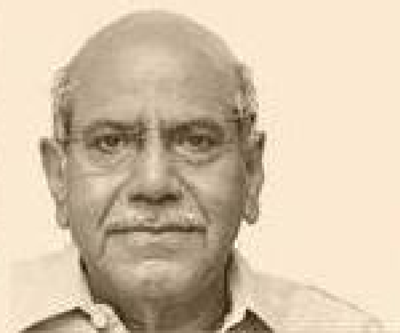
Translating economic scale into financial heft

China is the second largest economy in the world with a gross domestic product (GDP) of $14 trillion, about 18 per cent of global GDP, and may soon become No 1. It has been the world's biggest trading nation since 2013 and has a current export-import volume of more than $4.5 trillion. China has the world's second largest equity and bond markets, respectively. Its bond market is worth $13 trillion and constitutes 11 per cent of the global total. Similarly, its equity market by capitalisation is 12 per cent of the global volume. But its weight in the global economy is not reflected in its financial profile.

The use of renminbi (RMB) in trade settlement has fallen in recent years from a high of 25 per cent in 2013 to less than 15 per cent in 2018. Only 2 per cent of international payments is conducted in RMB. In 2016, the RMB was included in the trillion dollar Special Drawing Rights (SDR) of the International Monetary Fund (IMF) as a reserve currency alongside the US dollar, the euro, Japanese yen and the British pound and given a weight of 10.86 per cent. Its inclusion in the foreign exchange reserves of IMF member countries could reach a maximum of $1 trillion but is currently only $194 billion. China has encouraged currency swap agreements with over 30 countries and this is valued at $500 billion currently, but this has been used only marginally. The RMB has failed to achieve the same credibility as other reserve currencies. Its reluctance to give up control over capital flows and tolerate currency volatility, has stalled progress so far.



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China has now shifted to a different strategy to achieve the eventual goal of internationalisation of the yuan. It is pursuing the systematic integration of its huge equity and bond markets into global financial markets using sheer scale to gain pre-eminence. Initially, China set up the Hong Kong-Shanghai and Hong Kong-Shenzhen Stock Connect to allow quota-based trading in Chinese shares, progressively liberalising the quota and allowing easy repatriation of funds. It began to develop its bond market by allowing the issuing of RMB-denominated bonds initially in Hong Kong and then later in Singapore, Taiwan and London. It is now encouraging key global indices to include Chinese equities and bonds in their benchmarks. Chinese A-shares, which trade on the Shanghai and Shenzhen stock exchanges, have been included in the MSCI Emerging Market and MSCI All Country World Index. Chinese Government Bonds (CGB) have now been included in the Bloomberg Barclays Global Aggregate Index and may soon become part of the FTSE Russells Bond Index. Schroders, an investment firm, claims that the flow of funds from international institutional investors, who typically invest passively in indexed funds, would be $200 billion annually in each category initially, going up to $400 billion eventually. As the Chinese equity and bond markets expand and retail investors also begin to participate, we are looking at fund flows in trillions of dollars. It may be noted that only CGBs have been included so far. It is only a question of time before corporate bonds also get included. Standard and Poor's has been allowed to function as a rating agency inside China. Ratings of corporate bonds against international benchmarks will enable their inclusion in global indices and this will add to the volume of fund flow into the Chinese bond market. The setting up of a yuan-based oil futures exchange in Shanghai, leveraging the country's status as the world's largest oil importer is raising the currency's profile. Shanghai has emerged as the world's third largest oil futures market, overtaking Dubai this year.

China's UnionPay credit card is also helping raise the country's profile in international financial markets. UnionPay constitutes 58 per cent of all credit cards issued across the world and there are currently 7.6 billion UnionPay card holders. It is accepted in 174 countries. With Chinese making 150 million foreign trips each year and accounting for 20 per cent of tourism spending, acceptance of UnionPay has become indispensable for merchant establishments worldwide.

China set up its own international payment gateway, the Cross-border Interbank Payment System (CIPS) in 2015 on the lines of the Brussels-based SWIFT. Currently, CIPS is cooperating closely with SWIFT, but the ultimate aim is to emerge as an alternative global payment and settlement system. There are 31 participants, including 12 international banks, and 745 indirect participants associated with them, which take part in CIPS. In 2018, CIPS handled $755 billion in cross border yuan settlement business. This is minuscule compared to the SWIFT processing of $6 trillion daily, but is rising rapidly. Its use is being helped by the US using SWIFT to exclude countries under its sanctions such as Russia and Iran. Russia has set up its own System for Transfer of Financial Messages, which operates among the Eurasian Economic Union countries and has Chinese banks as participants. It has been reported that India, China and Russia are discussing the setting up of a trilateral payments gateway independent of SWIFT in order to avoid being targeted by US sanctions.

Finally, China is moving towards the launch of a sovereign digital currency based on blockchain technology, though details are unclear. Since over 70 per cent of all transactions in China are already digital this is not a farfetched idea. This is being linked to another parallel plan to create an "Asian Yuan". A Chinese economist Sun Mingqi spells out the strategy, "The short-term goal is to create the 'Greater China Renminbi' by internally integrating the Hong Kong dollar and the New Taiwan dollar. The medium-term goal is to build the Asian Yuan system in cooperation with the Japanese yen, the Republic of Korea won and other Asian currencies to establish a 'three-legged system' consisting of the US dollar, the euro and the Asian yuan under the global currency system. The ultimate goal is to establish an ideal, digital, decentralised or non-sovereign global currency based on each country's economic strength and trade value."

And if China is already off the mark with its digital currency, who will the future belong to when this ultimate goal is achieved? And where does all this leave India which is now reduced to gazing angrily at its turbulent navel?

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