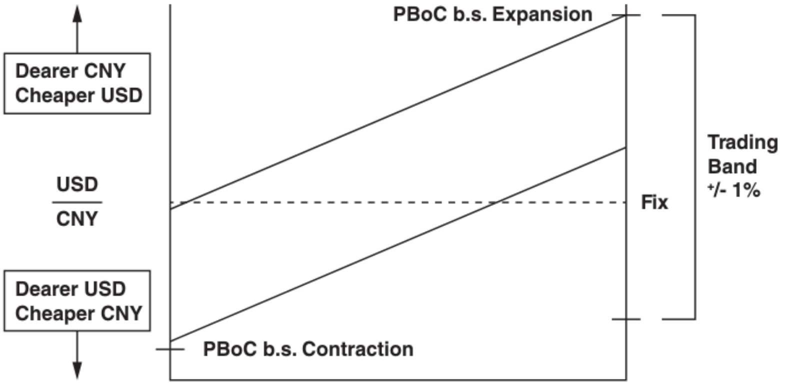

Figure 3: PBOC as an FX dealer

First resort

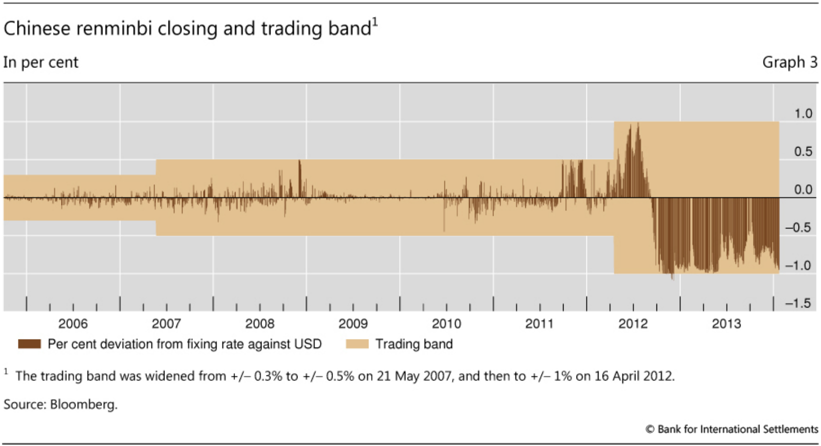

Figure 4: The PBOC as FX market-maker

Implications of the payments view

- Private dealers could take over from the PBOC, but their balance sheets would have to be able to absorb flows.
- This requires dealers to take on balances. This in turn necessitates money markets.
- Trade is only a small part of the story from a payments point of view.

Balance of payments

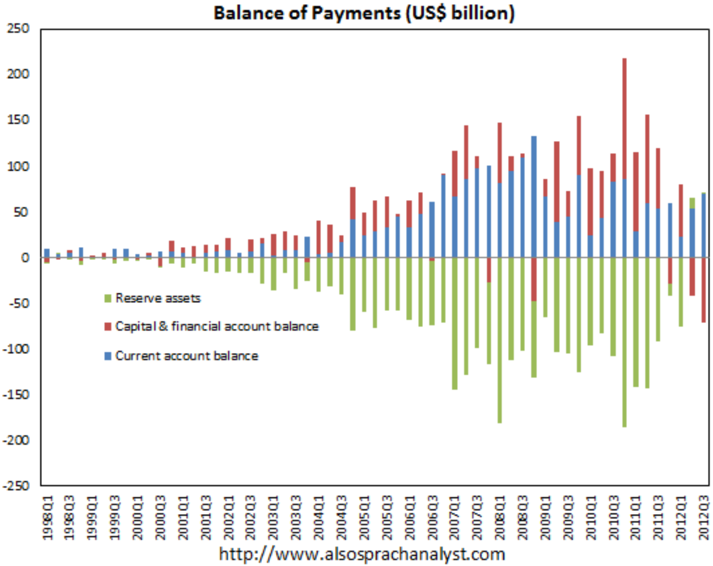

Figure 5: China's Balance of payments

Back to macro

- Fully private internationalization will require integrated money markets
- Payment mechanics scale up to the aggregate level
  - Gross flows net out to BOP, but only if liquidity doesn't get in the way
- China's domestic flows also relevant
  - Shadow banking as focal point of credit risk
  - Interest-rate liberalization as focal point of interest-rate risk